

Is Ryanair an Impact Corporation? Some notes on Impact Investing and Intentionality

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Abstract

These short notes want to give an answer to a question raised by Professor Calderini whether or not Ryanair may be considered as an “impact/sustainable” company.

The ground of this question is the ability of airline to revitalize many European not strategic airports.

I personally would also add the ability to create a deeper knowledge of Europe and common sense of European citizenship.

The answer of Prof. Caldererini was in the sense that Ryanair may not be eligible as a social impact corporation due to the lack of intentionality when pursuing its industrial strategy and particularly its social impact.

In fact, on the basis of the common adopted definition of “impact investing”, these are *“investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return”* (GIIN. 2014) or *investments that provides finance to organizations addressing social and/or environmental needs with the explicit expectation of a measurable social, as well as financial, return”* (OECD).

My personal opinion is that intentionality should not be considered as an autonomous requirement to define the impact investing market, as the measurability of the impact is itself able to define the market.

1. An “Old” Revolution

Let us start to consider the question whether or not Ryanair is a social impact company by a simple and well established theory.

The idea that an enterprise is capable of generating a social impact is, nowadays, widely accepted, even if this vocation and the advantages deriving from socially responsible actions have been acknowledged only recently (i.e. from 90’s) by economic literature.

Milton Friedman (Friedman, 1970), in 1970, considered that the sole commitment of an enterprise was profit maximization for its own investors, while possible social actions should be left to the “good hearth” of the economic players who, through donations and other forms of grant, will finance generic beneficial initiatives.

2. Externalities’ Theory

This general view can be considered a result of the theory of market and externality (A.C. Pigou). Under this Theory, a market-based economy is not a stable and efficient model due

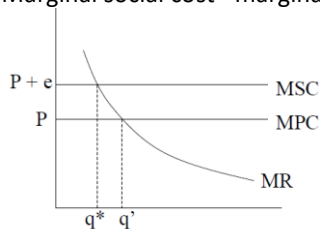
to the externalities, which, according to first author of the theory, is a cost or benefit that is experienced by someone who is not party to the transaction that produced it..

The classic example is the company that, running its production, causes air pollution in the city nearby the factory ⁽¹⁾.

Externalities generate a divergence between private costs and social costs: all the production exceeding the point q^* in the figure below is not efficient as it generates costs rather than profits.

MSC (marginal social cost) MPC (marginal private cost) MEC (marginal external cost)

Marginal social cost= marginal private cost + marginal external cost.



The correction of this market distortion proposed by Pigou was a per-unit tax. The tax would be set equal to marginal external cost, which in the case above is: e . In effect, this is making the firm pay to use one more factor of production (clean air) that previously had not been priced ⁽²⁾.

3. Positive Externalities

¹ Imagine the scenario of a company producing bicycles at €175/piece cost and a pool of customers willing to buy bicycles at €200/piece price: every purchase within these two values ($200 - 175 = €25$) generates wealth, leading the parties to both a profitable production and a satisfactory purchase price (Couter-Ulen, 2004). Let us speculate that the same bicycle producing company emits air polluting substances into the surrounding city centre and that the cost of reducing this pollution is the equivalent of €30 per bicycle produced. In this case, the Externalities' Theory leads to the conclusion of a market failure, caused by the fact that the social production price exceeds the sum of the private production price and the related externalities, hence the production of these goods and services is no longer profitable.

² Ronald Coase (Coase, 1960) criticized Pigou's theory on three main points:

The reciprocal nature of externalities and the consequence that, within certain circumstances, it is more efficient for the externalities' "victim" to change its behavior than for the author (the polluter) to do so. If a polluting factory should pay €100 for a depurator while the near farmers should pay €50 to move their stables, an economically efficient choice shall request to sacrifice farmers' interests.

Transaction costs, public good and holdout problems. In the market, certain transaction costs (e.g. lawyers) are capable of making the exchange inefficient and pushing predatory responses by the operators who could decide not to take part in the transaction and try to get a "free ride". In the aforementioned example, some farmers could opt not to participate to the transaction or to ask for a higher price in order to prevent the company from emitting polluting substances, hence increasing costs upon the efficient ones.

The possibility to internalise the externalities. Finally, Coase noted that an interested party (in the absence of legal remedy in term of property rules) had the chance to pay or to be indemnified in the event of the externalities' occurrence. In the example, an amount between €50 and €100 paid by way of either compensation or indemnity would still optimise the market, in the absence of a legal ban on pollution.

Externalities can be both negative and positive. Let us try now to list what positive externalities Ryanair realizes with its industrial strategy.

- a) Revitalization of the economic performance of the airport;
- b) Employment generation;
- c) Growth of tourism and accommodation in the area where the airport is located;
- d) Growth of tourism and accommodation of the destinations from the airport;
- e) Improvement of the sense of membership to the European Union.

Some of these positive externalities may be measured.

For example, if we consider the city of Ancona (Italy) after the establishment of Ryanair [***]

4. The Legal Perspective on Market Theories: Lawyers vs Economists

If you ask an economist how many barber shops there are in El Cairo (a city having on about 10 million inhabitants), the economist will (i) calculate the overall population of the city (10 million), (ii) divide it by two (male and female: 5 million each), (iii) consider the frequency of a haircut (once a month) and finally will reach a total demand of 60,000,000 haircuts per year.

Then, in order to calculate the offer, the same economist will consider the average duration of a haircut (15 minutes) and the average opening hours of a barber shop (8 hours per day), coming to a total of 32 haircuts per day and 9,600 per year (considering 300 working days a year). Therefore, in order to satisfy a demand of 60,000,00 haircuts, 6,250 barbers will be needed.

If you were to ask exactly the same question to a jurist, he or she would probably get the precise information from the local Chamber of Commerce office.

This story explains how the hypothesis of a free market is indeed (just) a hypothesis upon which to elaborate a theoretical economic model, which is impossible to make real, by definition, in the light of the necessary legislative intervention.

Furthermore, these models cannot account for all the externalities involved in a transaction: industrial pollution, the health of factory workers, the natural resources used to obtain the raw material necessary to produce the goods etc.

Secondly, any government or public authority, even in the most liberal markets, if do not provide specific regulations for the market, at least they provide principles and general rules that has to be applied.

Finally, the economic theory leaves to the jurist the non-secondary issue of deciding which subject (community, producer or consumer) should bear the costs and/or the benefits of an externality, as well as the choice on which legal remedy to implement (compensation or prohibition; liability rule or property rule).

In a legal perspective, this result cannot be considered a point of arrival without a previous exploration of the formants of the markets and of its rules.

5. What Sustainable Is

So, let us start from a legal approach and let us ask what sustainable means based on the current legal framework.

Article 3 (*Grundnorm*) of the EU Treaty provides that:

*"[the Union] shall work for the **sustainable development** of Europe based on balanced economic growth and price stability, a highly competitive **social** market economy, aiming at full employment and **social** progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance. It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child. [...] It shall contribute to [...] sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights [...]."*

A declination of this general provision may be found, at least, in the European Regulation 2017/1601 UE and in the Italian Law 208/15 on benefit corporations.

The first regulation established the EFSD, which aims *"to support investments primarily in Africa and the Union's Neighbourhood as a means to contribute to the achievement of the Sustainable Development Goals of the United Nations (UN) 2030 Agenda"* ⁽³⁾. Furthermore, when describing the scope of the EFSD, the Regulation provides that *"The EFSD should maximise additionality, address **market failures** and **sub-optimal investment** situations"*.

The latter provision (Italian Law 208/2015), provides a definition of benefit corporations in the terms of *"a company which pursuing an economic activity, beyond the scope of share the relevant profits, pursues one or more than one scope of common benefit and which acts responsibly, in sustainable and transparent way with the people, communities, lands and environments, cultural assets and activities, entities and associations and other stakeholders"*.

For the same regulation, "common benefit" is defined *"as the pursuit, in the exercise of an economic activity of the benefit corporation, of one or more than one positive effect or reduction of negative effects"*.

On the basis of the legal framework above, we can try to sketch a first definition of "sustainable" a market, company or economic system that, in a long-term period, is capable of internalising the largest amount of externalities (nota con direttiva degli azionisti).

³ The scope set forth in the regulation provides us a strong evidence that social impact and sustainability may be considered as synonyms for the European legislator.

This definition takes essential inspiration from the three main critics moved by Coase to the Pigouvian approach (par. 3), and particularly from the market's possibility to internalise externalities and from the public good.

Clearly, it is an "evolving" model, which progressively includes in the relation between demand and offer all the components (both active and passive) that do not belong to the parties of the transaction but to the other stakeholders.

It is clear a relationship between sustainability and externalities (in terms of generation of "positive effects" or reduction of "negative effects") and the necessary inclusion of social costs into the marginal costs of the production.

Therefore, the point of view is to maintain Pigou's theory perspective, revised in the light of Coase's theorem (Coase 1960, see footnote no 2), in order to sketch a first synthetic idea.

8. Taxonomy Approach & Market-Led initiatives: are They Useful or Even possible?

The major definitions in the market were elaborated by the GIIN and OECD.

According to the GIIN, impact investments are "*investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return*" while according to the OECD "*social impact investing provides finance to organizations addressing social and/or environmental needs with the explicit expectation of a measurable social, as well as financial, return*".

Three criteria therefore are generally adopted to describe impact investing: measurability, intentionality and additionality.

The two definitions have substantially the same meaning and a different "starting point": a pure economic player under the GIIN definition, general social entities according to the OECD definition.

The growing interest for social impact/sustainable markets has determined the European Commission to establish a Technical Expert Group on Sustainable Finance (TEG) with, *inter alia*, the task to provide "*an EU Classification system - the so-called taxonomy - to determine whether an economic activity is environmentally sustainable*".

In its state of play, as in July 2018, the TEG further noticed that "*Currently, no classification system exists at EU-level and market-led initiatives of recent years are not comprehensive enough to sufficiently reflect all EU environmental and broader sustainability priorities*" in order to conclude "*The taxonomy will serve as a basis for the future establishment of standards and labels for sustainable financial products that provide sustainable capital flows*".

As a matter of fact, and as considered by the TEG, market-led initiatives were not able to fully describe the industry. The definitions elaborated by the Global Impact Investing

Network (GIIN) and OECD are too wide or too restrictive, under different points of view, to realise a distinctive function.

However, any economic activity generates a social impact: eg. a factory by employing people reduce poverty and unemployment rates, while intentionality and measurability should not be a distinctive criteria.

For the first one (intentionality) all the economic players act on the assumption of being rational players, therefore the intention of achieving a goal should be considered as an assumption of any economic action. Furthermore, if an enterprise accidentally creates a positive externality in terms of social/environmental need (e.g. steel factories producing hot water for home-heating purposes, or the incinerator of Copenhagen which has a ski circuit on its roof) the exclusion of such initiatives is reasonless.

With respect to the second criteria, measurability depends on the model adopted (e.g. what items of needs are included in measurement) rather than on the concrete action purported by the economic player. Therefore, the same activity can be considered as having or not a social impact depending on the scale and criteria of measurement adopted.

Probably, considering the practical approach considered in par. 8 a taxonomic approach risks to be not feasible or useful due to the difficulties of selecting the externalities (both positives and negatives) which are part of the social costs to be associated to the private costs.

On the contrary an approach directed at pre-selecting the externalities to create (if positive) or to reduce (if negative) could lead to the construction of a “variable geometry” definition capable of including or excluding certain phenomena in the market.

10. First Conclusion

The first conclusion we can draw from the empirical data here analysed is that social impact tends naturally to the internalisation of externalities and to minimise cases traditionally considered as market failures, overcoming the main critics raised by the Coase theorem.

Under a different light, social impact segments are more capable of fully “describing” the market formants (offer and demand), taking more efficiently into account costs and benefits associated to those.

Moreover, in the light of the European and national market principles, we can assess that social impact is a form of compliance (the only worth considering) with current legal obligations to create a sustainable market, that every market should become “social impact” and that every economic player should follow the rules of this kind of market.

From this point of view, a taxonomic approach risks not to be feasible or useful if not directed to a pre-selection of what externalities has to be included or excluded as a social cost to the marginal cost of the offer ($MSC=MPC+MEC$).

11. Methodical Conclusion

On the basis of the preceding conclusions, the question now moves to a subjective level (who should bear costs and enjoy benefits from externalities?) and quantitative level (how do we calculate costs and benefits of internalising an externality?).

To make an example: if I build a house following the best green building practices, shall I be entitled of some kind of remuneration for contributing to lowering the environmental pollution I would have otherwise caused? If my company pays adequate wages, who will compensate for my competitive market disadvantage? If I finance the building of a cultural centre or a school, how much should I be remunerated for contributing to heighten social and democratic awareness?

A traditional answer of the legislator provides the state intervention, through either tax relief or tax burden, to balance the distortive effects in the market: the so-called *Pigou's tax*.

This traditional approach surely preserves, even nowadays, some degree of validity, but the existence of a specific obligations for citizens and for the economic players to act in a "sustainable" manner should require a more incisive approach.

Looking forward, we can infer from the legal (and empirical-historical) framework that the idea of a corrective intervention of the State is nowadays exceeded, in favor of a model that promotes markets which, due to their nature, do not require, or need in a lower grade a corrective intervention of the public authority.

The promotion of social impact industry and/or incentive through legal instruments should be considered, at least, as a way to compensate the negative effects on competitiveness associated to higher costs of production or to higher benefits for the stakeholders.

Beyond this first promotional step, legal principles concerning market regulation should arrive to exclude the existence of segments of market incapable of sufficiently internalise their externalities. This fact (for sure a mere tendency but partially realised in the energy market yet, see below) will determine a deeper commitment from stakeholders for sharing costs and benefits associated to externalities (in this perspective, we can consider a switch from a liability rule to a property rule according to the Coasean Approach).

As mentioned above, the roots of this system are in the energy tariff systems of many countries, in which, on the one hand, citizens participate to green energy production and, on the other hand, producers can bargain green certificates in a "market of pollution".

12. Measuring the Compensation

The second question becomes, therefore, crucial: namely, how can I calculate the remuneration for having internalise the externalities and how can I measure the social impact?

Indeed, the quantification of incentive/remuneration, on the one hand, or the taxation, on the other hand, shall determine the efficient point of equilibrium in the market as it provide the correct measurement of the social costs to be added to the private costs ($MSC=MPC+MEC$).

Different methods have been created, even at legislative level (see the GeCes Committee's legislative proposal to the EU Commission on June 2014). According to one of the most updated study (Sto - Staskevicius, 2015) four methods can be categorised as follows:

- a) Expected Return. These methods take into account the anticipated social benefits of an investment against its cost, discounted to the value of today's value. Examples are SROI (Social Return on Investment); Benefit Cost Ratio (BCR) and Economic Rate of Return (ERR).
- b) Theory of Change. Theory of Change and logic model explain the process of intended social impact. Specifically, logic model is a common tool used to map a theory of change of an organisation, intervention or program by outlining the linkage from input, to activities, to output, to outcomes and ultimately to impact.
- c) Mission Alignment. These methods measure the execution of a strategy against mission and end goals over time; examples includes value criteria and scorecards.
- d) Experimental Methods. These methods are after-the-fact evaluations that use a randomised control trial or other counterfactual to determine the impact of the intervention compared to the status quo.

Obviously, the existence of a plurality of models is not acceptable both for the adoption of a uniform regulation of the market and for the investors; however, each of the models set forth above has their own areas of strength and weakness particularly in the stage of the investment. For examples, SROI models are most efficient in estimating the impact, while model based on the Theory of Change or Experimental Methods are particularly efficient in planning the investment or in monitoring the impact.

The idea purported in this paper can be a common field for the creation of a uniform model based on comparative analysis of the kind of "*what if*" scenarios. In this possible model, on the basis of previous selection of the externalities to count into the social cost/benefit, the measurement of social impact begins from a stable point (the cost/benefit without considering externalities) and then it predicts or quantifies the impact generated by investment or by the industry.

13. Conclusions

In conclusion, the Theory of Externalities revised on the light of Coase Theorem can reach a clear understanding of the social impact market by avoiding a taxonomic/definitional approach, which could lead to unreasonable exclusions to the access to the market.

In this view, and according to the Principles set forth in Treaty on UE, there is no difference in the meaning between sustainability and social impact.

A ground for a legal definition of sustainability exists nowadays in Regulation 2017/1601/UE at EU level (promoting the European Fund on Sustainable Development) and in Law 208/2015 on benefit corporations in the Italian legal system. These regulations provides a clear link between sustainable economy/finance and Theory of Externalities and indicates, in accordance to the principle of economic action at EU level and under the Italian Fundamental Law:

- a) that specific obligations to act in a sustainable way exist;
- b) social impact/sustainable economy are (or should be) a mandatory way to act for all the economic players;

- c) preferred areas of intervention of the sustainable economy refers to market failure and suboptimal market.

Also, the Theory of Externalities can provide a solid ground not only for the understanding of the industry in terms of a "*geometrically variable definition*", but also for the construction of an homogeneous method of social impact measurement.

The intervention of the legislator shall be oriented on the identification of the cost bearer and of the legal remedies for the efficient allocation of resources and, therefore, for the symmetric allocation of the externalities of the market.

Finally, based on the proposed approach it is possible to create an impact measurement model based on "what if" scenarios.

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