What is the future of social enterprise in ethical markets?

By Dr Alex Nicholls MBA

A social enterprise think piece for the Office of the Third Sector, November 2007
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This think piece represents the views of the author alone. It is intended to stimulate consideration of the issues and debate. The ideas and analysis contained in this paper do not represent the views of ministers or government policy.
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1. Introduction

The rapid growth of ethical consumption in the UK over recent years – particularly fair trade and organic products – has demonstrated a systemic shift in the public perception of the nature of modern supply chains. At the same time, Socially Responsible Investment funds have mushroomed around the developed world, suggesting that there is investor appetite for economic returns that also generate added social and/or environmental benefit (or, at least, intend to do no harm). At a policy level, the UK government has been at the forefront of moves to enable and encourage the proliferation of social enterprises as part of both welfare services delivery and community regeneration. The impacts and influence of these three examples are empirically proven and demonstrate that all three of the conventional sectors of society – public, private, citizen – are playing a part in reassessing the value creation opportunities offered by more ethical market (or quasi-market) mechanisms.

However, the time is ripe for some more ambitious thinking to build on these ethical market foundations. Through both conceptual modelling and empirical case studies, this report will suggest that government has a unique policy opportunity to exploit this ethical turn in the behavioural economics of modern society. There is clear evidence that conventional notions of the ‘invisible hand’ as portrayed in the atomistic individualism of neo-liberal interpretations of economic theory are being rivalled to a more ‘regarding’ society that values community, reciprocity, and authenticity above isolated self-interest. This represents a challenge to the orthodox vision of Adam Smith as the champion of the action of impersonal markets first described in The Wealth of Nations and introduces the other as the humanist philosopher of The Theory of Moral Sentiments, in which economic activity is presented as a function of the acquisition of others’ ‘regard’ rather than pure self-interest. In the latter, notions of reciprocity and personal interaction become central to economic and social well-being – a stark contrast to the conventional presentation of Smithian economics. This provides the seed-bed for the development of more expansive visions of ethical markets that can shape the next generation’s attitude to work, society, and the environment. This report will explore three practical dimensions of this opportunity for change built around a new model of value chain economics:

- social finance and new ethical finance markets
- cross-community linkages to build both bonding and bridging social capital
- children’s education and ethical market development

The report will fall into four sections. First, the conceptual basis for the report will be set out drawing on a range of existing theory around ethical markets. A new analytic model – the enhanced social enterprise value chain – will be introduced. Next, the context and background for the report will be set out with a focus on the growth trajectories of ethical markets over time. The report will then move on to consider three emergent scenarios for social enterprise and ethical markets. Key questions include:

- Where can social enterprises leverage their influence most in growing existing ethical markets?
- What new and emergent ethical markets could be developed/fostered by social enterprises?
- What can be learnt from non-UK examples?

In each scenario the public policy implications will be explored. Finally, conclusions will be drawn.

The main objective of this report is to establish a forward-looking model of social enterprise within ethical markets that reflects both praxis and theory and that can help inform new policy thinking.
2. What is an ethical market?

Ethical markets can be defined as aggregated consumer-provider (demand-supply) exchange transactions of goods or services that have – as one of their defining product characteristics – a normalised notion of social and/or environmental benefit. To put it more plainly, ethical markets are economic spaces where consumers buy products that have added social or environmental value above other goods or services. However, the notions of both ‘ethical’ and ‘market’ are far from straightforward and need careful scrutiny in this context. This think piece does not propose to address in detail the question ‘what is ethical?’, but it does acknowledge that the adjective is problematic, contingent, and open to debate.

For example, there is no single ‘ethical consumer’ or ‘ethical market’, but rather a whole range of different ethical consumption demographic groups operating within and across product markets and sectors. Furthermore, the assumption of a linear relationship between ethical awareness/sensitivity and action in the ethical decision-making process is clearly flawed and this undermines much market research in the area. Researchers have noted the ‘30:3 phenomenon’, where more than 30% of consumers declare themselves ethical in surveys, but ethical markets are typically 3% (or less) of total trade by product or sector. In reality, there is a very complex series of connections between awareness, concern, and action that are shaped by many internal (personality, attitudes) external (peer group, competitive marketing ‘noise’) influences. For example, Newholm (1999) identified three categories of ethical consumer:

- **Distancers**: these consumers adopt a negative screening approach and avoid or boycott products they perceive to be unethical
- **Integrators**: these consumers attempt to integrate ethical purchase behaviour fully into their lifestyle and have a holistic view of their own ethical actions
- **Rationalizers**: these consumers limit their ethical purchases to extreme cases and distinct parts of their life and, whilst showing concern for issues, rarely sacrifice quality, choice, or pleasure

Such research questions assumptions about a single notional – and rational – ‘ethical’ consumer. Furthermore, in a largely qualitative study, it has been suggested that belief formation was the key to understanding ethical purchase behaviours. The research also highlighted the complexity of the ethical decision-making process and how contingent it is on multiple variables beyond the control of marketing communications. This is particularly true of local cultural variances across countries.

For example recent research published in the *Financial Times* demonstrated just how different the UK and US perceptions of ethical brands are with Coca-Cola, Kraft, and Procter and Gamble coming top in the US survey whilst the Co-op, the Body Shop and Marks and Spencer (a recent, but highly effective, convert) topped the UK survey. Clearly, the marketing power of Coke in the USA has managed to reinforce family-friendly images that sit closely to many Americans’ idea of what constitutes moral value, despite this having no intrinsic connection to the product’s inherent features. British consumers are more ethically sensitised and, in this context at least, more sophisticated.

The key point here is that ethical judgements are relative and personalised and, therefore, open to contestation. No two consumers share exactly the same moral or ethical orientation. Many consumers have to make multiple ethical judgements in their purchase behaviour. For example, fair trade customers must balance their environmental concerns over ‘food miles’ against their commitment to improve the livelihoods of producers in the South. So, ‘ethical’ is not an absolute in this context.

The market concept is also problematic here in terms of ethical consumption since the provision of comparative product/service information, as well as the range of choice alternatives, is currently significantly sub-optimal. The growing number of competing – and often third-party unaudited – social/environmental product labels bears witness to a growing lack of consensus over what constitutes such goods and fosters potentially damaging consumer confusion. Similarly, in many product/service categories there is little or no choice or range of social/environmental products – the great success of the Toyota Prius is, at least partly, a product of lack of competition.

Finally, sometimes (though not always) economic value creation cannot be maximised if ethical value added is the key objective. In this sense, ethical suppliers may be seen as ‘less competitive’ in standard market terms. So, care needs to be taken when discussing ethical markets in conventional economic terms.

The notion of an ethical market reconfigures what is meant by a market from a conventional transactional/contractual model...
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Current models identify three quite distinct markets:

- **an input market**
- **a process market**
- **an output market**

**Input markets** typically provide the resources than enable organisations to pursue their strategic objectives. These include investment markets, the competitive landscape for staff recruitment, and physical stock or plant. Such markets have typically been judged along their economic dimension.

**Process markets** represent the value creation activities that organisations pursue to take inputs and turn them into saleable outputs. These include workforce terms and conditions, factory health and safety issues, and supplier relations.

Finally, **output markets** represent the consumer interface for the organisation where value creation is given a financial value in exchange.

These three markets function along both economic and ethical dimensions. However, historically, these two dimensions have been seen as being in opposition. Namely, to be ‘more ethical’ you must be ‘less economic’. Whilst this will be the case in some situations, it is not a given and increasingly all organisations must pay attention to both across all three markets. This shift is of fundamental importance in redefining what we mean by ‘ethical markets’ as well as opening up new opportunities for social enterprise. In the context of this think piece:

- the input market centres on social finance, currently characterised by socially responsible investment (SRI) and ethical funds
- the process market consists of consumer judgements of company action and is typically defined by corporate social responsibility (CSR) issues such as the use of child-labour
- and the output market is defined by trends in consumption for organic, fair trade, and other ethical products

This report aims to expand these groupings by developing a new model of ethical markets ranging across the entire value chain.

In particular, this report aims to expand the conventional notion of an ethical market beyond the familiar model of consumer demand for supplies of goods and services with a positive social/environmental impact (eg. fair trade, organics, hybrid cars, green energy, etc.) to explore opportunities for social/environmental value creation across an enhanced social enterprise value chain.12

This think piece will develop a well establish analytic tool from strategic management – a Value Chain Analysis – to explore new ethical market opportunities for social enterprises. Value Chain Analysis aims to disaggregate distinct points of value creation between factor inputs and market-facing outputs and explains, for example, the price difference between the costs of the raw materials needed to make a product and its final selling-price. Such points could include the costs – and value added – of a manufacturer turning cocoa into chocolate or a supermarket bringing oranges from Florida to a British customer. The value chain model used here is adapted to social entrepreneurship13 to highlight the full range of social/environmental value creation opportunities available to such organisations (see Figure 1 overleaf).

The model first highlights the role of social or ethical finance as part of a social enterprise’s resource strategy. For example, new financial intermediaries are emerging both within and outside the mainstream to support social investors and social enterprises. These include ‘venture’ funds such as Catalyst (see page 13),14 retail banking operations such as Triodos Bank,15 and government-backed or philanthropic funds such as Bridges Community Ventures,16 the Adventure Capital Fund,17 Venturesome,18 UnLtd,19 the Sainsbury Family Trust, or the Skoll Foundation.20
Of equal importance to resource strategies, is the legal form of the social enterprise. By incorporating as a cooperative or Community Interest Company, the organisation can add further social value through its democratic and community-focused ownership model, enhancing local development and signalling its social purpose to potential investors and consumers.

Next, at the factor input stage, fair trade or organic sourcing strategies – for example – can add value by building community trade justice and sustainability at the start of the production/distribution process. Similarly, the employment practices of ‘social firms’ add further social value in the production process by offering training and work to otherwise disenfranchised members of the community. Green technologies offer new value adding mechanisms in the production and distribution phase.

Finally, via ethical market creation strategies, social enterprises can realign consumption behaviours to generate huge social/environmental value. Recycling is an obvious example, as is fair trade. Furthermore, microfinance represents a wholesale reconfiguring of a financial ‘output’ market that has embraced millions by generating new social value by recognising that the uncollateralized poor still represent a viable – indeed, ultimately less risky – debt market.

The enhanced social enterprise value chain model suggests that there are multiple ethical markets with which social enterprises already engage, from resource, incorporation and input strategies to staffing and production and, finally, output and consumer-facing activities. Thus, this new analytic model is used here to expand the concept of an ethical market to expose new points of policy leverage and opportunity for social/environmental value creation.

For example, Figure 2 (on page 7, adapted from Alter, 2007) takes the social enterprise value chain analytic to set out some policy options at each stage of an organisation’s activities. Firstly, economic and fiscal policy can be used to frame all the organisation’s activities whether it is to encourage investment in social enterprises, employ disenfranchised populations, or improve environmental performance.

Clearly, in the case of transnational organisations with significant and generalised externalities country-specific economic and fiscal policies may only have limited leverage – witness, for example, the failure of the Kyoto Protocol – but the importance of political leadership in this area can not be underestimated. For example, the European Union’s Carbon Trading initiative, though widely criticised, has proved to be highly influential in the longer run.

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**Figure 1: Enhanced social enterprise value chain**

- Resource strategies
- Organisation structure
- Procuring supplies
- Employing workers
- Producing and distributing product or service
- Employing workers
- Social finance
- CIC or cooperative
- Fair trade or organics
- Social firm approach
- Green techniques
- Microfinance
In conclusion, the enhanced social enterprise value chain reveals many opportunities for policy-lead initiatives that can allow social enterprise to grow ethical markets creatively and effectively. This report will not attempt to explore all the opportunities offered by this analytic lens, but rather will focus in on three high inflexion points within the model:

- new models of social finance
- new opportunities to build social capital via market-based action
- the development of ethical consumer markets via education

But first, the broader context of this discussion will be set out.

Within the structure of the social enterprise value chain itself, policy can target specific ethical outcomes. At the resource and production stages, government support for the Ethical Trading Initiative has been influential — though the lack of external oversight or legal regulation is a major weakness of the model — and has helped encourage the development of codes of conduct across most major firms in the UK. This is slowly transforming the behaviour of many corporations and is both fuelling and reflecting consumer expectations of firm social/environmental performance.

Elsewhere in the value chain, policy can be effective in encouraging market development through fiscal policy. To date this has largely been done through punitive taxation on a tightly defined group of products with damaging health or social characteristics (petrol, alcohol, cigarettes etc.) that encourages consumers and producers to seek alternatives and innovate (for example Nicorette nicotine patches, the Toyota Prius hybrid car, alcohol-free beers etc.). This report will suggest a more creative approach to the use of fiscal signalling further to grow ethical markets.

Finally, policy can influence social cohesion and development through planning regulations (for example to address the social deprivation around food ‘deserts’ and entrepreneurial thinking that connects and empowers communities in new ways. This report will highlight an interesting example of the latter, the Just Change partnership between Adivasis in Tamil Nadu and residents of the Marsh Farm Estate in Bedfordshire.

Clearly, some of these examples represent conventional businesses being given incentives to increase their environmental or social value added within existing profit-maximisation strategies. However, many of these examples offer social enterprises new market opportunities in which their social or environmental mission gives them an automatic competitive advantage. For example, a social enterprise whose mission is to offer training and employment opportunities to refugees will have a clear competitive advantage over other employment agencies in terms of broadening a firm’s staffing mix in line with a more ethical human resources strategy.
Figure 2: Policy inflexion points across a social enterprise supply chain (adapted from Alter, 2007)
3. The growth of ethical markets

This section will explore the landscape of ethical markets currently operating in the UK, with particular reference to social enterprise, in its historic context.

The idea of ‘ethical’ consumption is not new. Three waves of consumerism culminating in today’s ethical awareness have been identified.29

- The first wave focused on value-for-money, basic product information, and reliable labelling.
- The second concentrated on consumer safety and manufacturer accountability.
- The third – and most recent – introduced environmental and ethical issues linked to notions of corporate citizenship and social responsibility.

This latter wave is characterised by consumer awareness of animal welfare, environmental degradation and human working conditions and trade justice. In each case social enterprise organisations played key roles.

In another historical survey, four streams of ethical innovation were identified as emerging in the UK from 1800 to the present day (in roughly chronological order):

- human rights
- animal rights
- consumer protection
- environmentalism30

Each of these four themes has had a major impact on the practice of retail exchange.

1. In 1844 the ‘Rochdale Pioneers’ – early and highly influential social entrepreneurs – developed the first operational model of co-operative retailing in Northern England that clearly recognised the need for an approach to business exchange that was not driven solely by the demands of capital but also by human rights and social justice. The co-operative organisational form subsequently went on to become the most widely distributed business structure in the world, ranging from retail giants like the John Lewis Partnership to tiny producer groups in developing countries.

2. The Royal Society for the Prevention of Cruelty to Animals (RSPCA) came into being in 1840 and effectively sensitized the public to an issue that would lead directly to the anti-animal testing agenda championed with great commercial success by the Body Shop in 1980s and 1990s. Such has been the public engagement with animal welfare that the majority of cosmetics firms now avoid testing their products on animals. Indeed, the effect of RSPCA campaigning also encouraged significant changes in livestock husbandry – something accelerated by public demand for free-range and organic products.

3. In the 1960s, with the rise of the ‘consumerist’ movement, the power relationship between retailer and shopper – typically tilted heavily towards the former – began to balance out. Critical analyses of retail marketing, notably Vance Packard’s seminal work, The Hidden Persuaders (1957), further encouraged consumers to question the authenticity of what was presented to them in advertising and to demand to know more of the ‘truth’ about goods and services. As more information about goods and services has become available through third party campaigners and news providers (often via the internet), manufacturers and retailers have increasingly lost control of their carefully bounded marketing positioning of products. The Consumers Association – founded by serial social entrepreneur Michael Young – encapsulated this empowering change. In many cases, the result has been a move towards more values-driven marketing that acknowledges the consumer as an informed and involved participant in the exchange process. Ironically, however, much of this shift has been achieved through more sophisticated lifestyle branding that – when successful – often allows manufacturers and retailers to develop customer loyalty to a point where the consumer’s control of the terms of the exchange agenda actually diminishes. A good example is Nike, a company that has received significant criticism for the use of child labour in its third-party suppliers, but which has, nevertheless, created a sufficiently strong brand largely to survive such bad press.

4. Finally, the environmentalism that was evident in the Victorian passion for parks (the Open Spaces and Footpaths Preservation Society was founded in 1865) later evolved into a retail agenda with the foundation of the Soil Association in 1946 – another important social enterprise. The latter encouraged the production and sale of organic produce through campaigning and,
more recently, the development of a widely recognised certification system to reassure consumers of the authenticity of organic products.

Much of the research into ethical markets to date has focused on the output – or consumption – market. Since 2000, the Co-operative Bank has published a series of reports on ethical consumption – the Ethical Purchasing Index (EPI) – that have mapped extraordinary growth. The total market for ethical goods and services continues to grow across all developed countries, in some regions by as much as 20% per annum (NEF, 2001; 2004a) and a 2004 UK survey suggested that 65% of consumers now judge themselves ‘green or ethical consumers’. Such products typically fall within four ethical ‘themes’ and include:

- ethical banking
- responsible tourism
- recyclable or ‘green’/organic goods
- developmental aid/poverty reduction through fair trade

As an example, free-range eggs accounted for more than half of all retail egg sales by 2005. Consumer guides to ethical shopping are also becoming popular.

The most recent EPI valued the ethical ‘sector’ in the UK in 2005 at £29.3 billion (+11% on 2004) with the fastest growth in consumer goods being sustainable fish (+54.5%), Fairtrade products (+38.3%) and organic food (+17%).

IGD international have predicted that with the arrival of Whole Foods Market in the UK in 2007, sales of premium organic products will grow by £6bn to reach £19bn by 2011. IGD also suggested that the organic and fair-trade markets are going to increase by 50% and 100% respectively by the same year.

However, there is also research examining input – resource – markets. Ethical investments now command an important subsector of the total portfolios under management globally: amounting to £1.4 trillion in the USA and £11.6 billion in the UK (2006). According to Fidelity’s FundsNetwork, demand for ethical investment funds rose by 80% in the first four months of 2007 on the same period last year. Mainstream investors too are increasingly moving into the ethical investment sector as it outperforms the main market.

From the beginning, social entrepreneurs and social enterprise have been crucial to the development of ethical markets. Their strategic focus can be categorised under three types (see Table 1):

- addressing existing institutional voids and market failures through new products or services (institutional social enterprise)
- reconfiguring markets to create new or greater social value (normative social enterprise)
- challenging institutional arrangements through advocacy and political action (transformative social enterprise)

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<th>Table 1: Typology of social enterprise interventions in ethical markets</th>
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<td><strong>Type of social enterprise</strong></td>
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Each functions in quite different ways to address social/environmental issues and requires different bundles of resources and strategic skill sets.

Whilst institutional social enterprises often work as conventional businesses – following a typical start-up trajectory or life cycle – normative and transformative social enterprises are more disruptive and tend towards radical, systemic change, engaging politics and activism as well as market-facing competition.
Despite the distinctive features of each type of social enterprise, many social entrepreneurs engage with more than one of these strategic models to address their social/environmental mission. For example, fair trade is both a market-driven model of ethical consumption (institutional social enterprise) and an advocacy movement for trade justice at the global level (transformative social enterprise).\textsuperscript{32}

The need for trading income within the social enterprise model can also limit the scope for advocacy since this is resource-intensive. One solution – as witnessed in the case of Traidcraft – is to operate both a for-profit trading division and a not-for-profit producer development and advocacy division.

The next section of this report goes on to examine three scenarios for future social enterprise innovation in the creation of ethical markets.
4. Emergent ethical markets

Following the enhanced social enterprise value chain model set out above, this section considers three opportunities across the chain for social enterprises to create substantial new social/ environmental value. This is value which can be significantly enhanced by a sympathetic and enabling policy environment. The opportunity inflexion points lie in:

- social finance
- community cohesion and bridging social capital
- education and market creation

Ethical market opportunity 1: growing the social finance marketplace

The past twenty years has seen a dramatic change in the definitional boundaries set around the finance sector. As financial services have grown in size and influence in developed economies, the traditional boundaries between ‘economic’ and ‘social’ purpose activities have become increasingly blurred. From a public policy perspective, private capital has been encouraged to play a much more active role in delivering public goods and services with new contractual models such as the Private Finance Initiative blending public and private capital at a project level. Key opportunities for a new type of finance have included addressing economic exclusion and poverty and supporting community regeneration. More recently governments have also been exploring how better to support outsourcing relationships that go beyond the private sector to include charities and other public benefit organisations. In the UK, the establishment of a Social Enterprise Unit within Government in 2001 specifically supported this policy agenda.

From an investor perspective, there has been a growing recognition of the connection between the allocation of capital and its human and environmental impacts leading to a demand for a new set of investment opportunities loosely (and sometimes misleadingly) classed as Socially Responsible Investment (SRI). From a corporate perspective, the use of finance is under increasing external scrutiny from consumers and engaged shareholders driving new organisational strategies often termed as Corporate Social Responsibility.

The amount of assets under management within SRI has grown enormously in the last twenty years. Having its roots in a demand from Christian investors in the US in the 1920s for portfolios that excluded alcohol and tobacco, the SRI market has developed rapidly as concerns over social justice and environmental degradation have increased. In 2005, the SRI market in the US amounted to $1.4 trillion. In the UK, the Turnbull Report (1999), calling for boards to take more account of social and environmental issues in internal controls, and the Pension Amendment Act (2000), that requires pension funds to declare their ethical investment policies, have further fuelled the demand for SRI.

There are three main models of SRI, as follows:

- **Screening**: negative screening selects investment opportunities that do not include ‘wicked’ companies with poor social or environmental performance (including tobacco, alcohol, and arms manufacturers, as well as gambling); positive screening actively targets investments that add social or environmental value beyond the average in their sector. However, a major criticism of screened SRI is the use of low ethical barriers to entry. In order to spread risk and maximise returns, even positively-screened SRI funds attempt to track the main indices as closely as possible and, as a result, often include companies such as Coca Cola, WalMart, McDonalds, ExxonMobil, and BP. Screening accounts for around two-thirds of all SRI.

- **Shareholder activism**: shareholder activism aims to use ownership as the basis of engaged advocacy to critique and improve social and environmental performance within a company. This approach to SRI amounts to approximately a quarter of SRI.

- **Social investing**: this model aims to provide finance to disenfranchised individuals and groups that are typically not well served by conventional financial mechanisms. Social investing accounts for less than 1% of total SRI.

Social enterprises already play an important role within the provision of finance to social purpose organisations. The current marketplace for such social finance is composed of grant-awarding bodies (either government or charitable foundation), more engaged ‘venture’ philanthropy providers, social investors looking for soft or blended returns, and commercial investors driven by conventional market rate return motives that support financially successful social/environmental firms without particular regard for their products or services.

However, it is striking that, despite clear demand for ethical investments, so little capital is actually invested in social or
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Managed social investment/venture philanthropy funds  
Venture Philanthropy Partners, ARK, Venturesome, Ashoka, Social Venture Capital Foundation, NESsT, Venture Fund, Impetus, New Profit Inc

Intermediary and donor networking/information-sharing  
Global Philanthropists Circle, The Funding Network

There are three key intermediary services that social enterprises need to address to unblock the pipeline between ethical investors and social investees:

- information provision
- capitalisation
- liquidity

In each case, social enterprises can turn what are currently seen as market failures into new market opportunities.

The reason that private sector players are not already operating in these spaces is because conventional economic models do not present them as being commercially attractive. However, as has been the case with micro-finance, the twin social and economic objectives of social enterprises allow them to reconfigure a market failure as an opportunity and prove the case to more conventional businesses. In a sense, social enterprises here represent the risk capital or research and development division of social finance.

The Government is also present in the emerging social finance market but largely as a ‘pump primer’ of liquidity to support social investments (particularly in public welfare projects) rather than in broader intermediary roles. The main purpose of such investments is, effectively, to privatise social welfare provision on the grounds of increased responsiveness, choice, and value for money.

1. First, markets need credible data sets and reliable, comparable, information to flourish: a Social Performance Index. Despite the efforts of pioneering analytic organisation such as New Philanthropy Capital, such information is largely lacking for most social investment opportunities. The history of the development of accounting standards for commercial
Case Study 1: Catalyst
www.catfund.com

Founded in 1997 by Rod Schwartz, a former senior analyst at Lehman Brothers and Paribas, Catalyst began as a conventional fund management firm. In 1999, it closed its first major fund – the European Financial Services Venture Fund (EFSVF) – on roughly £40 million. However, in 2000, the management decided to diversify by identifying new sectors that, like financial services, seem destined for radical change, but with the added dimension of generating social as well as financial returns. In November, 2002, Catalyst launched its first social sector fund in partnership with the Big Issue. Following a detailed study of the broad sector, and organic food, alternative energy and education in particular, it secured this mandate in a competition with other venture capital firms. McKinsey, Clifford Chance and Gordon Roddick (ex-the Body Shop) are also strategic partners in this venture.

Today, Catalyst operates across three areas: investment; research; consultancy.

Investment
Catalyst has been authorised by the Financial Services Authority to raise and manage a fund to be invested in the social business sector. This fund seeks to invest in highly profitable and fast-growing social enterprises that have a strong financial performance as well as outstanding social returns. Opportunities have been identified in several sectors including, health, education, the environment, alternative energy, fair trade and regeneration.

The current range of philanthropic and government grants needs to be augmented by new ‘social’ venture funds that act as social enterprise investment vehicles bundling risk and bringing new investors to the table. Such funds would provide dedicated equity-like capital for social ventures, drawing on a mix of finance, with a risk-spreading approach to return by pooling investors. These funds would also add credibility to the growing social finance marketplace by testing the boundaries of social investment opportunities as well as helping segment social investors by (social) risk/return profiles. The action of such funds would also add to the information base and provide a virtuous circle of better information-increased investment. The Catalyst Fund offers an interesting example of such a fund.

companies demonstrates that agreed metrics take time to evolve along with resultant data. Today, commercial consultancies and even investment banks are beginning to explore social and environmental ratings and performance reporting in more depth to respond to investor concerns and develop new market opportunities. However, social enterprise actors already embedded in the sector should have a significant competitive advantage if they move fast (trust and legitimacy, networks, deep understanding of social/environmental mission impacts etc.). There are clear market opportunities here for social enterprises to develop sustainable business models based around information provision, whilst simultaneously contributing to the broader development of social finance for all.

2. Second, the social finance market needs increased capitalisation. There is simply not enough money in the current social finance landscape to encourage new players to enter or to offer scaling and growth opportunities to existing players. As has been the case in the development of conventional capital markets, only when a critical mass of finance is operating under a dedicated ‘social’ heading will a tipping point be reached in terms of wider access to more conventional finance. The growth of the AIM within the London Stock Exchange is a case in point.

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Research
Catalyst’s research aims to provide potential investors in social enterprises with clear and concise analysis of key social enterprise investment opportunities and trends within the sector. The approach follows conventional analytic techniques in commercial finance and includes:

- company reports
- news analyses
- social business glossaries (ethical and environmental)
- opinion pieces

Consultancy
Catalyst Strategy Advisors is a strategy consultancy focusing on social enterprise. It aims to provide business analysis and planning, growth strategy, strategic venturing planning and implementation, and ongoing advisory and board-level work.

3. Thirdly, there is a dearth of liquidity in the current market for social finance. Exit strategies from social investment are few and this limits both the pool of potential investors and the sustainability of investee organisations. The few social enterprises that have raised capital through (quasi) equity public offers, such as Cafédirect and the Ethical Property Company, list their shares on ‘swaps’ markets rather than conventional exchanges to control price fluctuation and speculation. Elsewhere, social investors often have to behave simply as philanthropists. The new Social Performance Index noted above could underpin a social finance exchange market that would trade not only (quasi) equity but also, bonds, debt, and even grant finance where the potential investee ‘sells’ bundles of social and environmental value to the mix of investors best suited to its organisation model, cross-subsidising risk-averse capital with grants and risk-free finance.

Policy implications
The UK Government has already taken a number of initiatives to create a legal and fiscal framework for the development of social finance, as well as to stimulate supply and demand. The principal ones are:

- The Compact with the voluntary sector and promises of longer term contracting and more attention to full cost recovery government and social enterprises.
- The Phoenix Fund (2002) that capitalised the Community Development Finance Initiatives and Bridges Community Ventures Ltd, the first fund to provide investment specifically for small businesses in deprived areas. It initially raised £20 million from the private sector and £20 million in government matching investment, and started investing a second fund in 2006.
- Community Investment Tax Relief (2003) that provides investors with an income tax break on investment in social purpose organisations in deprived areas: the CITR has attracted around £40 million of investment into the sector.
- Futurebuilders (2005) worth £215 million, which offers investment packages of grants, loans and support for organisations with reasonable prospects of winning service-delivery contracts.
- The Adventure Capital Fund (2002), worth £12 million, which offers longer-term financial and development investment to support enterprise growth.
- Two pilot funds (2006), worth £200k, for innovation in encouraging private sector investment in social enterprise.
- A Community Asset Transfer fund of £30 million to support local authority asset transfers into community ownership.
- On the demand side, Government policy has also supported financial awareness training and capacity-building via statutory bodies such as Business Link.

However, policy can be more proactive in addressing capital market distortions brought about by the imperfect capture of full social/economic value creation (or, for that matter, its destruction). Such approaches would facilitate the growth of social finance, in just the same way as establishing legal and regulatory structures around conventional capital markets helped their development. There are two areas of high inflexion intervention:

1. Currently, UK charities have something over £80 billion in assets under management. None of this is invested for a social purpose other than to maximise income that can be
spent on the organisation's social mission. This means that typically 95-97% of the finance under charitable control is not supporting social value creation at all.

The Charity Commission should encourage charities to develop a social investment strategy both to increase their mission impact and to avoid reputational damage from commercial investments that could create negative publicity by working against their core mission. Trustees should be empowered to think more creatively about their duty to maximise the social impact of their charity beyond simply spending income from capital invested. Models from the USA, such as the F.B. Heron Foundation, demonstrate how mission-related investment can play a powerful role in supporting grant-giving.

2. Signalling future fiscal policy based on social/environmental performance such that poorly performing companies would pay higher taxes and enterprises with strong social/environmental performance would face a lower tax burden. To a degree such differentiation is already happening within various pollution regulations. Such is the action of capital markets that by merely signalling this fiscal intent, government could create a virtuous spiral of improved social/environmental performance as markets priced in potential future taxation into stock values such that poorly performing organisations would be forced to improve without tax policy ever actually having to change. Such signalling would help develop a broader and deeper range of socially responsible businesses.

Ethical market opportunity 2: building community cohesion and bridging social capital

It is now widely recognised that building social capital is central to improving the community cohesion of today's modern societies that are increasingly typified by inequality, division, and atomisation. Revitalising inter-community ‘bonding’ social capital in community regeneration projects has been the focus of much UK government policy over the past decade. However, policy to address the more difficult task of building ‘bridging’ social capital has been less well developed. As a consequence, better understanding the latter has become increasingly important in the light of growing economic and refugee migration across national borders that is broadening diversity and heterogeneity across communities. Such patterns of migration look likely to increase globally.

Whilst developing new bridging social capital presents major challenges, there are opportunities within new ethical markets to contribute to this process at a transnational level. The opportunity grows out of two extant traditions:

1. The first is that of ‘twinning’ geographical locations in the UK with – typically – European equivalents. This tradition goes back to the period after the Second World War and represented an early attempt to build transnational bridging social capital across a politically divided and economically shattered continent.

2. The second is the fair trade movement that connects consumers and producers in a new model of market-driven ethical consumption.

An important development of the latter, that owes something to the twinning initiative, has been the creation of certified Fairtrade communities (towns, villages, churches, universities etc). These are geographical groups that adhere to minimum standards in terms of commercial engagement with Fairtrade and today there are more than 220 in the UK, as well as a number aboard. From the beginning, Fairtrade town groups took their engagement with producers via consumption beyond merely the product level. For example Garstang in Lancashire, the world’s first Fairtrade Town, arranges regular exchange visits with groups of cocoa farmers from Kuapa Kokoo in Ghana who produce Divine chocolate. Thus the fair trade model can go beyond building conceptual social capital via branding to bringing geographical diverse groups together to generate actual, bridging social capital via a market exchange mechanism.

In March 2006, Just Change – a Fairtrade and advocacy organisation based in India – took this model even further. For several years Just Change had worked with the indigenous Adivasi people of Tamil Nadu to help secure their economic future by, firstly, establishing land rights to their native homelands and, then, by developing economic activity primarily in the form of a fair trade tea plantation.

On a trip to the UK, the Adivasis were introduced to another marginalised community, the residents of the Marsh Farm Estate in Bedfordshire. The two groups felt an immediate affinity for each other and soon discovered a common interest...
What is the future of social enterprise in ethical markets?

The germ of the idea for Just Change was born in 1991, when tea from the Adivasis of Gudalur was successfully exchanged with saris from a women’s weaver co-operative in Madurai. Just Change is a community-based initiative headquartered in Gudalur, Tamil Nadu, India. It aims to establish alternative trading mechanisms that will benefit poor communities by directly linking them and encouraging them to trade among themselves. The vision of Just Change is to address social justice issues in the global economy by empowering communities to participate in an economy driven by human values and principles rather than by impersonal market forces. The idea grew when Stan and Mari Thekaekara, spent a month in the UK to do a critique of community work in Britain (1994) at the invitation of the Charities Advisory Trust and the Directory of Social Change, UK. They were put in touch with a number of poor communities in Britain and found that people were drinking large quantities of tea and paying a high price for it. The tribal groups in India grew tea so why not make a direct link to the benefit of both communities?

As a consequence, in 2006, Just Change has developed a new cross-cultural partnership between the Adivasi and the residents of the Marsh Farm Estate in Bedfordshire, UK, in order to create a new and alternative trade structure that will bring together the two ends of the market spectrum – producers and consumers – to work as members of a co-operative. By sharing the ownership of the supply chain, by spreading the risk along the chain and by exercising choice over whom they sell to and from whom they buy, both consumers and producers can gain greater control in the market economy. Producers can retain ownership over their product all along the market chain and can therefore benefit from the final retail value of the product. Consumers can work directly with producers to establish a price for the product that is based on principles of equity rather than fluctuating and speculative markets. They will also have the power to collectively determine the distribution of surplus. This helps address the ‘leaky bucket’ issue around with the local multiplier model of community development first identified by Keynes and, more recently, studied by the New Economics Foundation. Namely, that economic activity kept within and across deprived communities can multiply its effects many times.

Case study 2: Just Change

www.justchangeindia.com

Founded in 1986 by the social activist Stan Thekaekara and his journalist wife Mari, ACCORD aimed to work with the indigenous Adivasi communities of the Nilgiri Hills in Tamil Nadu, India. Through ACCORD they helped found the Adivasi Munnetra Sangam (AMS), a membership-based tribal organisation with 3,000 families as members. Traditionally nomadic, the Adivasi found their ancient homelands were under threat from competing claims to land ownership. A Tribal Land Rights Campaign was launched and ACCORD helped the Adivasis to fight a land rights campaign and establish ownership of their land. Next, it focused on their economic development by transitioning the Adivasi from labourers to producers by establishing their own tea plantation. Finally, in order to protect their economic development, ACCORD worked with the Adivasi to certify their tea as Fairtrade – a mechanism that ensures more of the value within the final selling price is returned to the producers via a fixed gate price – typically set above the spot market – with an additional development premium factored in (usually 10% of the contract).
Policy implications

Public procurement policy already recognises Fairtrade and many Government departments actively buy it, but it can do more. Charles Leadbeater notes that in the social enterprise state social innovation can be used to enhance the impact of public policy. There is an opportunity here for a new policy agenda that enables the diffusion of the Just Change Fairtrade ‘plus’ model as part of a drive towards both new community cohesion strategies and international economic development. There are number of enabling steps that government could take:

- use the existing twin town networks to publicise the model
- disseminate the model through international development networks
- provide a fiscal incentive for increased fair trade exchange by reducing VAT on such goods traded between communities

Whilst current policy on social cohesion tends to focus on a local/community agenda, this seems unnecessarily restrictive. If there is a clear public benefit in strengthening communities within the UK by celebrating their diversity and cultural/ethnic mix, there is an obvious argument for broadening the scope of policy around social cohesion to include building communities across societies and beyond national boundaries. Indeed, both policies should be mutually beneficial and supportive.

Ethical market opportunity 3: building new ethical markets through education

In order to build and grow a range of ethical markets for the future, social enterprise education will be crucial. Such education should be core in curricula at all ages, both in schools and higher education. Children are of particular importance, however, since it is commonly recognised that they represent three markets in one:

- a current (often pocket-money) market
- an influencing market on peers and family
- a future market of adult consumers

However, despite many children having access to teaching on ethical markets (broadly speaking) via the citizenship element of the National Curriculum, recent research demonstrates that there are significant challenges to developing this crucial future market.

A study of two focus groups of year 7 and 8 students that had been exposed to specific teaching on fair trade demonstrated a social enterprise ethical market opportunity for brand building.

Prior to this analysis of the focus groups, it was important to explore the actual teaching materials which were used by those delivering the fair trade content to the children. In conjunction with this, a component of the focus group was based around children explaining exactly what they did in the lesson.

The lesson materials themselves provided to schools by the British Association for Fair Trade Shops (BAFTS), with additional material by the Fairtrade Foundation, and were designed to be optional additions to the national ‘citizenship’ curriculum,

Drawing from the explicitly stated aims of the material, suggested lesson activities focus on firstly developing knowledge of fair trade issues, as well as how fair trade can help to reduce these problems.

Secondly, children are taught about fair trade products, the Fairtrade label, and where these products are available. Considerable effort also seems to go on developing empathy towards those whom fair trade should benefit.

These goals are supported by activities where children take the role of banana growers, some of whom sell to fair trade purchasers and some of whom do not. All of the children spoke about how effective this exercise was in showing how non-fair trade practices can lead to poor standards of living for growers.

Commercial or branding issues were never introduced – for example the ‘values’ or ‘lifestyles’ that fair trade products stand for. Purchase decisions were not explicitly discussed, although information was given to help children recognise fair trade products at retail outlets. Nevertheless, analysis of the focus groups suggested that the fair trade teacher did sometimes mention the ‘higher quality’ of fair trade food products over other types. Building on the class objectives and a first stage of holistic reading of the data, the primary analysis of the focus group data was thus structured around four key themes:

- knowledge of fair trade issues and problems
- awareness of fair trade products and their contribution towards helping solve fair trade problems
- attitudes towards fair trade products
- the purchase of fair trade products.
What the study demonstrated was that students had only a limited ‘top of the mind’ knowledge or awareness of fair trade, but once prompted demonstrated good understanding of the concept and a strong sense of fairness and solidarity with producers. Their attitudes were strongly inclined to buy and support fair trade. However, when their actual purchase behaviours were explored it became clear that brand allegiances to more established products dominated.

The ethical market opportunity here, therefore, is for both social enterprises within fair trade and others across the ethical marketplace more broadly to explore new brand building strategies to overcome such purchase resistance. This is already happening through conventional marketing communication in the case of Cafédirect, but for products aimed at the emerging – children’s – ethical market, joint branding and celebrity endorsement seem the most promising strategies. The Day Chocolate Company’s Dubble bar represents an important example of this approach by using an alliance with Comic Relief to build its brand value and values.

The key challenge here is to strengthen social enterprise marketing around consumer goods – particularly aimed at younger markets – so that they can compete better with the incumbent players. The message must be fairness is cool.

Case study 3: Day Chocolate Company

www.divinechocolate.com

In 1997, the Ghanaian co-operative of small-scale cocoa farmers, Kuapa Kokoo, voted at its annual general meeting to invest in a chocolate bar to be sold in the UK market. The Body Shop, Twin Trading (an alternative trading organisation that provides financing for fair trade businesses and co-operatives), and Christian Aid (a development charity) all supported the initial start-up sales and marketing firm, called The Day Chocolate Company. The UK Department for International Development guaranteed Day’s initial start-up loan of £400,000 from NatWest bank. After seeing the benefits Kuapa Kokoo gained for its members from fair trade, more and more farmers wanted to join and the association now has upwards of 40,000 members organised in approximately 1,300 village societies.

Day’s main consumer-facing brand, Divine chocolate, was launched in the UK mass market in 1998. Despite its atypical ownership structure, Divine was deliberately positioned as a mainstream chocolate bar to compete against such well-known brands as Cadbury and Nestlé, rather than as a gourmet or organic chocolate to be sold only in speciality and health food shops. Sainsbury’s introduced Divine in 70 stores in 1998, and after a successful ‘stock the choc’ postcard campaign organized by Christian Aid, added another 270 stores. The Divine brand now can be found in more than 5,000 shops in the UK, and the range includes several flavours of chocolate bars, including Divine Dark, as well as such seasonal products as chocolate eggs at Easter and Christmas advent calendars and coins.

In October of 2000, Day launched the Dubble chocolate bar, the first Fairtrade product aimed at the children’s market. Dubble is co-branded with Comic Relief, a well-known charity in the UK; Comic Relief earned a position on Day’s board when Dubble was launched. Dubble is tied to a range of educational tools and child-oriented marketing materials, including a dedicated child-oriented website, ‘Dubble Agents’ toolkits for children and links between children in schools in the UK and Ghana. Day has achieved impressive distribution of Dubble and in the process it has taken Fairtrade to outlets it had never been in before, including the Blockbuster Video chain, all major supermarket chains, regional confectionary distributors and independent shops.

In March 2000, the Co-op chain of supermarkets in the UK launched a co-branded Co-op/Divine private label chocolate bar, and in November of 2002 converted its entire range of own-brand chocolate to Fairtrade. In its press release announcing the launch, the Co-op indicated that it wished to “start a race amongst major UK supermarket groups anxious to demonstrate they care and are keen to establish their ethical credentials”. The product even replaced the mainstream Yorkie bars in some stores.
Policy implications

Government policy is already actively engaged with promoting greater responsibility and awareness of citizenship roles in students. A focused agenda around ethical markets could combine business studies, citizenship and personal development with specific learning objectives around social justice and environmental responsibility. This could take the form of a number of initiatives, including:

- Enhancing curricula for schools with a greater focus on the ethics of market exchange and social justice.
- Expanding the scope of a Young Social Entrepreneurs competition to engage all age groups from Year 4 onwards.
- Encouraging celebrity endorsement through charitable tax deductions for time as well as money spent supporting brands associated with positive models of ethical market exchange, such as fair trade and recycling.

As Leadbeater has noted, the government could also promote the giving economy further with students to encourage greater engagement with social justice and development issues.
5. Conclusions

This report has used an enhanced social value chain model as an analytic device to explore a range of new opportunities for social enterprises to create and enlarge ethical market activity in the UK (and beyond), broadly conceived. The challenge for social policy today is to address creatively the socially entrepreneurial processes that can develop these opportunities to ensure they maximise their ultimate impact.

Each of the three examples listed above represents an opportunity at a different point in the enhanced social value chain. Developing social finance represents a new resource strategy that works as institutional social enterprise providing an urgently needed (by both supply- and demand- side actors) new product to the marketplace. The Just Change model of creating new bridging social (and economic) capital via a reconfigured, social justice-driven, exchange and trade mechanism offers a normative social enterprise approach by which to generate new social value across the four central segments of the enhanced social value chain. Finally, building new – future – ethical markets via education addresses the end of the chain and demands socially entrepreneurial educators to develop methods and narratives that can be transformative in terms of students’ ethical landscape and worldview. In all of these areas there is tremendous scope for change and social impact.

The main barrier to grasping these new opportunities lies in the way many organisations conceptualise market opportunities. In the absence of wide recognition of enhanced analytics that recognise social and economic value creation opportunities equally, most businesses are effectively blind to many ethical market opportunities. Similarly, conventional public welfare models and citizens sector interventions have been wary of engaging with market mechanisms at all – though this is changing. Social enterprises that combine an entrepreneurial flair and appetite for innovation and risk are well-placed to path-find in this new opportunity landscape. Via creative thinking and implementation, policy makers have the opportunity to play a crucial role too, as the facilitating social entrepreneurs of a range of new futures for the development of ethical markets going forward.
About the author

Dr Alex Nicholls MBA is the first lecturer in social entrepreneurship appointed in the UK. He has a background in retail marketing and, before that, medieval lexicography, but in the last ten years has developed particular interests in fair trade, business ethics, and the interface between business, the public sector and society. He has been working in the specific area of social entrepreneurship for some time and was the first appointment at the Skoll Centre in Social Entrepreneurship at the Said Business School, University of Oxford.

Nicholls has strong links with industry, having spent seven years with the John Lewis Partnership, ending up as a senior figure in the central buying group. He has conducted a range of commercial consultancy in the social sector, including work on Fairtrade new product development and eco-tourism.

Nicholls has held lectureships at a wide variety of academic institutions including: University of Toronto, Canada; Leeds Metropolitan University; University of Surrey; Aston Business School. He is a Fellow of the Academy of Marketing Science and Member of the Institute of Learning and Teaching. He also sits on the regional social enterprise expert group for the South East of England. Nicholls has published widely on fair trade, ethical markets, and social entrepreneurship in peer-reviewed academic journals and has co-written one book and edited another on the subjects.
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Notes

3 Social Enterprise’ is defined in this report as any social purpose organisation that derives a significant proportion of its revenue from earned income. The Social Enterprise Unit, within the Cabinet Office, defines social enterprise as follows:

“Social enterprises are businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners” (www.cabinetoffice.gov.uk/third_sector/social_enterprise).

5 See eg Smith (1976a and b), Offer (2006), pp.75-99
6 See Putnam (2001)
7 A Note on Methodology. The report will use a case study methodology based upon a combination of new analyses of existing semi-structured interviews already carried out by the author and new desk research. Given the timelines of the project there will be only limited opportunity for new data collection. Three short cases – from the UK and abroad – will be developed to underpin the analytic arguments of the report.

8 Cowe and Williams (2000)
9 See Tallontire et al., 2001: pp.19-21
10 Shaw and Clarke (1999)
12 Adapted from Porter (1998) and Dees et al. (2004)
13 Nicholls (2006)
14 www.catfund.com
15 www.triodos.co.uk
16 www.bridgesventures.com
17 www.adventurecapitalfund.org.uk
18 www.cafonline.org
19 www.unltd.org.uk

20 www.skollfoundation.org
21 DTI (2004)
22 Note this term in largely used in the UK: see www.socialfirms.co.uk. Elsewhere, particularly in Europe, ‘work integration social enterprise’ (WISE) is more common: see Borzaga and DeFourny (2001), Nyssens (2006).
23 Yunus (1998).
24 For example, Community Investment Tax Relief to encourage investment in social or community enterprises; www.hmrc.gov.uk/specialist/citc_guidance.htm.
25 For example the Congestion Charge in London; see www.hmrc.gov.uk/specialist/citc_guidance.htm.
26 Kyoto Protocol: www.unfccc.int/kyoto_protocol/items/2830.php.
27 www.ethicaltrade.org
28 Wrigley (2002)
29 Lang and Hines (1993)
30 Cowe and Williams (2000)
33 See Offer (2001).
34 LeGrand and Bartlett (1993)
35 Yunus (1998)
36 Leadbeater (1997)
37 Salamon and Anheier (1999)
40 Ibid.
41 See Emerson (2003).
42 www.philanthropycapital.org
43 See NCVO (2005) The UK Voluntary Sector Almanac 2005
The term ‘social capital’ has been extensively researched and popularised by Putnam (2001) and can be conceived of as the product of new associative activity between groups/networks/individuals that contributes towards community cohesion.

Bonding social capital is generated by new associative activity between groups that share many common cultural/geographic/demographic features.

Bridging social capital is generated by associative activity between groups that do not share many common cultural/geographic/demographic features.

Twinning is a global phenomenon, however.

See Nicholls and Opal (2004).

www.fairtrade.org.uk/get_involved_fairtrade_towns.htm.

www.justchangeindia.com

Nicholls and Cullen (2004)

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