THE CASE FOR A SOCIAL EXCHANGE IN MALAYSIA

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Context

The University of Malaya (UM) and International Center for Education in Islamic Finance (INCEIF) pulled together a team of researchers ("research team"), led by Dr Sherin Kunhibava, Senior Lecturer under Faculty of Law, UM to produce a research publication on the legal framework required for an Islamic Social Exchange in Malaysia. They received a grant from the Universiti Malaya Research Excellence Grant (UMREG) in January 2024 and are expected to complete the publication within the next 3 years.

One of the UMREG's requirements was for the research team to have an industry partner and as such had reached out to the Institute for Capital Market Research Malaysia (ICMR). ICMR served as an intermediary to convene policymakers and industry players, together with the research team, to foster a more inclusive discussion and to ensure practical insights and perspectives from the various stakeholders are incorporated into the research analysis.

In the first quarter of 2024, ICMR conducted a series of Focus Group Discussions (FGDs). Alongside ICMR, UM, INCEIF and key individuals from the social development ecosystem, representatives from the Securities Commission (SC) also participated in these sessions. The primary objective of the FGDs was to discuss the feasibility and demand for a Social Exchange in Malaysia.

The FGDs were structured for three (3) distinct groups of participants, which are:-

i) Social enterprises;
ii) Non-Governmental Organisations (NGOs); and
iii) Funders and impact investors.

Another important objective was to engage grassroots representatives to gain deeper insights into their specific needs and interests, thus the need for three (3) distinct FGDs, to identify their unique challenges within the social impact ecosystem and explore the potential role of a Social Exchange in addressing these challenges.

This position paper, produced by ICMR, offers an independent perspective and aims to underscore the practical significance of the prospective establishment and execution of a Social Exchange in Malaysia, contributing to the ongoing discourse on sustainable social development and impact investment initiatives in the country. This paper also incorporates input from ICMR Distinguished Fellow, Tan Sri Andrew Sheng, and has been reviewed by him.

This position paper represents the independent views of ICMR and is not intended to either shape the outcome or to take precedence over the research paper that UM and INCEIF are working upon.

Background

Introduction

Malaysia has made significant strides in economic development over the years, but alongside this progress, there remains a pressing need to address social, environmental, and community-specific challenges. As the world embraces Sustainable Development Goals (SDGs), there is a growing recognition of the role that businesses and investors can play in driving positive impact to the society. An alternative being explored to spur investments that create social impact is the **Social Exchange**, a relatively new platform that has been established in a few other countries such as India, Singapore, and Canada. The platform aims to provide NGOs and social enterprises with a regulated space to access funding opportunities.

Given the absence of a standardised structure for the platform, each country has adopted their own name for their respective Exchanges. In this paper, we will use the term **"Social Exchange" (SE)** as a general term for the platform.

What is a Social Exchange?

A Social Exchange is designed to drive more positive social development by leveraging upon a robust market infrastructure. Essentially, a SE serves as a hub for impact investing, facilitating connections **between organisations or enterprises** committed to making a positive difference **and socially-conscious investors** eager to support such initiatives. As the business world undergoes a necessary transformation driven by new environmental and social challenges that we face, a SE has the potential to serve as an innovative alternative platform for capital market fund-raising dedicated toward socially impact-driven enterprises. The platform has garnered attention from policymakers fairly recently, particularly through its potential to catalyse transformative social change via market-driven initiatives.

Social Exchanges function akin to traditional investment and financial markets, facilitating the connection between supply and demand for capital. However, within this framework, the supply of investors is predominantly in search of investment opportunities which deliver social impact returns, and in most cases, complemented with financial returns. With increased awareness within the financial community regarding the importance of the social dimension of its activities, the emphasis for businesses has shifted from purely financial gains to also **prioritising social and environmental returns**. On the demand side, social enterprises and NGOs are actively seeking capital to fund their social initiatives. Broadly speaking, Social Exchanges serve as a conduit, mobilising private capital for the betterment of society.[1]

As Social Exchanges can take on different structures and forms, their differing factors can be distilled into three (3) aspects, which are:-

i. Type of activity undertaken (facilitating trading or a matchmaking function);
ii. Who can invest (the general public or only accredited investors);[2]
iii. Who can get listed (non-profits only or with profit-making enterprises).

[1] Logue, D., & Höllerer, M. A. (9 January, 2015). Social stock exchanges – do we need them? Retrieved from The Conversation: https://theconversation.com/social-stock-exchanges-do-we-need-them-35898

[2] Ashoka. (27 May, 2014). Stock Exchanges for Social Enterprises? Here's Where You Can Find Them. Retrieved from Forbes: https://www.forbes.com/sites/ashoka/2014/03/27/stock-exchanges-for-social-enterprises-heres-where-you-can-find-them/?sh=393bddab4e5a

Which countries have adopted a Social Exchange?

Since the early 2000s, there have been nine (9) social exchanges set up across the world. Of these, only four (4) are still actively operating. [3]

Table 1: Social Exchanges around the World [4]

	Countries	Platform	Year Introduced	Status
1	Brazil	Bolsa de Valores Socioambientais (BVSA)	2003	Not active *Closed in 2018*
2	South Africa	South African Social Investment Exchange (SASIX)	2006	Not active *Closed in 2009*
3	Portugal	Bolsa de Valores Sociais (BVS)	2009	Not active *Closed in 2015*
4	Kenya	Social Investment Exchange	2009	*Unknown*
5	Canada	Social Venture Connexion (SVX)	2013	Active
6	Singapore	Impact Investment Exchange (IIX)	2013	Active
7	UK	Social Stock Exchange	2013	Not active
8	Jamaica	Social Stock Exchange	2019	Active
9	India	Social Stock Exchange	2019	Active

Note: As information on Social Exchanges around the world is still fragmented, the list and information listed may not be exhaustive.

Given the platform's nascent stage, there is no standardised structure for a Social Exchange. Each platform varies in design to cater to the nation's specific needs and audience, as well as the philanthropy space within the nation.

In India, the Social Stock Exchange (SSE) is an electronic fund-raising platform under the regulatory ambit of the Securities and Exchange Board of India (SEBI). The SSE is a platform to bring together social organisations and impact investors, on which the investors can buy stakes in the form of bonds from listed organisations. [5]

It operates similarly to a regular stock exchange by facilitating listing, trading and settlement of shares, bonds and other financial instruments. However, instead of putting Profit and Loss as a central focus, the companies are required to provide social and environmental impact reporting (in addition to the regular financial reporting).

[3] Shekhar, D. J. (14 July, 2023). Can India's social stock exchange flourish where others have failed? Retrieved from Forbes India: https://www.forbesindia.com/article/take-one-big-story-of-the-day/can-indias-social-stock-exchange-flourish-where-others-have-failed/86659/1; Asilah, Sharifah; Muneeza, Aishath. (2024). Harnessing the Power of the Stock Market for Social Good: Establishing an Islamic Social Stock Exchange in Malaysia. International Journal of Management and Applied Research, Vol. 11, No. 1, pp. 1-17.

[4] Mehra, P., & Vij, M. (May, 2023). Social Stock Exchange: New Paradigm For Social Enterprises. Retrieved from The Institute of Company Secretaries of India: https://www.icsi.edu/media/webmodules/CSJ/May/22ResearchCornerDrPragatiMehraDrMadhuVij.pdf

[5] KPMG. (July, 2020). Analysing the Concept of 'Social Stock Exchange' in India. Retrieved from KPMG: https://assets.kpmg.com/content/dam/kpmg/in/pdf/2020/07/analysing-the-concept-of-social-stock-exchange-in-india.pdf

One of the leading factors supporting the development of India's Social Stock Exchange is the significant number of NGOs, numbering as high as 3.3 million.

Table 2: Social Impact Enterprise in Canada, Singapore, India and Malaysia (estimates)

	India	Canada	Singapore	Malaysia
Total Population	1.4 billion	39 million	6 million	34 million
Number of NGOs	3.3 million	86 thousand	2.4 thousand	85 thousand
Number of social enterprises	2 million	7 thousand	2.7 thousand	414

Sources: World O Meter (2024); Department of Statistics Malaysia (2024); International Center for Non-Profit Law (2024); Canadian Charity Law (2023); Singapore Company Incorporation; Registrar of Societies (2024); Intellecap (2018); Canadian Community Economic Development (2016); Malaysia's Ministry of Entrepreneur and Cooperatives Development (2022)

It is interesting to note that in Malaysia as of 2022, only 414 social enterprises were registered with the Ministry of Entrepreneur and Cooperatives Development (KUSKOP), whilst the British Council's study on the State of Social Enterprise in Malaysia 2018 had estimated a significantly higher number of 20,749 social enterprises (which includes cooperatives and NGOs). The precise number of social enterprises in Malaysia is uncertain and the identification mechanism remains unclear, primarily due to the lack of legislation mandating their registration.[6]

Overview of Key Players in Malaysia's Social Impact Ecosystem

The social impact ecosystem in Malaysia comprises a diverse range of key players, such as NGOs, social enterprises, funders and impact investors.

i. Non-Governmental Organisations (NGOs)

In Malaysia, NGOs are governed by multiple Acts, depending on their registration category and structure. Generally, the registrations can be summarised as follows:-

a. NGOs registered as Company Limited by Guarantee (CLBG) fall under the jurisdiction of the **Companies Commission of Malaysia (SSM)**, operating in accordance with the provisions of the Company Act Malaysia 2016.
b. NGOs registered as Societies/Associations are governed by the **Registrar of Societies (ROS)** under the Ministry of Home Affairs, in accordance with the Societies Act 1966.
c. NGOs registered under the **Registrar of Youth Office (ROY)** are established under the Ministry of Youth and Sports (KBS) in accordance with the Youth Societies and Youth Development Act 2007.[7]

Entities registered under SSM adhere to structured financial statement and auditing requirements under the Malaysian Financial Reporting Standards (MFRS), while those established under ROS are merely **encouraged** to adhere to these standards.[8]

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[6] Juen, J. Y., & Ng, B.-K. (6 September, 2022). Empowering and sustaining social enterprises. Retrieved from The Edge Malaysia: https://theedgemalaysia.com/article/empowering-and-sustaining-social-enterprises

[7] Pejabat Pendaftar Pertubuhan Belia. (n.d.). Retrieved from Pejabat Pendaftar Pertubuhan Belia: https://roy.kbs.gov.my/

[8] 3E Accounting. (n.d.). Champion Society by Starting a Non-profit Organization in Malaysia. Retrieved from https://www.3ecpa.com.my/resources/industry-guide/starting-a-non-profit-organization-in-malaysia/

ii. Social enterprises

There is yet no globally accepted common understanding around the idea of social enterprises. In Malaysia, social enterprises can be classified as business activities that are primarily motivated by social good, with profits reinvested towards advancing a social cause.[9] Currently, Social Entrepreneurship is a key agenda for the **Ministry of Entrepreneur and Cooperatives Development (KUSKOP),** who in 2022 launched the Malaysia Social Entrepreneurship Blueprint 2030 (or SEMy2030) to lay out the strategic national direction for the development of social enterprises.

Over the past decade, the development of social enterprises has fallen under the purview of different government-related entities.[10] In 2010, the government set up **Agensi Inovasi Malaysia (AIM)** to drive social innovation initiatives, producing several blueprints during its tenure. Under AIM, a new funding approach based on the Pay for Success (PFS) model of a Social Outcome Fund was introduced in 2017 as part of an ambitious effort to boost Malaysia's social economy.[11] Its objective was to make it easier for "high-potential" social enterprises and other social purpose organisations to obtain funding from social impact investors, corporations and foundations based on pre-agreed social outcomes and consequently, help plug funding gaps in government spending. There have not been many updates on the progress of the fund since its launch and in 2020, AIM was dissolved following its 10-year mandate as a statutory body.

In 2014, the Ministry of Finance established the **Malaysian Global Innovation and Creativity Centre (MaGIC)** to promote the development of impact driven start-ups and an inclusive ecosystem. During this time, MaGIC developed the Malaysian Social Enterprise Blueprint 2015-2018 that aimed to support the development of social enterprises to grow from only 200 in 2016 to 1,000 by 2018. In 2017, MAGIC and AIM launched a platform to link social entrepreneurs and social impact investors, called the **Social Impact Exchange (SIX).**

SIX was Malaysia's first pay-for-impact exchange, designed to **parallel a traditional stock exchange**, and to be the focal point for raising funding for Social Purpose Organisations, or SPOs, and their intervention projects. Prior to listing on the SIX, SPOs, including but not limited to non-governmental organisations, non-profit organisations, social businesses and social enterprises, will be evaluated based on their capacity, track record, intended social impact, financial sustainability, measurement and innovative elements in a process similar to an initial public offering listing exercise for a company. As at December 2018, 19 SPOs were listed.

In 2018, MaGIC was placed under KUSKOP's jurisdiction. Subsequently, in 2019, KUSKOP introduced the National Social Enterprise Accreditation guidelines to enhance the recognition and credibility of social enterprises in Malaysia. As of 2021, 414 social enterprises were registered under KUSKOP and out of this, 48 are accredited.

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9 British Council. (2018). The State of Social Enterprise in Malaysia. Retrieved from https://www.britishcouncil.org/sites/default/files/the_state_of_social_enterprise_in_malaysia_british_council_low_res.pdf

10 KUSKOP. (2022). Malaysia Social Entrepreneurship Blueprint 2030. Retrieved from https://www.kuskop.gov.my/admin/files/med/image/portal/PDF/SEMy2030/SEMy2030_Booklet_ENG.pdf

11 Damodaran, R. (13 March 2017) Govt launches Social Outcome Fund for marginalised communities. Retrieved from the New Straits Times: https://www.nst.com.my/news/2017/03/220229/govt-launches-social-outcome-fund-marginalised-communities#google_vignette

Later in 2021, the Malaysian Research Accelerator for Technology and Innovation (MRANTI) was established through the merger of two agencies - Technology Park Malaysia and MaGIC, with SIX being absorbed under MRANTI. However, SIX does not appear to be currently active.

iii. Funders

Within the social impact landscape, funders or donors encompass a variety of entities such as **foundations, international organisations, family offices, and philanthropic arms**. In contrast to conventional investors, these entities typically prioritise altruism or social impact over financial returns when allocating their funds. Corporate Social Responsibility (CSR) programmes are also considered funders, as they seek to create impact with no expectations of financial gains from the organisations they reach out to. Additionally, funders may also include retail fundraising or **individual donors** (such as through charity donations or crowdfunding platforms).

iv. Impact Investors

Impact investments are investments made with the intention to generate positive, measurable social and environmental impact **alongside a financial return**[12]. Contributors within Malaysia's impact investing landscape include but are not limited to **private equity and venture capital firms, institutional and corporate investors, social impact funds, and High Net Worth Individuals.** This has also included investments in the impact sector that form part of broader funds or portfolios. However, until recently there has been a lack of private investors who are dedicated to investing in social impact-driven entities.

While Malaysia does not have specific regulations dedicated to impact investing, the government and other key organisations have introduced various initiatives to promote sustainable development. For example, in 2014, Bursa Malaysia introduced the FTSE4Good Index, measuring the performance of public listed companies (PLCs) that demonstrate strong environmental, social and governance (ESG) practices. Subsequently, in 2021, Bursa launched FTSE4Good Bursa Malaysia Shariah (F4GBMS) Index to cater to investor demand for ESG and Shariah-compliant index solutions.[13] Several Government-Linked Investment Companies (GLICs) have also set up dedicated impact funds, such as Khazanah Nasional Berhad's Dana Impak in 2022.

[12] Global Impact Investing Network. (n.d.). What You Need to Know About Impact Investing. Retrieved from https://thegiin.org/impact-investing/need-to-know/
[13] FTSE4Good Bursa Malaysia (F4GBM) Index. (n.d.). Retrieved from Bursa Malaysia: https://www.bursamalaysia.com/trade/our_products_services/indices/ftse4good-bursa-malaysia-f4gbm-index

The Case for Malaysia

The role of a Social Exchange

The idea of a Social Exchange is in tandem with a global shift in the discourse surrounding the role of markets and the purpose of businesses. The advent of Milton Friedman's shareholder capitalism in the early 1970s championed the idea that a corporation's sole purpose was to generate profits.[14] While capitalism has brought unmatched economic growth, there has been a realisation that this has come at the cost of externalities such as environmental destruction and climate change, wealth and income inequalities, and exploitation of natural and human resources in less developed countries.[15]

Calls for reform have come not just from policymakers or academics but also from business leaders themselves. For example, in 2019 the US Business Roundtable, representing the CEOs of America's largest corporations, redefined the purpose of corporations as going **beyond serving shareholders to commitments to all stakeholders**, promoting "an economy that serves all Americans."[16] This move towards stakeholder capitalism is also reflected in the exponential growth of movements like B Corp, the global nonprofit network that aims to "transform business for good" and has certified more than 8,600 companies in 98 countries since 2007.[17]

In Malaysia, policymakers too have recognised the importance of this shift. Securities Commission Chairman, Dato' Seri Dr. Awang Adek Hussin had previously highlighted that "this translates into companies requiring to balance their drive for profitability with their social responsibility" and that in this regard, "the capital market can play a pivotal role by facilitating funding access".[18] This is also in line with Malaysia's **urgent need to meet its SDG targets**, as more than 60% of targets are currently not on track or even worsening.[19]

It is evident that the previously held dichotomy between profit and social good can no longer hold true, and that solutions that can bring together the state, the markets and civil society is the way forward. Here, platforms like a **Social Exchange can harness the efficiencies and innovation of market-based financing while providing social value to beneficiaries in need**. Primarily, as an intermediation channel, a Social Exchange can help facilitate the flow of capital towards social good. Having social enterprises and NGOs listed on a regulated exchange enhances the matching mechanism and may potentially open up a larger pool of funds, thus providing not only more diverse funding opportunities but also more certainty in funding.

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[14] Friedman, M. (13 September, 1970). A Friedman doctrine-- The Social Responsibility of Business Is to Increase Its Profits. Retrieved from The New York Times: https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html

[15] Reeves, R. V. (5 June, 2019). Capitalism used to promise a better future. Can it still do that? Retrieved from Brookings: https://www.brookings.edu/articles/capitalism-used-to-promise-a-better-future-can-it-still-do-that/

[16] Corporate Governance. (19 August , 2019). Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'. Retrieved from Business Roundtable: https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans

[17] B Lab. (n.d.). Make Business a Force For Good. Retrieved from B Corporation: https://www.bcorporation.net/en-us/

[18] Speech by Dato' Seri Dr. Awang Adek Hussin. (2023). Opening Address at the Sustainable and Responsible Investment (SRI) Virtual Conference 2023 "Revving up the Race for Sustainability". Retrieved from Securities Commission Malaysia: https://www.sc.com.my/resources/speeches/opening-address-at-the-sustainable-and-responsible-investment-sri-virtual-conference-2023-revving-up-the-race-for-sustainability

[19] UN Sustainable Development Solutions Network . (n.d.). Malaysia. Retrieved from Sustainable Development Report: https://dashboards.sdgindex.org/profiles/malaysia

A Social Exchange can also capitalise on **Malaysia's position as a global leader in Islamic Finance** to reshape markets and reallocate capital based on the close alignment between Shariah principles and values of sustainability and social good. An increase in the flow of capital towards this sector can create an ecosystem where more social enterprises can thrive, thus **fostering more opportunities for young and dynamic social entrepreneurs** to be innovative and creative in addressing social or environmental challenges. As evidenced by the growth of movements like B Corp as highlighted above, having a Social Exchange will also put Malaysia (and by extension Islamic Finance) in the position to **leverage on a changing demographic**, where companies are catering to consumers and investors who want to put their money where their values are. This is in line with ICMR's previous research that had indicated that 74% of millennial and Gen Zs were more likely to invest in options with good causes.[20]

More importantly, having an exchange with a regulated framework will also provide a more structured pathway for entities looking to raise funds for social good. Having **streamlined reporting requirements with clear guidelines** will allow for much needed **transparency and accountability**. This can help in addressing the trust deficit between funders and recipients, while also contributing towards internal capacity building and professionalisation for the NGOs/social enterprises. It is envisaged that over time, this will help the NGOs and social enterprises with their own long-term sustainability.

Discussion on the state of readiness for a Social Exchange in Malaysia

As highlighted earlier, three separate FGDs were conducted to better understand the specific needs and challenges of the various players in the industry. A few **key ideas and practical challenges** emerged that were consistently discussed in all three FGDs and appear to be prevalent across the industry:

1. Lack of resources to build capacity and for long-term planning

   Most NGOs are currently dependent on grants, which are limited and difficult to secure, with some NGOs stating that up to 80% of their time and efforts go towards securing funding. NGOs have also noted that post-COVID 19, corporate foundations are moving away from 3 to 5-year funding cycles towards **shorter-term funding**. These factors significantly affect their ability to plan strategically or allocate resources for projects with longer-term impact.

   As funding tends to be disbursed on project-basis, many NGOs also face a shortfall in **covering operational expenditure**. This means that they are unable to hire the right people with the necessary skillsets such as grant proposal writing or impact reporting, thus hindering their ability to obtain further funding, creating a vicious "chicken-and-egg" cycle. Similarly, social enterprises too find it difficult to scale as they operate very lean teams wholly focused on on-the-ground impact.

   From a funder's perspective, many funders highlighted that most social impact organisations who approach them require a lot of **training and capacity-building** to enhance their business knowledge and professionalism. While some funders, particularly the larger corporate foundations, currently take on this role of coaching NGOs and social enterprises, this

[20] Jalaludin, A. J., Nasihin, A., Ibrahim, N., & Ithari, Z. (2021). The Rise of Millennial & Gen Z Investors: Trends, Opportunities and Challenges for Malaysia. Retrieved from Institute for Capital Market Research Malaysia (ICMR): https://www.icmr.my/wp-content/uploads/2021/10/FINAL-VERSION-The-Rise-of-Millennial-and-Gen-Z-Investors.pdf

undertaking is time-consuming and takes away from the core role of the funder. This puts into question the level of organisational quality of the impact-driven organisations which will determine their **level of investment readiness** for listing on a Social Exchange.

2. Lack of consistent methodology to assess and measure impact

The majority of NGOs and social enterprises are not well equipped to rigorously measure and report their impact as there is no consistent methodology, and **reporting requirements** by funders vary greatly. NGOs and social enterprises who receive grants from international donors and larger corporate foundations will tend to follow the methodology or frameworks provided by these funders.

As discussed above, the lack of resources to hire and build capacity exacerbates the problem, and hiring external consultants or specialists tend to be costly. However, NGOs and social enterprises also expressed concern about the ability of their grassroots and community leaders to meet stringent reporting requirements. Even where impact reports are provided, there is a **lack of validation or audit mechanism** in place, with due diligence primarily reliant on the specific funder.

3. Fragmented and inconsistent regulatory environment

The current regulatory environment has not always been conducive for many NGOs and social enterprises. This is exacerbated by the vast number of agencies involved and the restructuring of government agencies under different ministries which can lead to a **lack of policy continuity**. For example, social enterprises shared that obtaining accreditation under KUSKOP (which allows for tax benefits) is a lengthy process that requires a lot of paperwork, which they do not have the resources for. They also shared that the accreditation process under KUSKOP differs from the previous process under MaGIC, with the overall process has gotten more extensive after MaGIC was closed and social enterprises receiving less guidance. In cases where applications for accreditation had been rejected, some social enterprises did not receive feedback as to the reasons why.

Similarly, NGOs have shared that the **absence of a Charities Commission** or any centralised regulatory body means there is a lack of standard **best practices** across the industry, and newer NGOs struggle to find information or guidance.

NGOs, social enterprises, and funders all agreed that greater clarity is required around the **tax exemption regime**. Currently, many NGOs and social enterprises are not clear on the parameters on which tax exemption status is granted, which greatly affects their fundraising efforts.

4. Misalignment of vision and limited pool of funding

A significant challenge for many NGOs and social enterprises lies in finding funders that are **aligned with their vision and mission**. Social enterprises who had previously received private venture capital funding faced difficulties in balancing the expectations of their investors who mainly prioritise financials and business growth metrics, while staying true to their mission. As such, many are not keen on relinquishing ownership equity, as they are concerned about how this may dilute their social mission and impact.

NGOs and social enterprises also shared that there is a **limited pool of funders** available in Malaysia, which means that a large number of NGOs and social enterprises are competing for the same pool of available funding. From the funders' perspective, corporate foundations shared that the amount they have available to disburse may vary from year to year, depending on the goals and priorities of the parent corporation. As discussed above, there is also **a lack of patient capital** within the ecosystem, as there is a tendency for funders to favour shorter funding cycles.

Ex Ante Considerations for a Social Exchange

As with any other policy development effort, great care needs to be taken to ensure that potential issues are identified and addressed prior to implementation. This is particularly important in the case of a Social Exchange, as the work done by NGOs and social enterprises directly impact grassroot or underserved communities, and any unforeseen consequences could be detrimental to their wellbeing.

1. At the onset, it is important that any regulatory framework for a social exchange **draws a distinction between NGOs and social enterprises**, as they have differing structures, goals, and needs. The framework should ensure that this distinction extends beyond just having separate funding instruments, but also in terms of impact measurement, capacity building, and reporting requirements. By extension, this distinction will have to be made clear not only to the fundraising entity, but also to funders and investors, to ensure expectations are aligned.

2. While having an NGO or social enterprise registered or listed on a regulated exchange can help build public confidence that they have passed a certain threshold of due diligence, it may conversely give the perception that NGOs and social enterprise that are not listed are less credible. This may have **unintended implications for the fundraising efforts of smaller or newer NGOs and social enterprises,** particularly in a sector where NGOs may be visible only at a community/grassroots level or had emerged as an urgent response to crisis situations. Subsequently, if funders adopt a preference for entities that are registered or listed, there could be a situation where only a few larger and more renowned NGOs or social enterprises can reap the benefits of the exchange thus creating an unintended "two-tier system".

   As such, adopting a **tiered and phased approach to regulations** is crucial to allow more equitable and flexible opportunities for smaller players, and enabling them to be registered on the exchange even if they may not meet the full suite of regulations yet. This should allow for NGOs and social enterprises to slowly adapt to a more regulated environment, particularly in the initial stages. Ideally, a tiered approach would also cater to the nuances and differing needs of various social enterprises, based on their respective business models.

3. Given the recurring theme of there being a large capacity gap, an issue raised during all the FGDs, a tiered approach will require policymakers to consider the kind of **capacity building programmes** needed and who will be providing them. This area is particularly critical as "low awareness and training about how social stock exchanges work, which resulted in low enthusiasm among the investor community…" has been cited as one the main reasons that Social Exchanges in other countries have failed.[21]

   Capacity building should not be a one-off effort at the onset; instead there should be an **ongoing pipeline**, which should include raising awareness about capital market fundraising options, basic business and professional management skills (bookkeeping, procurement, report writing, etc.),

[21] Shekhar, D. J. (14 July, 2023). Can India's social stock exchange flourish where others have failed? Retrieved from Forbes India: https://www.forbesindia.com/article/take-one-big-story-of-the-day/can-indias-social-stock-exchange-flourish-where-others-have-failed/86659/1

impact assessments and more. Concurrently, **financial education programmes** and **awareness-building among policymakers and agencies** should also be run continuously and in parallel to ensure all stakeholders are familiar with the dynamics of a social exchange.

4. To ensure that entities listed on the exchange meet the baseline requirements, **more investment into an ecosystem of supporting services** will need to be introduced and possibly regulated. Key among this is the crucial role of third-party independent auditors or impact consultants who have the capability to assess and verify social impact, as this will be important to narrow the trust deficit. This will have to be developed in tandem with the establishment of a **standard impact reporting framework** that is clear and concise, but also allows for the nuances of different forms of social impact that may be hard to quantify. This of course, requires additional resources beyond what the social impact organisations can currently mobilize.

5. Related to the point above, one of the key issues faced by NGOs and social enterprises, today, is the shorter funding runway, which hinders them from planning strategically and investing in their capacity development. This is exacerbated by the fact that most funders prefer to provide funding for projects, which means there is a gap in funding for operational cost. Any regulatory framework for a social enterprise would need to take this into account, and **either allow for a mechanism to fund the entity itself (rather than a project) or specifically allow for operational costs and salaries to be incorporated into project budgets**.

6. Given the limited resources available for most NGOs and social enterprises, it is important that any new platform or framework **does not impose disproportionate additional regulatory burden** on them, as doing so may lead to a low take-up rate for NGOs and social enterprises.

   The introduction of an exchange should be looked at in tandem with an assessment of **the overall regulatory and developmental ecosystem for NGOs and social enterprises**, including ensuring there is a centralised body to oversee their needs. A **centralised body would hopefully be able to coordinate efforts and provide clarity on existing regimes**, e.g. tax exemptions, accreditation, and best practices. This will help provide some certainty to NGOs and social enterprises, as many have been affected by the fragmentation and constant changes in the regulatory environment.

   This is echoed by the **renewed calls to set up a Charities Commission in Malaysia,** akin to the initiatives in the UK and Singapore, following a few recent high-profile scam cases.[22] In addition, an overall assessment of the ecosystem should also provide support for a **government and GLC social procurement policy** to enhance market access for social enterprises and reduce reliance on external financing.

7. Given that one of the main roles of a social exchange is to facilitate the flow of monies towards NGOs and social enterprises, it is imperative that the regulatory framework **mobilises and incentivises the supply of capital**. While there will always be demand for funding, the overall success of the Social Exchange is also dependent on having **consistent supply of capital with sufficient breadth, depth, and diversity**.

   In many ways, the existence of a regulated Social Exchange would require investors, particularly large institutional investors, to truly commit to making an impact beyond adopting an ESG rhetoric or a mere box-ticking exercise. Investors will not only need to reevaluate their portfolio allocations and timelines, but also their ability to price in the impact measurements as part of a broader strategy to manage risks and externalities in a diversified portfolio. This may be a

[22] Koya, Z. (27 February, 2024). Charities commission needed to weed out scams. Retrieved from The Star: https://www.thestar.com.my/news/nation/2024/02/27/charities-commission-needed#:~:text=In%202020%2C%20then%20Deputy%20Prime,do%20due%20diligence%20on%20charities

particular challenge in the Malaysian market, as many of the key institutional investors have implicit mandates tied to specific financial returns and broader national agendas.[23] Thus, investing for impact will require a concerted shift of mindsets and expectations to support a profound change in the system.

The long-term aim of the Social Exchange should be to **stimulate new capital and investors into the social space**, as opposed to merely providing an alternative channel for existing philanthropy or impact investing funds. Key to this is having **clear tax incentives** that can attract new investors and private donors, especially if the overall outcome reduces government spending on social services. Further, introducing a **requirement for all public-listed companies to contribute a certain percentage of profits "for good"** could also channel private capital towards the Social Exchange, similar to India's requirement that companies over a certain net worth spend 2% of net profit on CSR. However, any such regulation would need to be clear enough to ensure no leakages or "greenwashing" takes place. Down the line, the Social Exchange could also be opened up to retail investors to cater to greater demand from younger consumers and investors for products that resonate with their values. The huge success of the #kitajagakita movement during the pandemic demonstrated that there is an appetite among Malaysians to support social causes.

8. Another way to increase the supply of capital would be to attract foreign funders and investors. In this case, policymakers could **harness Malaysia's value proposition as an Islamic Finance hub**, and leverage on the similar principles underlying Islamic Finance and social investing. Further, an Islamic Social Exchange could open up an additional avenue for zakat, waqf, and wakalah funds. This is in line with the Malaysian International Islamic Financial Centre Leadership Council's aim to move from a Halal financial ecosystem towards Tayyib- shifting from mere permissibility and harm avoidance to actively creating positive impact and doing good.[24]

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[23] ICMR (2018) The Evolving Business of Asset Management. Retrieved from Institute for Capital Market Research Malaysia: https://www.icmr.my/wp-content/uploads/2020/08/Evolving-Business-of-Asset-Management-1.pdf

[24] Speech by Tan Sri Azman Mokhtar. (4 October, 2021). Scaling the Sustainability Mountain: Moving from Halal to Tayyib1. Retrieved from Halal Universe: https://www.halaluniverse.net/in-depth/scaling-the-sustainability-mountain-moving-from-halal-to-tayyib1/

Conclusion

In a post-pandemic world, we stand at a precipice where climate change, ongoing genocide and conflicts, increasing sociopolitical division, and economic uncertainty has become the pervasive global reality. It is estimated that the annual global shortfall in SDG financing stands at USD 3.3 trillion.[25] It has become even more critical to have innovative solutions that can harness the power of private financing to address public social needs.

The introduction of a Social Exchange based on the conceptual idea of creating a capital market for social impact organisations would be a step in the right direction to meet the funding gaps within the social sector in Malaysia. In the words of ICMR Distinguished Fellow Tan Sri Andrew Sheng, we must "create the diverse eco-system which will grow [the NGOs and social enterprises] through a disciplined process of transparency, accountability and integrity" to ensure that social value is created.[26]

In conclusion, a Social Exchange, under the purview of the SC, can be a revolutionary idea which can provide a significant boost to Malaysia's social economy by leveraging on the efficiencies of a market-based infrastructure. However, our position paper points to several critical success factors and operational aspects that need to be developed, better defined and to be thoroughly considered prior to implementation. The success of the Social Exchange will depend on building **a robust and sustainable market infrastructure**, paired with **clarity of operational and regulatory frameworks**, and the ability to **attract and maintain sufficient market participants (both supply and demand) with compelling value propositions**.[27] Ignoring any of these elements could run the risk of the Social Exchange not meeting its full potential, or even worse negatively disrupting the social landscape in Malaysia. Amidst the regulations and technicalities that will inevitably need to be ironed out, it is crucial that policymakers keep in mind the end beneficiaries at the heart of this endeavour.

[25] Speech by Karima El Korri. (19 June, 2023). Launch of the Malaysia SDG Investor Map: Investing for a Better Future. Retrieved from United Nations: https://malaysia.un.org/en/237093-launch-malaysia-sdg-investor-map-investing-better-future

[26] Speech by Tan Sri Andrew Sheng (4 November, 2023). INCEIF University 14th Convocation. Retrieved from INCEIF: https://inceif.edu.my/wp-content/uploads/2023/11/INCEIF14th-Convo-Tan-Sri-Andrew-Sheng-2.pdf

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Appendix: List of participants

Social enterprise participants

No	Social Enterprise	No	Social Enterprise
1	Earth Heir	4	Pepper Labs
2	Langit Collective	5	Beebag
3	Maideasy	6	SAPOT

NGO participants

No	NGO	No	NGO
1	PERTIWI	6	Teach for Malaysia
2	Sahabat Alam Malaysia	7	Women Of Will
3	Reef Check Malaysia	8	Zero Waste Malaysia
4	SUKA Society	9	Girls For Girls
5	Small Changes MY		

Funders & impact investors

No	Funders & impact investors	No	Funders & impact investors
1	Yayasan Hasanah	6	Dana Impak, Khazanah Nasional Berhad
2	Yayasan Petronas	7	Malaysia Impact Alliance
3	Yayasan Sime Darby	8	Bintang Capital Partners
4	Yayasan MySDG	9	PurpoSE Malaysia
5	Maxis Foundation	10	Asian Venture Philanthropy Network Malaysia

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