A Decade of Impact Investing in India

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March 28, 2016

Abstract

Impact investments are those that create social or environmental impact and at the same time generate a financial return. While globally, impact investing or socially responsible finance has been growing and constantly gaining attention from academic as well as corporate circles, the industry is still at a nascent stage in India. This paper presents a snapshot of growth of the impact investing industry in India over the decade 2005-2015. It also presents potential ways for the industry to develop, taking into account the recent developments in India.

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1 Introduction

1.1 Introduction to impact investing

Impact investments are "investments made in companies, organizations, and funds with the intention to generate social or environmental impact alongside a financial return"[1] . The growing impact investment industry provides capital, along with professional expertise based on management principles, to address the world's most pressing challenges in sectors such as sustainable agriculture, clean technology, microfinance, and affordable and accessible basic services including housing, healthcare and education.

1.2 Global trends in impact investing

Worldwide, social sector investing has been a constant source of innovation. It is believed that impact investing is an effective way of unlocking private capital and directing the fund to social sector across the globe. New securities linking social impact to financial returns are being created. JP Morgan estimates that potential profit for impact investors globally across five sub-sectors (housing, rural water delivery, maternal health, primary education and financial services) could range between $183 billion - $667 billion over the next 10 years[2] .

1.3 Impact investing in India

The impact investing industry in India is rapidly growing since 2000. Investments per annum initially stood at $ 1.17 million in 2000 and it grew rapidly to $ 250 million since 2011. According to a report by Intellecap, of the total $1.6 billion invested in impact enterprises in 2014, $906 million was from private equity and venture capital investments[3] .

The industry is regarded as the largest in South Asia and second largest in the world, in terms of size. India accounts for over half of the impact capital deployed in the South Asian region. An analysis of 523 deals based in 212 companies in India reveals that the maximum amount of investment (64%) is made in BFSI (Banking, Financial Services and Insurance) industry. The number of deals and number of companies have also been highest for the BFSI industry at 287 and 72, respectively[4] .

However, despite being a key market in the impact investing landscape, research on the Indian industry has been limited. This presents opportunities to undertake research and study in understanding the details and dynamics of the Indian impact investing industry.

2 Key differences in industry strategies between India and developed countries

1. The report published by J.P Morgan and GIIN states that there are around 50 impact investment funds (fund management firms) that are active and are leading efforts in developing the industry in India[2]. These firms raise capital from a variety of sources, including DFIs, institutional investors, family offices, High-Net-Worth Individuals (HNIs), commercial banks and foundations. In contrast to this, impact investment by retail investors in the developed countries is encouraged by wealth management firms which help in achieving scale. In US and UK, there are many organisations actively making impact investments funded by retail investors – including banks, specialist funds, cooperatives, CDFIs and crowdfunding platforms. Some of the success stories of individuals investing in impact funds include Dutch Green Funds ($9 billion) and French 'Solidarity' Pension Funds ($7.7 billion)[5, 6]. Retail investing can be encouraged in India with the right framework –comprising of regulations, tax and fiscal incentives for individual investors.

2. Impact investment in the US has been democratized by the creation of depository institutions such as community banks and community development finance institutions. These institutions engage in 'crowdfunding' i.e. pooling of individual investments from retail investors and lending this capital to ventures and projects designed to positively impact local communities and environment. Smaller investors with individual investments as low as $20 are willing to invest in projects that bring social and environmental impact through crowdfunding. In India, Milaap Social Ventures and Rang De are a few non-profit organizations that focus on facilitating social investments in the field of microfinance and enterprise development. These organizations are, however, in their nascent stage.

3. Social stock exchanges have helped in attracting retail investors by providing liquidity and transparency to impact investments. From the supply side, these exchanges help in unlocking large amounts of funds whereas from the demand perspective, they enable social enterprises to gain access to funds from diverse investors. Moreover, they can act as platforms that accelerate the transition towards consistent and widely accepted social and environmental impact reporting. Bolsa deValores de Sao Paulo (BOVESPA) was developed as the philanthropic donation arm of Brazilian Stock Exchange. A similar initiative was introduced by Johannesburg Stock Exchange as South African Social Investment Exchange (SASIX). In June 2013, Social Stock Exchange (SEE) was launched in London which exhibits information on socially responsible companies already listed on regulated stock exchanges. Social Venture Connection (SVX) was launched by Toronto Stock Exchange in 2013 for issuances of small and midsized social enterprises. However, shares cannot be traded in SVX.

In India, there exists a stock exchange for trading the shares/securities of SMEs (SME Exchange) under both BSE and NSE, where there exists no such stock exchange for funding socially responsible enterprises.

4. Investors in developed countries make investments not only in private projects and ventures but also in social sector initiatives, in the form of 'Social Impact Bonds', which is a contract with the public sector where a commitment is made to pay for improved social outcomes that result in public sector savings. These Social Impact Bonds (SIBs) were first launched in 2010 by Social Finance UK. As of 2014, totally 25 SIBs have been commissioned by 7 countries (USA, UK, Canada, Australia, Belgium, Germany and Netherlands) aimed at tackling a variety of social problems. SIBs have been used by the Governments in UK and US for social issues such as public safety, health, community development and children and family care. In India, Educate Girls has become the first and only organization to make use of Social Impact Bonds to launch a Pay by Results Programme, receiving support from Instiglio, a US-based non-profit social enterprise. The programme is currently running a pilot with 200 schools in Rajasthan and aims to create long term and sustainable social change by creating awareness about importance of educating girls. With the attractive market in India, SIBs have immense relevance and potential which is yet to be completely tapped.

5. Linkage between the industry & academia In the developed world, several universities and academic institutions have set up separate wings for promoting and undertaking research on this sector. Some of these include:

- Harvard University - Initiative for Responsible Investment - http://hausercenter.org
- MIT - http://netimpact.mit.edu/ and http://mitsloan.mit.edu/sustainability/about
- Wharton – University of Pennsylvania - http://socialimpact.wharton.upenn.edu/impact-investing/
- University of California – Berkeley - http://nonprofit.haas.berkeley.edu/programs/haas-impact-investing-network.html
- Yale University - http://som.yale.edu/faculty-research/our-centersinitiatives/program-social-enterprise
- Duke University - http://sites.duke.edu/casei3/case-i3-basics/case-i3research/impact-investor-project/
- Oxford University - http://www.sbs.ox.ac.uk/programmes/execed/iip
- Columbia University - http://www8.gsb.columbia.edu/socialenterprise/research
- IIT Madras – Centre for Social Innovation and Entrepreneurship - http://csie.iitm.ac.in/

- IIM Ahmedabad – Centre for Innovation, Incubation and Entrepreneurship - http://www.iimahd.ernet.in/faculty-and-research/research-centers/ciie.html

More incubation centres should be supported by the Central, state and private institutions in India.

3 Future prospects of impact investing in India

In the past decade, India has emerged as a major hub for impact investing with a highly evolved ecosystem comprising diverse stakeholders, well-regarded successes in Base of the Pyramid (BoP) entrepreneurship, pioneering investors, and a wide array of enterprise enablers. Looking ahead, there exists various opportunities that are yet to be tapped in the Indian impact investing market.

3.1 Recent developments that create a conducive ecosystem for impact investing in India

3.1.1 Setting up of India Inclusive Innovation Fund (IIIF)

Approved by the Union Cabinet, the National Innovation Council and the Ministry of Micro, Small and Medium Enterprises (MSME) jointly set up the India Inclusive Innovation Fund (IIIF) on 27th January 2014 with a corpus of 500 crore[7] . IIIF seeks to create a new class of capital which helps to set up and scale entrepreneurial skills and innovation. The fund will invest in innovative ventures that are scalable, sustainable and therefore profitable, but address social needs of the less privileged citizens in areas such as healthcare, food, nutrition, agriculture, education and skill development, energy, financial inclusion, water, sanitation and employment generation.

3.1.2 Formation of Indian Impact Investors Council (IIC)

In May 2013, nine entities in the impact investing industry came together to form an industry grouping that will define self-regulatory practices for the industry to follow. Besides the promotion and advocacy work, Indian Impact Investor Council (IIIC), will make it binding on its members to follow the standards set by it on investing: for example, which sectors qualify for impact investments, how long should be the holding period, how to measure returns, and so on. The experience of Indian Microfinance industry in 2006 and 2010 highlighted the importance of accountability in the system and therefore, the IIIC acts as a Self-Regulatory Organization that enforces ethics, transparency and consumer protection and implements operating, governance and measurement standards.

3.1.3 Corporate Social Responsibility (CSR)

The new Companies Act 2013 requires businesses to spend 2% of their average net profits of the past 3 years on social activities, making corporate social responsibility a legal requirement. As a result, the total annual spend on CSR is estimated to range between $2.5 billion and $3.3 billion. This CSR corpus would be useful in financing projects in sectors such as water, sanitation, healthcare and basic education where access to capital in the form of traditional equity investments is extremely limited.

3.2 The way forward - potential ways to further develop the industry in India

3.2.1 Leveraging CSR funds as sources of impact capital

The new CSR policy, which unlocks a significant amount of development capital, presents an opportunity to look for new ways of creating sustainable impact. However, the CSR guidelines in the Companies Act 2013 currently do not allow for financing of for-profit social business models. With CSR funding currently allowed only in non profit organizations, impact investors need to develop fund structures with return expectations that align with the new guidelines [8]. For CSR to be effective as a source of impact capital, current guidelines need to allow for patient capital that finances for-profit social enterprises, but might not yield same returns on investment as other financial investments. This can help widen the available capital base for impact investments in India and make the market for impact investing more sustainable by reducing reliance on foreign capital.

3.2.2 Replicating the best practices from successful models

Further growth and development of the impact investing market in India requires the adoption of best practices from the successful models in developed countries.

- First, there is a need for an appropriate structure and ecosystem that encourages the entrance of retail investors in the impact investing industry. Self-regulatory organizations that IIIC help not only in promoting retail investors, but also in boosting their confidence in the market.

- Creation of social stock exchanges in developed countries has helped several social enterprises in gaining access to required funds. A similar initiative called the Impact Investment Exchange (IIX) launched in July 2013 in Asia is a positive step towards this direction. Based in Singapore, IIX bridges the gap between social enterprises and impact investors through three main platforms which offer services like seed-funding and mentorship for early-stage social enterprises, market assessment and public trading of securities. With the necessary infrastructure, regulatory measures and technology, such a model of impact investment exchange can be replicated in the Indian setup to provide liquidity and transparency to investments in social enterprises.

- To date, very few Social Impact Bonds (SIBs) have been launched in low income countries, despite many parties closely watching deployments elsewhere because of issues such as legal constraints and high transaction costs. In India, there is still a large potential for SIBs to be invested in key areas.

- The experience of microfinance in India during the period 2006-10 has indicated the need to develop new models that are sustainable. Community based lending may help in bringing about the desired level of impact in the long run.

- The Government plays a significant role in classifying the social enterprises. Currently, there is some ambiguity surrounding the definition of social enterprises. Several important aspects of the social enterprises such as flow of funds, registration and regulation depend on the classification of social enterprises into either Micro, Small and Medium Enterprises (MSMEs), Non-profit organizations or Startups. Clearer classification from the Government on social enterprises can help these enterprises in easing the processes of registrations, compliance, financing, and so on.

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For the impact investing industry in India to grow and develop, there is a need for government support in the form of tax and fiscal incentives, and official championing. A report by Global Social Impact Investment Steering Group suggests that empowering a senior government official to act as a leading champion for impact investment, would help to formulate and implement appropriate policies that build market infrastructure and to support the development of the sector [9]. For instance, Jayanth Sinha, Minister of State for Finance and Former Managing Director for Omidyar Network in India (an impact investment fund), is one of the founding members of the IIIC, could be the key in shaping and accelerate the growth of the impact investing sector in India.

3.2.4 Role of technology

Technology plays a very important role in facilitating the development of impact investing industry. It serves as a platform for attracting investments, ensuring safety of investment transactions and establishing a reporting relationship between the investors and investee firms. For example, Kiva is an online platform for borrowers and lenders to make a social difference by supporting activities such as starting or growing a business, affording school, building a house, switching to clean energy and so on. It is good to note that Indian economy in particular, is primed for entrepreneurs using technology to promote financial inclusion. This is because 40% of the population remains unbanked, while 53% of the population owns mobile phones, which is expected to increase to 64% by 2018. In addition to this, 90% of small businesses do not access to formal finance [10]. Fintech solutions can help bridge the gap by connecting these businesses to formal sources of funding, or through better methods to manage finances, etc.

Though not limited to FinTech, Government of India is promoting startups in a big way through various incubation efforts led by the Department of Science and Technology (DST) and through the financial assistance offered by Technology Development Board. Many such incubators spread across various leading academic institutions and other host institutes have started churning out quality startups that are focused on products targeting Indian as well as global markets.

3.2.5 Role of research and academia

In the past, research work has been focused on debating the sustainability of the impact investing industry in India and its various implications. There exists immense scope for research into development of market-based solutions to address social issues, through impact investing. Going forward, collaborations between organizations and researchers working on relevant research topics and jointly work on projects will drive in developing a strong ecosystem & knowledge transfer at a global level.

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