India Venture Capital and Private Equity Report 2013

Convergence of Patience, Purpose and Profit

An analysis of impact investments in India

Edited by
Thillai Rajan A.

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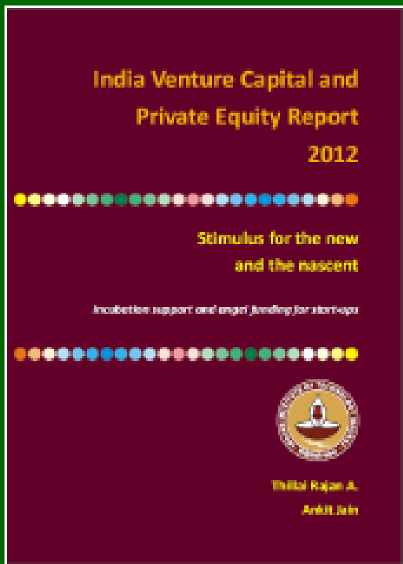

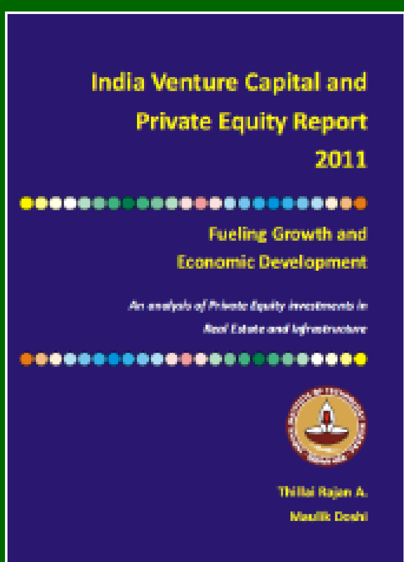

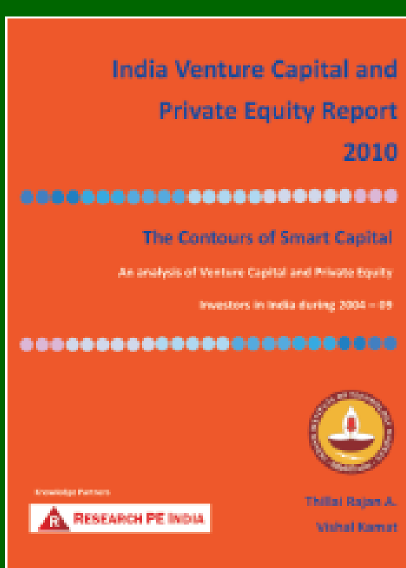

India Venture Capital and Private Equity Report 2013

Convergence of patience, purpose, and profit

An analysis of impact investments in India

Department of Management Studies
Indian Institute of Technology Madras
Chennai 600 036
India

The India Venture Capital and Private Equity Report Series is an annual publication of the Indian Institute of Technology Madras.

Previous reports

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Department of Management Studies, Indian Institute Of Technology Madras

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Authors and Reviewers

Authors

Jessica Seddon

Jessica Seddon is the Founder of Okapi Research and Advisory. Her research and consulting focus on the interaction of institutions with the information ecology and their joint effect on group behaviour. She has worked in development social science and institutional design for over a decade and a half, with employers and clients ranging from the World Bank and Inter-American Development Bank research departments to a start-up university in Bangalore and national government committees in India. Jessica earned her Ph.D. from Stanford University Graduate School of Business and her B.A. from Harvard University.

Keerthana Sundar

Keerthana obtained her Masters' degree in Financial Economics from the Madras school Of Economics. She is a Project Associate at the Department of Management Studies, IIT Madras.

Pawan Koserwal

Pawan obtained his graduate degree in Mineral Engineering from the Indian School of Mines, after qualifying through the highly competitive IIT-JEE 2006, where he secured a rank in the 98th percentile. After graduation, he worked in Jindal Steel and Power Limited as an operations engineer. Currently he is in the second year of his MBA degree program at the Department of Management Studies, IIT Madras.

Smitha Hari

Smitha has over 8 years of experience in the fields of investment banking, equity research, banking and consulting. She is the founder-partner of THINK Financial Advisors & Consultants, a financial consulting firm offering business research services, feasibility studies, B-plans and valuations and fund raising services to SMEs. Before starting on her own, she has worked in various organizations like Spark Capital, Ernst & Young, and ING Vysya Bank. She regularly writes for magazines like Small Enterprise India and Money Indices. She holds a degree in commerce and an MBA Bharathidasan Institute of Management, Trichy.

Thillai Rajan A.

Thillai Rajan is an Associate Professor in the Department of Management Studies at the Indian Institute of Technology Madras. His areas of research interest include venture capital, private equity, corporate finance, and infrastructure finance. He has edited and co-authored the past four annual reports in this series. He has received the Young Faculty Recognition Award at IIT Madras and the Ramaswamy P. Aiyar Young Teacher Award of the Association of Indian Management Schools. He received his graduate degrees from Birla Institute of Technology and Science, Pilani and completed his doctorate from the Indian Institute of Management Bangalore. He is also an alumni of the Chevening Gurukul Program at the London School of Economics, the Endeavour Executive Fellow at the Macquarie Graduate School of Management at Sydney, and the Fulbright Nehru Senior Research Fellowship at the Harvard University.

Advisory Review Board

Paul Basil, Founder & CEO, Villgro

Paul has over the last decade worked in discovering several innovations and innovators, and incubated around 60 rural businesses. He was awarded the Ashoka Fellowship in 2002 for his outstanding social entrepreneurship in setting up Villgro. He has also been conferred the Samaj Seva Bhushan Award and the Star Entrepreneur Award. Prior to setting up Villgro, Paul was part of the initial marketing team at Kerala Horticulture Development Programme (a collaborative programme of the Govt of Kerala and the European Union) in developing farmers' markets.

K. Ramakrishnan, Executive Director & Head - Investment Banking, Spark Capital
Ramakrishnan has over two decades of experience in corporate finance & advisory and capital markets. He has led and worked on transactions across the entire investment banking spectrum. Prior to Spark, Ramki headed ICICI Securities' investment banking business for South India, having worked earlier for Arthur Andersen, Ind Global Financial Trust, and Deloitte. He is a commentator on corporate affairs and capital markets and is quoted widely by the business media. He has a Bachelors Degree in Mechanical Engineering and an MBA from Bharathidasan Institute of Management, Trichy (India).

P. N. Vasudevan, Managing Director, Equitas Holdings Private Ltd
Vasudevan currently heads Equitas Microfinance. Prior to this, he was the Executive Vice President and Head - Consumer Banking Group in Development Credit Bank Ltd. In this position he was responsible for the retail banking including retail liabilities, branch banking, retail assets and alternate channels and managing a branch network of 72 branches. Earlier to this, he was the Vice President and Business Head, at Cholamandalam Investment and Finance Co Ltd, a part of the Murugappa Group. Vasudevan has contributed many articles to various journals such as Chartered Secretary and Company Law Journal.

Editors' Note

We are happy to present this fifth annual report on the Indian Venture Capital and Private Equity (VCPE) industry. It is quite gratifying to note that the annual report series, which was started as a pilot initiative in 2009, is continuing to be received extremely well. The requests for the past four annual reports have come from all corners of the globe. We were encouraged by the strong response to our efforts, which in a way confirmed our conviction that there is a need for a publication of this nature to get a holistic perspective on the different segments of the Indian VCPE industry. Key features of the report series are: First, the focus of this series is not to present quarter on quarter developments, for which there are many providers, but to provide a big picture perspective on the various hues and shades of the industry. Second, is the extensive use of empirical data to describe the findings, rather than rely on anecdotal evidence. Third, the findings are based on the data available over many years, rather than being cross sectional. Our modest aim in coming out with the report series is to provide a good narrative of the development of the venture capital ecosystem in India.

This years' report focuses on impact investments. We define venture capital investments that are made in social enterprises as impact investments. Broadly, enterprises that are engaged in the making of products or services that benefit people from the low income or the Base of the pyramid (BoP) segments in a cost effective and sustainable manner can be called as social enterprises. In recent years, the commercial opportunity that exists in the BoP segment has caught the imagination of the VC investors and there has been a robust growth in deal making in this sector.

As India moves up the growth trajectory, it becomes critical to address the basic needs of the large population at the BoP. Meeting the needs of the burgeoning consumer set in rural and semi-urban areas of India has thus become a focal point for impact and venture funds across the world, where there is an opportunity to get attractive financial returns in addition to creating a social impact. However, there can be substantial differences between investors on what constitutes impact, and the way it is measured. While some of the investors denote impact investments as reducing poverty levels, providing education, protecting the environment, etc., others have a more nuanced approach - which looks at impact investment as one of the approaches to make commercial returns by investing in those enterprises that can scale, grow and become profitable. The argument is that attractive returns are needed to help the investment ecosystem itself to survive.

There are differing estimates on the quantum of impact investments that have happened in recent years in India. However, there is broad agreement on the velocity of the investment flow. Let us take these examples: This segment is expected to grow at an annual pace of 30% and India occupies the second position globally next only to the US.[1] Acumen Fund, one of the leading impact investors, has invested $31 million in India out of the cumulative global investments of $84 million.[2] Jayant Sinha, Managing of Omidyar Network India, one of the leading players in the segment had said, “India is at the epicentre of impact investing in the world.”[3] His fund plans to invest $200 million in India over the next 3 to 5 years. Similarly, another global fund - Gray Ghost Ventures plans to invest $60 million in India over the next 5 years[4]. Such investment plans of funds in this space definitely bode well for the growth and prospects of this sector in India.

[1] http://www.livemint.com/Industry/Tgybd0OVnCoCZnt1abLhLJ/Impact-investing-likely-to-grow-at-30-annually.html
[2] http://timesofindia.indiatimes.com/business/india-business/India-takes-centre-stage-in-impact-investing/articleshow/20512517.cms
[3] http://www.nextbigwhat.com/impact-investing-in-india-jayant-sinha-omidyar-network-297/
[4] http://www.siliconindia.com/finance/news/India-Becomes-the-Epicenter-of-Impact-Investing-nid-148715.html

Seen in this context, it is felt that the theme for this years' report is timely as it focuses on one of the vibrant segments of the Indian VCPE industry. The report has five chapters. The first chapter by Smitha Hari provides an overview of social enterprises and impact investments, with special reference to the developments seen in India. The second chapter by me and Pawan Koserwal provides an analysis on impact investments in India. The analysis is based on the investment of $1,303 million in 173 companies. The third chapter, again by me and Pawan Koserwal, extends the analysis in chapter 2 by considering the characteristics of investors. The investors were classified into domestic or foreign, based on their origin; and social or mainstream, based on the focus of the fund. The fourth chapter, authored by me, Pawan Koserwal, and Keerthana Sundar, is an attempt to identify the differences in investment patterns between the active and the occasional investors in impact investing. Since a large number of impact investments were in microfinance companies, this chapter also provides a comparative analysis of microfinance firms that received venture investment vis a vis those that did not. The fifth chapter, by Jessica Seddon, underlines the tensions between commercial success and social impact, and suggests ways to address them for strengthening the impact investment ecosystem.

Interspersed between the five chapters are five interviews with industry practitioners. Vineet Rai, founder of Aavishkaar states that impact investment is still in the early growth stage. He underlines that that it is important to be patient in this sector, and the focus should be on bringing capital for the long term. Anurag Agrawal, Chief Executive Officer at Intellecap feels that the term “social” can be a branding tool for differentiated positioning, which can help businesses to secure funding. However, despite the “social” tag, social entrepreneurs are expected to meet the business plan targets and achieve the growth that they have promised the investors. Ronnie Screwvala, Unilazer Ventures, states that as a country of 1.2 billion people, we cannot be satisfied with small impact. Creating a large impact means achieving scale, but scale just does not always mean an increase in the size of the company. Anil Sinha, Regional Head, Advisory Services of South Asia region at IFC states that profitability and social are not two different issues. Investments need to be profitable in order to ensure that the development impact is sustainable. Rohini Nilekani, founder-chairperson of Arghyam, states there are some limits on markets, and there has been limited discourse in understanding those limitations. There is a need to build societal institutions that can build capacity in the people to insist on equity and sustainability, and philanthropy can play an important role in contributing to that.

We thank all those who have constantly encouraged and urged to continue our efforts. Specifically, we would like to acknowledge the support from Prof. G. Srinivasan, Head, Department of Management Studies; Prof. R. Nagarajan, Dean, International and Alumni Relations; and Prof. L. S. Ganesh, Dean of Students. We would also like to thank all the faculty members of the Department of Management Studies for their constant support and encouragement. The MILS student team took care of the production of this report and all the logistics in connection with the release function. We gratefully acknowledge the financial support received from IIT Madras for the study and the preparation of this report.

I hope you enjoy reading this report, and I look forward to your suggestions and comments.

Thillai Rajan A.

1. Social enterprises and impact investments: Overview

Smitha Hari

1.1 The need for social innovation

Innovation is among the most important functions of any business enterprise. Constant innovation and generation of ideas is critical for all aspects of business - be it to respond to competition and changing trends or to improve efficiencies or to attract new customers. Companies like Apple, Microsoft and Google are popular examples where innovation has been the order of the day. That said, innovation and generation of new ideas is anything but easy. This process becomes even more complex in a social enterprise, because of the constraints in funding and difficulties involved with creating a market where demand does not already exist. The compulsion to reduce negative impacts of the product/service on the intended beneficiaries and the concern that donors may not fund risky innovations are major challenges faced by the social entrepreneurs.[1]

Nevertheless, small but significant steps in innovation are definite must-haves in the social sector. While there is vast information on innovation in conventional businesses, the discussion on innovation in the social sector has been comparatively limited. In general, social sector seeks to address major challenges - be it in providing better food, housing and healthcare, improving lifestyles, reducing poverty levels, providing education, catering to financial needs, or protecting the environment. As 'for-profit' companies in the social sector strive to create the desired social impact as well as earn financial returns, it becomes imperative to find new ways of doing business, improve efficiencies, cut down costs, reach a larger audience and keep up with changing market dynamics.

Innovation calls for high investment and continuous financial support. Governments and philanthropic organizations have tried to improve the lifestyle of people living at the Base of the Pyramid (BoP) by providing grants and other forms of support for decades. However, grants, subsidies, donations, and other forms of philanthropic capital have not been effective in supporting innovation. This gap in innovation funding for the social sector has led to the emergence of a new class of capital - Social Venture Capital (SVC) or impact investing. Like the traditional venture capitalists, the SVC's not only provide capital, but also encourage innovation and play a vital role in guiding and mentoring the social entrepreneur.

1.2 The social enterprise

Broadly, enterprises that are engaged in the making of products or services that benefit people from the low income or BoP segments in a cost effective and sustainable manner can be called as social enterprises. They are engaged in a range of activities: from reducing poverty levels to improving living standards, from providing affordable housing to financial solutions, and from improving education levels to providing healthcare to people in the BoP.

Social enterprises are increasingly being set up as entities incorporated under the Companies Act, 1956. When set up as a corporate form they can either be a non-profit enterprise or a 'for-profit' enterprise. 'For-profit' social enterprises aim to build a profitable business in addition to creating a social impact. A company structure also enables to get investment from external sources of capital such as venture capital funds.

Table 1.1 compares the salient features of different sources of capital for social enterprises. The choice of funding depends on various factors such as the sector, background of the entrepreneur, stage of the enterprise, nature of business model, and the outputs of the enterprise.

Table 1.1: Comparison of capital sources for social enterprises

Parameter	Sources of capital			
	Banks	Grants & Donations	Promoter equity	Venture capital
Quantum of finance	Limited - depends on credit rating and amount of equity in capital structure	Limited	Depends on the financial capacity of the promoter	Large - depends on company performance, social impact achieved and valuation
Financing need	Depends on type of finance - term loan or working capital	Project specific	Any business need	Any business need
Tenure of funding	Long term and short term	Long term and short term	Long term	Long term (6 - 8 years)
Repayment	Interest and principal to be serviced promptly	Not applicable	Own source - hence repayment has no timeline	By secondary sale of shareholding
Effect on cash outflows	Regular cash outflow to meet interest payments	Not applicable	No effect	No effect
Dilution of entrepreneur's shareholding	No equity dilution	No equity dilution	Not applicable	Equity stake to be given up by the entrepreneur
Loss of control in decision making	To a limited extent	No loss of control	No loss of control	Major decisions may have to be approved by the investor
Mentoring and business advice	Banks normally do not get involved in providing mentoring or advice	Limited	Not applicable	Investors play an active role in mentoring and advising post investment
Enhanced company visibility	Limited	Limited	High	High

Social entrepreneurs, those who start social enterprises, can be broadly classified into three categories based on their background. The first type would comprise an entrepreneur who is actually from the BoP. An entrepreneur of this type wishes to create a change in the society and his conviction comes from having been a part of the problems that the social enterprise seeks to address. Founders of Bangalore-based Snehadeep Trust for the Disabled are three visually impaired individuals who wish to address problems which are similar to what they faced in life through their social enterprise[2]. The second type is one who has had a successful career in the past, and is financially well off. The objective of starting a social enterprise for such an entrepreneur is to contribute something back to the society. Bangalore-based Janaagraha is an example of this. The third type is one who is in the early stages of his professional career or is a first generation entrepreneur, who identifies a business opportunity in the social sector and enters this space as a social entrepreneur on the expectation of good commercial returns. Since such entrepreneurs may not have the necessary financial resources, they usually seek external capital from other sources as venture capital, grant bodies, etc.

1.3 Venture capital funding for social enterprises

The objective of the VC investors in the social sector is to create a social impact through the investment, while expecting to earn financial returns from the investment made. There are some organizations like Michael & Susan Dell Foundation which was earlier working only on the grants model, but has now started making equity investments in the organizations that they support. Such organizations, which have been supporting the social sector for long by means of grants, have started adopting the venture style of investing to make their investments more effective.

1.3.1 Common terminologies of social venture funding

SVC funding is known by several other names in different parts of the world. According to the Monitor Institute on social impact investing, SVC funding is also known as Socially Responsible Investing, Blended Value, Impact Investing, Mission-Driven Investing, Mission-Related Investing, Triple-Bottom Line, Social Investing, Values-Based Investing, Program Related Investing, Sustainable and Responsible Investing, Responsible Investing, Ethical Investing and Environmental, Social, and Governance Screening[3]. Sometimes, this kind of investment is also known as 'Patient Capital', as the investment timeframe of social sector venture capitalists can be longer than what it is for traditional venture capitalists.

Some terms such as Impact Investing cover a wider universe of asset classes such as equity, debt, working capital lines and loan guarantees. However, impact investments are structured similar to venture capital investments, and hence the term is often used synonymously[4]. Despite differences between these forms, there is a common theme that cuts across all of these forms of investment, thereby enabling them to be grouped under the broader umbrella of social venture investing.

The following are some definitions of Social Sector VC funding:

- *Socially Responsible Investing:* (a) Socially responsible investing, also known as sustainable, socially conscious, "green" or ethical investing, is any investment strategy which seeks to consider both financial return and social good[5]. (b) Socially responsible investing is an investment strategy employed by individuals, corporations, and governments looking for ways to ensure their funds go to support socially responsible firms[6]. Such funds deploy negative screening criteria, i.e., not invest in companies that qualify certain social criteria – such as companies in tobacco, alcohol, or gambling.

- *Blended Value:* Blended value refers to a business model that combines a revenue-generating business with a component which generates social-value[7].

- *Impact Investing:* Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return[8]. These funds tend to have inclusive, rather than exclusive mandates – for example, they will only invest in companies impacting the BoP in certain regions.

- *Mission-Driven Investing:* Investing that has a double bottom line focused on achieving both financial and social returns[9].

- *Mission-Related Investing:* Mission related investing (MRI) is the term used to describe investments made by philanthropic entities in the pursuit of both financial and social returns. MRI implies proactively seeking investment opportunities that produce a blend of financial returns and social impact that are in line with the philanthropy's mission[10].

- *Triple-Bottom Line:* (a) The triple bottom line (abbreviated as TBL or 3BL, and also known as people, planet, profit or "the three pillars") captures an expanded spectrum of values and criteria for measuring organizational (and societal) success: economic, ecological, and social[11]. (b) Financial, social, and environmental effects of a firm's policies and actions that determine its viability as a sustainable organization[12].

- *Values-Based Investing:* Values-Based investing is an investment philosophy that considers criteria based on social and environmental values alongside financial returns when selecting an investment opportunity[13].

- *Program Related Investing:* Program-related investments are investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame[14].

- *Responsible Investing:* Responsible investment is an investment strategy which seeks to generate both financial and sustainable value. It consists of a set of investment approaches that integrate environmental, social and governance and ethical issues into financial analysis and decision-making[15].

- *Ethical Investing:* Ethical investing gives individuals the power to allocate capital toward companies that are in line with their personal views, whether they are based on environmental, religious or political precepts[16].

- *Environmental, Social, and Governance Screening:* Environmental, social and corporate governance, also known as ESG, describes the three main areas of concern that have developed as the central factors in measuring the sustainability and ethical impact of an investment in a company or business[17].

In this report, we have used SVC investing or impact investing (used synonymously) to capture the different spectrum of social venture investments.

1.3.2 Differences between mainstream VC funding and social VC funding

Social venture funding can happen from any of the following sources: venture funds that are dedicated for investments only in the social sector (for example Acumen Fund), venture funds that also incidentally invest in social businesses (for example Ventureast), and other sources that are not structured as a traditional VC fund partnership, but follow a style of investing practiced by VC investors (for example, Dell Foundation). The basic theme of investing by SVC funds and mainstream VC funds is the same - that is, investing in companies which help them earn attractive financial returns. The biggest difference between these two forms of investing is that SVC's invest with the aim of creating an impact in the low income or BoP segments (synonymously referred to as social impact in this report), while conventional investors do not explicitly consider the social impact for their investment decisions. In order to make the funding a success for both the investor as well as the entrepreneur, SVC funds need to adapt the conventional venture industry practices to meet the requirements of their target segments. (Vineet Rai in his interview talks about some of the salient features of funding by Aavishkaar)

Table 1.2: Key differences between mainstream and social VC funding[$]

Parameter	Mainstream VC funding	Social VC funding
Investment selection	Based on company financials, company growth prospects, sector growth prospects, management quality and the risk involved in the investment.	Based on the social impact created, financial returns expected, company growth prospects, sector growth prospects, management quality and the risk involved in the investment.
Investment monitoring	Financial performance and business related non-financial factors like client additions, expansion benchmarks etc.	Monitoring the social impact in addition to all the other parameters of a mainstream VC[*]
Exit routes	Exit route of VC investor can be by means of a stake sale to other investors, a trade sale or a strategic sale, sale of investor's shares back to the company or an Initial Public Offer (IPO).	Sale to other investors and strategic sale are more popular exit routes compared to IPO.
Typical investment range	Between \$2 - \$10 million	≤ \$1 million.[18] However some funds also make larger investments
Typical duration of Investment	4 to 6 years	6 to 8 years; Sometimes longer (Acumen Fund invests for up to 15 years)
Typical return expectations	IRR of 25%	IRR of 15% - 18% in addition to social returns[*] from the investment
Risk tolerance	Lower than social VC investors	Higher than mainstream VC investors
Typical Investors in the VC fund	99% by Limited Partners (LPs) which can be pension funds, insurance companies, hedge funds, endowments, corporates, high net-worth individuals or Governments. 1% by General Partners, who are the actual venture capitalists who manage the fund[19],[20]	Donations and investments from philanthropic institutions, individuals and foundations, high net-worth individuals and institutional investors. Some funds raise monies from banks, NABARD, commercial organizations and retail individual investors[21].
Fund Life	Generally 10 years with investing life-cycle of 3-5 years for each fund[22]	Generally long-term and more than 10 years
Returns to the fund	Management fee (ranging between 1.5% and 2.5% of funds under management) and a profit share or carried interest (ranging between 15% - 25% of profits). The size and success of the fund usually determine which end of the spectrum they can demand from the investors[23]	Management fee paid to the VC fund is normally in the range of 1%-1.9% due to the lower returns from the investments made[24]

[$] *Mainstream VC funding has been much longer than SVC funding allowing it to build a track record. Data on the social VC's, on the other hand has been much more limited*

[*] *Absence of a standardized approach to measure social impact has resulted in many VC investors using their own proprietary models to evaluate and measure the social performance of the company in which they have invested. Adoption of Impact Reporting and Investment Standards (IRIS) by the Global Impact Investing Network (GIIN) by a broader spectrum*

of impact investors will solve this problem to a large extent, as it brings about a standardized framework for measuring the social performance of impact investments[25].

Table 1.2 captures the key differences between mainstream and social VC funding. Social venture investing is typically characterized by investments in early stage enterprises that are servicing the people in the BoP, a high risk tolerance and a longer time horizon for investments compared to mainstream VC investments. A majority of the social investors give equal importance to financial returns and social returns, although the actual returns clocked might be lower than conventional investments, mainly due to the sector in which they operate and the unique challenges faced by this sector.

1.4 Global trends in social venture funding

With Governments across the world finding it increasingly difficult to fund social sector activities, private capital have become more and more popular in recent times. According to a report by the Monitor Group[26] in 2009, the impact investing industry was estimated to grow from $50 billion to $500 billion in assets within a decade[27]. This translates to a CAGR of 25% for the global impact investing industry.

The long debatable issue and a source of criticism of impact investing was that the two factors of creating social impact and earning commercial returns do not go hand in hand and that one has to be compromised for the other. However, this need not be the case always. JP Morgan, Rockefeller Foundation and the Global Impact Investing Network (GIIN) brought out a report in November 2010 which estimated that the 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 for an invested capital of $400 billion - $1 trillion[28].

Last year, The Aspen Network of Development Entrepreneurs (ANDE) counted about 199 impact investing funds globally[29]. The popular social venture capital firms include Acumen Fund, First Light, Gray Ghost Ventures, Root Capital, TBL Capital, and Underdog Ventures among others[30]. Most of these funds look at the developing and underdeveloped world, as these regions have a large potential as well as need for social development. In fact, many global social VC funds have dedicated funds looking at investing in different countries of Africa and Asia. As the sector is growing and more opportunities for funding are being thrown open, new social VC funds coming up in different parts of the world every year.

Worldwide, the social sector and social sector investing has been a constant source of innovation[31]. New securities linking social impact to financial returns and new tools of finance are being created to earn returns out of social activities. Specialized agencies like Endeavor and Social Finance help social entrepreneurs gain access to global markets. Social impact bonds are another invention by many Government agencies in UK, USA, Canada, Australia and Israel, which reward investors according to results achieved. These involve investments of private capital from either philanthropists or commercial investors to fund social sector initiatives. After a specified time limit, the social impact is measured. If the social impact achieved is as desired, the investors are rewarded; if not, investors lose the invested capital[32]. It is believed that social VC funding is an effective way of unlocking private capital and directing the much needed funds to the social sector across the globe.

1.5 Current status of social venture funding in India

Measurement of poverty in India has been a debatable issue for long as there is no standard measure of poverty in the country. Different sources give out different statistics with regard to poverty numbers. World Bank indicated that 32.7% of the country's population lived below the international poverty line of $1.25 per day in 2010, while 29.8% of the country's population were below the national poverty line in the same year[33].

The Tendulkar Committee in India held 37% of the country's population to be below the poverty line in 2010, which has been accepted by the Planning Commission as well[34]. Irrespective of the actual proportion of the population living below the poverty line, it is apparent that the number of people who are poor is large in India. What is more shocking is that 8 Indian states (including the states of Bihar, Uttar Pradesh and West Bengal) have more poor people than the total poor people living in 26 of Africa's poorest nations[35] .

With such a large proportion of people living below the poverty line in India and the vast amount of development possible in both rural as well as urban areas, the potential for social venture investing is considered promising. India's social sector venture funding has gained popularity in recent years, thanks predominantly to the microfinance sector. Though impact investing has become popular in India in recent years, it still falls significantly behind traditional venture capital and private equity investments, with the amount invested being very low compared to traditional VC funding. A senior advisor in investment banking firm Resurgent India opines that in India, it will take at least another 7-9 years before impact investing reaches levels where traditional venture capital and private equity investments are today[36].

According to the Planning Commission, India has about 17 funds which operate in this sector[37]. However, if all one-off investments are considered it is estimated that there are more than 100 funds operating in this segment in India. The most popular funds are Aavishkaar, Lok Capital, Acumen Fund, Bellwether, Grassroots, Michael and Susan Dell Foundation, Omidyar Networks, Oasis Fund, Gray Matters Capital and Unitus among others[32]. VC funds specializing in social sector investments have their own preferences in balancing social returns and financial returns. Table 1.3 captures the key parameters of important social VC funds in India.

Table 1.3: Illustrative list of some popular social VC funds operating in India[38]

Fund name	Aavishkaar[39]	Lok Capital[40]	Acumen Fund[41]	Unitus[42]	Oasis Fund[43]	Gray Matters Capital[44]
Sector focus	Agriculture and Dairy, Education, Energy, Handicrafts, Health, Water and Sanitation, Technology for Development and Microfinance and Financial Inclusion	Financial inclusion, education, healthcare and technology	Health, water, energy, education and agriculture	Rural distribution, Microfinance and financial inclusion, IT services and Education	Affordable housing, healthcare, education, energy, livelihood opportunities, water and sanitation	Information, communication and technology space to bridge the urban-rural digital gap
Investment size (million)	$0.05 - $9	$0.2 - $5	$0.3 - $2.5	$0.6 - $15	$3 - $7	Information not available
Fund investors	Development Finance Institutions, Apex Indian Banks, Corporates, Foundations and retail individual Indian investors	Information not available	Philanthropic donations from local and foreign individuals, institutions, foundations	Information not available	Managed by Bamboo Finance; Targets high net worth and institutional investors for funds	Foundations like Rockdale, Rockefeller and Global Investment Initiative, among others

Fund name	Aavishkaar[39]	Lok Capital[40]	Acumen Fund[41]	Unitus[42]	Oasis Fund[43]	Gray Matters Capital[44]
Aim of investment	Invest into early and growth stage companies that provide products or services to Tier 2 and lower towns, semi-urban and rural parts of India	To promote inclusive growth by supporting the development of social enterprises to deliver basic services to serve the BoP segment	Potential to create significant social impact, show financial stability within 5-7 years and potential to achieve scale	To reduce global poverty through economic self-empowerment	To create significant social impact while earning attractive financial returns	Look at opportunities considering market demand and social impact
Stage of Investment	Early stage	Across all stages	Across all stages	Across all stages	Across all stages	Information not available
Instrument	Generally a mix of common equity and convertible debentures. When appropriate, other venture capital instruments are used	Equity	Equity or Debt or Quasi- Equity instruments	Equity or Debt or Structured Products	Equity	Information not available
Number of Funds	4	2 + 1 charitable trust	Information not available	4	Information not available	Information not available
Number of Investments	>45	Information not available	16	39	7	3

(Note: The information in Table 1.3 is based on publicly available information in the firm websites and might not capture recent developments if not updated in the website)

1.6 Benefits of social venture funding

Social VC funds are essentially early stage risk capital investors, funding social enterprises when no other source of finance looks feasible. The crucial role of VC funding in starting Servals Automation (a company that manufactures energy efficient burners) was highlighted by the founder Mukundan. He said, *"If Aavishkaar had not invested, probably there wouldn't have been a major activity. Frankly I would not have got into it".* A unique feature of the VC funding at this stage is that the investment is made when there is no proven product or service. Although grants have been the most popular source of finance for social enterprises for long, they are not considered as scalable and does not help the social enterprise to grow quickly. As Vortex Engineering's (a company that manufactures ATM's for rural areas) founder Kannan stated, *"Grants are not repeatable and not scalable. Normally the grant giving agency has the mandate to disburse certain amount of money, and the decision makers there are concerned about doing the disbursals on some acceptable quality projects. But they do not have a larger commitment to it".*

On the other hand, by making larger investments, VC investments help their investee companies to scale faster. This leads to a scaling of the impact created by these companies as well. For example, Bihar based Husk Power Systems has received investment from a number of investors since it started operations in 2008. The company, which started with serving one village in Bihar, as a result of the funding, has today expanded operations to 84 other villages across Bihar, and is planning to expand to other parts of India and Africa.[45] Further, an increased network also facilitates investments from mainstream VC investors when the company achieves scale. Presence of a VC investor also helps the investee company to command a better valuation for subsequent financing rounds.

VC funding helps to increase the equity base of the company, which can then be leveraged to attract debt capital. Because the investment is in the form of equity, VC funding also indirectly helps the investee company by meeting the eligibility criteria requirements of large projects. As indicated by Waterlife India's (a company that supplies drinking water to rural and peri-urban areas) founder Sudesh, *"Increase in equity also makes the company bid for some large projects, which would not have been possible at lower levels of equity".* Further rounds of investments are also scalable, with each round seeing a higher infusion than the previous round. For example, Vortex Engineering, which received Rs. 30 lakhs from its first investor in 2005 saw a progressive increase in investment amounts in every subsequent round, with the company raising up to Rs. 37 crores in December 2011. The long duration of the VC investment also helps in building trust among all stakeholders of the company.

A key benefit of venture investors is their ability to provide management inputs in the company they have invested. Since venture funds invest in the form of equity, such managerial inputs and value additions help in increasing the valuation of their investee companies, which in turn help the investors to achieve a better return on their investments. VC funding is a valuable source of motivation and support at different stages of the innovation lifecycle. A VC firm comes with extensive experience on the back of investing in companies across different sectors and businesses. and is able to provide the entrepreneur valuable inputs on different fronts. VC funds help in strengthening internal systems and processes, assist in building a strong team and help in strategizing and taking business decisions. In short, VC funding gives the social enterprise a partner for both the risks and rewards of the business. Vortex Engineering's CEO Vijay Babu agreed, *"….In fact we would not be where we are without the active investment by the investors and the trust the investors had in the product and the team. It's a huge risk that the investors had taken…without them it would be impossible to develop such a product".*

Yet another key benefit of VC funding is increased visibility and networking. Many social sector companies are confined to a particular area and are unable to scale and succeed despite having exceptional business models. VC funds help their companies to get increased visibility and recognition through their network of contacts. This also automatically increases the social entrepreneur's professional network, helping him explore newer markets and opportunities. Vortex Engineering's Kannan opined, *"With VC funding, you become a part of a broader fraternity, which gives you access to networks. Moreover, it gives you credibility, than if you are a lone ranger trying to prove that you are a credible person. And when you need to meet some potential customer or you need to raise additional finance, the kind of investor you are already associated with, what that investor has to say about his conviction in your business model - all these definitely help a great deal".* A similar thought was expressed by Servals Automation's Sujatha when she said, *"Having a [social] VC investor on board is a good endorsement of the mission of the business itself. The investor is like a brand ambassador. This is an intangible, but good marketing collateral. You cannot say that with banks; you can say that with social investors".*

VC funding helps the social enterprise to improve their corporate governance practices. Companies are often required to set right the books and accounts and have proper legal documentation, which help in overall improvement in regulatory compliance. A VC firm undertakes detailed due diligence of a prospective investee firm before making an investment. It is said that going through the process of due diligence in itself helps the company in strengthening their internal processes. This was corroborated by Vortex Engineering's CFO Indira, *"their* [VC's] *due diligence process helped us identify the business structure we need to put in place; from a* *situation where we would struggle to provide the social impact matrix required by various investors every quarter, we are now in a position to send it ahead of them [the VC's] asking us".*

1.7 Concerns of exuberance in social venture investments[46]

Over the past few years, impact investing has increasingly come under the limelight, both internationally and in India. The increasing popularity and expectations from impact investments has led many to believe that a bubble is building up, as was already witnessed in the microfinance space. It is believed that deep rooted problems in the society can be solved if a company receives funding from impact investors. As Aavishkaar's founder Vineet Rai puts it, "*The hype around impact investing far outweighs reality*". There are also cases when entrepreneurs show impact targets which are highly unrealistic, simply to secure funds. However, the societal problems require years of work before the intended results can be achieved. The gap between what is promised and what is being delivered is being seen in several impact investments across the country, resulting in problems within the sector.

The focus and spotlight on the sector increased considerably in 2010, when JP Morgan classified impact investments as a separate asset class. The study also highlighted huge profit potential for such investments, resulting in an increased outcry against the concept of impact investments. With an increasing number of impact investments, the industry has came under criticism that this strong momentum could result in a conflict between social and financial objectives. In fact, this is one of the main challenges seen in social VC investments.

Although a social VC fund gives importance to the social impact created, financial performance of the investment assumes equal importance in most cases. As a result, critics are of the view that the social entrepreneur's intent may get stifled by the investor's aspiration to earn higher returns. This is especially true when the entrepreneur dilutes a majority stake in his company to secure the funding, resulting in marginalisation of his interests. When the entrepreneur begins to follow the investors' directives to increase financial returns, it could dilute the long term objectives of the social enterprise, leading to sub-optimal levels of impact creation.

Besides, the increasing focus on returns can also result in a pressure to scale and grow fast. However, social venture capital is also known as patient capital, meaning that this form of investing requires time and patience. As in the case of the microfinance sector, the desire to earn high profits in a short time can hamper the entire industry. The pressure to scale can also sometimes de-motivate the social entrepreneurs, as indicated by Servals Automation's founder Mukundan, *"…the relentless pursuit of scaling, can liquidate the passion of the entrepreneur"*.

Another concern in this space is that it is extremely difficult to measure social returns. As social investors also look at the social impact created, it becomes imperative to measure the social returns created by the investment. Most SVC funds follow a proprietary model to measure social impact, as there is no uniform standard available. The new Impact Reporting and Investment Standards which is being developed by the Global Impact Investing Network seeks to develop a standardized framework for measuring the social performance of impact investments[47]. Comparison across investment performance should be possible as more and more investors adopt this approach.

1.8 Summary

The need to marry social motive and commercial gains often leaves social entrepreneurs grappling with several issues and challenges. Social enterprises usually operate in challenging market conditions, dealing with a difficult customer base with limited resources and suppliers with limited capabilities. Products and services offered are usually in the 'push category', requiring extensive marketing.[48] Attracting and retaining human resources could be a lot more challenging for social enterprises as the sector offers a lower pay as compared to corporates.[49] A social enterprise is bound by far higher regulations and legislations compared to traditional business as the products and services offered are targeted at the low income and BoP segments, which constitute a majority of the country's electorate. Regulatory hurdles and setbacks are common in a social setup and social entrepreneurs often require in-depth knowledge to overcome these challenges.

Because of the aforementioned challenges, social ventures find it very difficult to obtain investments from commercial capital sources in the early stage. Traditional sources of finance for the social sector like bank debt, grants, donations and promoters' equity come with their own limitations. The difficulties in accessing long-term capital have restricted growth for many social enterprises, resulting in confining their operations to a restricted geographical area. SVC funds have resulted in the emergence of a new source of capital for the social enterprises. Apart from providing capital, SVC funds have provided valuable management to the social enterprise such as mentoring, fine tuning the business model, and offering guidance on various aspects of running an enterprise. They have also encouraged social entrepreneurs to grow and scale their operations, both for better returns as well as impact.

The impact investment industry is still in its early growth phase. Given the potential of impact investments for social development, it is hoped that the industry would evolve in a form and fashion, which addresses the various concerns expressed by different stakeholders.

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Democratising entrepreneurship; Bringing in change

A conversation with Vineet Rai

Vineet Rai is the Founder and Managing Director of Aavishkaar Venture Management Services, cofounder and Chairman of Intellecap and Intellegrow and Chairman of Villgro. He has over 19 years of experience in early stage investing, small business incubation, and microfinance.

Aavishkaar is a pioneer in early stage investing in the country and has been an active investor for over a decade. The firm manages four funds having a total corpus of INR 950 crore or $160 million and has recently launched a fifth fund focussed on South and South East Asia. As of August 2013 Aavishkaar had made investments in 40 companies. Aavishkaar aims to support the entrepreneurial spirit in underserved areas with the objective of creating inclusive economic development. Through its investments, it expects to create economic activity that either can create livelihoods for the low income population or reduce vulnerabilities of the people.

ED Team: How has the social venture sector evolved in the last 10-15 years? As one of the early investors in this segment, what do you think have been the major turning points?

Vineet: We started in 2001 and at that time, the dominant business in social space was microfinance. The idea about base of the pyramid was known as Prof. Prahalad had talked about the concept, but it was largely seen as a market to be tapped by the large corporate. The blossoming of microfinance industry demonstrated that not only you can do business with the poor; but you can also create value for them while generating profits for yourself. The biggest milestone that was achieved in the decade of microfinance growth was an acceptance that business can really reach out to people who were not part of the economic cycle.

A key change that took place between 2001 and 2007 was the movement of talent from financial institutions like banks to the microfinance institutions. This movement inspired many others from different professional background like doctors, engineers, etc., to explore rural India with the desire to build a business that was focussed on marginalized sections, though not in the charity mode. They started looking for options beyond microfinance in the space of technology, health, water and sanitation. Thus microfinance sector indirectly played a critical role in streaming talent to social entrepreneurship. However, unlike microfinance which was easily replicable and scalable, the social enterprises space is far more complicated and has a higher degree of variability making it difficult to build and scale the business as compared to microfinance. For example, health is different from education, as is agriculture from energy. In agriculture crops are different, land holdings are different, and land restrictions are different. Business models are complicated and we realised that it is going to be far more difficult to create value in this space and one needs both patient capital and patient talent.

Going by the way impact investing has evolved over the last few years, it would not be out of place to say that while 2001 to 2010 could be called as decade of microfinance, 2011-2020 will be known as the decade of impact investing / social entrepreneurship.

Let me summarize my learning over the last decade. First, there is an acceptance that business models can work to create change, and the micro finance sector helped to establish that. Second, unlike microfinance, social entrepreneurship space is far more complicated – effort needed is much higher, time needed is much longer, and success ratios will be much lower. Third, the previous decade has been the decade of micro finance, while the current decade belongs to social entrepreneurship and impact investing. Fourth, the impact investment space has got over-hyped already, and people are expecting far too much from it including a change in the world order! However, fact of the matter is that, impact investments are yet to demonstrate significant ability to bring about change. Fifth, we are in early stage of our growth and everybody must realise that the right thing to do is to under-promise and over-deliver rather than over-promise and end up not delivering at all. Since we are in the early stage of our growth, we need to be patient and calm. Our focus should be on the inputs, viz., bringing in capital for long-term, working with good entrepreneurs and helping them to scale their business.

ED Team: What has been the impact of social venture or impact investments in the country so far?

Vineet: In a country of 1.3 billion people, we should be able to actually stand-up and say we have invested in more than 500 companies before we claim that we have impacted the country. Additionally, we should be able to say that these 500-odd companies have actually created 10 thousand unique jobs, 5 million unique beneficiaries, and these companies are operating in 100 districts which are in the bottom 20% in terms of human development index and so on. Unless we are able to show such a track record, we cannot really say that we have made an impact.

ED Team: Where does India stand in the global marketplace in terms of impact investments?

Vineet: I think India is the global leader in this segment. What we are trying to do in India is in many ways unique. Lets' take the case of Aavishkaar as a venture capital fund. Aavishkaar invests in the needs of the people in rural areas. How do you build a venture capital fund that invest in the needs of rural India and yet generate competitive returns without having access to talent or infrastructure that Silicon Valley based venture funds have? We have to innovate an approach that would allow us to compete with investments made in businesses by conventional venture funds, who, despite having only a 20% success ratio are able to compensate for the remaining 80% failures because of large returns from their successful investments.

Impact investments not only involve the early stage risk seen in conventional venture investments, but also have to deal with other risks. For example, when investing in faraway low income states in hinterlands of India, there are issues such as talent, infrastructure, outreach, and corruption. In addition, there are also social and cultural issues that need to be handled effectively. Even after assuming these additional risks, we are trying to have a success ratio of 50 – 60% in our investee companies by innovating around the frugal hand holding and advisory process, and shifting the risk from IP and technology to execution. While our successful businesses might not give 100 times returns, we are hopeful that it gives us 5 – 8 times returns.

The shift of risk from intellectual property and technology to business execution as a strategy, providing intense hand holding support despite small fund size through frugal talent management, increasing success ratio to 50 and 60% and delivering near commercial returns is what India has offered the world as our innovation in the venture capital space.

ED Team: How do you marry the social objectives of impact investment with the requirement of financial returns? Is there a conflict between the two?

Vineet: As a general principle let us accept that there is no conflict between social and financial returns, in legitimate businesses. All businesses contribute to societal development in some way or the other. Impact focussed funds focus on investing in businesses that are working with or producing products for people in the low income population. To make this happen we focus on business aspects that are in our control – i.e., an appetite to take very high risk, investing in difficult geographies, skill to identify good entrepreneurs, and a team that can actually contribute in creating value for the entrepreneurs. For example, we have invested in an entrepreneur, who has set up a dairy in Orissa. This gives an opportunity to farmers of Orissa to buy a cow and sell the milk to the dairy from their village itself. The entrepreneur then pasteurizes the milk collected in his dairy and sells it in Bhubaneswar and Cuttack. There is no conflict between social objectives and financial investment in on organization like this, isn't it? If the entrepreneur runs his business successfully, he would have actually benefitted some 15000-20000 farmers. What we did here was to take the risk of going in a really difficult geography, identify a good entrepreneur, and helped him setup a business. The outcome is that tens of thousands of farmers have actually got an additional source of livelihood, by getting new income stream. Hundreds of people have got employment in the dairy, in different forms. All this is happened in a state where no commercial venture fund wanted to invest.

Conflicts' sometime take place when the act of business and act of development are not aligned one hundred percent. It could possibly happen in a hybrid kind of organizational set up. For example, when we invest in a company that will make a profit, and will donate 10% of this profit toward running NGOs to make an impact. If at some point in time in future, the entrepreneur doesn't want to give that 10% of profit away it would be a conflict. A conflict can also happen when an entrepreneur produces a drug which is life saving but is the monopoly of the company. In such a situation, the company does save life every time people buy the medicine but they may charge an exorbitant price for it. However in case the business is not monopolistic, market forces would not allow enterprises to continue with challenging prices or the regulator would step in. We separate businesses that have very clearly defined risks, identified promoter, and well defined value proposition that would create value in case the entrepreneur is successful.

ED Team: I think this argument of conflict was largely targeted at the microfinance industry – they charge such a high rate of interest, because they want to get higher returns. In that sense, is investing in micro finance really a social investment?

The economics of a business is based on its cost and margins. Microfinance gets money from banks at a high rate of interest, and has to deliver money in small amounts at the door steps to people. A process considered very expensive, time consuming, and manpower intensive. As the microfinance industry grew, competition forced them to look at their cost ratio. By 2010, the Indian microfinance had the most cost effective delivery mechanism anywhere in the world. However it still was considered expensive and finally government started to regulate the interest rate.

This interest rate regulation has forced MFIs to do further innovations so that they can manage their cost better. The current regulatory oversight and strong self regulation has allowed the microfinance industry to become more transparent and put in place mechanism that creates collective value for the borrower, the banks and the microfinance institutions.

ED Team: What has been done to improve the capacity of entrepreneurs to benefit from the increased interest of investor community in social ventures?

Vineet: When I said that we are world leaders in impact investing, it is not only because of the capital we have invested, but also because of our efforts in building an entire ecosystem. For example, in the last 10 – 12 years, two of our initiatives - Intellecap and Aavishkaar have done many such interventions in building the infrastructure needed to make impact investing successful. While Aavishkaar provide early stage equity both for social enterprises and microfinance, Intellecap has set up an angel network which is called Intellecap impact investing network to provide very early stage capital to young entrepreneurs with mentoring from angel investors. Intellecap also organizes 'Sankalp', voted as one of the 8 most important milestones in Indian social landscape, which brings investors and entrepreneurs together. We also founded a company called IntelleGrow which provides venture debt to these enterprises.

Both Aavishkaar and Intellecap are working closely with other investors and have facilitated setting up the India Impact Investors Council, which is envisaged as a self-regulatory body for impact investors. In partnership with other institutions such as GIZ and IFC, we are coming up with a fund impact rating tool as well. Thus, India has the presence of strong infrastructure and a powerful ecosystem that provides or thrives to provide support to entrepreneurs at every stage.

ED Team: Network of contacts play an important role in getting VC funding. Are the social entrepreneurs able to reach out to impact investors? As investors how are you able to reach out to the poor farmer who wants to start an enterprise?

Vineet: Let's actually understand this – barring exceptions, farmers do not have the understanding to build businesses. Our business is to actually democratise entrepreneurship. What we are basically doing is looking for talented people - who understand business and capital, are able to provide leadership, and able to attract talent and hire them. If a farmer could do this, great, we have a farmer entrepreneur but in my experience I would say that such an event would be an exception rather than the rule. Essentially we look for talented people willing to go back to Tier 2 or 3 cities or low income states and start a business that will finally benefit the local population and is scalable. There is nothing stopping us from investing in somebody who actually may come from farming background or with an MBA from London and wants to work in, for example, Bihar. It does not matter on where the entrepreneur comes from. What matters is that the entrepreneur is actually going to work in remote locations and build his enterprise. The entrepreneurs' ability to run such an enterprise is what we look for. We tell the entrepreneurs that 20% of India, which translates into roughly around 0.2 billion people waiting are for them in case they have a good solution or good product. There are people who are willing to invest money and support them in doing this business. What we need from an entrepreneur is the ability to take risk and enjoy the process and stay on course for the long term.

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2. Impact investments in India: An analysis

Thillai Rajan A. and Pawan Koserwal

This chapter presents an analysis of the impact investments in India. The results are based on an analysis of 523 deals in 212 companies. However, since all deals did not have information on the amount of investment, analysis on investment amount was based on the investment of $1,303 million in 173 companies.

2.1 Investments by Industry

Investments were classified into eight categories based on the industry / sector. Table 2.1 shows the distribution of investments in different industry sectors. In terms of investment, close to two-thirds of the total investment has been in the BFSI segment, most of which can be attributed to the micro-finance segment. The other sectors that account for a reasonable amount of investment are Agriculture & Healthcare and Non-financial Consumer Services. These three industries account for 90% of the total investments. The trends are similar when the analysis is done based on the number of investments. Though the proportion of BFSI is the largest even when considered by the number of deals, it does not account for as large a proportion as it does when the analysis was based on investment value. In terms of the number of deals, the top three sectors account for 77% of the total. Of the total number of companies that have received investment, 72 (34%) are in the BFSI sector. It can be seen that this proportion is considerably lower as compared to the proportion accounted for by the BFSI sector when the analysis was in terms of investment amount or the number of deals. While the top three sectors accounted for 73% of the total companies that have received venture investments, the dominance of BFSI has considerably reduced. The ratio of number of deals to number of companies is the highest for BFSI sector (3.98) among all the sectors. An inference from this trend is that investors seem to be more upbeat about the prospects of companies in the BFSI sector, which is evidenced by the number of investors investing in companies in the BFSI sector as compared to other industries.

Table 2.1: Impact investments in different sectors

Industry	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No of companies
Agriculture & healthcare	156.69	12%	54	10%	3.48	35
BFSI	835.3	64%	287	55%	3.02	72
Engineering & construction	29.08	2%	40	8%	1.04	16
IT & ITES	59.64	5%	34	7%	2.39	19
Manufacturing	1.39	0%	7	1%	0.28	5
Travel & transport	1.2	0%	1	0%	1.20	1
Other services	39.07	3%	35	7%	1.56	17
Non-financial consumer services	180.91	14%	65	12%	3.23	47
Total	1303.28	100%	523	100%	2.82	212

The trends in impact investment differ markedly when compared to other segments of venture capital investing. For example, BFSI segment accounts for only 24% of the overall VCPE investment. In terms of number of investments, IT&ITES and Manufacturing sector were the top two sectors in the overall VCPE investments.[50] Analysis of incubation investments revealed that IT&ITES accounted for the highest proportion of incubatees, whereas BFSI contribution was just 1%. The trends in angel investments were similar to that seen in incubation support.[51] Impact investments are thus characterized by a high degree of concentration in the BFSI segment, because of the micro-finance sector. This trend has also been emphasized by Vineet Rai and Anurag Agrawal in their interviews (see elsewhere in this report). With investments gradually increasing in other industry categories, it can be expected that the dominance of BFSI segment will reduce in the coming years.

Average investment per deal presents an interesting picture. The average investment per deal in impact investments works out to be $2.82 million. This is much lower than the overall average deal size ($32million) seen in VCPE investments. This is also lower than the average deal size seen in early stage VCPE investments ($12.6 million)[52]. Two inferences can be made from this trend. First, impact investments are happening in comparatively the earlier stage in social enterprises as compared to the overall industry trends. This indicates the important role played by the investors in providing early stage capital to firms in the social sector. Second, social enterprise investing is still in a nascent phase. As the companies in this sector grow in size, they will attract larger and larger investments, which would then increase the average deal size.

2.2 Geographical distribution of investments

2.2.1 Distribution by region

Table 2.2 gives the distribution of investments in the four geographical regions. It can be seen that Southern region clearly dominates across all parameters. It accounts for 65% of the total investment, 55% of the total deals, and 48% of the total companies that have received investment. The ratio of number of deals to number of companies is also the highest for South (2.84) as compared to that of the other three regions. The average investment per deal is also the highest for South, and difference between South and West, which has the second highest average investment per deal is close to 30%.

This indicates the favourable conditions for business, entrepreneurship, and investment in the Southern region. Though Western region, comprising investment friendly states such as Maharashtra and Gujarat, should also rank favourably on the above characteristics, there is substantial difference in the numbers between the two regions.

Table 2.2: Distribution of impact investments by region

Region	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
East	61.47	5%	30	6%	2.20	17
North	181.85	14%	109	21%	1.96	42
South	847.93	65%	290	55%	3.29	102
West	212.03	16%	94	18%	2.55	51
Total	1303.28	100%	523	100%	2.82	212

The dominance of the Southern region is more prominent in the impact investments segment as compared to the overall trends in VCPE investments. While most VCPE investment happened in companies in the Western region (~40%), in terms of number of investments, Southern region accounted for the largest share (~40%)[53]. But the difference between South and West is not as high as what is seen in the case of impact investments. However, the trends in impact investment seem to be in line with the trends seen in incubation support, which is characterized by a strong dominance of incubatees from the Southern region.[54]

2.2.2 Distribution by city

Investments were analysed based on the type of city in which the enterprises were located. The cities were classified into two types - Metropolitan and Non-metropolitan cities. The six cities, viz., Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai were classified as metropolitan cities. All the other cities were classified as non-metropolitan cities. Table 2.3 gives the results.

Table 2.3: Distribution of impact investments by type of city

City type	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
Metro	1056.43	81%	389	74%	3.05	144
Non-metro	246.85	19%	134	26%	2.13	68
Total	1303.28	100%	523	100%	2.82	212

Despite the perception that the target customer segment for social enterprises would generally be in smaller cities, the enterprises themselves are located in the large metropolitan cities. This could be attributed to the poor quality of business support infrastructure in smaller cities. While the enterprises could have their operations in rural areas or smaller towns, their main offices are likely to be located in a metropolitan city. As it can be seen in Table 2.3, metropolitan cities account for a large chunk of investments, deals, and companies. The average investment per deal in metropolitan city is higher by 43% as compared to the average investment per deal in a non-metropolitan city. The deals to companies ratio is also significantly higher in the case of metropolitan cities (2.70) as compared to that of non-metropolitan cities (1.97). In fact, the share of metro cities in impact investments is similar to the trends seen in overall VCPE investment[55] and angel investments[56]. A departure from this trend was seen in the case of incubation support, where a large number of incubatees were from non-metropolitan cities.[57] A possible explanation for this trend is that venture funds invest in highly capable entrepreneurs, and such entrepreneurs prefer to locate their enterprises in the metropolitan cities for a variety of reasons. As various entrepreneurship development programs such as incubation support programs bear fruit, impact investors would be able to find more entrepreneurs to fund even from smaller cities.

2.2.3 Distribution by city tier

To further understand the trend of impact investments in different cities, cities were classified into three tiers based on the population of the city as per Census 2011. The details of the classification are as follows

- Tier I cities: Cities that had a population of 5 million or more were classified as Tier I cities. In our study, seven cities were classified as Tier I, viz., Ahmedabad, Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai.

- Tier II cities: Cities that had a population between 1 and 5 million were classified as Tier II cities. The following cities in the investment sample were classified as Tier II cities: Allahabad, Aurangabad, Coimbatore, Jaipur, Jodhpur, Kanpur, Kota, Lucknow, Patna, Pune, and Varanasi.

- Tier III cities: Cities which had a population less than 1 million were classified as Tier III cities. The following cities in the investment sample were classified as Tier III cities: Bhubaneswar, Chittoor, Dehradun, Deoghar, Erode, Gurgaon, Guwahati, Khatoli, Kochi, Noida, Ooty, Palakkad, Pithoragarh, Rajahmundry, Rourkela, Sambalpur, Secunderabad, Shimla, Simayal, Sivagangai, Thrissur, Tiruchirappalli, Udaipur, Vallabh Vidyanagar, and Villupuram.

In all, our sample consisted of investments in 43 cities, thus making it reasonably representative. Table 2.4 provides the distribution of investments among the three categories of cities. It can be seen that more than five-sixths of the total investments and more than three-fourth of the total deals are in companies that are located in Tier 1 cities. The finding by city tier is on similar lines as seen in the case of metro/ non-metro analysis. The average investment per deal is the highest for deals in Tier 1 cities, and so is the ratio of No. of deals to No. of companies.

Table 2.4: Distribution of impact investments by city tier

City tier	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
Tier I	1100.59	85%	401	77%	3.07	152
Tier II	78.43	6%	49	9%	1.91	24
Tier III	124.26	10%	73	14%	2.00	36
Total	1303.28	100%	523	100%	2.82	212

The inferences from this trend can be as follows: First, the impact investment activity is in the initial years, and therefore the investors are focused more on the low hanging fruits, i.e., to look for quality investment opportunities in the larger cities, where the environment is more supportive for business. With time, the investors would actively venture into more difficult geographies, thereby reducing the high proportion of investments in Tier I cities. Second, investment opportunities are actually lacking in smaller cities, despite the investors actively seeking them. For entrepreneurs to successfully raise funding from smaller cities, there is a need for more and better inputs for entrepreneurship development in such locations. Third, social entrepreneurs in the smaller cities could have difficulties in accessing impact investors. Fourth, there are challenges in scaling in tier 2 and tier 3 cities, given the size of their catchment. Fifth, it is a reiteration of the opportunity available in the BoP segment in urban areas.

2.3 Year wise analysis of investments

Table 2.5 provides the distribution based on the year of investment. In the 13-year period that has been studied, the investment activity has been very marginal for the first five years, viz., till 2005. This indicates that the impact investment as a sector is in the very early stages. The investment activity picked up only after 2006. The noticeable drop in investment activity during 2011 and 2012 can be attributed to the micro-finance crisis and also to the general slowdown in the VCPE industry during these years.

The number of yearly investments that happen in the impact segment is only a fraction of the overall VCPE investments. The average amount of impact investments made in a year is around $180 million (based on the investments during the seven year period 2006 – 12), whereas the average yearly VC investment in India during the same period is about $812 million.[58] The average yearly PE investment (other than in real estate) during the same period is about $9.1 billion.[59] Therefore, in terms of size, impact investments account for about 22% and 2% of the total VC and PE investment in the country. However, the picture changes slightly when analyzed in terms of number of deals. There is an average of about 69 impact investments in an year (during 2006 – 12), whereas in the case of VC and PE investments, it is about 354 and 878 respectively for the same period[60]. Thus, in terms of deals, impact investments is about 20% and 8% of the deals in the VC and PE investments respectively. Since impact investments is at a much lower proportion of the overall VCPE investments, when compared in terms of investment amount as compared to that of number of deals, the inference is that the average investment size is much smaller as compared to the overall VCPE industry. As the segment matures, and when a greater number of companies that have obtained early stage funding start getting late stage funding, the average investment per deal can also be expected to increase.

Table 2.5: Distribution based on the year of investment

Year	Investment ($, million)	Cumulative % of total investment	No. of deals	Cumulative % of total deals	Average investment/deal ($, million)	No. of companies	No. of deals / No. of companies
2001	7.82	1%	8	2%	0.98	5	1.6
2002	18.02	2%	2	2%	9.01	2	1.0
2003	0.67	2%	2	2%	0.34	2	1.0
2004	1.25	2%	6	3%	0.21	4	1.5
2005	8.52	3%	19	7%	0.50	14	1.4
2006	121.04	12%	42	15%	3.10	28	1.5
2007	273.39	33%	83	31%	3.75	37	2.2
2008	162.77	45%	83	47%	2.09	52	1.6
2009	277.79	66%	98	66%	3.02	58	1.7
2010	235.62	84%	82	81%	3.57	58	1.4
2011	160.27	96%	70	95%	2.72	39	1.8
2012	36.12	99%	28	100%	1.81	17	1.6
2013#	7.82	100%	8	100%	0.98	5	1.6
Total	1303.28		523		2.82	212	

(# 2013 investments are only for the January - June 2013)

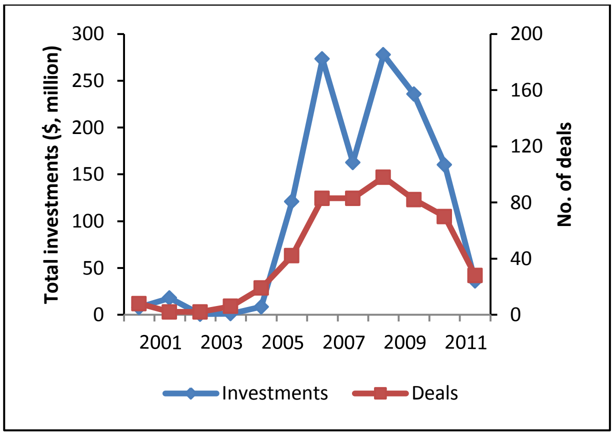

Figure 2.1: Total investments and deals in different years

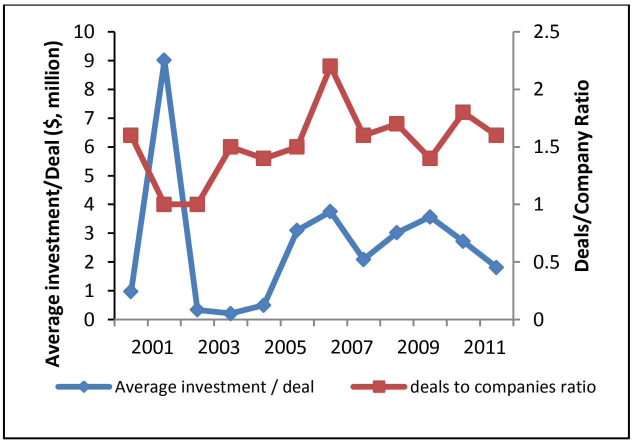

Figure 2.2: Average investment per deal and deals to company ratio in different years

Figure 2.1 provide a graphical representation of the total investments and deals in different years. As expected, total investments and deals are strongly correlated, with a correlation ratio of 0.96. It was however seen that the volatility of investments is much higher than the volatility in the number of deals. This indicates that even when the funding environment turns adverse, the number of deals that gets funding does not reduce as much as amount of investment. Figure 2.2 provides a graphical representation of average investment per deal and deals to companies ratio for different years. Though there is an inverse relationship between average investment per deal and deals to companies ratio, the association is only marginal (a correlation of -0.16). It was also seen that the volatility in average investment per deal is much higher as compared to deals to company ratio. This also shows that the investors' interest in a company does not change as much as quantum of capital they are prepared to invest.

2.4 Investments by type of business

2.4.1 Classification on business models

Companies were classified into two categories based on their business model - B2B or B2C. Enterprises that only supply to other businesses or organizations were classified as B2B. Enterprises that directly deal with the end consumers were classified as B2C. An example of the former is Vortex Engineering Limited (Vortex). Vortex is a company that produces low cost ATM's for use in rural areas. The ATM's are sold to banks and other organizations, which in turn installs them in rural areas, thereby benefitting those living in those areas. Since Vortex does not directly sell their products to end users, i.e., the users of ATM machines, it is classified as a B2B enterprise. An example of the later would be Servals Engineering Private Limited (Servals). Servals manufactures energy efficient fuel burners for use by poor households. The company sells its products directly to the end-users, and is therefore a B2C company. Similarly, microfinance enterprises, since they directly deal with the borrowers, have been classified as B2C enterprises.

In terms of investment risk, B2C businesses are generally perceived to have a higher level of risk as compared to B2B businesses. However, since B2C businesses directly create an impact at the level of end-users, they can affect impact more effectively as compared to B2B businesses, which have to depend on other agents in the value chain to realize the impact potential of their product or service.

Table 2.6 shows the split of impact investments between B2B and B2C businesses. It can be seen that bulk of the investment has been in B2C businesses. This cannot be fully attributed to the dominance of micro-finance investments, since even if the entire portfolio of investments from the BFSI is excluded, the investments in B2C companies were higher than that of the investments in B2B companies. It can also be seen that B2C companies have obtained more investment ($6.98 million) as compared to that of B2B businesses ($3.52 million). However, the findings also show that the average investment per deal is higher in B2B enterprises as compared to what was seen in B2C enterprises. On the other hand, the ratio of the number of deals to number of companies is higher for B2C (2.75) as compared to that of B2B (1.59). The results also show that more number of investors are involved per dollar of investment in a B2C enterprise, indicating a higher degree of syndication in B2C businesses. The higher level of syndication could be attributed to the larger capital requirements in B2C businesses (i.e., financing motive) and the need to diversify the relatively higher risks in these businesses (i.e., risk management motive). A dominance of B2C investments indicates that most SVC investments are in companies that are directly creating an impact at the BoP and the higher levels of syndication is a response by the venture funds to manage the risk associated with such an investment strategy.

Table 2.6: Distribution of impact investments by type of business						
Business type	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
B2B	179.75	14%	81	15%	3.02	51
B2C	1123.53	86%	442	85%	2.72	161
Total	1303.28	100%	523	100%	2.82	212

2.4.2 Classification on social orientation

Businesses can be characterized into different categories based on where they source their inputs from and where they sell their outputs. The social enterprises were classified into four categories on the basis of their inputs and outputs as follows:

1. Rural Supply and Sourcing (RSS): Companies whose primary input sources are from the non-urban and rural areas and whose primary target consumers are also located in non-urban and rural areas belong to this category. For example, Husk Power which sources plant husk as raw material for power generation and supplies the power generated to the mills located in rural areas is an example in this category. The plant sources its inputs from non-urban areas and also supplies it outputs to non-urban areas. Another example would be Waterlife India which uses underground water in rural areas to supply clean drinking water to the local population. Since both the sourcing and supply is done locally, the company has been classified under this category.

2. Rural Supply (RSU): Companies whose primary input sources are from the non-rural areas, but whose primary target consumers are also located in non-urban and rural areas are classified in this category. For example, microfinance companies are classified in this category because they service primarily customers in rural and non-urban areas, but they do not source their loan capital (their main input) from these markets.

3. Rural Sourcing (RSO): Companies whose primary input sources are from the non-urban and rural areas, but whose primary target consumers are located in non-rural areas belong to this category. For example, enterprises that source crafts and products from rural artisans and sell them in urban markets belong to this category. An example firm in this category would be DesiCrew, a rural BPO company that uses the talent from smaller towns to provide transcription and other business process services to large corporations. Since the company is using local talent from the smaller cities, while servicing its customers across the globe, it has been classified in this category. Other examples would be Rural Tourism Network Enterprise, which promotes rural tourism, and Industree, which sources handicrafts and artisans products from rural areas and sells across the world.

4. Non-Rural (NRU): Companies whose primary input sources are from the non rural areas and whose primary target consumers are also located in non- rural areas belong to this category. While the existing business models for enterprises in this category are not targeted at the low income/ BoP segment, they have the potential to create substantial social impact in the future because of the social relevance of the sectors. An example in this category would be AyurVaid Hospitals, which provides ayurvedic healthcare. Though the hospital is currently targeting patients in urban centres, it has the potential to create social impact by catering to non-urban patients in the coming years. A

second example would be the firm, Your Kids R Our Kids, which providing education and child care services. Though it is currently targeting urban consumers, it has the potential to create impact in child education even in the lower strata of the society in the coming years.

Given the poverty levels at the BoP, it is perceived that investments that provide income opportunities among the low income and the BoP would be able create a higher degree of impact as compared to those investments that make various products and services available for consumption at the BoP. In essence, investments that enable the BoP to be a net producer would be more socially desirable as compared to those that facilitate the BoP to be a net consumer. Seen in that perspective, the type of businesses at the top of desirability pecking order would be RSO and RSS. This would be followed by RSU. NRU would rank the last because the potential to create an impact at the BoP is in the future.

Table 2.7: Distribution of impact investments by the social orientation of business

Business type	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
NRU	369.74	28%	133	25%	3.39	92
RSO	35.92	3%	34	7%	1.56	23
RSS	28.54	2%	16	3%	2.04	5
RSU	869.08	67%	340	65%	2.75	92
Total	1303.28	100%	523	100%	2.82	212

Table 2.7 gives the split up of investments in terms of their social orientation. It would have been ideal to have had the largest amount of investments in RSO and RSS businesses. But, sadly, that was not the case to be. RSS businesses have obtained the lowest investments, and account for the lowest number of deals. RSO fares better than RSS, but only slightly. Both the categories have low average investment per deal. The ratio of number of deals to number of companies is also lower than the average. This indicates that there is not much interest among the investor community in investing in RSO type businesses.

Most interest is seen in the RSU type of businesses. It has attracted two-thirds of the total investment, and accounts for 65% of the total deals. At 3.7, the ratio of number of deals to number of companies is the highest among the all the four categories, indicating a high degree of interest among the investors for businesses in this segment. In terms of number of companies, NRU accounts for as many companies as that of RSU. However, the investment in NRU businesses, is just 43% of the investment in RSU businesses. This indicates that the average investment in a NRU business enterprise is lower ($5.13 million) than that of the average investment in a RSU business enterprise ($10.6 million). It is felt that the trajectory of the trend in impact investments should alter in such a way that more businesses in the RSO and RSS category are funded. In our sample, RSO and RSS together accounts for just 5% of the total investment, 10% of the total deals, and 13% of the total companies that have received some form of impact investment. RSO and RSS businesses would be better engines for employment generation and therefore creating additional incomes at the BoP as compared to other models. Additional income would provide increased ability to those at the BoP to consume new products and services.

2.4.3 Classification on form of innovation

Table 2.8 categorizes the investments based on the form of innovation. Broadly, the companies were classified into three categories depending on the predominant form of innovation. Those companies that provided supply chain solutions or access to new markets (for example, sourcing of rural crafts for selling in urban markets) were classified in "Channels and process" category. Companies that provided solutions by integrating different components or provided new service offerings (for example, supply of safe drinking water or setting of schools) were classified in "System integration / service innovation" category. Companies that were based on new technology development were classified under the "Technology innovation" category.

Table 2.8: Distribution of impact investments by the form of innovation

Forms of innovation	Invested amount ($ million)	% of Total amount invested	Investor deals	Average investment per deal	No of Companies
Channels and process	205.53	16%	132	2.10	77
System integration/ Service innovation	1031.73	79%	364	3.02	122
Technology innovation	66.02	5%	27	3.00	13
Grand Total	1303.28	100%	523	2.82	212

Results indicate that close to four-fifths of the investment have been made in companies that fall under the "System integration / service innovation" category. In terms of the number of the companies, 58% of the companies were in this category. The average investment per deal is also the highest for this category. Companies under "Channels and process" account for 16 percent of the total investment, but have the lowest average investment per deal. "Technology innovation" category accounts for the lowest proportion of investment.

The inferences from this trend is that, in a majority of the cases investors are relying on the implementation capabilities of the entrepreneurs for the success of the investment, as it is felt that implementation skills are most predominantly needed for the companies in the "System integration / service innovation" category. Investments in this category largely treats the BoP market as a consuming market, and facilitates to provide various products and services to that market. While that is an important contribution in a supply constrained situation, what would be even more important is provide income generating opportunities at the BoP, i.e., investments in the "channels and process" category. This will help in increasing the income levels of the BoP segment, and enable them to consume products and services offered by the "System integration / service innovation" companies. Even in this category, investors would have to substantially rely on the implementation skills of the entrepreneur for the success of the investment. "Technology innovation" category aims to develop products specifically suited for the BoP segment, and can make a stronger contribution on the impact scale. It can catalyze both income generation and consumption. If investors would like to create a stronger impact at the BoP, they need to make more investments in both the "Technology innovation" and "Channels and process" categories as compared to the present levels. It is hoped that after the low lying fruits are plucked, investors would gradually shift towards making more investments in these two categories that can potentially create a stronger impact at the BoP.

2.5 Timing of investments

2.5.1 Analysis of rounds of funding

Normally, a firm raises multiple rounds of VC funding to meet their financing requirements. Raising capital through multiple rounds rather than raising all the capital in one go benefits both the investors and entrepreneurs. The first instance of funding from a VC fund is called the first round, and the second instance the second round and so on. In a single round, there can be more than one investor investing jointly. In this report, any subsequent funding is considered as a separate round if there is a gap of three months or more from the previous round. Table 2.9 gives details of the investment done in different rounds. Out of the 173 companies used in this analysis, it can be seen that only about 10% of the companies have successfully raised more than three rounds of funding, indicating that most impact investments have been recent. Out of the total investment, 70% of the investment has been made in the first three rounds. As expected, the average investment per round shows an increasing trend with increasing round number, since the funding requirements also increase with the size of the company.

Table 2.10 shows the distribution of companies by the number of funding rounds they have raised. There were a total of 297 funding rounds. 117 of the 173 companies (i.e., 68%) have raised only one round of funding. The impact of SVC funding depends on how these companies are able to scale up and obtain subsequent rounds of funding. It is highly unlikely that companies would be able to achieve self-sustenance after one round of funding.

Table 2.9: Investment details in different rounds

Round number	No of companies	No. of investors	Total deals	Invested amount ($, million)	% of total invest ment	Average investment/ Round ($, million)	Average investment/Deal ($, million)
1	173	80	223	531.35	41%	3.07	2.38
2	56	42	93	209.79	16%	3.75	2.26
3	30	32	57	171.01	13%	5.70	3.00
4	18	26	40	165.09	13%	9.17	4.13
5	9	17	23	99.98	8%	11.11	4.35
6	4	9	9	39.36	3%	9.84	4.37
7	3	4	5	38.70	3%	12.90	7.74
8	2	4	4	13.30	1%	6.65	3.33
9	1	6	6	25.50	2%	25.50	4.25
10	1	2	2	9.00	1%	9.00	4.50
Total	173	103	462	1303.28	100%	4.39	2.82

Table 2.10: Distribution of companies by number of funding rounds

Round number	No of Companies	Total Deals	Invested amount ($, million)	% of Total Amount	Average investment/Round ($, million)	Average investment/Deal ($, million)
1	117	146	402.38	31%	3.44	2.76
2	26	85	199.15	15%	3.83	2.34
3	12	56	145.02	11%	4.03	2.59
4	9	60	193.19	15%	5.37	3.22
5	5	43	116.45	9%	4.66	2.71
6	1	10	32.27	2%	5.38	3.23
7	1	16	108.52	8%	15.50	6.78
8	1	12	26.57	2%	3.32	2.21
10	1	34	79.73	6%	7.97	2.35
Total (297)	173	462	1303.28	100%	4.39	2.82

2.5.2 Company incorporation and first round of funding

Availability of early stage funding is critical for the initial sustenance of the social enterprise. Evidence indicates that lack of early stage funding is one of the biggest hurdles facing entrepreneurs in India. We studied the duration between date of incorporation and first round of funding as an indication of early access to external funding. Table 2.11 gives the results. It can be seen that out of the total investment $280 million in the first round, 42.5 percent of the investment happened within 24 months. In terms of deals, the proportion of deals happening within 24 months from incorporation is also 42 percent.

Table 2.11: Duration (in months) between date of incorporation and first investment

Duration in months (Inc. date to 1st Inv)	No of companies	No of deals	Average duration (months)	Amount (in $ Million)	Average investment/ deal ($ Million)
<24 Months	52	71	14	119	1.95
<48 Months	40	48	36	79	1.88
<96 Months	34	41	67	62	1.94
≥96 Months	8	9	131	20	2.5
Overall	134	169	39	280	1.96

(Note: only companies incorporated after year 2000 were included in the analysis, since first round of funding of details were not fully known for companies incorporated prior to year 2000)

For deals within 24 months from incorporation, the average duration has been 14 months. The average investment per deal in the first round is also lower than the average investment per deal ($2.82 million) for the whole sample. This is on expected lines, since the initial funding requirement would be lower than the requirement in the later stages of the enterprise. While the trends for average duration and average investment per deal are on expected lines, there is scope for improvement in increasing the proportion of first round of funding that is occurring within 24 months.

Our results indicate a significant proportion of impact investments happen within two years from the date of incorporation of the enterprise. Impact investments, as a category is supposed to facilitate early stage investments in those companies that are expected to create a social impact. Our analysis indicates that that has indeed been the case. Impact investments not only make early stage investments, but also facilitated the availability of lower investment ticket sizes, in the early stage. The investment sizes of conventional VCPE investors are much larger, which might not be appropriate for early stage funding for social enterprises. Analysis on the basis of fund focus (see next chapter for details on classifying funds by their focus) indicated that social investors have made first round investments in more companies as compared to mainstream investors. The former have made first round investments in 72 companies as compared to that of 49 by the latter. In the case of companies that have received their first round investment within 24 months from the date of incorporation, SVC funds have invested in 32 companies while mainstream VC funds have invested only 18 companies. It is thus felt that the emergence of SVC funding has clearly resulted in tangible benefits to social enterprises.

2.5.3 Interval between successive rounds of funding

In venture investments, it is common for the investments to happen in many rounds. This process is called staging. Staging of investments can be advantageous for both the investor as well as investee company. From an investors' perspective, staging is an effective mechanism to monitor the progress achieved. Unless the investee company is not able to show adequate progress, it would not be successful in raising the next round of funding from the investors. If the progress has been slack, it would help the investors to conserve scarce capital by not making further investments in non-performing companies. For the entrepreneurs, obtaining investment in stages would help to realize better value for their companies. The investee company would be in a better position to claim higher valuation in a subsequent round, if they are able to show progress from their previous round. When the investee company is able to raise a subsequent round of funding, it also indicates a certain degree of success - as without evidence of success, investors (either existing or new) would not have made an investment in the next round.

In our sample, 67 companies of the 212, i.e., 32% of the companies have had more than one round of funding. This is a satisfactory ratio, as close to one-third of the companies have been able to show a degree of progress, which has enabled to attract the next round of funding. This compares favourably with the investment trends in the overall VCPE industry, where only 19% of the companies have been able to attract more than one round of funding.[61] Table 2.12 gives the details about the trends in duration between successive rounds of funding.

Table 2.12: Duration between successive funding rounds

Duration in months	No of companies	Pairs of rounds	Average duration between successive rounds (in months)
Less than six months	12	19	4
Less than 24 months	49	85	13.47
Less than 48 months	18	19	31
48 months or more	6	6	82.66
Total	67	129	17.88

The results indicate that in about 66% of the total 129 round-pairs, the average funding duration was 13.47 months, i.e., on an average the firm is able to raise the next round of funding in slightly more than a year after the previous round. Fund raising demands considerable time on the entrepreneurs and top management and divert their attention from focusing on the operations of the business. It would have been ideal that the companies have able to raise adequate capital that would meet the requirements for the next two years. Such frequent staging could also be a result of investors' risk perception of the investment - they are investing smaller amounts in each round thereby forcing the investee companies to seek funding at shorter intervals. The overall average funding duration is 17.88 months. This is comparatively higher than the 10 - 15 month duration seen in the overall VCPE investments.[62] An explanation for the higher duration in the case of social enterprises is that they take more time to scale up as compared to mainstream enterprises.

2.6 Syndication patterns

The pattern of VC investment can be classified into two categories depending on the number of investors involved in a particular round of funding. If there is only one investor in a round, then they are called as sole investor deals. If there is more than one investor investing jointly in a single round, then they are called as syndicated deals. The extent of syndication is said to increase with the increase in the number of investors in the syndicate. Table 2.13 gives the results of the syndication pattern in our sample. It can be seen that single investor deals account for a substantial portion (44.6%) of the total amount invested. Among the total number of investment rounds, the largest number of rounds (71%) are those that have only one investor. Since syndication is normally the norm when the investment amounts are large, our results indicate that investment rounds are not very large in the case of impact investments. An inference to this trend is that most investments are early stage investments. This reinforces the earlier results that the emergence of SVC funds and impact investment approaches have resulted in smaller investment ticket sizes. Previously, such small investment opportunities were overlooked and not get adequate attention from the mainstream VCPE investors, as their average investment levels are higher. However, with the emergence of SVC funds, entrepreneurs, particularly in the social sector, now have an avenue to raise lower levels of capital.

Table 2.13: Syndication pattern among investors

No. of investors in the round	Total amount invested ($, million)	No. of rounds in the sample	Percent of total amount invested	No. of deals	Average investment per investor ($, million)	Average investment per round ($, million)	No. of companies
Single	581.2	245	44.6%	245	2.86	2.86	180
Up to 4	617.32	93	47.4%	227	2.90	7.18	61
More than 4	104.76	9	8.0%	51	2.28	13.10	5
Total	1303.28	347	100.0%	523	2.82	4.39	212

2.7 Summary

Key findings of our analysis can be summarized as follows:

- Close to two-thirds of the total impact investment has been in the BFSI segment, most of which can be attributed to the micro-finance segment. The other major sectors that account for considerable amount of investment are Agriculture & Healthcare and Non-financial Consumer Services. These three industries account for 90% of the total investments. The trends in impact investment differ markedly when compared to other segments of venture capital investing. For example, BFSI segment accounts for only 24% of the overall VCPE investment. In terms of number of investments, IT&ITES and Manufacturing sector were the top two sectors in the overall VCPE investments.

- Average investment per deal presents an interesting picture. The average investment per deal in impact investments works out to be $2.82 million. This is much lower than the overall average deal size ($32 million) seen in VCPE investments. This is also lower than the average deal size seen in early stage VCPE investments ($12.6 million).

- Despite the perception that the target customer segment for social enterprises would generally be in smaller towns, the enterprises themselves are located in the large metropolitan cities. Enterprises in metropolitan cities account for a large chunk of investments, deals, and companies. The average investment per deal in metropolitan city is higher by 43% as compared to the average investment per deal in a non-metropolitan city.

- The number of yearly investments that happen in the impact segment is only fraction of the overall VCPE investments. The average amount of impact investment made in a year is around $180 million, whereas the total PE investments that happen in India in an year is about $9.1 billion. Therefore, in terms of size, impact investments account for about 2% of the total PE investment in the country.

- When investments were analyzed on their business model, viz., B2B or B2C, it was seen that bulk of the investment has been in B2C businesses. This cannot be fully attributed to the dominance of micro-finance investments, since even if the entire portfolio of investments from the BFSI is excluded, the investments in B2C companies are higher than that of the investments in B2B companies. It can also be seen that aggregate investment has been higher in B2C companies ($6.98 million) as compared to that of B2B businesses ($3.52 million)

- When investments were analyzed on the basis of social orientation, it was seen that most investment was in RSU type of businesses. These businesses had two-thirds of the total investment, and accounts for 65% of the total deals. At 3.7, the ratio of number of deals to number of companies is the highest for RSU businesses among all the four categories, indicating a high degree of interest among the investors for businesses in this segment.

- About four-fifths of the investment have been made in companies that fall under the "System integration / service innovation" category. The average investment per deal is also the highest for this category. On the contrary, "Technology innovation" category accounted for the least investment among the three categories.

- A significant proportion of first round impact investments happen within two years from the date of incorporation of the enterprise. Impact investments, as a category is supposed to facilitate early stage investments in those companies and sectors that are expected to have a social impact. We find that this has indeed been the case. Impact investments not only make early stage investments, but also facilitate the availability of lower investment ticket sizes, in the early stage.

■

Strengthening the impact investing ecosystem

A conversation with Anurag Agrawal

Anurag Agrawal is the Chief Executive Officer at Intellecap and manages key investor and client relationships. He has over a decade of experience in helping companies raise early and growth stage capital and works with several social sector enterprises.

Intellecap, established in 2002, focuses on supporting profitable enterprises which bring about social and environmental change. Concentrating on key sectors such as healthcare, water, sanitation, clean energy, education, agriculture, rural businesses and financial services, Intellecap's philosophy revolves around improving the lives of the people at the Bottom of the Pyramid. Intellecap provides Investment Banking, Consulting and Research services to its clients. Over the last ten years, Intellecap and its sister organizations have helped over 50 firms raise over $200 million from investors, and have worked with over 60 clients in over 250 engagements across 20 countries.

ED Team: How has the social venture sector evolved and what have been the major turning points in this sector in the last 10-15 years?

Anurag: The whole impact investment terminology is relatively recent and was coined by the Rockefeller institute only in 2007. In addition to impact investment, various other terms are also being used to describe the sector, viz., social enterprise, inclusive business, double bottom line enterprises, triple bottom line enterprises and so on. People raising money to invest in this concept didn't exist initially. In the first half of the decade, 2000-10, there were very few investors. The first traction in impact investments started happening in the microfinance sector, and the initial funds that focused on investing in microfinance companies emerged during 2005 – 07. The fund size was typically smaller, between $10 - $25 million. Most of the investors were first time fund managers. If I remember correctly, the first fund that came up in India with an exclusive focus on microfinance was the Bellwether microfinance fund. Other microfinance funds that were set up at more or less the same time were Aavishkaar Goodwell, Lok Capital, and Unitus.

Subsequently, these funds raised larger sized follow on funds, in the range of $50 - $100 million. Corresponding to the increase in fund size, the size of the investment team also became larger. While the first fund invested only in microfinance companies, the larger follow on funds, started looking at the broader concept of financial inclusion. In addition, they started looking at other non-financial sectors as well. With that, the development of the sector has almost come a full circle – the early social enterprise focused funds in the industry, Aavishkaar and Acumen had started investing in rural enterprises that focussed on poor people, then came the clearly focussed funds for microfinance and broader financial inclusion, and in the next stage, investors looked at other sectors including water, health, sanitation, affordable education, green energy, rural BPO and vocational training. However, financial inclusion still plays a key part in the social venture sector.

ED Team: What could be the reason for the initial major thrust on microfinance in the impact investments sector?

Anurag: Initially, the impact investing space did not start with investments in the microfinance sector. Both Aavishkaar and Acumen, which were probably the first few social venture funds in India, were investing in the non-finance areas. However, microfinance became very popular and picked up as it was found that the business model was proven and straight forward. Besides, scaling up could be done profitably and in a quick manner. Further, it was one model in the for-profit development space where both the companies and the investors could make money. Another feature was that the microfinance sector showed a track record of successful exits. The first stage of investment was usually followed by the traditional mainstream investors like Sequoia, which was then followed by the large private equity investors like Carlyle or General Atlantic.

Understandably, the initial social investors could not compete with the larger funds which were much bigger in size. This was because in the subsequent rounds, the investment size itself would be high. Larger VCs or PE funds bought out the initial investors, which created a track record of successful exits. Funds could invest and exit with minimal difficulty and could return the money to their investors with a profit. Thereafter these funds were also able to raise a second fund based on this track record.

The microfinance sector has gone through a full cycle, where tremendous growth was witnessed in the initial part of the decade, followed by regulatory interventions and resultant failure of some companies. After a 2 year lull period when hardly anything happened, some companies have recovered, new leaders have emerged and investments are coming in again.

ED Team: How different are entrepreneurs in the social enterprise space compared to entrepreneurs in conventional businesses?

Anurag: The profile of entrepreneurs in the social space has changed dramatically. In the beginning, entrepreneurs in this space were basically those who were engaged in running not-for-profit organisations, which were mostly NGOs, engaged in developmental work. They were people who wanted to do something good for the society and make a difference. These entrepreneurs realised the limitations of the not-for-profit model as they were constrained by scale, capital and growth. They understood that the organization could not scale due to difficulties in obtaining commercial capital. This forced many such entrepreneurs to convert their businesses into for-profit business models. However, they continued to face difficulties as they had to deal with a variety of aspects which were new to them - corporate structures, investors, investment terms and scaling issues.

The new category of entrepreneurs that have emerged consisted of people who were successful in their professional lives in the past and who had the experience of dealing with large organizations. For instance, a lot of bankers entered the microfinance space. Therefore the quality of entrepreneurs changed dramatically over the past decade.

However, both types of entrepreneurs continue to exist even today - entrepreneurs with an NGO background who are looking at for-profit models, as well as entrepreneurs with a corporate background who are looking at non-profit models. There are also young professionals, who are in their first job or fresh out of college, entering the social sector space. The profile of each type of entrepreneur is different and the support system needed differs according to their background and experience. Irrespective of the type of the entrepreneur and his background, the key parameter for success is to sustain the business for at least 3 years after starting it and to raise the first round of funding.

ED Team: With the profiles of social entrepreneurs changing over the period, how has Intellecap's support to such entrepreneurs also changed?

Anurag: One cannot offer the same support to an entrepreneur who comes from an NGO setup and to an entrepreneur who comes from a large corporate background as the profiles and experiences of the two categories of entrepreneurs are different. For instance, an entrepreneur from an NGO background has lower reach among the investor community compared to someone from a corporate background. In such cases, forums such as Sankalp that we have launched will help the entrepreneur to connect with potential investors. Sometimes, an entrepreneur from a corporate background may be familiar with fund raising, but may not know the nuances as he may not have been directly involved in it in his earlier profession. In such a case, we help him with the entire fund raising process.

In case the entrepreneur has a hands-on experience of various aspects of fund raising, he will simply look at the quality of investors who can be brought on board. In other cases, despite the entrepreneur having a wide professional network and fund raising experience, he may still want to take our services, as there might be an issue of having the necessary bandwidth. As the entrepreneur's core focus is on growing the business, he might not want to take the burden of fund raising and thus would want to opt for our advisory services. So the support offered would change depending on the entrepreneur's needs.

ED Team: When you provide assistance to entrepreneurs for raising capital, do you also help in traditional grant funding and bank funding?

Anurag: We have traditionally stayed away from helping entrepreneurs raise grants or debt capital. One of the reasons why we stayed away was because we were originally doing a lot of work in the microfinance sector, where raising debt is a part of normal business operations. As a result, microfinance companies usually have an in-house team that raises debt. Therefore, we had started off by focussing on raising equity. As we moved from the microfinance sector to other sectors, we have started offering debt services as well. Having our own set up that assists the entrepreneur to obtain grants and debt is an additional benefit that we offer to entrepreneur. It also needs to be remembered, getting a grant is also not easy and the entrepreneur would benefit from proper advice. In 'smart grants' – a new trend seen these days, the grant body asks a lot of questions that the entrepreneur has to respond to. Sometimes, it could be harder to get a grant compared to getting an equity investment.

ED Team: As an advisor, you interact with both the investors and investees. What is your perception on the expectations - is social sector investing any different from normal venture investments because of the word 'social' attached to it?

Anurag: Personally, I think social is just a branding tool for a differentiated positioning. There are many organizations which do not call themselves as social businesses, but still do good to the society and create an impact on the ground. Calling a business 'social' helps in securing funding. In a way, this can be seen as an extension of how the NGO sector grant selling has happened. Despite the 'social' tag, investors continue to expect the social entrepreneurs to meet the business plan targets and achieve the growth that they have promised to the investors.

ED Team: Do entrepreneurs find return expectations of investors to be a sticky point, or do they realise the importance of these returns?

Anurag: Entrepreneurs have a good understanding of what a bank loan is meant to be. They understand that the interest should be serviced regularly and the principal should be repaid at some point in time in the future. However, many entrepreneurs do not fully comprehend the way equity investors expect to realize a profit on their investments. Equity investments don't have interest payments and the entrepreneur gives up a part of his ownership in return for the equity funding. If the business does not do well, then the investor loses either some or all of the investment. However, if the business does well, the equity investor has an upside and returns could be as high as 100 - 200%. This return is not being paid by the company per se, but is being paid by the next investor. That is, the business will need more money to fuel growth and the subsequent investor will bring in the capital to realize this growth. Therefore the business or the entrepreneur per se is not returning the money to the investors.

However, the business is able to attract new investors to fund its growth due to the value that has been created. Thus investors expect that the promoters achieve the promised numbers and generate this value to attract new investments. Investors have a certain target IRR. Typically for a social fund it is in the range of 15% - 20% on an overall portfolio basis. Investors' return expectations on individual investments would be in the range of 25% - 30%, as they would need to cover up for the companies in their portfolio which have not performed well or those that have failed. If the investee companies do very well, it is not unusual for an investor to generate returns as high as 100% - 200% from some of their investments.

ED Team: What should be done to strengthen the ecosystem to increase the effectiveness of social enterprises?

Anurag: India is among the lowest ranked countries in terms of ease of doing business. For an entrepreneur, it is important to know the various steps involved in starting a new business. The ecosystem can be strengthened by simplifying basic laws around setting up a company, capital requirements, FDI requirements and labour law requirements. In simple words, the overall environment should be made easier.

The two biggest requirements of a business are people and capital. Typically an entrepreneur will start with a founding team up to three people. However, when the enterprise begins to do well, he will need to expand the team. Therefore it is critical to get the best possible manpower at a reasonable cost. Another important factor is capital and ease of raising capital. The ecosystem should favour getting the right kind of funding from the right kind of people with the right kind of expectations. A social entrepreneur needs the right market linkages and connections in addition to getting the capital. Basic infrastructure and access to relevant information should also be strengthened in the ecosystem to increase the effectiveness of social enterprises.

ED Team: What is the leadership India has in the impact investment space, and how is the future going to evolve?

Anurag: I am very bullish about the future of India in the impact investment space. India happens to be the epicentre of the impact investment movement. Maximum numbers of innovative and interesting business models in the social enterprise space that have been successful are from India. Also, globally, the maximum number of impact investments is happening in India. India constitutes a disproportionately large proportion of the portfolio of global funds. This is because the business models are more evolved here and we are talking about taking these models to other places as well.

One of the factors in our favour is a large and diverse market, and the reasonably well developed human capital. All this progress is despite not having the best business environment. I think the whole economic situation and the progress that we have made as a country among the developing countries is also in our favour. Since India has some natural advantages and already has a head start, I do see our country to be the leader in the impact investment space. Over time, I expect the social investment to become integrated as a mainstream investment activity, and for investors it will just make plain economic sense to be involved in this space and do business in this sector. I expect the 'social' branding to become redundant over a period of time.

ED Team: In such a case, do you think such social businesses will be able to attract funds from mainstream venture funds?

Anurag: There will always be different classes of investors. They are a continuum, with philanthropic form of investments in the one side and the hard core mainstream venture investments on the other side, and the remaining investors featuring in between these two extremes. Therefore entrepreneurs can pick their preference. However, a lot of what we are saying as a 'social enterprise' or 'impact investment' will probably be measured more on stronger business terms in the future and so these businesses should be able to attract mainstream capital. In fact, we have already seen a lot of such investments in the microfinance sector. Nevertheless, it is important not to go overboard in making tall claims. Instead both the entrepreneurs and the investors in this space should focus on their core business and try to run them in the most efficient and effective manner. This will not only ensure that these social businesses generate competitive returns that are attractive for mainstream investors but also create significant impact on the ground.

3. Patterns in the Investor - Investee dyad

Thillai Rajan A. and Pawan Koserwal

Chapter 2 provided an analysis on the impact investments in India. A successful venture investment transaction needs two participants - the investor and investee company. Accordingly, this chapter presents an analysis of the patterns seen in investor - investee dyad, i.e., the characteristics of both the investors and investee companies were included for analysis. The sample included a total of 114 investors, who had invested in the 523 deals.

3.1 Broad characterization of the investors

The investors were broadly classified on the basis of their focus and on the basis of their origin. On the basis of their focus, investors were classified into either a social or mainstream fund. On the basis of their origin, investors were classified as either a domestic of foreign fund. Definitions for these classifications are given in the Appendix.

Table 3.1 gives the distribution of investors in each of the classification. Foreign investors account for 61% of the total sample. Though this is a high proportion, this is lower than the overall proportion of foreign VCPE investors (71%) who have made an investment in India.[63] On the basis of investor focus, mainstream investors account for 61% of the total sample. This indicates the interest among the mainstream VCPE investors to invest in social sector enterprises, and these enterprises are capable of meeting the return and exit criteria of mainstream venture funds. Within the social segment, domestic investors account for one-third of the sample, and foreign investors account for the remaining two-third. Though India is one of the leading players in the impact investment segment, it is more a destination for attracting investment because of the large market size. India is yet to achieve leadership as a source of capital. These trends seen in impact investments, are similar to the trends in the overall VCPE industry.

Table 3.1: Number of investors in different categories

Investor origin	Investor focus		Total
	Mainstream	Social	
Domestic	29	15	44
Foreign	40	30	70
Total	69	45	114

Table 3.2: Investment by fund type

	Sample	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
No. of companies	165	100	103	112	82
Amount Invested ($, million)	1221.01	444.50	757.49	462.88	739.11
Deals	404	181	201	243	139
No of Investors	96	38	55	32	61

Table 3.2 gives the main features of investment by fund type. Both domestic and foreign investors have invested in roughly equal number of companies.[64] On the other hand, social investors have invested in more

number of companies as compared to main stream investors. The former have invested in 35% more companies than the later. However, as expected, mainstream investors have invested more than social investors. Taking into consideration the number of investors in each fund type, it can be said that, on an average domestic and social investors invest in more number of companies, whereas foreign and mainstream investors make higher investment per deal. A possible inference to this trend is that domestic and social investors often invest in the early stages of the business, where the funding requirement is lower. In the absence of dedicated SVC funds, it would not have been possible for so many social enterprises to get venture funded.

Table 3.3: Cross tabulation of no. of investors and deals

Fund type	Mainstream	Social	Grand total
Domestic	[29, 53]	[15, 174]	[44, 227]
Foreign	[40, 119]	[30, 144]	[70, 263]
Grand Total	[69, 172]	[45, 318]	[114, 490]

Note: In [a, b], a indicates the number of investors and b indicates the number of deals

Table 3.3 gives the cross tabulation of number of investors and deals by fund type. This analysis also includes deals for which fund amount was not available, and therefore the sample consists of a larger number of deals and investors than those in Table 3.2. The average number of deals by a social investor is 7.1, which is more than twice that of the mainstream investor (2.5). The average number of deals by a domestic investor is 5.2, whereas for a foreign investor it is 3.8. This supports our earlier finding that social and domestic investors are more active in funding social enterprises. Within the social fund, domestic funds have invested in more number of deals (11.6) vis a vis foreign funds (4.8). This indicates that setting up of domestic social VC funds can play an important role in funding more number of social enterprises.

3.2 Industry choice preferences of the investors

3.2.1 Sectors in the investors' radar

Generally, the investors indicate the industries in which they are keen to invest. This information for different investors was obtained from the websites of investors. While some investors are sector specific, i.e., they invest in one or two sectors only, others have indicated a fairly large interest preference set as their target sectors.

Table 3.4 gives the number of investors who have expressed an interest to invest in the different sectors. It needs to be remembered that, this is only an indication to invest in different sectors - the investors would not have actually made investments in all their sectors of interest. For the purpose of this analysis, the industry has been divided into eight different categories. Panel A in Table 3.2 shows the investor interest across the eight different industry categories. In the total investor sample, the largest number of investors have shown an interest in investing in the BFSI sector. The other industries that have high investor interest are Agriculture & Healthcare, Engineering & Construction, and Non-financial consumer services. If we analyse the investor interest of dedicated SVC funds, BFSI emerges as the industry that has the most interest among the investors. As a percentage of total investors in the sample, BFSI accounts for a similar percentage at the overall level and also within SVC category. The other sectors that have about one-third investors interested from the sample are Non-financial consumer services, Agriculture & Healthcare, and IT & ITES. Notably, many social investors have not shown an interest in the manufacturing sector, whereas, 36% of the total investors in the sample have identified the manufacturing sector as an area of interest.

Table 3.4: Investor interest in different industry categories					
Industry	No. of Investors	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
Panel A: Investor interest in different industry categories					
Agriculture & healthcare	52	23	29	3	49
BFSI	71	27	44	29	42
Engineering & construction	46	18	28	10	36
IT & ITES	55	22	33	14	41
Manufacturing	32	16	16	5	27
Travel & transport	9	7	2	1	8
Other services	22	10	12	9	13
Non-financial consumer services	52	26	26	11	41
Panel B: Investor interest in select sub-categories					
FMCG	3	1	2	-	3
Advertising & Marketing	4	2	2	-	4
Food & Beverages	19	13	6	-	19
Media & Entertainment	17	10	7	-	17
Hotels & Resorts	10	4	6	-	10
Shipping & Logistics	10	6	4	-	10
Telecom	6	2	4	-	6
Mining & Minerals	2	2	0	-	2
Diversified	2	1	1	-	2
Total	114	44	70	45	69

Panel B in Table 3.4 provides an illustrative list of investor interest in some of the sector sub-categories under the eight broad categories. While mainstream investors have indicated an interest in these sector sub-categories, none of the social investors have indicated an interest to invest in these sector sub-categories. This indicates that there is a level of sector specificity associated with social venture investments. Since some sectors have more developmental impact as compared to the others, they have the potential to attract investment from the SVC funds.

3.2.2 Sectors in which investment happened

Table 3.5 indicates the number of investors who have made at least one investment in the eight industry sectors. The objective of this is to find whether there are differences intent and actual investment. By and large, the trends seen in intent is reflected in the actual investment for the social investors. For example, the considerable interest to invest in the BFSI sector can be seen in the number of investors who have actually made an investment in the sector. 60 percent of the social investors in the sample have made at least one investment in the sector. At the overall level, 50 percent of the investors have made an investment in the BFSI sector. This indicates that social investors are more active in investing in the BFSI sector (which could be attributed to the investments in the microfinance companies) as compared to the mainstream investor. This underlines that financial inclusion is an important theme in social / impact investments. In all the remaining sectors, except those classified as "other services", the percentage of social investors who have expressed an interest to invest and the percentage of social investors who have actually made an investment are quite close.

While 20% of the social investors had expressed an interest to invest in a plethora of sectors that could not be grouped under the remaining seven sector categories, there has been no investment made in companies under this category.

Table 3.5: Number of investors who have made at least one investment in the various sectors

Industry	No. of Investors	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
Agriculture & healthcare	32	13	19	11	21
BFSI	57	20	37	27	30
Engineering & construction	16	5	11	9	7
IT & ITES	22	9	13	13	9
Manufacturing	4	2	2	4	0
Travel & transport	1	1	0	1	0
Other services	16	6	10	0	7
Non-financial consumer services	38	18	20	12	25
Total	114	44	70	45	69

3.3 Stage choice preferences of the investors

Investments have been classified into seven categories depending on the life cycle stage of the investee company, timing and/ or the quantum of investment. The interest to invest at different stages and the number of investors who have actually invested in these stages are given below.

3.3.1 Interest in investing in different stages

Table 3.6 gives the number of investors interested to invest in different stages of the enterprise. If the investors have indicated an interest to invest in more than one stage, then they would be counted in both the categories. For example, if a VCPE fund has indicated that it would invest in both early and growth stages, then it would be counted in both the categories. At the overall level, it can be seen that maximum number of investors (about 79% of the 114 investors) are interested to invest in the early stage of the business. At the same time, it needs to be noted that the count of investors in the early stage is not equal to the total number of investors in the sample. This indicates that not all of the investors invest in the early stage of the enterprise. There are some who invest only after the business has reached a certain stage. In terms of fund origin, 89% of the domestic investors have indicated an intention to invest in the early stage, whereas the comparative proportion of foreign investors is 73%. Early stage investment, particularly in impact investments, involves substantial risk and understanding of the local context. Since domestic investors are more familiar with the local conditions and are therefore able to assess the underlying risks in a better way, a larger proportion of domestic investors are prepared to invest in the early stage. An inference from this trend is that early stage investment can be stimulated by growth in domestic VCPE funds.

Analysis based on fund focus also presents interesting trend. While the proportion of social investors and mainstream investors who invest in the early stage of the business is more or less the same (~78%), there is a dramatic drop in the proportion of social investors who invest in the subsequent stages of the enterprise. For example, while the percentage of social investors who invest in the growth stage is 56%, in the case of mainstream investors it is 81%. An explanation for this trend is that SVC funds generally have a smaller corpus and therefore invest largely in the early stages of the business. Their fund management team is more familiar with the ground realities and are in a better position to evaluate and assume these risks. However, they might not be able to completely meet the growth and late stage funding requirements of the investee company. Mainstream investors, being larger in size, are able to support the larger funding needs of the enterprise. Therefore, setting up of more SVC funds facilitates early stage funding to social enterprises, but it is only the mainstream funds that can support the funding needs of the subsequent stages.

Table 3.6: Number of investors who have expressed interest to invest in different stages

Investment stage	No. of Investors	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
Early	90	39	51	35	55
Growth	81	30	51	25	56
Late	70	28	42	22	48
Other	21	8	13	10	11
Buyout	15	9	6	3	12
Pre-IPO	21	8	13	0	21
PIPE	26	8	18	2	24
Total	114	44	70	45	69

3.3.2 Stages in which investment happened

Table 3.7 gives details about the actual number of investors who have invested in different stages. It is interesting to note that 62% of the total number of investors have made at least one early stage investment. Analysing by fund type, it can be seen that the proportion of domestic investors and social investors making an early stage investment (68% and 77% respectively) is much more than that of foreign and mainstream investors (59% and 52% respectively). Since early stage financing play a critical role in start up companies, domestic and SVC funds can play a important function in nurturing and supporting social enterprises in a stage where they are most vulnerable.

Table 3.7: Number of investors who have actually made an investment in different stages

Investment stage	No. of Investors	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
Early	71	30	41	35	36
Growth	57	20	36	23	34
Late	42	15	27	19	23
Other	9	5	4	7	2
Buyout	4	2	2	3	1
Pre-IPO	-	-	-	-	-
PIPE	-	-	-	-	-
Total	114	44	70	45	69

Analysing the growth stage investments indicate that there is not much difference across fund types in the proportion of investors who have made at least one investment in the growth stage. This supports the previous finding that domestic and social investors play a predominant role in the early stage financing. For policy makers, an important implication is setting up more domestic SVC funds can clearly facilitate more early stage of funding.

3.4 Nature of investments by fund type

Table 3.8 gives the aggregate investment made by different fund types across different deal sizes. For example, $29.32 million of investment by domestic investors happened in those deals where the investment was less than $1 million. The total investment in deals where the value of investment was less than one million dollars by both domestic and foreign investors was $62.45 million. Table 3.8 indicates that, as the investment range increases, the ratio of investment made by foreign to domestic investors also increase. This shows that foreign investors make most of their investments in larger deal sizes as compared to domestic investors. Similarly, most of the investment by social investors has been in deals where the value was less than one million dollars. However, as the investment range increases, the proportion of investment by mainstream investors increases substantially. While the ratio of investment by mainstream investors to social investors is 0.32 for investment ranges less than one million dollars, it increases to 3.93 and 5.98 when the investment range is between $8 - $13 million and more than $13 million respectively. As the deal size increases, there is a decrease in investment from SVC funds. It is thus clear that SVC funds seek to invest in a clear niche - early stage investing at low to moderate investment amounts, that are not that the target of the larger mainstream venture funds.

Table 3.8: Distribution of deal size by fund type

Size of the deal ($, million)	Investment by fund type ($, million)		Investment by fund focus ($, million)		Total investment ($, million)
	Domestic	Foreign	Social	Mainstream	
<1	29.32	33.13	47.29	15.16	62.45
<3	104.60	113.21	155.49	62.33	217.82
<8	167.10	206.11	165.48	207.73	373.21
<13	88.71	180.73	54.68	214.77	269.45
≥13	54.76	224.30	39.95	239.12	279.07
Total	444.50	757.49	462.88	739.11	1202.00

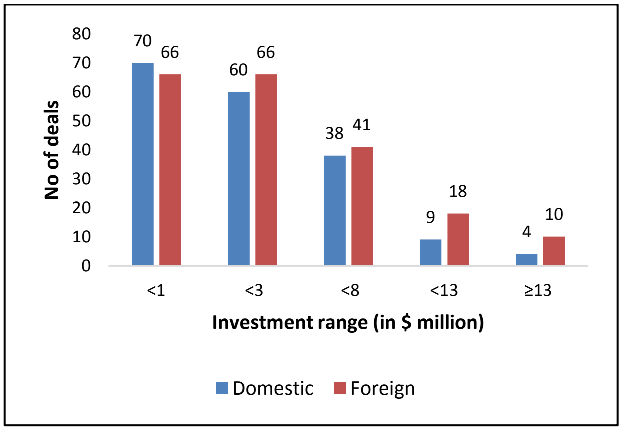

Figure 3.1: Investment amount by fund type

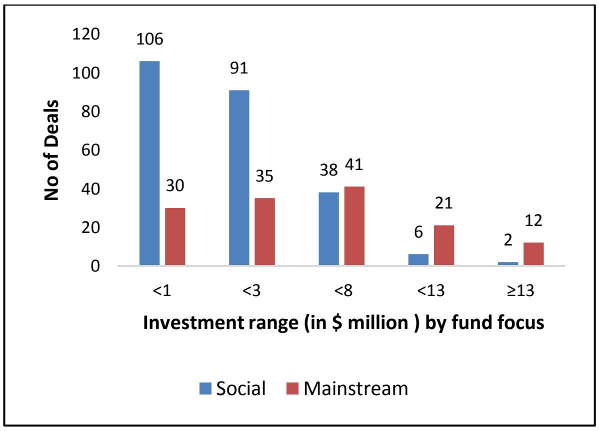

Figure 3.2: Investment amount by fund focus

Figure 3.1 indicates the number of deals by domestic and foreign investors in different deal sizes. It can be seen that there is a secular decline in the deals size as the investment amount increases. While domestic investors have made slightly more number of investments where the deal value was less than one million dollars, for all the remaining investment ranges, number of investments made by foreign investors are higher. Figure 3.2 indicates the number of deals by social and mainstream investors in different deal sizes. Similar to the trends seen for fund origin, there has been a secular decline in the number of deals, with increase in investment amount. While SVC funds have invested in more number of deals at lower investment ranges, the trend gradually changes as the investment amount increases. Though the number of deals are lesser, mainstream investors have made more number of investments at higher investment levels.

3.5 Exit and investment duration

3.5.1 Exit from investee companies

Exit from portfolio companies play an important role in the venture investment lifecycle. Venture funds realize returns on the investment only upon successful exit from their portfolio companies. Our sample had a total of 36 exit deals in 20 companies comprising 26 investors (including partial exits). Thus the proportion of companies that have provided an exit to their investors is 9.4%. This is lower than the proportion seen for the overall VCPE investments in the country (15.1%).[65]

Table 3.9: Type of exits by investors

Type of exit	Total exit deals	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
IPO	9	2	7	1	8
M&A	27	11	16	12	15
Overall exits	36	13	23	13	23

Analysis of number of exits indicates that foreign investors and mainstream investors have been able to realize more exits as compared to domestic and social investors. This could be attributed to the fact that domestic and social investors invest in early stages and therefore need more time to exit. Second, on an average, there are more number of mainstream or foreign investors in a firm as compared to the numbers of social or domestic investors. The pattern of exit is not very different between the different investor types. Across all categories, M&A is the most frequent mode of exit. Table 3.10 provides additional information on the number of companies and the number of investors for both type of exits.

Table 3.10: Number of companies and investors with exits

Type of exit	Total	Investor by fund origin		Investor by fund focus	
		Domestic	Foreign	Social	Mainstream
IPO	[3, 9]	[2, 2]	[2, 7]	[1, 1]	[3, 8]
M&A	[18, 19]	[10, 8]	[8, 11]	[12, 8]	[9, 11]
Total	[20, 26]	[12, 10]	[9, 16]	[12, 8]	[12, 18]

Note: In [a, b], a indicates the number of companies and b indicates the number of investors

3.5.2 Duration of investment before exit

Table 3.11 and 3.12 shows the pattern in investment duration before exit. Investment duration is the amount of time the investor had stayed invested in the company. The results indicate that majority of the exits have been seen in the category where the investment duration is between 2 - 4 years.

Table 3.13 provides the cross tabulation of average duration of investment before exit for different fund types. The results provide confirmation of the patient nature of SVC and domestic venture funds. It can be seen that the average investment duration of a social fund is 57 months, whereas it is 46 months for a mainstream fund. Similarly, the average duration of investment by domestic fund (54 months) is also higher than that of a foreign fund (47 months). On the whole, the average duration of investment in social enterprises is 50 months, which is substantially higher than the average investment duration of 17 months for overall VCPE investments in India.[66] The big difference in investment duration is actually seen between the domestic mainstream and domestic social investors. The average duration of investment for domestic social investors is 65 months, which is 71% more than the average duration of investment for domestic mainstream investors. Since social enterprises are expected to take more time in scaling up, they would need investors who can stay invested in the company for a longer duration, and who would not unduly pressure the entrepreneurs to provide them a quick exit. Our results show that social venture funds have been able to provide the patient capital that entrepreneurs in the social sector require.

Table 3.11: Duration of investment before exit (by fund focus)

Investment duration (months)	Total Exit deals	IPO		M&A	
		Social	Mainstream	Social	Mainstream
<24	8		2	1	5
<48	15	1	4	5	5
≥48	13		2	6	5
Total Exits	36	1	8	12	15

Table 3.12: Duration of investment before exit (by fund origin)

Investment duration (months)	Total Exits	IPO		M&A	
		Domestic	Foreign	Domestic	Foreign
<24	8		2		6
<48	15	1	4	5	5
≥48	13	1	1	6	5
Total Exits	36	2	7	11	16

Table 3.13: Average investment duration before exit (in months)

Fund type	Mainstream	Social	Average
Domestic	38	65	54
Foreign	48	45	47
Average	46	57	50

3.5.3 Duration of investment in existing investments

Table 3.14 provides the cross tabulation of investment duration in existing investments. In the 203 companies where investors are yet to exit, 145 of them (71%) have received investment from SVC funds. Mainstream venture funds, however, have invested in only 44% of the companies. A possible inference is that growth in the SVC funds can play an important role in more social enterprises getting funded. Table 3.15 indicates the average duration of investment in enterprises where the investors yet to exit. The results are consistent with those seen in Table 3.13. SVC funds have a higher average invested duration among the different investor types. The overall average duration of investment in existing investments is 38 months, i.e., just about three years, indicating the social investing in India has been a recent phenomenon.

Moreover, it can be seen that the average investment duration of existing investments is lower than the average investment duration for companies where investors have exited. This is how it should be, for it would have been a cause for worry if it had been otherwise. If the average investment duration of existing investments had been higher, it would have indicated an unhealthy portfolio, where firms are finding it difficult to provide an exit to investors. On the other hand, a lower investment duration in current investments shows that, (i) most of the investments are recent; (ii) there is nothing that specifically indicates the poor health of current investments; and (iii) with time, these investments could provide an exit to their investors.

Table 3.14: Fund type and existing investments

Fund type	Mainstream	Social	Total
Domestic	[36, 25]	[92, 15]	[119, 40]
Foreign	[63, 34]	[80, 29]	[124, 63]
Total	[89, 59]	[145, 44]	[203, 103]

Note: In [a, b], a indicates the number of companies and b indicates the number of investors

Table 3.15: Average invested duration in the existing investments (in months)

Fund Type	Mainstream	Social	Average
Domestic	33	43	41
Foreign	35	37	36
Average	34	40	38

Figure 3.3 provides the duration of investment in the current portfolio of companies. It can be seen that social investors and domestic investors have a high proportion of deals (73% and 76% respectively) where the investment duration has been 24 months or more. The corresponding figure for both mainstream and foreign investors is 68%. SVC investors account for the largest deals where the investment duration has been six years or more. Out of the total 36 deals, where the investment duration has been six years or more, 30, i.e., 83% are pertaining to investments by SVC investors.

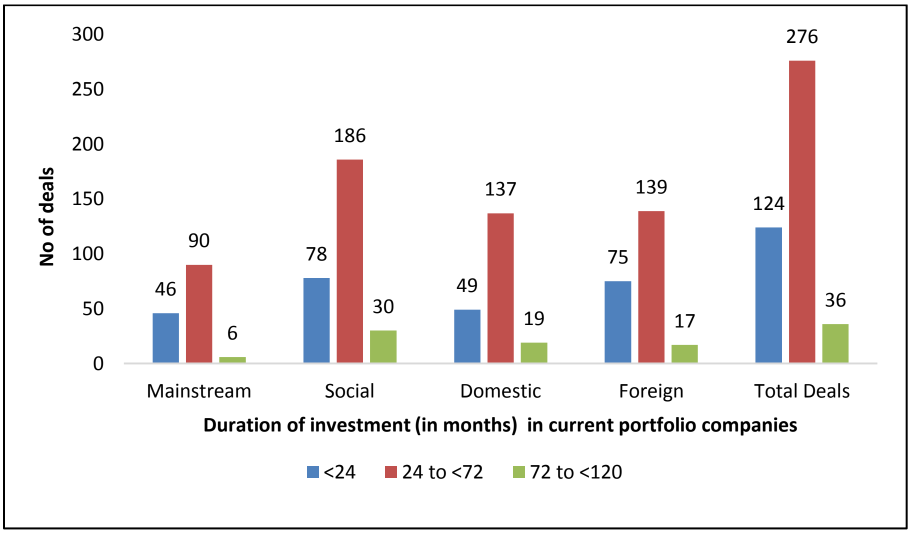

Figure 3.3: Duration of investment in current portfolio companies

3.6 Impact investors as investment catalyst

One of the important roles of SVC funds is their ability to facilitate additional investments from larger mainstream investors. We identified those companies that had investment from both SVC and mainstream venture funds to estimate the impact of SVC funds as a financial catalyst. The following companies were included in the analysis: (i) Companies that had first received investment from SVC funds before mainstream venture funds; and (ii) Companies that had simultaneously received investment from both social and mainstream venture funds. Those companies where investment from mainstream venture funds preceded investment from SVC funds were excluded from the analysis.

Table 3.16 gives the results of the analysis. It was seen that 41 companies out of the sample of 212 companies had investment from both social and mainstream investors that met the criteria listed above. The total investment in these 41 companies was $607.49 million. 31% of the investment ($188 million) was from social investors, and the remaining 69% ($419 million) was from the mainstream investors. Thus, on the whole, a dollar of investment from SVC funds is associated with an investment of 2.2 dollars from mainstream investors. In terms of number of deals and number of investors, it was seen that investment from 31 social investors had resulted in investments from 39 mainstream investors. While the average investment per deal by a social investor was $1.46 million, it was $4.11 million in the case of a mainstream investor. The results indicate that, though the SVC funds make smaller investments per deal, their presence leads to a certification effect, thereby leading to a larger investment by mainstream venture funds.

Table 3.16: Social venture funds as financial catalysts

No of companies	Mainstream investor (% of Amount invested)	Social investor (% of Amount invested)	Total amount ($ million)
41	69%	31%	607.49
	Mainstream investor (Deals, No. of investors)	Social investor (Deals, No. of investors)	Total (Deals, No. of investors)
	102,39	129,31	231,70

3.7 Summary

Key findings of our analysis can be summarized as follows:

- On the basis of fund origin, foreign as well as mainstream investors account for 61% of the total investors. Though India is one of the leading players in the impact investment segment, it is more a destination for attracting investment because of the large market size. India is yet to achieve leadership as a source of impact investment, a trend that is in line with the overall trends in the VCPE industry.

- Social investors have invested in more number of companies as compared to main stream investors. However, in terms of amount invested, foreign investors and mainstream investors have made more investment. On an average domestic as well as social investors invest in more number of companies, whereas foreign and mainstream investors make higher investment per deal.

- While maximum number of investors (about 79% of the 114 investors) are interested to invest in the early stage of the business, not all of them have actually made early stage investments. In terms of fund origin, 89% of the domestic investors have indicated an intention to invest in the early stage, whereas the comparative proportion of foreign investors is 73%.

- While the ratio of investment by mainstream investors to social investors is 0.32 for deal sizes less than one million dollars, it increases to 3.93 and 5.98 when deal size is between $8 - $13 million and more than $13 million respectively. This underlines that SVC funds make smaller investments per deal, as compared to foreign investors.

- Foreign investors and mainstream investors have been able to realize more exits as compared to domestic and SVC investors. This could be attributed to the fact that domestic and social investors invest in early stages and therefore need more time to exit. Second, on an average, there are more number of mainstream or foreign investors in a firm as compared to the numbers of social or domestic investors. Across all categories, M&A is the most frequent route to exit.

- Social investors are prepared to stay invested in a company for a longer duration as compared to other fund types. The average investment duration of a social fund is 57 months, whereas it is 46 months for a mainstream fund. On the whole, the average duration of investment in social enterprises is 50 months, which is substantially higher than the average investment duration of 17 months for overall VCPE investments in India.

- In the 203 companies that have received some form of impact investment and where investors are yet to exit, 145 of them (71%) have received investment from social venture funds. Mainstream venture funds, however, have invested in only 44% of the companies. Social investors also have a highest average duration of investment in the existing investments. The overall average duration of investment in existing portfolio of companies is 38 months, i.e., just about three years, indicating the social investing in India has been a recent phenomenon.

- A dollar of investment from social investors is associated with an investment of 2.2 dollars from mainstream investors. Though the social venture funds make smaller investments per deal, their presence leads to a certification effect, thereby leading to a larger investment by mainstream venture funds.

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Scale critical for impact

A conversation with Ronnie Screwvala

Ronnie Screwvala is a first generation entrepreneur, founder and CEO of the UTV Group and also a social philanthropist. Ronnie's philanthropic initiatives are through his family foundation – The Swades Foundation – and are focused on villages in Maharashtra. His investment vehicle is Unilazer Ventures Ltd, which is For Profits and invests in the impact sector along with tech/ ecommerce and other sectors. He, therefore, spans both ends – social and not for profit funding via Swades Foundation and for profit impact investments via Unilazer Ventures. In addition to winning several accolades, Ronnie was also featured in the annual list of 'Heroes of Philanthropy' compiled by Forbes Asia.

Swades works in several areas of rural development including education, healthcare, sanitation, clean water and rural livelihood and has a five to seven year goal to empower and make self-sustainable the approximately one million population it has identified to work with. Unilazer Ventures on the other hand takes an equity stake in companies and looks at various asset classes, including for profit impact investments in agriculture, education, healthcare, microfinance and rural consumption, along with other high growth sectors connected to the India consumption story.

ED Team: What would be your views on impact investing and investing in commercial ventures? How different are they?

Ronnie: They should not be and are not different. Why should investing in impact sectors not be commercially viable? So let's take some of the "impact" sectors – agriculture, health care, education. Do we think these are non-commercial sectors?! Far from it! They are some of the sunrise sectors for a market like India. Do we think that by giving them "commercial" benchmarks, we will not be able to create impact? Wrong! Quite the opposite! This is a flawed theory, one that needs to be corrected. It's time to strike the right balance as only then will we see scale and success, otherwise it will remain a "grant and subsidy" dependant sector and the net impact will be much much less.

ED Team: What is the difference between impact investing in India and that which is done in other countries?

Ronnie: In an evolved, mature and advanced economy, Impact has a different Ask – as it's more about better technology, better life styles and a lot more about the "next level". In an existential economy, and India comes under that category, impact is a lot more about basic innovations, and impact is at the core of existence of life - health and well-being, and more. So the parameters are different and the focus to solutions is very different. Impact investing, therefore, is very different.

ED Team: What is the relation between achieving scale and creating the impact?

Ronnie: Keeping India's context of basic needs in mind, it is clear that we need investments to impact many sectors. Scale is going to be the most important thing as we need breakthroughs on a massive scale. To achieve this, investments need to be fundamentally commercial. We need to enter sectors that are going to be life changing, because if something is life changing then it is impactful. If a business needs to be life changing, then it has to be scalable. With India having 1.2 billion people, we cannot afford to have just a small impact. If the impact is not large, it will not really be an impact. Creating a large impact means achieving scale. Simply put, to make the business really impactful, it is important to achieve scale.

For example, consider a small business which makes potable water and which has obtained funding from a small fund. If the business really needs to be life changing, there is a need to increase it in size, scale higher and reach a larger market. In order to scale, there is a need for the business to secure more funding from larger investors. When large investors look at low margins of the business, they may not be willing to invest in the business, as these may be funds which invest in potentially high profit businesses. The entrepreneur may not understand the significance, as the initial investors, carrying the 'social investors' labeling may have been fine with the lower margins, and this would not have encouraged him to increase the margins. Thus the mismatch in returns expectations can harm the scaling up process of the business. This is why there should be no categorization between a social investment and a commercial investment.

ED Team: Sometimes there is a mismatch in expectations of scaling between the entrepreneurs and the investors. What is your view on this?

Ronnie: Venture capital funds today are beginning to understand that scale just does not mean an increase in the size of the company. Value is sometimes created by growth in the top line, sometimes it is a margin business, sometimes it is an impact business and sometimes it is a brand business. There are people who might look at profitability differently because they create a mindshare and a brand which will then convert to a much larger scale. Therefore scaling can have different meanings. This depends on the way the project is presented to the investors and the basis on which the funds are raised. For example, some businesses may look at investing in R&D for the first couple of years, and this will help in scaling and creating an impact after these 2 years. The investors who invest in that stage of the firm may be fine with such a model and may invest on this basis.

ED Team: What is the limitation of the grants model and the philanthropy model?

Ronnie: Grants and subsides are from the government and these are made to give a fillip to a sector which is new. It is fine as long as there is a set road map to put the sector on its feet, go forward and then build it. After the desired results have been achieved, the grants should be phased down gradually. But in most cases, this is not done. For instance, when many governments in the West continue to support certain sectors with grants for a long period of time, they actually kill the commercial viability of those sectors there. If the grants are not phased down gradually after the initial years, such sectors never make money, as there is no profit discipline in them.

Even in philanthropy, there is a similar problem. When a philanthropist thinks that, say, a village will need donations lifelong, then the philanthropic capital does not really create a permanent change. Most philanthropic models do not ask basic questions of how the capital will be used to make a reliable plan such that the entity / village / individual can stand on its own eventually. This is the main limitation of the grant model and the philanthropic model.

ED Team: How does Unilazer Ventures participate in the social sector as an investor?

Ronnie: Unilazer is committed to the social sector through the Swades Foundation. Our key focus is to make permanent change. This, therefore, requires monitoring constant change and impact. We believe permanent change cannot take place without substantial upliftment of livelihood for each of the families where we work. We work closely to enhance water, health, and education – invest all our efforts in training and sharing knowledge and engaging with the community, so they can take full responsibility for their own upliftment. But the final and lasting change is when they can stand on their own feet and take care of their family and their needs and one singular focus is to help them get there. After that, they do not need any of our help – just our support from the outside.

ED Team: Is impact investment different from traditional venture capital investment?

Ronnie: Right now, there is a difference and this is mainly because of the perception in everyone's minds. Normal venture capital views this business as a social business, which requires a specific fund that can work with lower returns. This approach is flawed and not correct. The problem is that the impact brand has been made out to be a social brand. All funds should view impact sectors in India as high growth and for profit sectors that can create shareholder value as well as create impact.

ED Team: Would you agree that the impact investment model in India addresses products and services to the bottom of the pyramid?

Ronnie: Bottom of the pyramid should not be construed as 'social'. For example, Unilever which sells shampoo sachets at a price point that also addresses the bottom of the pyramid, do not claim to be 'social'. The bottom of the pyramid actually means a massive market which can be serviced by offering the right product or service at the right price. The right price should be a sustainable right price and not a subsidized right price. The BRIC countries have been identified primarily due to the huge market potential available on the back of the bottom of the pyramid. Therefore this potential should not be addressed as 'social' or 'impact', as this does not compare correctly with the definition of 'impact' in other countries, which is much more sophisticated.

ED Team: How has the impact segment evolved over the years?

Ronnie: The impact sector is just getting noticed. But the problem has been of communication and positioning. There is no forum where success stories are discussed at length and these do not receive national attention. Entrepreneurs in this space also do not seek to celebrate the innovations. So although this sector has evolved, success stories usually do not receive much attention or publicity.

ED Team: Have there been any changes in the way entrepreneurship has been perceived in the country over the past few years?

Ronnie: Sadly, there has not been much change in the way entrepreneurship is viewed in this country over the last 2 decades. The perception continues to be that of – "if one cannot manage to get a job and be employed successfully, then entrepreneurship is the back-up option". This is a ridiculous thought process. Entrepreneurship needs much higher acumen in terms of the vision, guts, execution and more, when compared to a regular job and therefore should be idealized, promoted and glorified.

It is not easy to do business in India and most entrepreneurs are disadvantaged as the ecosystem doesn't support them with good mentoring options and funding options. Therefore, I don't think the ecosystem has changed significantly over the years. I also hope that the ecosystem doesn't change to the extent that it is difficult to get a job and therefore people turn to entrepreneurship. Such forced entrepreneurships may not yield the right results.

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4. The performance differential

Thillai Rajan A., Pawan Koserwal, and Keerthana Sundar

This chapter attempts to capture the differences among investors when they are classified on the basis of the number of deals and amount of investment. This chapter also presents the exploratory findings of a comparative study of microfinance companies that had venture investments vis a vis those that did not have any venture investment.

4.1 Quartile classification of investors

Investors were categorized into two quartile classifications: one, on the basis of the number of deals, and two, on the basis of amount invested. For the quartile classification based on the number of deals, the interval between the venture investor that invested in the highest number of deals and the venture investor that invested in the lowest number of deals was classified into four equal intervals. The investors were then classified into respective quartiles depending the number of deals they have invested. For the quartile classification based on the amount of investment, the interval between the venture investor that had invested the highest aggregate amount and the venture investor that had invested the lowest aggregate amount was classified into four equal intervals. The investors were then classified into respective quartiles depending on the total aggregate amount they had invested.

Table 4.1 gives the results when the quartile classification was based on the number of deals. It is seen that in the top quartile, there is only one investor, and in the second and third quartile there are only five investors. This indicates that a large number of investors who invest in social enterprises are not very active, and they are probably making only one-off investments. The average investment per deal increases with the increase in quartile numbers, indicating that investors who invest infrequently make larger investments, whereas those who invest frequently make smaller investments. Top two quartile investors in this classification have a significantly higher proportion of deals in early stage as compared to bottom two quartile investors. The average investment duration in a portfolio company is also higher for the top quartile investor as compared to that of the bottom quartile investor. It can be thus seen that there are significant differences between the top quartile and the bottom quartile investors. The investment practices of top quartile investors are more attuned to the needs of the impact investments, and if the industry needs to grow, then there is a need to have more number of top quartile investors.

Table 4.1: Investors separated by number of deals

Quartile	No. of investors	Average No. of deals	Average investment per deal ($, million)	Average investment duration (in months)	Total average investment per investor ($, million)	% of deals in early stage
1	1	43	1.18	53	34.4	54%
2	5	26	0.97	47	19.9	58%
3	5	17	3.29	46	47.5	22%
4	106	3	5.27	34	10.1	37%
Total	117	4	2.82	35	12.7	50%

Table 4.2 gives the results when the quartile classification was based on the amount of investment. The number of investors in the top two quartiles are low as compared to the fourth quartile, indicating that there

are just a handful of investors who have made higher investments in social enterprise segment. The top quartile investors also have average investment per deal as compared to bottom quartile investors. No significant trends could be observed in the average investment duration for the different groups. Top quartile investors have a lower percentage of deals in early stage as compared to the bottom quartile investors - which explains the high average investment per deal by the top quartile investors. While it is important to have investors who will fund all stages of the enterprise, it is important to have more investors who will fund more early stage enterprises, which in turn will create a pipeline for growth and late stage investments. The quartiles based on aggregate investment amount indicates that there are a large number of investors who are in investing in early stages. However, when inferred in conjunction with the findings in Table 4.1, it can be seen that many of these investors are investing infrequently. The need of the hour is to not only have more early stage investors, but also to have investors who make more number of investments.

Table 4.2: Investors separated by investment amount

Quartile	No. of investors	Average No. of deals	Average investment per deal ($, million)	Average investment duration (in months)	Total average investment per investor ($, million)	% of deals in early stage
1	2	14	7.75	40	84.1	14%
2	2	8	27.36	50	50.0	24%
3	10	10	5.73	45	33.8	35%
4	82	4	4.13	36	7.5	39%
Total	96	4	4.85	38	12.7	45%

4.2 A comparison of microfinance companies with and without venture investments

An exploratory attempt has been made to see the impact of venture funding in investee companies in the social sector. Since the sample consists of a large number of microfinance companies, we decided to consider only microfinance companies for this analysis. Firm level data on microfinance companies were obtained from MIX[67], which is a leading source of information on performance of microfinance companies. Recent financial and operating information on various microfinance companies operating in India were obtained from MIX. We identified the list of microfinance companies that had received venture funding from our dataset and did a comparative analysis on companies that had received venture funding vis a vis those that had not. In all, firm level data for microfinance companies was obtained from 125 companies, out of which 45 had received venture investment in some form. Given the reasonable size of the sample, the results are expected to be reasonably representative of the industry trends.

Results are given in Figures 4.1 - 4.4. It can be clearly seen that microfinance companies that had received venture funding are clearly larger than those that had not received venture funding. On an average microfinance companies with venture funding had more number of borrowers, had higher gross loan portfolio, employed more number of people, and had a higher amount of financial revenue. The results are consistent for the all the three years. Table 5.3 gives the comparative CAGR for both the groups. Again it can be seen that, CAGR of venture funded microfinance companies are higher than those that had not received venture funding. Not only are the venture funded microfinance companies larger, but they also grew faster during the study period.

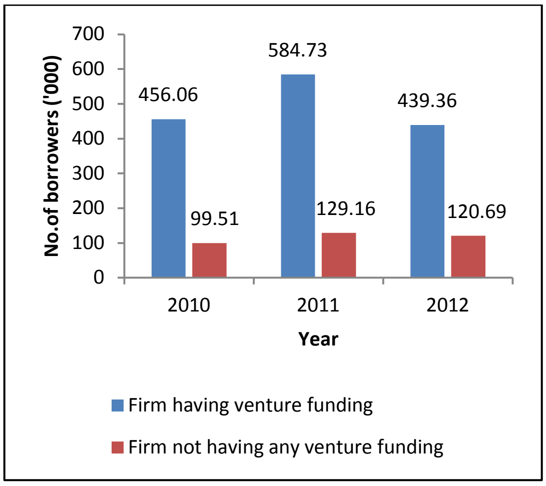

Figure 4.1: Average active borrowers

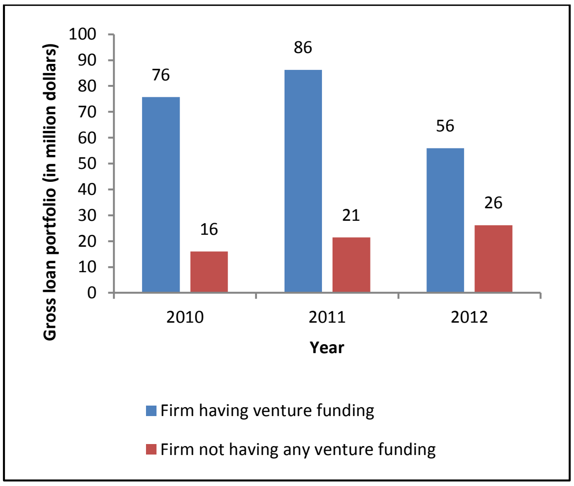

Figure 4.2: Gross loan portfolio

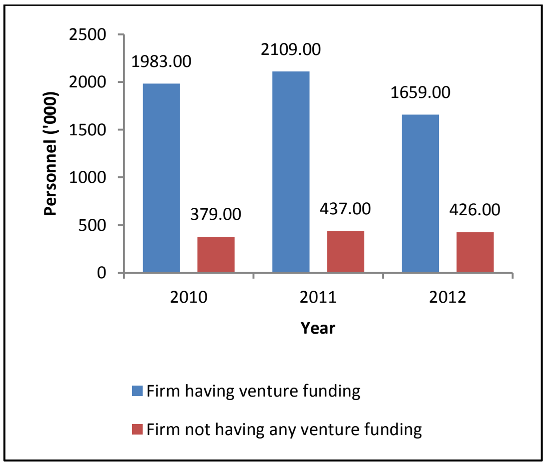

Figure 4.3: Average personnel

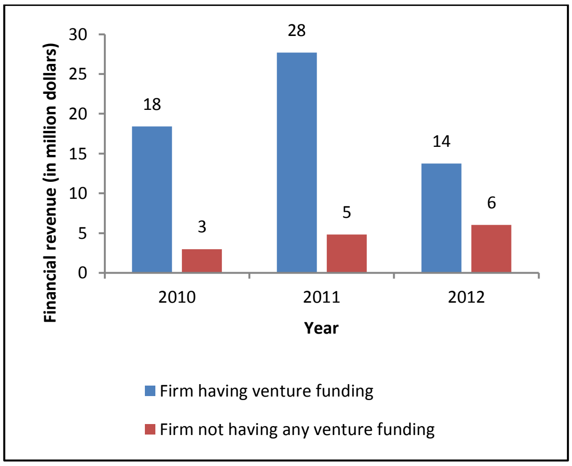

Figure 4.4: Average revenues

Table 4.3: Comparison of mean CAGR rates (2010-12) for microfinance firms

Growth parameter	Firms with venture investment	Firms without venture investment	Total
No. of borrowers	34%	10%	18%
Gross loan portfolio	60%	11%	29%
No. of personnel	16%	13%	14%
Financial revenue	55%	29%	41%

Figure 4.5 and 4.6 gives the profit margin and debt-equity ratio for the two groups. Surprisingly, it can be seen that for two of the three years, microfinance companies with venture funding had lower profit margins. A possible explanation for this is that their profit margins are compromised because of their higher growth rates. Firms with venture funding have lower debt to equity ratios, indicating lower risks due to leverage. This could

be an impact of venture fund investment, as they stress on good governance and avoiding excessive risks. Figure 4.7 indicates that microfinance companies with venture fund investments have lower productivity ratios. A possible explanation for this is that venture funded companies pursue a path of rapid growth and scaling up, which can affect some of the productivity measures in the short term.

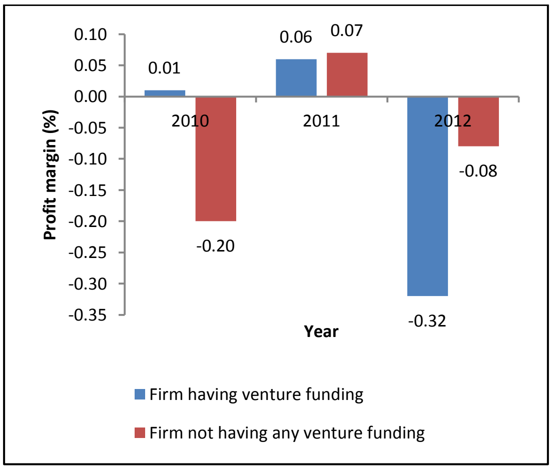

Figure 4.5: Average profit margin

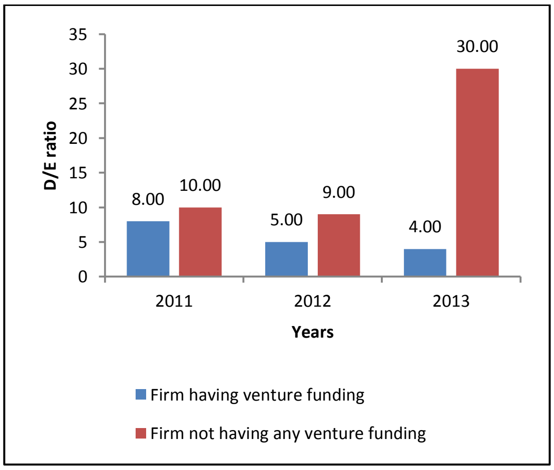

Figure 4.6: Average debt equity ratio

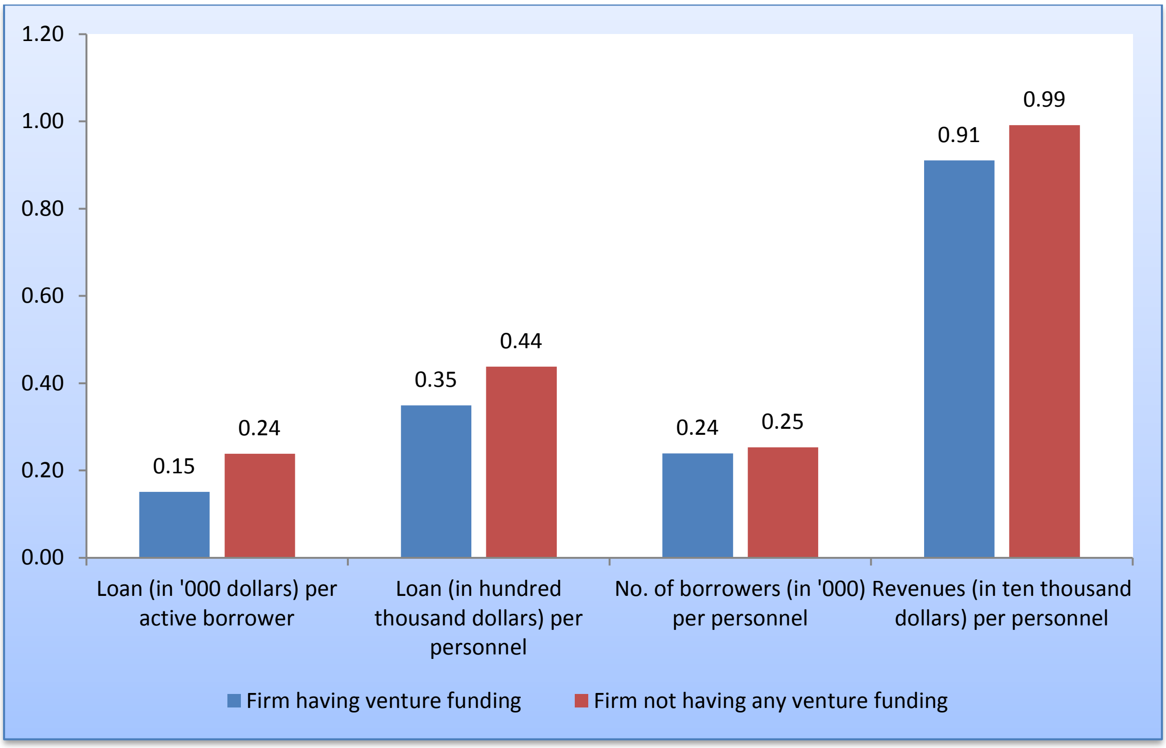

Figure 4.7: Productivity ratios

4.3 Summary

The analysis on investors separated by the number of investments and the amount of investment indicates key differences between the top quartile and bottom quartile group. Top quartile investors by number of deals invest lower amounts per deal but make more number of early stage investments as compared to bottom quartile investors. They also have a longer average duration of investment. Top quartile investors by amount of investment invest higher amounts, but have lower early stage investments. It is important that there are not only more number of early stage investors, but also have early stage investors who invest frequently.

Comparative analysis of microfinance companies with and without venture fund investment indicated that the former are larger and show faster growth as compared to the latter. They also have lower leverage risks as compared to the latter. On the other hand, microfinance companies without venture fund investment showed higher profit margins and higher productivity ratios. The lower productivity ratios for venture funded companies could be attributed to the rapid scaling and growth trajectory pursued by these companies.

Our analysis does not show whether the larger size and higher growth seen in venture funded microfinance companies can be attributed to venture investors or to the strength of the entrepreneurial team. In other words, we have not studied whether the venture investors simply select better performing companies (or larger companies) or whether the companies that they invest perform better because of the investors' value addition. This can be a topic of future study. The venture investors play an important role when even selecting better performing companies - by providing support to superior companies, they are able to weed out the laggards and thereby strengthen the microfinance ecosystem.

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Sustaining the impact

A conversation with Anil Sinha

Anil Sinha is the Regional Head, Advisory Services of South Asia region at IFC and is based in New Delhi. With close to 30 years' experience in private sector development, Anil has worked in different areas ranging from project design and implementation to consulting. At IFC, Anil looks at increasing the development impact of the private sector through sustainable and inclusive business models.

IFC, set up in 1956 is a part of the World Bank group and focuses on the development of the private sector in developing countries. IFC's services include investment services (including debt and equity products) and advisory services. In terms of direct equity investments in private sector enterprises, IFC has invested about $12.5 billion globally during the five year period 2007-12. These investments were done in 633 enterprises. For the same five year period, the total investment made in India was $6.6 billion in 165 enterprises. The total investments in inclusive businesses during the five year period have been $6.7 billion, out of which $668 million have been to enterprises in India.

ED Team: What is the broad vision of IFC in terms of using private capital for the social sector? How does this fit into the bigger vision of IFC?

Anil: IFC provides both equity and debt to the private sector. We also help in capacity building in the form of providing advisory services to the private sector. The core aspect of our business is to work with companies that impact the base of the pyramid and be involved with them across the board. We work with both large companies as well as with smaller companies, which involves both a top-down and a bottom-up approach. Usually investments are made with the objective of scaling up or expanding a business. IFC also supports inclusive innovation that happens within large corporations. There is a separate group within IFC, called the inclusive business group, which looks at high bottom-of-pyramid businesses. The group provides both financing and advisory services. For example, we provided both equity and debt to a company called Financial Inclusion and Network Operations Limited (FINO), an India based financial inclusion facilitator. Our advisory services team worked with FINO for 4 years. Today FINO has 60 million customers in their total portfolio. This is an example of an inclusive innovation which originated from a large financial institution, in this case ICICI Bank. As regards examples of bottom up innovations we have been working with many social enterprises, such as Water Health International, Attero etc. This segment of investment is very integral to IFC as well as to the World Bank Group's vision of shared prosperity.

ED Team: Are there any specific metrics that you look at in inclusive business models which are different when compared to the conventional investment space?

Anil: When we look at inclusive business models, the primary criterion to be satisfied is that the impact should be created at the Base of the Pyramid (BOP). Measurement of the impact created is also important. In order to achieve this, IFC works very closely with the enterprise to measure the impact created as well as to overlay this impact with the specific needs of the particular area or district. More importantly, it is critical to undertake rigorous monitoring and evaluation to ascertain if the impact is being created on a continuous basis. We have a strong evaluation team for South Asia that works with companies to clearly identify the impact. The BOP segment is a unique segment in its own right, with unique needs. It is important to understand the needs of this segment in order to successfully do business in this segment. In my opinion, one reason why many BOP impact investments are not successful is because they have not understood the buying trends of the BOP segment or their unique needs.

ED Team: Would large construction companies providing employment opportunities to people at the bottom of the pyramid qualify as inclusive business models?

Anil: Skill development is critical. This is a good model where construction companies provide skills to potential workers in the rural areas. They offer mechanisms and training schemes to people at the BOP and guarantee them employment. I think this is a valuable development contribution. The development impact created by opportunities provided by such companies cannot be underestimated.

ED Team: Is there a trade-off between social and financial returns in the case of investments in inclusive business models compared to conventional corporate investments?

Anil: At IFC, we do not see any duality in financial returns and the development impact created. We also do not set any limits as such on financial returns. Instead, we look at the sustainability of the business and the impact created. If the business is profitable, then it means it will be sustainable in terms of the development impact created. Therefore, profitability and social impact are not two different issues. In fact, as we deal with private sector companies, it is very important that our investments need to be profitable, in order to ensure that the development impact is sustainable.

ED Team: What would be the advantages of an investment style approach in the social investment sector, compared to traditional grant making models?

Anil: In the case of social enterprises, it is critical that the development impact created should be sustainable. If a social enterprise relies on grants on a continuous basis, the sustainability of the impact it creates would depend on the grants which may dry up. However, if such a social enterprise can be profitable based on commercial finance, then the development impact created will be sustainable.

It is acceptable when start-ups look at the grants route initially. However, eventually scalability and sustainability is best achieved by graduating commercial finance. IFC has advisory assistance programs that help social enterprises to scale initially and fine-tune the business model. Nevertheless, the company should continue to grow and be sustainable after a certain stage. This is possible only by opting for funding from commercial sources. A social enterprise can create sustainable impact only if it progresses across the entire spectrum of financing sources - from pure grants to philanthropy to incubation to semi-commercial finance and finally to commercial finance.

ED Team: Given that IFC operates in many emerging markets, what is the scope and potential for India to become a leader in impact investments segment?

Anil: India has a huge potential to be a leader in developing inclusive business models. This is especially true in the case of development of bottom-up business models. Some regions in the world are very strong at the top-down approach. For example, Latin America has a very strong organized sector, with many big landholding companies and hybrid processing companies. As a result, there are many models originating with large corporates, which impact the base of the pyramid. Although India also has these types of models, our uniqueness is in bottom-up business models. The innovation and development which has been taking place in the bottom-up business models is unique to India and also reflects the high entrepreneurial ability of the people in India.

ED Team: In India, the bottom of the pyramid is very large, presenting a huge market opportunity for funding in this segment. Is this a major attraction for global funding agencies?

Anil: As you rightly said, India has a huge market and therefore the needs are also vast. In addition to having a large market opportunity, India has a high level of entrepreneurial ability which can drive the innovation needed. Another important factor needed to drive innovation is technology. India has a strong technological base which is used in innovations to create a positive impact at the base of the pyramid. These conditions present a huge opportunity in this sector for global funding agencies for supporting such initiatives.

ED Team: As an investor in the microfinance space, would you consider that the microfinance sector really meets the needs of the bottom of the pyramid and how would you view the criticism that this sector has been subject to?

Anil: The microfinance sector provides livelihood finance to the BOP, which is a very important and necessary aspect of improving the lives of the people at that level. IFC is very much supportive of this sector. After the crisis hit the sector and there was severe shortage of funds, we felt that some of the more responsible MFIs will be affected. IFC made its biggest investment in the microfinance sector in India to support this sector. We support a microfinance institution only if it is doing responsible lending and has good governance. Both our investment side and advisory side support this, and our advisory team is developing common codes of conduct for the microfinance sector. We are getting together all the players in this sector and ensuring that lending is done on a responsible basis.

The Malegam committee report lays down what the spread earned by a microfinance company should be. IFC does not support those microfinance companies which operate at a spread which is beyond this specification, as responsible lending is very important for us. The microfinance sector went through a much needed correction in the past. However, now that the correction has taken place, it is important not to discard the good things with the bad. It is critical to look at the way forward to support this sector.

ED Team: What is the timeframe envisaged for investments made by IFC in the social investment space? Do you stay invested for a longer duration compared to other mainstream investments?

Anil: IFC is generally a long term investor in all its investments. We stay invested for a longer duration compared to other investors. The duration of investment would depend on the need of the project. In the case of some infrastructure projects, we can stay invested for a period even beyond 10 years, if needed. Therefore, we remain invested for a long duration even in the case of our investments in inclusive businesses.

ED Team: Given the size of the opportunity in India in the inclusive businesses segment, has the allocation to investments in India been on an increasing trend in recent years in IFC?

Anil: The investment portfolio in South Asia saw a healthy increase last year. India is an important market for IFC and last year was the best year for us in the country. Further, investments in India constitute the largest part of the total invested portfolio of IFC. The proportion of our investments in inclusive businesses in India in relation to our global portfolio increased from 6 % in FY2012 to 13 % in FY2013.[1]

ED Team: Grassroots Business Fund (GBF) was originally started by IFC although IFC also had its own investing business. What was the reason of starting another fund and why was this subsequently spun off as a separate fund?

Anil: Grassroots Business Fund was set up within IFC as an experiment to invest smaller amounts into innovative and impactful companies. The size of investment was much lower than what IFC would normally invest in a mainstream investment. It was eventually decided to spin this off into a separate fund and to let it develop on its own, by focusing on the lower segments. The segment focus was an important reason for spinning off GBF into a separate fund and it is doing very well.

[1] Reference to fiscal year (FY) in this conversation refers to IFC's fiscal year of July 01 - June 30

ED Team: What is the kind of technical assistance given by IFC in various areas?

Anil: IFC advisory services has four verticals. The first vertical is Access to Finance, which involves working with financial institutions and microfinance companies and financial structures. Financial inclusion is the bottom-line for this pillar. The second vertical is the Sustainable Business Advisory, which works with companies in various areas including supply chain, value chain and climate change activities. The third aspect is PPPs or Public-Private Partnerships which involves PPP transactions for the state and national government. The fourth vertical is Investment Climate which involves advising the state and national government for improving policies. Each of the four verticals is run by a senior manager. Cross-cutting across the four verticals is the inclusive business working group as there may be some inclusive businesses which may be in the financial inclusion space, some of them could be in the corporate space and so on.

The PPP vertical and the Investment Climate vertical work with the international governments. The Access to Finance vertical works with the financial intermediaries and financial institutions, while the Sustainable Business Advisory vertical works at the company level. Both investments and advisory are important for a business and they go hand in hand. We find that in companies where investment and advisory work together, there is greater development impact compared to companies where either of them works separately.

ED Team: How does the technical assistance component work when you make an investment in a company and what type of entrepreneur would expect technical assistance?

Anil: The investments made by IFC are based on certain investment criteria. Services of the advisory team are to enhance the development impact. In fact, we are more interested in enhancing the scalability and the reach of the impact created by the social enterprise. Our model of providing advisory services always involves a contribution by the beneficiary and therefore does not come free. We provide advice to all categories of entrepreneurs from large corporates to smaller enterprises. However, the main requirement of all our advisory programs is that the enterprise should create a development impact, which is continuous and sustainable in nature.

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5. Institutionalizing impact investing

Jessica Seddon

5.1 The dynamics of Investing, the direction of social

Impact investing seeks to combine the dynamics of investing with the directional impulse of social impact. The idea is appealing in a hazy kind of way. Investing is an adaptive, decentralized, information-efficient system for multiplying cash by converting it into innovations, products, and services that somebody values enough to bother buying. Entrepreneurs search for solutions that meet a definable want, investors review these choices, assess risks and returns, and bet accordingly. Everybody learns in the process, from both the dialogue during the bet and the observation of its results. Impact provides a worthy direction for this system: applying the effort to address important, complex social challenges with solutions that somebody values enough to buy. The net result (in principle): many entrepreneurial minds identifying problems, developing innovative approaches to solving them, creating new business models, and learning by trial and error about effective social contributions.

Impact investors are reaching for the sky. The Global Impact Investors Network (GIIN) seeks to make impact investing "a powerful complement to philanthropy and government efforts to address such issues as disease eradication, climate change stabilization and provision of basic social services, including housing and sanitation."[68] Ennovent, an innovation accelerator, notes that "investors, entrepreneurs, and other ecosystem players are collaborating with each other to fast track the progression of [social] ventures that are looking to make an impact in the lives of millions of low-income people" in India.[69] Omidyar Networks Managing Director Jayant Sinha calls India the "epicenter of impact investing" in the world, with over $500 million having been invested in more than 100 impact-creating companies.[70]

Down in the weeds of efforts to pursue, support, and scale up impact investing, however, the fit between the dynamics and the direction is not always easy. Tensions between the impact and investing world are already starting to surface in conferences, blog posts, soul-searching articles by practitioners, and clinical industry analyses by academics. Does going to scale conflict with continued recognition and responsiveness to local needs? Loans - capital that needs to be repaid - are supposed to create hunger for performance, but does the obligation decrease appetite for innovation? Equity – capital that shares in eventual financial returns – is supposed to create common cause between entrepreneurs and their supporters, but what guarantees that shared goal encompasses social and financial performance in the same proportion? What is the best way to combine grants with investments, in principle and in practice, by one organization and the broader collection of donors, investors, and government? Can financial, social, and environmental returns really be co-managed when there are such differences in the clarity and ease of measurement? "Even now, at conferences the debate continues on what is social and what's not," notes Karan Gupta of Insitor Management.[71] Has the popularity and buzz around impact investing crowded out other reasonable approaches to scaling up high-impact changes?

This essay argues that many of these tensions stem from the fundamental differences between the nature of commercial success and that of social impact, and the kinds of metrics realistically required to assess, learn, and communicate about the two forms of performance. These differences need to be recognized and explicitly addressed in the current round of policy and industry efforts to strengthen the ecosystem for impact investing in India. The final part of the piece lays out some elements of an agenda for doing so.

5.2 Common terminology, distinct foundations

Investing and impact investing may share terminology, but they rely on distinct informational foundations. The investing ecosystem is built around enterprises' and portfolios' financial success as a metric for performance. The system learns how to manage risk and achieve overall returns; how to spot innovations with potential to scale; and how to support such scaling on the basis of trial, error, and feedback in the form of financial returns. Investors track many attributes of the individuals and firms that they invest in – technology, strategy, talent acquisition, projections, market-place and policy risks, to name a few – but in the end, success has one dimension and the enterprise is the unit of analysis.

"Impact" on the other hand, defines success in terms of the many effects that an organization has had on its surroundings. "Effects" are multi-dimensional and difficult to measure and surroundings are more of a canvas than a unit of analysis. "Surroundings" may mean people, companies, or ecosystems that are nearby in a geographic sense, connected in a social sense, or linked as part of a common industry. Think of the "impact" of planting a forest or creating a job exchange for domestic help versus that of local language voice biometrics that allow people to authenticate their identity without reading, speaking English, or accessing data service. And whatever the surroundings, one has to not only be able to see the change, but also distinguish the organization's specific contribution from the normal evolution of things in order to fully assess "impact."

These differences require innovation in institutional design above and beyond the currently prevailing approach of simply transplanting "investment" practices into the "impact" world and retreating into the limited arena where the dynamics and the purpose fit together well.

Impact investors and their supporters and scribes appear to be reacting to the tensions outlined above in three broad ways. First, the industry is tightening its positioning among the broad set of organizations in the business of converting cash into sustainable development. Impact investors' general pitch has become something along the lines of "We focus on social impact organizations that have the potential to scale up into large enterprises. Efforts better suited to replication or to non-profit approaches would do well to look elsewhere for funding." In other words, "Buyer beware. If the world is overly excited about impact investing as the approach for righting all wrongs, then that is its fault. We have our fundamentals clear and we don't claim to be the end-all and be-all for transforming India." Except once in a while.

Second, impact investors and their supporters are exploring various proxies for impact that simplify the metrics required and can use the enterprise as the unit of analysis. Conflating (positive) impact with financial viability and scale has become almost reflexive. Trelstad & Katz (2012) for example note that: "However, despite the profusion of social enterprises and impact investing funds, there are relatively few success stories. Acumen Fund has looked into thousands of BoP businesses, and only a small proportion are clearly achieving viability and scale."[72] Similarly, success meant commercially viable and operating at scale for the Monitor Group's 2009 assessment of impact investing in Africa. [73] "The potential is that the word 'impact' goes away, that the practice of serving 800 million low-income people with quality products and services in a timely and affordable way becomes standard procedure for Indian business," Bob Pattillo, founder of Gray Ghost Ventures, told the Times of India in a recent interview."[74] Karan Gupta of Insitor Management summarizes the continued tension in the background of this approach, "One of the key things for a venture capitalist, social or not, is scale – the enterprise must have the potential to be able to grow rapidly, expand in new geographies, take on debt. However, not all social venture models can be this aggressive so the entrepreneur and the investor both must continue to tread a fine line in balancing purpose with profit."[75] Exactly. A fine line. Balance.

A third response, and perhaps the most productive response to the challenge of integrating impact with investing, is to start to manage the informational foundations of impact to massage them toward the same level of visibility, communicability, and credibility as the informational foundations of commercial success. Social Return on Investment (SROI), a system for laying out the "supply chain" (aka "Theory of Change") for producing social impacts, estimating or assigning financial value of these impacts, and aggregating, seeks to reduce the dimensions of performance, while recognizing that impact involves changes in the organization's surroundings.

Taxonomies such as the GIIN's Impact Reporting and Investment Standards (IRIS), seek to preserve both the attention to change in organizations' surroundings and the ability to track many dimensions of social impact performance. IRIS focuses on creating a standard, a set of common definitions for different aspects of impact, much as the Generally Accepted Accounting Principles (GAAP) does for financial reporting. The approach goes a long way toward strengthening our ability to benchmark impact against competitors and to characterize information from experience in a way that enables industry learning.

But there's still some friction. The elements in the GAAP taxonomy are all pieces of information meant to feed into inferences about a single dimension of performance: financial returns. The elements in IRIS cannot be aggregated in the same way to feed into impact investor decision-making. They are also inherently limited in characterizing the diverse ways in which social impact unfolds in different contexts. Standardised definitions seek to ensure that figures reported for "female attendance" in education-focused enterprises are calculated in the same way across organizations. But the meaning of this attendance, the challenges that attendees had to overcome, and the social impact of sitting in the classroom depend highly on whose attendance, where, and what they attended – the context, in other words.

The three broad responses to tensions are not sufficient to achieve impact investing's potential as a system for converting cash into more as well as furthering socially sustainable development. All three focus on how a complex form of performance can be captured by metrics that are intelligible and useful within the given institutional setting of investing. This institutional setting - broadly defined as organizations, rules, processes, norms – is designed to work with a single dimension of performance and a readily observable, verifiable, known universe of particular units of analysis.

The remainder of this essay shifts the focus to the inverse question: what are the changes required in the institutional system of investment to accommodate the more complex set of metrics required to characterize the performance of impact? How can smart institutional design help impact investing achieve investment-like dynamics with impact-like measures of performance?

5.3 Get used to dashboards

As much as we hope for coincidence between financial and social returns, there will inevitably be trade-offs between social and financial performance. Small farmers may be an entrepreneur's neediest customers, larger farmers are often an easier market to target. Low-income schools may gain the most from educational software, higher-income private schools may be more motivated to add it to their offerings and earn a margin through tuition increase.

How can the impact investing industry best manage these trade-offs? It must embrace them, examine them, and learn from them. Not ignore or simplify them.

The first step is to build entrepreneurs' and investors' capacity to know the various combinations of social and financial returns and the depth of the trade-offs. The entrepreneur is generally in the best position to know the frontier of social and financial performance, but assessing the tradeoffs takes information, time, and, sometimes, specialized analysis. All of these may be in short supply in the early days of an enterprise with a few founders working overtime to survive on a shoestring budget.

Decisions made at this early stage have lasting impact and impact investors may consider devoting extra attention to helping the enterprises they work with move from simple summary indicators to some as to dashboard-type reports that make various dimensions of performance more visible for entrepreneurs (and investors) to learn from. Investing early in building business systems for capturing, exploring and aggregating different types of data from customer feedback to economic indicators of target markets could help build the skills to learn about a multi-dimensional performance space rather than urging entrepreneurs to crib from standard business methods focused, in the end, on financial achievement. Better-funded impact investors have fewer excuses for not investing in building knowledge about financial and social performance and trade-offs between them. Communicating clearly and credibly about multiple dimensions of impact will become all the more important as the impact investing moves into the advocacy stage, succeeds in obtaining concessions, and becomes publicly accountable for using this leeway well for social good in addition to financial gain.

Many impact investors acknowledge and account for trade-offs: "You can't get penalized for generating 0 percent return or -10 percent return if you are creating the country's first sanitation project in 30 years," for example, notes Jacqueline Novogratz, founder and CEO of Acumen Fund.[76] Most of the examples, however are anecdotal, reported as the outcome of an impact investor art of making the right judgment. This works on a case-by-case basis in front of a largely sympathetic audience. It does not stand up to skeptical scrutiny of public policy favors to an industry group. Impact investors report the most reasonable trade-offs; critics will hone in on the most lucrative investments as reason that special treatment is unnecessary or unwarranted. The broader background for each of these extreme cases needs to be readily visible to keep them in context.

We must move beyond pain and patience (lower returns and longer commitments) as a proxy for "focus on impact." This approach to justifying membership in the impact investors club confuses causation with correlation. "Impact investments" may, in general, produce lower returns and require "patient capital," but they do not always do so; nor do low returns and patience mean effective impact. Any effort to require impact investors to fit this profile would damage the potential for trial and error to drive learning in investment. What if the investor got lucky and achieves an unusually high return on a risky venture? Does she then have to go find a loss? Or if the company wants to repay debt or buy out equity in some time that's shorter than what's deemed to be "patient"?

5.4 Legitimize common sense for social

Institutions must adapt to uncertainty as well as other additional dimensions. All of the dashboards in the world will not eliminate the grey areas around measuring impact performance. Impact, an attribute of the company's imprint on its context, is harder to measure than financial returns, an attribute of the company. Impact investors need to think about first measuring the social outputs and second, attributing the impact. Social outputs require measuring the changes in the firms' surroundings, while firms maintain, for the most part, information on themselves. Even if they maintain information about their customers, employees, and suppliers (the various beneficiaries), this is a limited slice of context that may be affected. Impact attribution is an academic science under scrutiny, expensive to implement, and sometimes incorrect.

Impact also evolves, both as the social need changes and innovative possibilities for solving problems emerge. No checklist of types of impact will ever recognize all possibilities.

It's also harder to control. The environment responds to companies in ways that are related to but not determined by company actions. Yes, this is also true for companies – financial performance can suffer from market conditions even under the best management. But corporate leaders have a mandate to cope with changing conditions, and their coping can be readily observed to assess fault. Primary school children do not have a mandate to be affected by a new teaching method, and assessing their response to it across hundreds of classrooms requires additional investment.

The rewards for achieving social impact – policy concessions or low-cost capital for impact investors; grants, capacity-building, and favorable term sheets for impact enterprises – create incentives for both the investors and the impact enterprises to strategically exploit this uncertainty about what impact is. Impact enterprises have more ways to lie about performance, and much more room to hide in legitimately grey areas of indiscernible "impact" amidst obvious "change." The same applies one level up: impact investors have the same latitude to lie as well as the additional potential to shift blame for poor reporting to their investees.

How can institutional design at both contract and policy level eliminate or at least discourage such lying? The looser correlation between social impact effort and observable outcomes and strategic incentives for both entrepreneurs and investors to exploit this grey area to gain access to the concessions of more patient, financially forgiving capital both complicate the simple transplant of investing practices and regulation to impact investing.

Investor term sheets have evolved to lay out specific "if X then Y provisions" backed by security law. Contracts constrain the "no fault" deviation to specific instances that have legally recognized meaning. Public policy around investing has historically focused on limiting the grey area by shoring up the information flow and credibility with laws on disclosure, enforcement agencies armed with criminal investigation and prosecution powers, publicly reinforced standards of accounting, and other means. The audit industry has grown up around the need for third-party seals of approval, and policy oversight provides an additional bulwark to keep everybody honest.

Impact investing would gain from an equivalent push toward specificity. Take for example, Vineet Rai (Founder and CEO of Aavishkaar)'s simple statement: "We are looking at the economics of impact … under our definition, if you want to be an impact fund, then 100% of your portfolio needs to deal with low-income population."[77] What is "deal with"? And does it have to be direct or do indirect benefits like secondary employment generated count? And what is low-income?

Even with this push, regulation of "impact investing," particularly the terms of access to any special treatment impact investors or enterprises are eligible for, needs to be modeled more on jury trials than rule-based regulation applied mechanically by auditors armed with checklists.

Contracts and regulation must be able to deliver legitimate verdicts on unclear cases of impact performance in the absence of certain verifiability. Shoring up social impact metrics with standards, auditing, and oversight will not eliminate the grey, at any reasonable cost. The process for assessing impact performance, eligibility for impact investment or concessions for impact investors, must contain room for debate that is more nuanced than filling out a checklist or mechanically applying a rule, but at the same time include process safeguards to avoid conflict of interest.

The process cannot pretend to be entirely objective, but must pay particular attention to managing subjectivity since "social impact" runs into normative considerations and judgment. One person's impact is another person's destruction of society. All of the paternalistic impulses of the sector also come to bear. Is curing vitilago a social impact, for example? Yes, argue those who take a pragmatic look at the reality of unmarriageable females in rural India. No, say those who view it as a cosmetic matter or see the emphasis on beauty in the marriage market as illegitimate and not to be catered to.

This kind of flexible approach would also help the oversight of impact investing evolve faster to accommodate innovation. "Jury" type reviews would allow people to make their cases for the validity of new forms of impact rather than be ignored because their project does not fit into the conventional format.

Oversight also requires a new form of punishing lying, to accommodate the possibilities that actual social impact would go unrecognized or limited impact would be accounted for as substantial. Regimes that offer high rewards tightly coupled with observed impact ("high powered incentives" in microeconomics jargon), have less effect when the effort to generate impact might not be recognized. Strong punishments for not having impact can actually dissuade people from trying if their efforts are not registered or might look like they failed when they actually succeeded.

5.5 Don't ignore the financial flows

Impact investing is still social enough to have a norm of common cause and harmonious co-existence with its cousins, the do-gooders, as well as the capitalists on the other side of the family tree. But there is ample room to squabble.

There are various stages that a social enterprise, or any enterprise goes from being an idea to becoming a business.[78] The way a business changes over different periods of the journey from "blueprint to scale" (to borrow Koh, et al (2012)'s title) varies, not only in the net change in value, but also the risk, or distribution of that potential change in value. Decisions made at any point during the journey also affect the risk and potential returns in all of the subsequent periods. Good early stage mentoring can build a much more profitable, quickly scaling business. Early stage capital infusion via debt versus equity is likely to affect the entrepreneurs' risk tolerance later. Seeding the right professional and market contacts can foster powerful high-value networks later. And so on.

So who invests at what stage? How are they compensated? Can their contributions even be reasonably quantified so that they could be fully compensated? General theory of human behavior is that full compensation – in some form, financial or other – is necessary for full effort, otherwise there is underinvestment. Actions that create positive externalities – social good that goes unrewarded – tend to be underdone; actions that create negative externalities, bads that go unpunished, are overdone. Government (or governance – some kind of intervention) is supposed to even out the scales in such situations.

Impact enterprises, impact investors, and their do-gooder cousins produce substantial positive externalities. Their contribution to the market and to other enterprises will produce returns for other investors, who may never be known or knowable and who certainly are not excludable. Early stage investments in impact ventures often create market infrastructure, even things as simple as awareness, that can be used by others. Preparatory work to nurture a company through the blueprint or prepare stage makes the distribution of returns look that much better for those who invest in scaling. So how do the end-stage investors reimburse the early-stage investors? Moreover, how do they do so in a way that actually rewards performance and spurs ever better performance?

Impact investors and their relatives will have to address these externalities rather than assume that industry is immune to the incentives that they create. There are already some tensions cropping up. Baird, Bowles, and Lall (2013) found that many accelerators sought formal partnerships with impact investors, while impact investors preferred to maintain informal relationships and did not commit capital to accelerator operations or enterprises.[79] The intrinsic rewards of watching an entrepreneur one has mentored into fledgling enterprise turn around and attract commercial venture capital are high. Watching the venture capitalist turn around and make crores on the exit takes more substantial amounts of zen.

Philanthropy and impact capital may play an important role in helping enterprises build missing market infrastructure. But if there are concessions for giving and impact investing, what's to stop commercial capital from dipping into impact capital to boost its returns? This is an especially important question for India today, as the terms of the corporate social responsibility mandate in the 2013 Companies Act become clearer. Schedule 7 of that Act says that these can be used for "social business" and there are rumors that they can be used for incubators. But what would happen if an incubator groomed a company using CSR funds, and later made a killing on that investment?

Both market and norms seem to be emerging to address these conflicts of interest. On the market side, some accelerators charge enterprises for their services, either as upfront payment or equity. Others are seeking preferred partnerships or otherwise charging investors for early access to enterprises. There are competitive constraints on this tactic, since obviously enterprises would prefer to receive services for free and not be bound by the terms of the partnership between accelerator and investor. On the social norms side, there are exhortations to collaborate. Trelstad and Katz (2013) end with the message: "Now it is up to impact investors and grant-makers to work together to ensure a robust pipeline of high impact businesses in which impact investors can invest – and that will serve hundreds of millions of low-income customers."

This hybrid of market and normative approaches may be a workable solution, allowing a variety of accelerators, impact investors, and relationships to develop. Industry efforts to recognize and give credit to the work of accelerators and community groups may go a long way in enhancing non-financial rewards for the groups that make the enterprise aspect in social enterprise viable. It's hard to think of a better option. Policy interventions to compensate the do-gooders in the family for the pains they take in preparing impact enterprises run the risk of attracting imposters (as discussed above). However, behavioral research in settings from childcare to workplace scheduling has shown that putting a price on relationships tends to corrode the social underpinnings of give-and-take in interactions and bring out our more transactional nature.[80]

It's time to openly confront the relationships and address them to at least clarify expectations and address unspoken tensions. Finances should not be taboo in the discussion of social performance, any more than social should be dropped in the practice of financial achievement.

5.6 Conclusion

Institutional theorist W. Richard Scott defines institutions as "regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior."[81] Regulative structures prompt behaviors through formal rules and enforcement, normative through social pressure, and cognitive through formation of beliefs or establishing baselines that are taken for granted. It is clear that we will need to rely on all three pillars of institutions to design a framework for scaling up impact investing. Regulation can only go so far in the absence of black and white truth and the ability to verify it at reasonable cost. Normative influences have their limitations when valuation of impact is subjective and intertwined with other social and cultural beliefs. Cognitive structures can waver when diverse cultures of investing and impact-seeking collide – both groups take different things for granted.

Building the ecosystem for "impact investing" requires moving from the broadly held, very human, yet highly individualized ability to balance good and gain to build an impersonal framework of rules, norms, and authorities. Simply repackaging impact to look more intelligible to the market context for investing will not achieve the potential that we can already see in the actions and achievements of individual impact investors. These success stories have come from intrinsic motivation that rules, norms, and external expectations can reinforce but not replicate.

Looking ahead, we must think carefully about what we borrow from the impact and investing worlds and why, learning from experience as we do.

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Impact through philanthropic grants

A conversation with Rohini Nilekani

Rohini Nilekani is the founder - chairperson of Arghyam, a grant making foundation that funds work in the water and sanitation sector. Being a philanthropist and writer, Rohini has invested across different sectors in the social space including education, governance, and environment. She has been involved in philanthropy and grant making for more than 15 years.

Bangalore based Arghyam was founded in 2001 but since 2005, its focus has been on water and sanitation in India. Since its inception, the organization has made grants to several NGOs across 22 states in India. It was started by a personal endowment from Rohini Nilekani and works through partnerships with the Government, NGOs and various other institutions.

ED Team: How do you think the impact investing segment has evolved in the last 10 years? Have there been any significant turning points in this segment?

Rohini: I am more familiar with the Indian impact investing sector than the international. In my opinion, the space has seen significant change over the past decade. Ten years ago, there was a sense of euphoria and immense positivism. It was felt that all the problems of poverty could be solved by impact investing models and that it was a win-win for everyone. Many entrepreneurs too signed up for new things. Today, there is a shift, where all the players in this segment have become more pragmatic and cautious in what impact investing can and should do. People have got a clearer idea of impact investment and there is a clear transition in thinking. The limits of the markets and the limits of the entrepreneurs to work in an undeveloped ecosystem are being understood. The euphoria has gone away, which is good. However, the optimism about such models still exists. So this is a positive thing. People are learning quickly and there is good intent.

Although an entrepreneur's innovation and the impact investor's intentions may be excellent, the entire ecosystem should be improved for us to witness successful impact investment stories. In this context, the microfinance incident in the recent past is a good reference. There are a few important lessons learnt from the developments in this sector. The first is that the industry will have to create norms and regulations to make sure that the good in the sector is not overtaken by the bad, and that profiteering does not set in. The second is that the entire policy framework of the country should be kept in mind while the sector grows. However, there are many questions which are yet to be addressed by impact investors when it relates to basic services in the country.

I also think there is very limited discourse on impact investments in essential services in India. Market opportunity has sprung up where the state is unable to expand basic services infrastructure to the next 400 million or so people who have been left behind. However, there are some limits which are imposed on markets, which are not being discussed. Should markets play the role that the state or communities used to have, in areas such as drinking water, access to basic health, education, housing and energy? If so, under what circumstances? Under what regulatory guidance? As markets cannot ensure equity, what of those who fall below markets? Also, especially in water, there are other questions to be asked. Whose water is it anyway? Will those private sector players who supply drinking water to communities at a price also take into account the negative externalities caused through their filtration process? And will they be responsible for the primary water resource, to make sure it is recharged and sustainable? If those social costs were internalised to a business, I doubt many market players would venture into the space, right? These are issues that have to be discussed and understood.

Also, when impact investing, which has the ultimate goal of making profits, comes into these sensitive areas, there can be a political backlash, especially in a democracy like ours. For one thing, government does not really like competition. Also, governments have been seen to be as well as to be pro-poor. But if there is a sudden overturning of policy, who suffers, as we saw from the microfinance sector crash? Yes, the investors do, but the poor in whose name the enterprises are set up might suffer the most. In Andhra Pradesh, with all that happened, I was told that people had to go back to the money lenders with their incredibly high interest rates. These things have to be put in perspective.

For example, there is a danger that a sudden political or policy change might harm a sector overnight, where investments have taken place. But most investors do not have enough consideration to what can actually change in the policy environment. Therefore the discourse on impact investing is limited and has to deepen considerably.

ED Team: What is different about Indian investors when compared to international investors in the social sector space?

Rohini: As far as financing by international investors is concerned, the capital is from rich countries where their local context is not so deprived, obviously. On the other hand, if a social enterprise is funded by local capital, there is a better understanding of the context, as well as better sensitivity to the ecosystem in which the enterprise exists. Therefore, the primary difference would be in the area of contextual understanding.

I also believe that in the area of returns expectations, Indian investors have become more pragmatic and more realistic over time. They also understand the challenges in the ecosystem and the policy environment within which the social enterprise operates.

ED Team: What is the main reason for you to have chosen the grant making route of operations and not the venture investment style of working?

Rohini: My understanding of this is fairly political. In my opinion, the biggest lesson of the past century is that both governments as well as markets can become highly oppressive if citizens do not come together and challenge the abuse of power. When there are no institutions of people to ask questions and challenge authority, then there could be tremendous abuse of power. Therefore there has to be a lot of attention on developing societal institutions which can help in building the capacity of people - especially unserved communities - to resist this abuse and insist on inclusion. The new philanthropy which has come up in India in the past 20 years or so is as a result of huge wealth that has been created. However, many of todays' wealthy come with a strong market perspective. This is natural since the wealth they have, has been given and created by the market. Their philanthropy has often been in the areas of education, skill building etc, and also on social impact investing. All this is critical and essential. And after all, philanthropy is voluntary and must follow the passions of the donor. But we do need to build societal institutions and leadership that can look at the balance of power between samaj, bazar and sarkar. So far, all this kind of rights and inclusion based work in India was done with international philanthropy. That money is now receding. Will our own wealthy occupy that vacuum? This is not work that can be attempted through markets. This capacity in the people to insist on equity and sustainability can only be built through collective action backed by grants. That's where my philanthropic interest lies.

ED Team: Impact investors regularly monitor their investee companies. As a grant making organization, do you also regularly monitor the use of the grants, to ensure that it is being efficiently used?

Rohini: I undertake grant making in a number of ways. In Arghyam, which is an institution that I have set up, there are formal methods of monitoring and evaluation. However, we are not impact measurement freaks. We are moderators and we co-create metrics along with the partner to whom we have given the grant. We help the partner in doing course correction and are fairly lenient on these counts. The leniency is also because we take care in choosing our partner in the first place and build a relationship of trust from the beginning. However, because both Arghyam as well as the partner would like to know if there is impact created on the lives of people, we do have some metrics to go by. In Arghyam, along with the grant, we also seek in giving empowerment. As empowerment metrics are very difficult to be built, the work here is a bit fuzzy. On the other hand, Pratham Books, which is another institution that I have co-founded, the metrics are pretty easy and straightforward when compared to Arghyam. I also do a lot of general charity on my own. In these cases, I work with institutions and leaders who are trusted and credible and when there is a clear purpose for the money. I do get reports in these cases as well, but I do not involve myself a lot in the day to day affairs. We do need metrics in the grant making space. But beyond this, if there is commitment, professionalism, and if the trust is built, a lot is achieved.

ED Team: In Arghyam, have you provided grants to organizations which work on commercial models in the social sector?

Rohini: In my personal capacity, Nandan and I invested in Acumen Fund long back. This can be an example of a market based investment. In Arghyam, we find occasionally that even impact investment funds sometimes require a philanthropic component. We have made some grants to market based institutions to cover soft aspects such as capacity building and training. For example, in the case of Sanghamithra Rural Financial Services which borrows capital from the market, I have given money without any covenants to help it bring down its cost of capital and to innovate. Another example would be Pratham Books which is a hybrid model. I have funded this organization with over Rs. 7 crores in the past several years. The model is part market and part philanthropy, where the books are sold at a subsidized rate. Over the past 9.5 years, we have published and distributed 11 million books and 10 million story cards. Therefore, we have been able to demonstrate that there is a market at a certain price point. And that an organisation working with donors, volunteers, markets and the state can achieve a lot very quickly. There is a lot of market re-definition work and market creation work which is done at Pratham Books.

ED Team: Is there any particular stage or type of the entrepreneurial venture you would look at while providing grants?

Rohini: Providing grants is contextual and there is no fixed strategy related to the stage of the organization which we fund. We have provided grants to organizations in different stages. For example, when I founded Pratham Books, it was at an early stage. We also invested early in Acumen Fund in India. On the other hand, Sanghamithra Rural Financial Services was in a relatively advanced stage when I funded it.

Currently, especially at Arghyam, we are working extensively on building knowledge networks, by funding research and advocacy institutions. In the country, issues have progressed from one area to another. For example, in water, we have moved from questions of access to drinking water to access to quality of drinking water. Similarly, in education, we have moved from just enrolment to quality of education. One of the next problems we need to address is in creating knowledge networks as India is very diverse and has a lot of hidden knowledge which has to come together.

ED Team: What is the value addition you provide to your grantees, in addition to the funding?

Rohini: As a philanthropist, in addition to the basic funding, I try to add value to our partners or grantees in many ways. The first is to bring in co-donors and additional funding. Next is to become a convener. The third value addition would be to help the grantees in leveraging our networks and introduce our partners into a much higher ecosystem where they can be much more effective. We have achieved that in Arghyam to a certain extent, wherein some of our grantees who are extremely good but were unknown at the national level were able to achieve a national profile. They are now helping to create national policies on important aspects relating to ground water and other areas. Our fourth value addition would be to improve the financial management systems of our partner organisations by creating training and capacity building workshops. We also provide help in kind. For example, in Arghyam, the employees in the HR, admin and finance departments go out of their way to help the organisations that need help. In this respect, we are like matchmakers. We help in increasing the efficiency and influence of our partners with the help of our networks. For example, in Bihar we are supporting a partner to improve the shallow aquifer. We made sure that our other grantee from Pune who has a good understanding of hydrogeology could also train those people in Bihar and create a whole new way of working. We therefore help in connecting practices across different states in the country.

ED Team: Are there any key elements of your selection process to provide grants? How do you get introduced to organizations which need grants?

Rohini: We get to know organizations that need grants in many ways. As Arghyam is a grant making institution, we have set up a process to invite applications. Next, there is also a lot of word of mouth that happens in India. We also find people through professional networks. There is also an advertising process which helps us find organizations that need support.

At Arghyam, we have some criteria, of course. In the first seven years, we gave many kinds of grants across a diverse area, as we were learning too. We do obviously look at intent and the need of the work proposed. As the complexity of problems faced by people on the ground is growing, we try to fund innovative approaches. Therefore, any model where there is a new way of looking at an old problem will be interesting. We also give a lot of importance to good leadership and institution building.

ED Team: How would you provide grants if there are two or three competing applications in a similar area?

Rohini: Arghyam has a clear budget and has a 5 year strategy plan within which we work. If we are looking to upscale something, then we might support two players even if they are in the same area. However, if we are looking to innovate, then we might support only one model. Therefore, this depends on resources and the situation. If there are funds for two models, we will support two models.

ED Team: What is the average amount you provide to organizations as grant funding?

Rohini: In Arghyam we have given grants of varying amounts. There is a grant which is as low as Rs. 25,000 and one which is as large as Rs. 3 crores. The average amount per annum would be Rs. 20 lakhs per annum.

ED Team: How does the grant funding cycle work?

Rohini: In Arghyam, we normally follow annual cycles. Please understand that we have a CEO and a great team to manage all this. Depending on the project and the needs, we decide on the number of years for which the funding might be required. For example, if the total grant funding needed is Rs. 75 lakhs over 3 years, it could be Rs. 25 lakhs every year. However, this completely depends on the project and is evaluated on a case to case basis. If after the initial funding period, the entrepreneur, the NGO or the non-profit realises that the model needs to be changed or additional improvements need to be made, they may approach us for another round of funding. If our team finds merit in the case, we do support them in the second round as well. The organizations need to show progress based on the co-designed metrics at the end of the year. Unlike impact investments, all the funding that is sanctioned is not given upfront; rather, it is staged assistance. This is because of the regulatory regime to which grant funding is subject to. If 85% of the funding assistance in a year is not deployed successfully, then this is subject to various regulatory issues. Sometimes, we give an institutional grant in the form of a corpus.

ED Team: Over time, would you see an organization funded by grants grow on its own, rather than continuing to rely on Arghyam?

Rohini: In a market framework, it is desirable for the organization to be financially sustainable and to generate revenues and profit over time. It is also best if the organization can grow on its own, not requiring the support funding anymore. However, I personally believe that some things require continuous support at a societal level. We would like to see an institution get more funding from another source, alongside us. That would be a metric of our success as we could draw in more philanthropic capital for that institution. But as I said earlier, some things require continuous philanthropic capital either in terms of money or time.

In terms of Arghyam's policy regarding the period of support, we do not have a limit or cut-off. For instance, some foundations agree to provide grant funding only for 1 year or 2 years or 3 years. But we are deliberately staying away from such a policy and do not have any fixed limit.

ED Team: Do you think there are any limitations to the grant making model?

Rohini: I think the first limitation would be that as recipients of grant funding, generally persons and institutions would not want to be seen as dependent on grants. It is important to create a partnership model rather than a patron-client one. Secondly, both those seeking funds and those offering support may themselves have capacity and sustainability issues. Thirdly, sometimes donors can be far removed from the context of the NGOs or of the eventual citizens that the grant is made for, which creates some issues. A whole industry has sprung up based on foundations and NGOs but there are accountability issues all around too. There are moral and philosophical issues about philanthropy. High end philanthropy is important, but it can and should only play a limited role in society. We have to ask more upstream questions about society in general and why value is accumulating so narrowly in the first place.

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Appendix: Methodology and definitions

Sample of impact investments

The list of social venture investments was obtained from Venture Intelligence database. The database classified a venture investment as a social venture investment when it met any of the following: (i) the investment was by dedicated social venture funds such as Aavishkaar, Acumen Fund, etc. (ii) it was a early or growth stage investment in social infrastructure sectors like education, healthcare, etc. (iii) Investments in rural banking or microfinance were classified as social sector investments.

Type of investors

- By investor origin: (i) Domestic, if registered as a domestic investor by SEBI, located in India, major investments are in India, and main promoters based in India; (ii) Foreign, if registered as a foreign investor by SEBI, head office is outside India, main promoters are not based in India

- By investor focus: (i) Social, when the investors are dedicated social sector venture funds; (ii) Mainstream, when the investors are not dedicated venture funds, and invest in both social and conventional enterprises

Stage of investment

The stage of investment has been defined as follows:

- Early: First or second round of institutional investments in companies that are: (i) less than five years old, and (ii) not part of a larger business group, and (iii) investment amount in the round is less than $20 million

- Growth: (i) Third or fourth round funding of institutional investments in companies that are less than five years old; or (ii) First or second round of institutional investments in companies that are 5 - 10 years old or spin-offs from larger businesses and investment amount is less than $20 million; or (iii) First-to-fourth round investments more than$20 million in companies that are less than ten years old; or (iv) Fifth or sixth round of institutional investments in companies that are less than ten years old

- Late: Investment in companies that are over 10 years old, or seventh or later rounds of institutional investments

- PIPE: Private equity investments in publicly-listed companies via preferential allotments / private placements, or acquisition of shares by PE firms via the secondary market

- Buyout: Acquisition of controlling stake via purchase of stakes of existing shareholders

- Others: Investments which cannot be classified in any of the above categories

Unit of analysis

- Deals: An instance of investment by an institutional investor is defined as a deal. If there are more than one investors who make an investment jointly at the same time, then the investment made by each of the investor is treated as a separate deal. By the same token, if the same investor is investing more than once in the same company at different periods of time, then each investment is treated as a separate deal.

- Rounds: An investment received by a company at a point in time from one or more institutional investors. A round can comprise a single investor or more than one investor. The aggregate investment received by the company from all the institutional investors investing in the round is referred as the round investment. An investment occurring within three months has been considered as a part of the same round, whereas an investment that is separated by at least three months or more is considered as a separate round. The first instance of investment from the institutional investors is called as the first round of investment and so on.

- Exit: The occurrence of an exit event such as an M&A or a public offering. Total number of exits refers to the number of companies where such an exit event has occurred.

- Exit deals: Refers to the number of investors who are likely to exit from a company following the exit event. For example, if the enterprise has six different institutional investors who have invested in the company in one or more rounds, then the occurrence of an exit event in the company would result in an exit of the six investors. The number of exit deals in that instance would be six.

- Investment amount: Investment made by institutional investors in million dollars. Depending on the level of analysis, it would be deal investment or round investment. Total investment refers to the investment made in all the companies during the study period.

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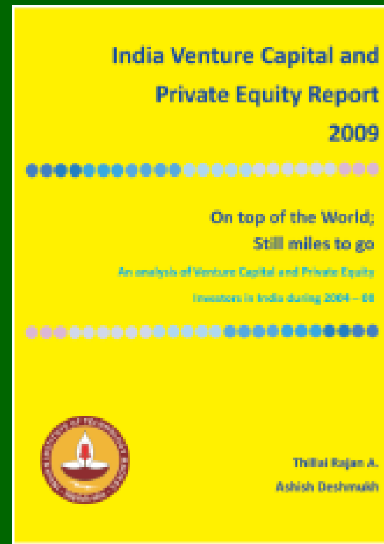

Credits

Cover design
Pawan Koserwal

Research assistance
Keerthana Sundar
Denila Jinny
Sheeba Rajagopalan

Logistics
MILS Team

Production assistance
New Horizon Media

Contact information

Thillai Rajan A.
Associate Professor
Department of Management Studies
IIT Madras, Chennai 600036
Email: thillair@iitm.ac.in
Phone: +91 44 2257 4569 / +91 94449 26442

भारतीय प्रौद्योगिकी संस्थान मद्रास
Indian Institute of Technology Madras