

INDIA

# THE LANDSCAPE FOR IMPACT INVESTING IN SOUTH ASIA

Understanding the current status,  
trends, opportunities, and challenges  
in **BANGLADESH, INDIA, MYANMAR,**  
**NEPAL, PAKISTAN, and SRI LANKA**



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# ACKNOWLEDGMENTS

This project was funded with UK aid from the UK Government through the Department for International Development's Impact Programme. The Impact Programme aims to catalyse the market for impact investment in sub-Saharan Africa and South Asia. [www.theimpactprogramme.org.uk](http://www.theimpactprogramme.org.uk)

This report was made possible by the generous contributions of time and expert knowledge from many individuals and organizations. The GIIN Advisory Team provided invaluable insights, guidance, and support throughout the preparation of this report. In addition, we would like to thank all individuals that took part in the interviews and surveys in each of the six countries of study. Through these interviews and surveys, we obtained a wealth of experience, understanding, and data on impact investing activities in South Asia. We would also like to acknowledge the country experts who provided critical feedback on our preliminary findings. A full list of the interviewees, survey respondents, and country experts can be found in the Appendices.

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# LIST OF COMMON ACRONYMS

<b>ADB</b>   Asian Development Bank	<b>MDG</b>   Millennium Development Goal
<b>AIF</b>   Alternative Investment Funds	<b>MEB</b>   Myanmar Economic Bank
<b>BoP</b>   Base of the Pyramid	<b>MFI</b>   Microfinance Institution
<b>BRICS</b>   Brazil, Russia, India, China, South Africa	<b>MFTB</b>   Myanmar Foreign Trade Bank
<b>CA</b>   Chartered Accountancy	<b>MNC</b>   Multinational Corporation
<b>CIIE</b>   Centre for Innovation, Incubation and Entrepreneurship	<b>MICB</b>   Myanmar Investment and Commercial Bank
<b>CGTMSE</b>   Credit Guarantee Fund Trust for Micro & Small Enterprises (India)	<b>NABARD</b>   National Bank for Agriculture and Rural Development
<b>CSR</b>   Corporate Social Responsibility	<b>NASE</b>   National Association of Social Enterprises (India)
<b>DFI</b>   Development Finance Institution	<b>NEDA</b>   National Enterprise Development Authority (Sri Lanka)
<b>DFID</b>   Department for International Development	<b>OPIC</b>   Overseas Private Investment Corporation
<b>FIL</b>   Foreign Investment Law	<b>PE</b>   Private Equity
<b>FDI</b>   Foreign Direct Investment	<b>PM</b>   Prime Minister
<b>GAAR</b>   General Anti-Avoidance Rules (India)	<b>PPP</b>   Purchasing Power Parity
<b>GIZ</b>   Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)	<b>RBI</b>   Reserve Bank of India
<b>HDI</b>   Human Development Index	<b>SEBI</b>   Securities and Exchange Board of India
<b>HNWI</b>   High Net-Worth Individual	<b>SIB</b>   Social Impact Bond
<b>HR</b>   Human Resources	<b>SIDBI</b>   Small Industries Development Bank of India
<b>ICT</b>   Information and Communication Technology	<b>SME</b>   Small or Medium Enterprise
<b>IFC</b>   International Finance Corporation	<b>SMED</b>   Small and Medium Enterprise Development (Sri Lanka)
<b>IFI</b>   International Financial Institution	<b>SVF</b>   Social Venture Fund
<b>IE</b>   Impact Enterprise	<b>VC</b>   Venture Capital
<b>IIC</b>   Impact Investors' Council (India)	<b>WHO</b>   World Health Organization
<b>IMF</b>   International Monetary Fund	
<b>LP</b>   Limited Partner	
<b>LTTE</b>   Liberation Tigers of Tamil Eelam	



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# ABOUT THIS REPORT

The objective of this study is to develop an understanding of the status of the impact investing markets in six countries in South Asia—Bangladesh, India, Myanmar, Nepal, Pakistan, and Sri Lanka. The full report includes an introduction and a chapter for each country. This research is intended to serve as a critical input to future investments and engagement to build and grow these markets. The key themes explored include the current status and trends in terms of the types of active investors, capital deployment, opportunities for and challenges to investing, the demand for impact capital, challenges to accessing capital and opportunities for enterprise growth, and the vibrancy and scale of the supportive ecosystem for the industry.

## Introduction

In recent years, impact investing has become prominent on the global stage as an approach to deploying capital with social/environmental goals as well as financial return objectives. Deployed in both developing and developed markets, impact investments are made across a range of sectors and asset classes.

South Asia is home to more than 1.6 billion people and has experienced dramatic economic growth over the last decade. However, this rapid growth, while changing some economies dramatically, has been uneven between and within countries; about a quarter of the region's population continues to live on less than USD 1.25 per day<sup>1</sup> and large population segments lack access to quality social services, finance, energy, and infrastructure as well as to affordable consumer products. The opportunity for impact through the deployment of capital into organizations and enterprises that increase incomes, create jobs, and provide access to essential services is significant, and the status of the impact investing industries in these countries is worthy of attention.

## Who is an impact investor?

Impact investments are “investments made in companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.”<sup>2</sup>

The three key characteristics of an impact investor are as follows:

- Expectation of a financial return that can range from the return of capital to risk-adjusted market-rate returns and that can be derived from investments in a range of asset classes.

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<sup>1</sup> Weighted average calculated with the latest country data (2010–2012) from World Development Indicators, The World Bank; Myanmar figures are not included in the weighted average as this indicator is not available for Myanmar.

<sup>2</sup> For more details, refer to the GIIN website, [www.thegiin.org](http://www.thegiin.org).

- Intent to generate a positive social and/or environmental impact through investments. For example, investors may seek to use investments to increase access to basic services or invest in solutions aimed at mitigating the negative effects of climate change.
- Commitment of the investor to measure the social/environmental performance of the underlying investments.

This report focuses significantly on the impact investing landscape in each of the six countries covered. Various terms may be used to refer to the impact investing landscape, including “impact capital” and “impact funds,” depending on the context. For the sake of fluency, the modifier “impact” will be dropped when the context is clear.

While the central goal of this study is to map the current landscape of the impact investing activity, there is also significant investment activity on the periphery of impact investing that is interesting to explore. In particular, we consider the following two types of investment activity:

- a. Investments in businesses serving BoP populations by investors who may not have explicit impact intention
- b. Investments where there is some intention to have social and/or environmental impact, but this impact is assumed to occur as a by-product and is not measured in any meaningful way

Such investment activity is also important for an analysis conducted to gain a better understanding of the broader opportunity landscape for impact investing going forward. When a section in the report focuses particularly on the investment activity in this peripheral region, we will explicitly refer to these as “impact-related” investments, thereby clearly differentiating them from “impact investing.” (Please note that we are using these labels purely for the ease of reference and do not intend the names to imply any subjective judgment on the nature of an investor’s investment activity or approach.)

## COUNTRY CONTEXT

### GDP growth and drivers of foreign direct investment (FDI)

India is the leading economy in South Asia, and the third largest in the world in PPP terms, with a GDP of international USD 6.3 trillion in purchasing power parity (PPP) terms. However, growth has slowed since 2010 (see Figure 1). India has been at the forefront of the developing world since the early 2000s, with a rapidly growing economy. Between 2004 and 2009, India’s PPP GDP grew at an annual average of 11%. However, in the aftermath of the global debt crisis, and in the face of

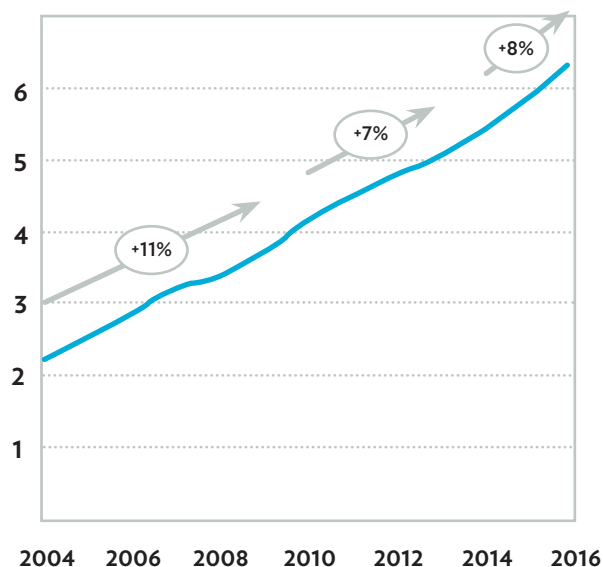


poor coalition governance as well as “policy paralysis,”<sup>3</sup> growth slowed in 2010. Going forward, the International Monetary Fund (IMF) predicts a gradual recovery for India. In particular, the IMF estimates that India’s PPP GDP will grow at an average annual rate of 8% as macroeconomic conditions improve.

**FIGURE 1: GDP (PPP) OF INDIA AND COMPARISON WITH OTHER SOUTH ASIAN COUNTRIES**  
(2013, 2014-2016: PROJECTED)

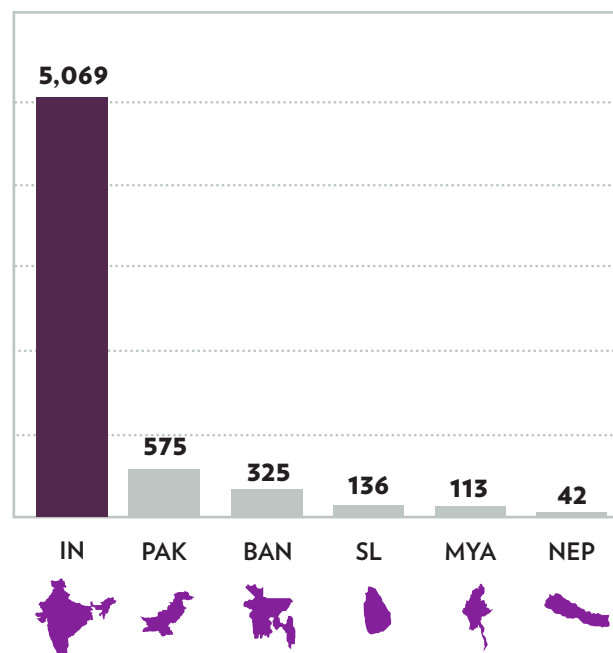
### GDP OF INDIA

(PPP, CURRENT INTERNATIONAL DOLLAR, TRILLIONS)



### GDP BY COUNTRY

(PPP, CURRENT INTERNATIONAL DOLLAR, BILLIONS, 2013)



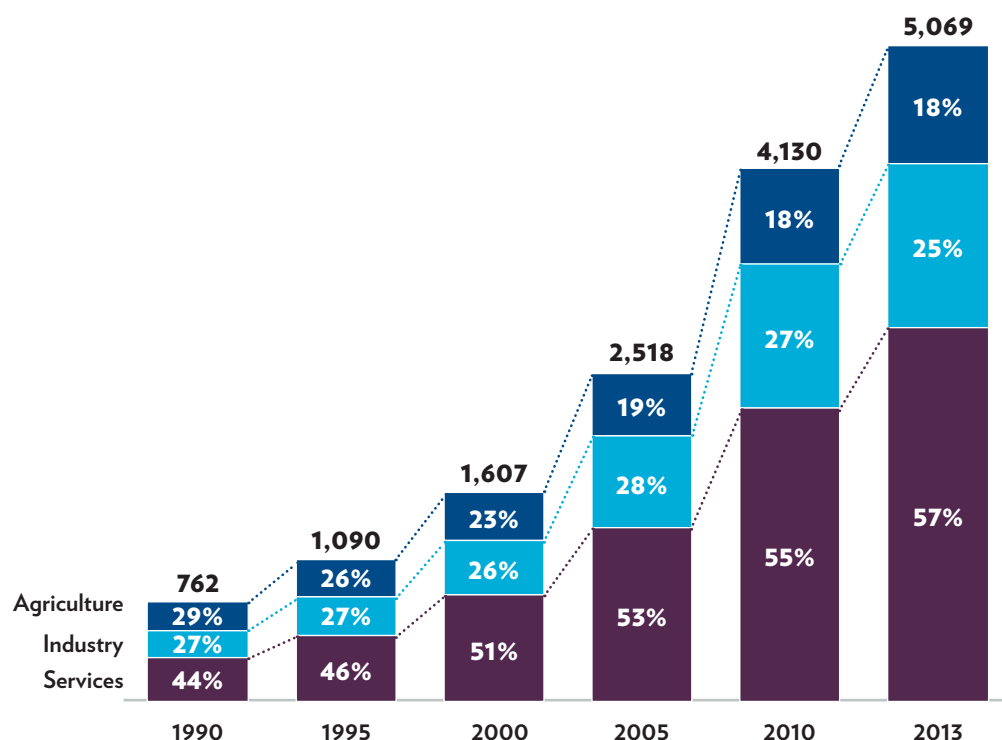
Source: IMF World Economic Outlook Database 2014

**India’s services sector has been the key contributor to its growth, accounting for more than half of GDP growth after 2000 (see Figure 2).** Since India began liberalizing its economy in the 1980s, the services sector has grown in contribution to India’s GDP, whereas agriculture and manufacturing have progressed slowly and seen a decline in contribution. According to the Indian Economic Survey 2014, India has one of the fastest growing services sectors in the world, second only to China; the sector grew at an average annual rate of 9% between 2001 and 2012.

<sup>3</sup> “Policy paralysis’ responsible for India’s slowdown,” Firstpost.com, September 8, 2013.



FIGURE 2: EVOLUTION OF SECTOR CONTRIBUTION TO GDP (% OF GDP PPP, INTERNATIONAL DOLLAR BILLIONS)



Source: World Development Indicators, The World Bank; IMF World Economic Outlook Database 2014

**Economists have suggested that India is experiencing a temporary “stagflation,” posing challenges to growth.<sup>4</sup>** Stagflation refers to a situation of slow growth and high inflation, which India has been facing over the past few years. In addition,

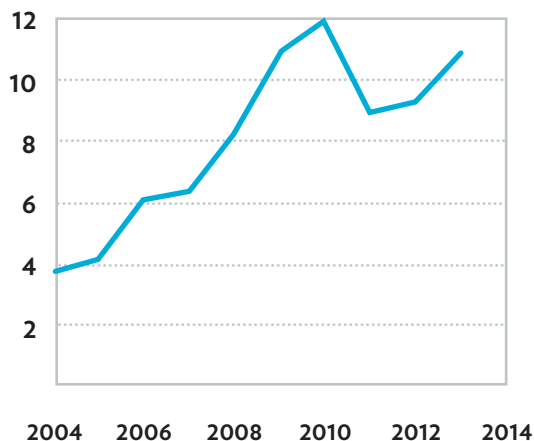
the fiscal deficit has increased since 2008, as seen in Figure 3. In light of these developments, the Reserve Bank of India (RBI), has raised interest rates and considered an inflation target to curb inflation, which hovered around 11% in 2013, but has fallen slightly recently. Moreover, the government has stated an aim to bring the fiscal deficit down to 4.1% in 2014. However, Fitch, Moody’s, and Standard & Poor’s have stated that they are not convinced that this is a realistic target.<sup>5</sup> All in all, an improvement of macroeconomic fundamentals is a key requirement for sustaining and improving investor sentiment and the momentum of FDI inflows into India.

<sup>4</sup> “India in stagflation, not crisis,” Economic Times, December 22, 2013.

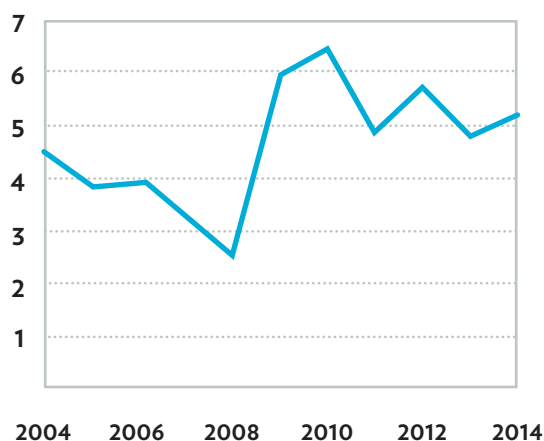
<sup>5</sup> “Finance secretary Mayaram defends 4.1 percent fiscal deficit target,” Reuters, July 12, 2014.

FIGURE 3: INFLATION RATE, CONSUMER PRICE INDEX (CPI) AND FISCAL DEFICIT (% OF GDP)

**INFLATION RATE,  
CONSUMER PRICE INDEX (CPI)**  
(ANNUAL, %)



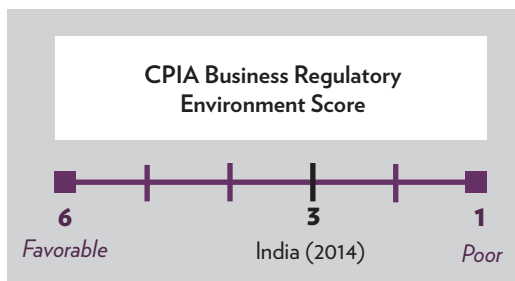
**FISCAL DEFICIT**  
(% OF GDP)



Sources: World Development Indicators, The World Bank; Planning Commission of India

**After a surge in the early and mid-2000s, India has seen unusually volatile FDI flows, caused largely by regulatory uncertainty and the global financial crisis.**

Mirroring India's emergence as a rapidly growing economy, investor sentiment and FDI inflows grew rapidly in the 2000s, peaking in 2008 at USD 43.4 billion (see Figure 4). However, regulations such as the General Anti-Avoidance Rules<sup>6</sup> (GAAR) and frequently changing tax laws have led to uncertainties in the regulatory environment. This has augmented foreign investors' perception of the risk of investing in India, and has led to lower inflows. This is reflected in India's low score of 3/6 on the World Bank's Country Policy and Institutional Assessment (CPIA).<sup>7</sup>

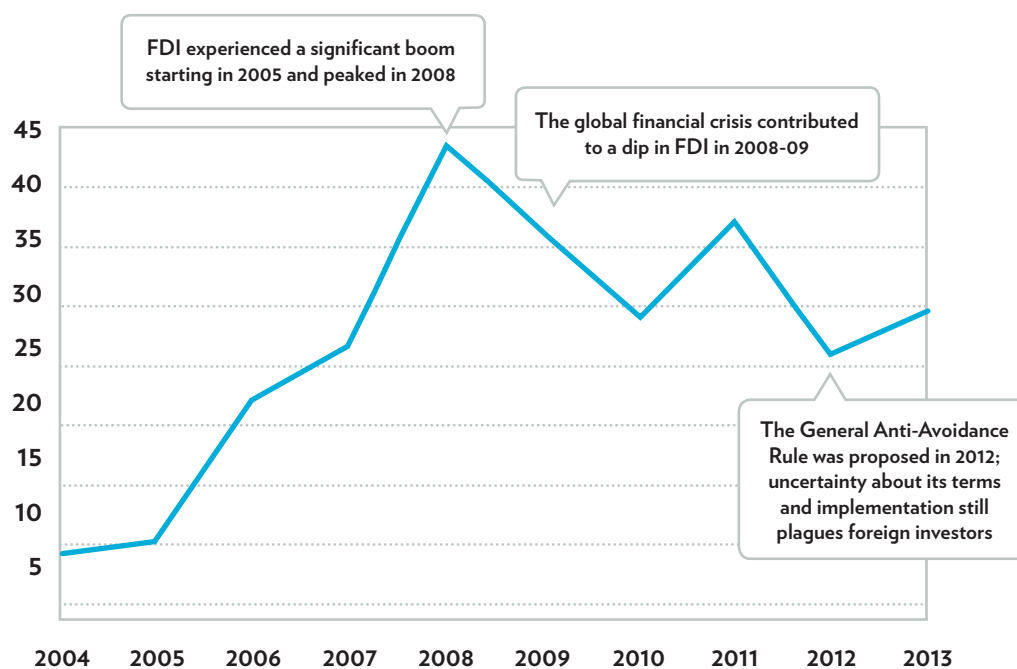


Further, negative global forces such as the global financial crisis and the Eurozone debt crisis have reduced FDI inflows. In the short-to-medium term, the growth of FDI inflows will hinge on the creation of an investor-friendly environment, as the global economy recovers. There are initial signs of investor confidence improving slightly, but sustained improvement is required to revert to earlier levels.

<sup>6</sup> In Indian law, the General Anti-Avoidance Rules are a set of rules designed to minimize tax avoidance, for example by siphoning off profits to tax havens. They are due to be implemented in April 2015.

<sup>7</sup> The CPIA Business Regulatory Environment scale of the World Bank, assesses the extent to which the legal, regulatory, and policy environments help or hinder private businesses in investing, creating jobs, and becoming more productive.

FIGURE 4: FOREIGN DIRECT INVESTMENT (FDI) NET INFLOWS (2004-2013), CURRENT USD BILLIONS



Sources: World Development Indicators, The World Bank

## Key constraints in India

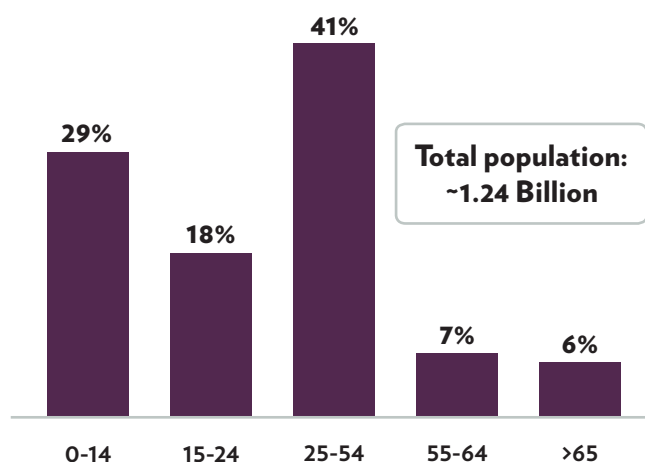
**With 47% of its population under the age of 25, India can leverage its demographic dividend to great effect if it can overcome key challenges.**

**However, skill deficits and a low-quality higher education system remain a key constraint to India achieving this potential.** In a recent report, the IMF argues that a large part of India's growth acceleration since the 1980s is attributable to changes in the country's age structure. Building on this, they estimate that India's young population has the potential to produce an additional 2% per capita GDP growth each year for the next two decades.<sup>8</sup> Such a high potential for acceleration can further attract foreign investors to look for investment opportunities in India. Unfortunately, however, 16.3% of urban males who were at least college graduates in the age group of up to 29 years were unemployed in 2011-12; the overall unemployment rate for males is 3% and for females is 5%.<sup>9</sup> Moreover, India's expansive population dilutes the positive effects of growth. The average Indian is considered to be of lower-middle income status by the World Bank with a per capita PPP GDP at USD 5,410. If India can effectively absorb the added labor force, then there is likely to be a significant push to growth.

<sup>8</sup> "The demographic dividend: Evidence from the Indian states," IMF, 2011.

<sup>9</sup> National Sample Survey, India.

FIGURE 5: POPULATION AGE DISTRIBUTION (% OF POPULATION, 2014)



Source: CIA World Factbook

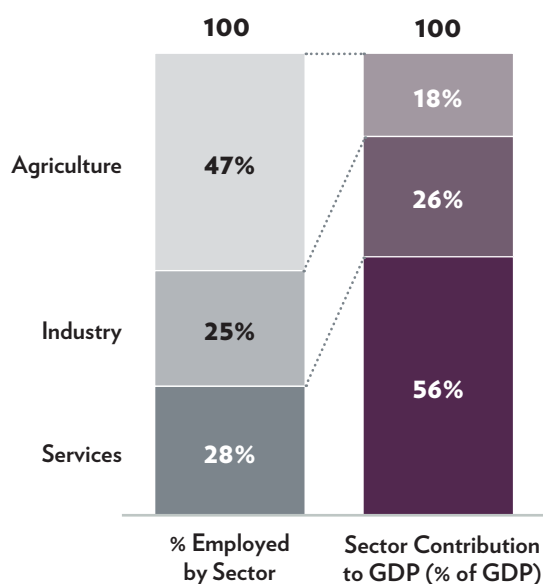
**Although India's high growth has reduced poverty levels, concerns remain around income inequality, regional disparities, and gender inequality.** As of 2010, nearly

a quarter of the population was below the poverty line of international USD 2 a day (PPP).<sup>10</sup> This is a five percentage point improvement over 2005. However, large disparities remain across states. Over 50% of the population of Bihar was below the domestic poverty line. In contrast, the figure for Kerala was 12%. Income inequality is quite high and has increased since the beginning of the liberalization era in the 1980s: the Gini coefficient rose to 0.34 in 2010 from 0.31 in 1983.<sup>11</sup> As seen in Figure 6, the contribution to GDP and the labor force employed by sectors are widely disproportionate. In 2012, services contributed to more than half the GDP but employed just over a quarter of the labor force. In contrast, agriculture employed nearly half of the labor force but contributed less than a fifth of the GDP. Moreover, India ranks 101 out of 136 countries for gender equality, the lowest of the BRICS economies. This is due to its poor performance on measures of health, education, and economic participation and equality for women.

<sup>10</sup> Using the World Bank methodology.

<sup>11</sup> The Gini coefficient (also known as the Gini index or Gini ratio) is a measure of statistical dispersion intended to represent the income distribution of a country. A higher co-efficient represents greater inequality.

FIGURE 6: CONTRIBUTION TO GDP AND LABOR FORCE EMPLOYED BY SECTOR (2012, %)



Source: World Development Indicators, The World Bank

**Despite its rapid growth, India has lagged behind many emerging economies in ensuring a decent standard of living for its population.**

India is ranked 135th in the world on the Human Development Index (HDI), and is significantly below the BRICS average score, as seen in Figure 7. According to the 2014 UNDP Human Development Report, life expectancy at birth is at 66.4 years. This is up 11 years from 1983 but is still lower than in all BRICS countries, except South Africa. Further, healthcare provision is inadequate to meet demand: as of 2011, there were 0.7 hospital beds and 0.63 doctors per 1000 people in India,<sup>12</sup> compared with 2.3 in Brazil, 3.8 in China, 3.6 in Sri Lanka, and 2.5 in Turkey, for example.

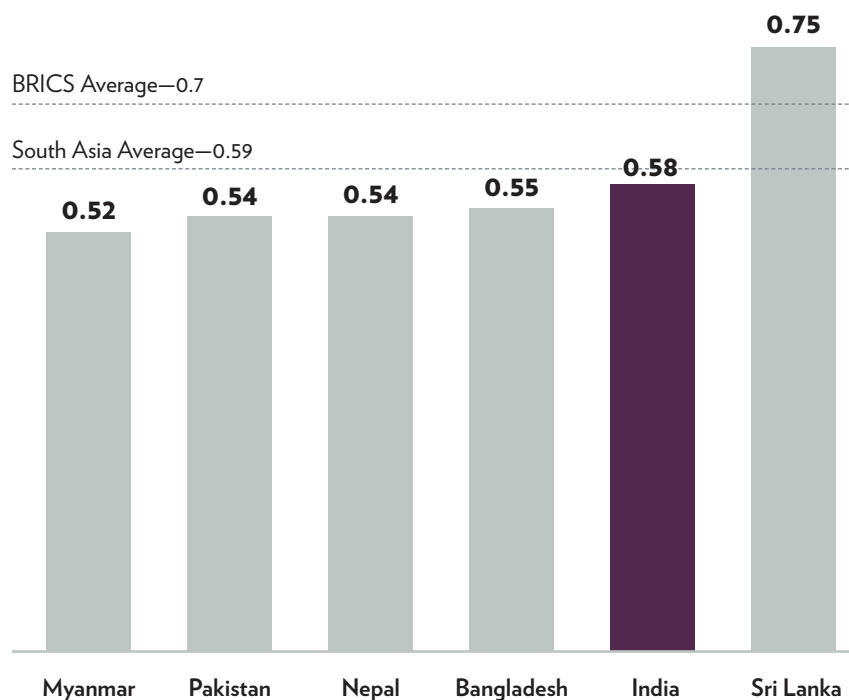
India also lags behind the other BRICS countries on measures of education and literacy. The mean number of years of schooling in India is 4.43 years, which is up by 2.5 years since 1980, but lower than that of all BRICS countries. Although the rate of school attendance is improving for primary and secondary schools, the education system remains inadequately developed due to a shortage of infrastructure, finances, and quality staff. Currently, the Indian government has focused on achieving the universalization of primary education through its “Sarva Shiksha Abhiyan,” i.e., the Education for All Movement. This program was launched in 2001 and made education free and compulsory to children between six and 14 years of age.

Sanitation has also remained a key problem in India. The WHO/UNICEF Joint Monitoring Program (JMP) for Water Supply and Sanitation estimates that only 25%

<sup>12</sup> World Health Organization, 2011.

of the rural population has access to improved sanitation facilities;<sup>13</sup> the corresponding figure for urban India is 60%. For India as a whole, this figure has doubled from 18% in 1990 to 36% in 2012, but this is still not on track to meet the country's Millennium Development Goal (MDG) target. In addition, of India's 700,000 rural schools, only one-sixth have toilets, deterring girls from attending school.

FIGURE 7: HUMAN DEVELOPMENT INDEX (HDI) SCORE FOR THE SOUTH ASIAN COUNTRIES UNDER STUDY (0 TO 1)



Source: UNDP Human Development Report, 2014

<sup>13</sup> For Millennium Development Goals (MDG) monitoring, an improved sanitation facility is defined as one that “hygienically separates human excreta from human contact” by WHO/UNICEF Joint Monitoring Program (JMP) for Water Supply and Sanitation.

# INVESTING IN INDIA: THE SUPPLY SIDE

## Overview of impact investing in India

The impact investing space in India is robust and continuing to grow; it represents the largest impact investment market in South Asia. DFIs have deployed close to USD 5 billion in direct investments in India to date, while other impact investors have deployed USD 438 million. In addition to this, approximately USD 2.6 billion has been channeled by DFIs through fund managers as indirect investments; however, we refrain from using these indirect investments in our calculation of overall totals in order to avoid possible double counting of investments.<sup>14</sup> A majority (greater than 90%) of both direct and indirect investments in India is made by development finance institutions (DFIs), suggesting that their investing behavior largely drives trends within the overall investment space; however, a large number of impact investment funds are also making a mark, independent of DFIs.

A relatively large domestic impact enterprise<sup>15</sup> market, the emergence of several exits from investments made in the mid-2000s, and the perceived strong return potential make India an attractive market for impact investors. As a result, the impact investing market in India is expected to grow further. Regulatory considerations are not a significant barrier for foreign or domestic players to enter the market, despite posing specific challenges in raising and deploying capital or structuring deals. Conventional investors often participate alongside impact investors in many deals, increasing competition and sometimes cooperation between investor segments.

**A range of foreign and domestic players have deployed capital in the Indian impact investing market.** Figure 8 provides an overview of the actors in this space.

FIGURE 8: OVERVIEW OF IMPACT INVESTORS IN INDIA

TYPE OF INVESTOR	ESTIMATED NUMBER OR RANGE	EXAMPLES		
Fund Managers	>50	<ul style="list-style-type: none"> <li>• Aavishkaar</li> <li>• Acumen Fund</li> <li>• Elevar (Unitus Equity)</li> </ul>	<ul style="list-style-type: none"> <li>• Khosla Impact</li> <li>• Lok Capital</li> </ul>	<ul style="list-style-type: none"> <li>• LGTVP</li> <li>• responsAbility</li> <li>• Sangam</li> </ul>
Development Finance Institutions	10-12	<ul style="list-style-type: none"> <li>• ADB</li> <li>• CDC</li> <li>• DEG</li> </ul>	<ul style="list-style-type: none"> <li>• FMO</li> <li>• IFC</li> <li>• KfW</li> </ul>	<ul style="list-style-type: none"> <li>• OPIC</li> <li>• Proparco</li> <li>• SIDBI/NABARD</li> </ul>
Foundations, HNWI's, and Family Offices	10-12	<ul style="list-style-type: none"> <li>• Michael and Susan Dell Foundation</li> <li>• Omidyar Network</li> </ul>		

<sup>14</sup> The share of the indirect investments already included in the direct investment total is not known.

<sup>15</sup> Impact enterprises for the purposes of this report are defined as those that have articulated a core objective to generate positive social or environmental impact (i.e. as a part of their operating model rather than an ancillary activity as with CSR programs); and seek to grow to financial viability and sustainability.



**Although both foreign and domestic impact funds are active in India, the majority are based offshore due to more favorable regulations.** Of the total of about 50 prominent impact investment funds active in India, our estimate is that approximately 80% are based outside the country, to avoid issues related to taxation and repatriation. An increase in domestic funds is expected in the future, as local investors gain confidence in impact investing.

**In the past 7-10 years, DFIs have invested over USD 7.5 billion into India, combining both direct and indirect investments.** Approximately USD 5 billion has been invested directly into enterprises, while approximately USD 2.6 billion has been invested into funds. (The impact capital invested into funds has not been included in our overall calculations to avoid double counting of fund investments into enterprises as well as the possibility of including capital that has been yet to be deployed by these funds.)

**Foundations are initiating impact investments in India; high net-worth individuals (HNWIs) and family offices are a critical source of seed-stage funds in impact-related investments (though they may lack intention or measurement).** Until recently, foundations largely only engaged in grant provision to NGOs and non-profits in India. Domestic foundations currently offer modest amounts of investment and focus on technical assistance and supportive networks for small or medium enterprises (SMEs) in India. International foundations tend to function as catalysts in specific sectors, aiming to encourage additional commercial capital in areas where investors are otherwise reluctant to invest, such as in education in India. Foundations tend to have significantly lower set expectations for returns, or sometimes none.

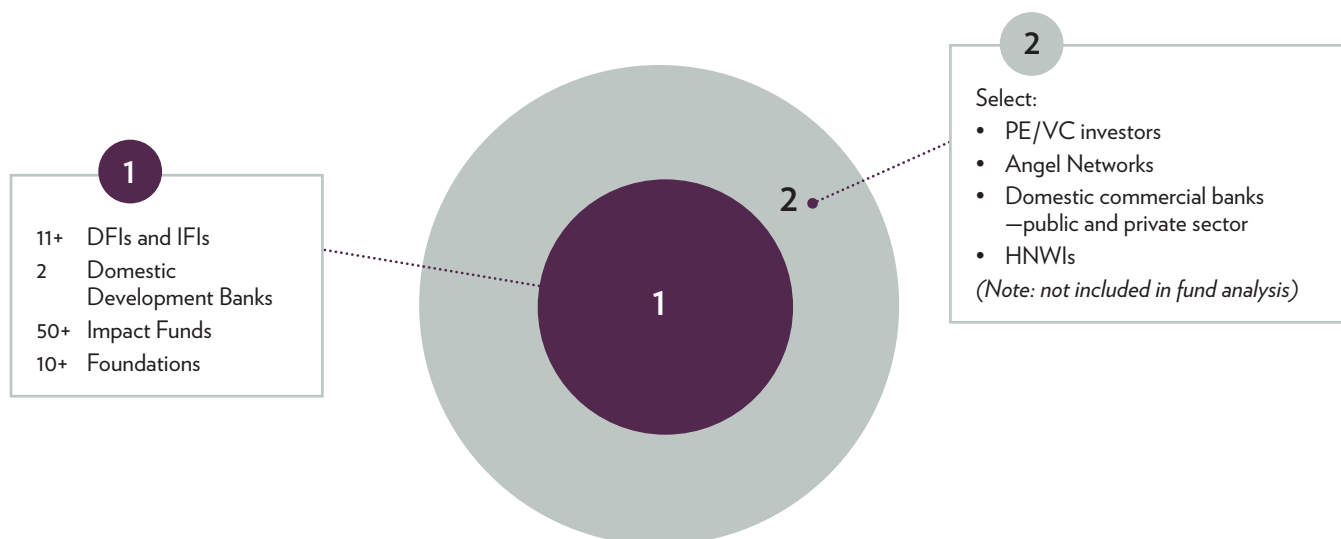
Individual investors are a predominant source of seed funding; however they are primarily driven by commercial returns. Furthermore, these investors are largely connected to enterprises through family and friend networks. Well-established angel networks, such as the Intelicap Impact Investment Network (I3N), Mumbai Angels, and the Indian Angels Network, are engaging further and more formally in impact investments, providing greater access to enterprises seeking access to seed funding.

Large business conglomerates may contribute to the pool of domestic funds for impact investment in the future; however, they are currently engaging in philanthropic efforts or purely commercially oriented investments.

**Public sector banks are involved in SME financing.** They are mandated to lend into government-determined priority sectors, including agriculture, education, and housing. On the other hand, they are wary of entering sectors deemed as new or uncertain, including renewable energy, water, and sanitation.

**India houses the largest number of impact investors in the region.** For the purposes of this study, due to the size of the Indian market and the difficulty of quantifying capital deployed by impact-related investors, the following analysis focuses only on impact investors (Ring 1 in Figure 9). As seen in Figure 9, there exists a minimum of 75 impact investors active in India.

FIGURE 9: NUMBER OF DIRECT IMPACT AND IMPACT-RELATED INVESTORS ACTIVE IN INDIA<sup>16</sup>



Source: Stakeholder interviews; Investor websites; Dalberg analysis

The total known impact capital deployed by DFIs directly into enterprises is approximately USD 5 billion. A further USD 437 million has been deployed by other impact investors. These figures quantify capital from over 300 deals.<sup>17</sup>

## RECENT STUDIES ON IMPACT INVESTING IN INDIA

**The 2014 Intelicap Impact Investing Report:** “Invest. Catalyze. Mainstream. The Indian Impact Investing Story,” is a recent assessment of the impact investing space in India produced by Intelicap and funded by GlZ. The report analyzes a total of USD 1.6 billion invested by impact investors in over 220 enterprises. The report focuses on the “venture approach” to investing. The higher estimate of invested impact capital in this study is primarily driven by the inclusion of all investments made by impact investors, as well as an enumeration of debt investments. The Intelicap report plays a prominent role in heightening our understanding of challenges and directions of impact investing in India.

**The 2013 Unitus Capital India Impact Equity Investment Report:** Unitus Capital aims to release regular reports to capture annual impact equity investing in India. Unitus Capital estimates that, in 2013, approximately USD 390 million was invested through impact private equity transactions. Yearly assessments of transactions and key trends provide the opportunity for almost real-time understanding and projections of future activity in the impact investing space.

**The 2013 Unitus Seed Fund Impact Investing Report:** In 2013, the Unitus Seed Fund published “Impact Investing Reaches a Tipping Point in India,” which provides a landscape overview of the history and relevance of impact investing in the context of economic development in India.

<sup>16</sup> See “Defining key terms and concepts” in the introduction chapter of this report for an explanation of the framework used for categorizing investors using a two-ring framework, where the inner ring—Ring 1—represents the impact investing activity and the outer ring—Ring 2—represents the activity related to impact investing but lacking either an explicit impact intention or measurement.

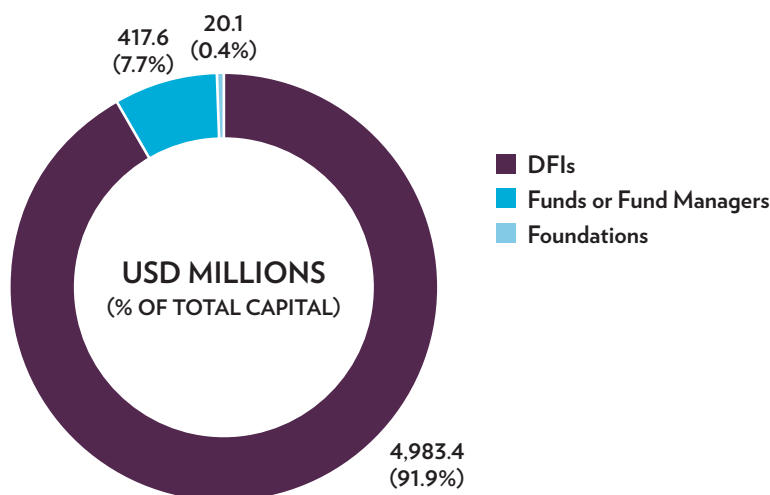
<sup>17</sup> While approximately 100 additional deals have been captured in our database, the value for these deals are undisclosed; however, the majority of these undisclosed deals are between funds and enterprises, and therefore have relatively low investment sizes in comparison to DFI deals.

# Key trends of impact investing in India

## INVESTOR MIX

**DFIs represent the largest share of capital deployed at USD 5 billion. Known investments from impact investment funds total approximately USD 418 million (Figure 10).** Our analysis suggests that at least 40% of fund deals are undisclosed, indicating that the total for fund direct investments could be as high as USD 700 million. Foundations, in addition, are mostly new actors in the impact investment space in India, and have deployed approximately USD 20 million to date. Of all known direct investments, DFI investments account for about 92%, while fund investments represent about 8%. Less than 1% of current investments originate from foundations; however, foundations exhibit a growing interest to make impact investments in addition to grants in the future.

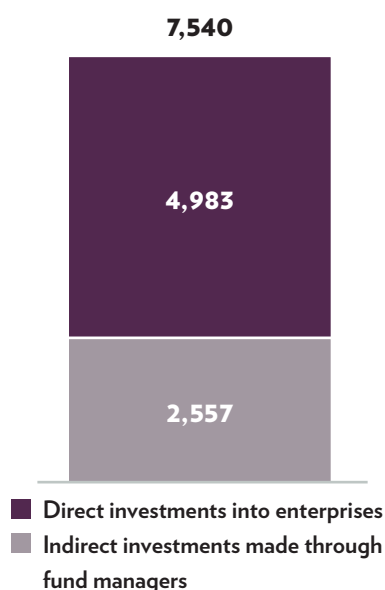
FIGURE 10: TOTAL IMPACT CAPITAL (DIRECT INVESTMENTS) DEPLOYED BY INVESTOR TYPE



Source: Stakeholder interviews; Investor websites; Dalberg analysis

**An additional USD 2.6 billion from DFIs has been channeled through investment funds.** This represents a sizeable additional investment to those that DFIs made directly into enterprises. An unknown percentage of this capital may have been captured in the previous total of direct investments from funds to enterprises (USD 418 million). While this USD 2.6 billion is not included in our estimation of the total impact capital in India, in order to avoid double counting, our estimate is that a portion of this contributes to an additional amount of capital overall.

FIGURE 11: TOTAL DFI DIRECT AND INDIRECT INVESTMENTS, USD MILLIONS



Source: Stakeholder interviews; Investor websites; Dalberg analysis

Outside the realm of impact investing as defined in this study, DFIs also contribute a significant amount of funding directly to the Indian government as public sector investments for large-scale programs in infrastructure and energy. Investments from two DFIs alone—Asian Development Bank and KfW (the German development bank)—in the past 5 years total approximately USD 5 billion into state- and national-level programming.

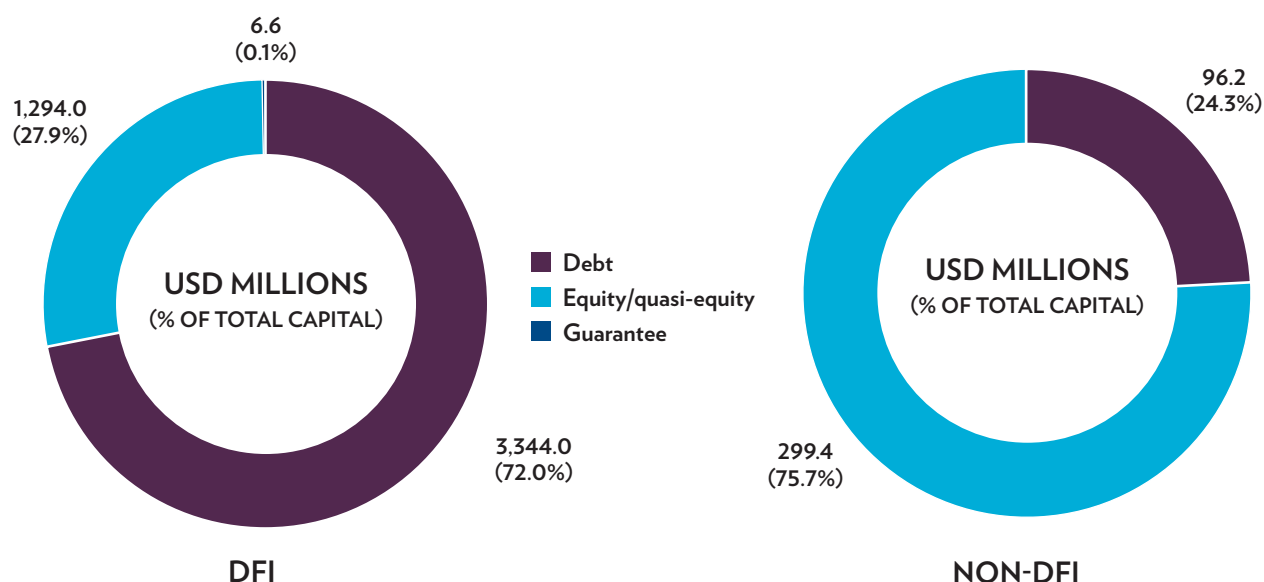
## INSTRUMENT

Approximately 68% of the total known impact capital deployed to date in the Indian market has been invested as debt; this trend is largely driven by DFIs. With the DFI percentage of overall impact capital at approximately 92%, DFI preference for debt financing drives the overall trend in instrument use. When looking at DFI investments alone, the percentage of known investments in debt is 72% and that in equity or quasi-equity is 28%. DFIs have historically tended to engage primarily in large debt deals, citing this as a lower-risk way to engage in a particular market. However, anecdotally, DFIs indicate that they do have a growing interest in equity investments, motivated by a desire to establish deeper and longer-term partnerships with their investees. The debt/equity split for a DFI could be closer to 60/40 in the next five to ten years.

Among non-DFI investments in India, 76% of known investments are in equity or quasi-equity products, while only 24% are debt. There exists a strong preference for equity among non-DFI investors. Impact funds tend to be engaged in either all debt or all equity, and only engage in a mix of investment types in cases where equity funds agree to provide debt to an existing investee as part of a follow-on round of funding. Foundations that are beginning to initiate impact investments primarily

engage in equity (approximately 90% of the known investment sample of USD 8.77 million<sup>18</sup>). The preference for equity indicates a willingness and desire for non-DFI investors to provide in-depth organizational support and take on a greater role within investee organizations. However, it also suggests a serious gap in debt financing for investees, which will be discussed later in this report.

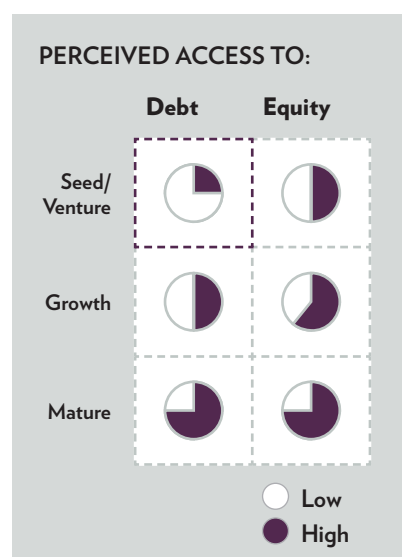
FIGURE 12: IMPACT CAPITAL BY INSTRUMENT



Sources: Stakeholder interviews; Investor websites; Dalberg analysis. Note: Unknown amount (DFI: USD 338.9 million, Non-DFI: USD 42.1 million) not included in the graphs

### Regulations prohibit most foreign providers of capital from engaging in debt transactions.

Another reason for the high percentage of equity investments among non-DFI investors is the regulation against debt provision for non-domestic investors. The Securities and Exchange Board of India (SEBI) regulations do not allow foreign investors to engage in debt transactions unless they are registered as a Foreign Portfolio Investor (FPI), a designation for which not all funds qualify. (DFIs are regulated as “internationally recognized sources” and thus are able to use debt.)<sup>19</sup> Investors often prefer to set up foreign entities, in Mauritius



18 The remaining USD 11.4 million investments from foundations are unknown in terms of instrument.

19 The Reserve Bank of India master circular from July 2014 clarifies that borrowers can raise external commercial borrowings from “internationally recognized sources” (which include multilateral financial institutions). View the circular at [http://www.rbi.org.in/scripts/BS\\_ViewMasCircularDetails.aspx?id=9069](http://www.rbi.org.in/scripts/BS_ViewMasCircularDetails.aspx?id=9069).

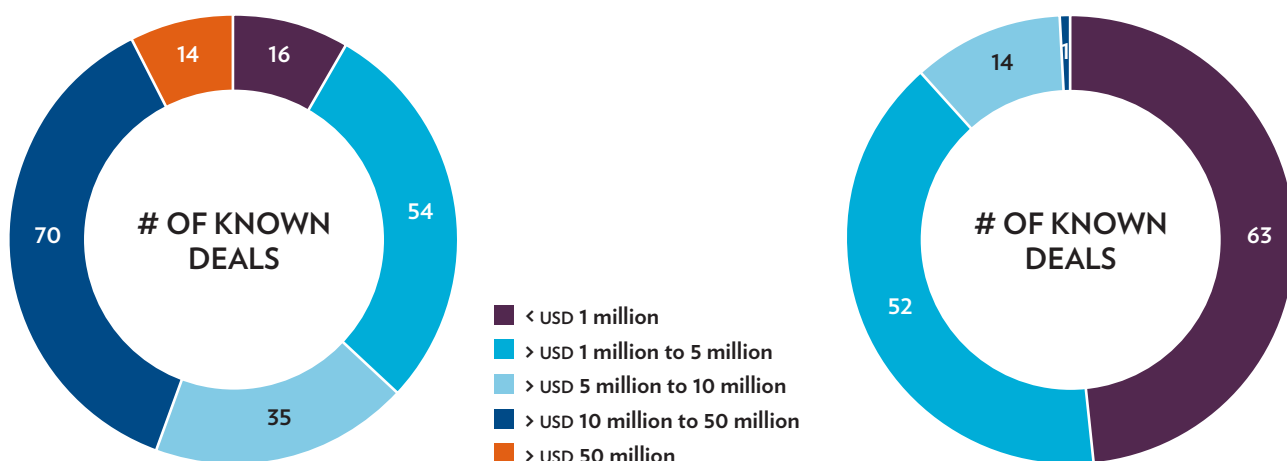
or Singapore for example, because of favorable tax structures, seamless repatriation, and a more conducive legal environment. As a result, given that most of the impact capital in India is invested through foreign entities, many are not eligible to provide debt.

**Apart from a few quasi-equity instruments, structured as convertible debt, few innovative investment instruments exist in the market.** The presence of innovative financing instruments is yet to be seen in the Indian impact investment market. Social impact bonds (SIBs), which operate on a pay-for-success model, present a great amount of potential for the future of impact investing. Educate Girls was the first Indian organization to receive support through a pay for results program that pays for outcomes, rather than outputs, of an enterprise's activities. While outcomes in the development sector are rather difficult to quantify, the increasing interest in pay-for-performance models presents SIBs as a potentially relevant option for the future.

## GROWTH STAGE AND DEAL SIZE

As expected, given the large number of impact investment deals in the Indian market in comparison to other South Asian countries, we see a spread across a range of deal sizes. With exceptions, DFIs engage in deal sizes up to USD 50 million, with an average deal size of USD 25 million. DFI deals can range from as small as USD 25,000 to deals in the hundreds of millions of dollars, suggesting varied investment behaviors and trends. Most non-DFI investors engage in deal sizes up to USD 10 million, with an average deal size of USD 3 million, including both first round and follow-on investments. Figure 13 provides an overview of the distribution in deal sizes for all impact investors in India.

FIGURE 13: IMPACT CAPITAL BY DEAL SIZE



Sources: Stakeholder interviews; Investor websites; Dalberg analysis. Note: Unknown deals not included in the graphs.

**Given co-investments in deals between DFIs, non-DFI impact investors, and conventional investors, deal sizes do not always correspond to growth stage. On the whole, impact funds and foundations engage mostly with seed-, venture-, and growth-stage organizations while DFIs prefer to engage with growth-stage and mature companies.** Mature companies have naturally absorbed the greatest amount of impact capital, given their relatively large individual deal sizes. Of the known investments in this analysis, the number of deals under USD 5 million represents more than 50% of the total number of known deals in the sample. However, despite this figure, investors do not perceive that access to capital for enterprises at the seed and venture stages is sufficient in the Indian market.

**Overall, investors indicate reluctance to engage with seed- and venture-stage enterprises, given that there is not yet enough confidence in the financial viability of investing at these early stages.** As a result, growth-stage and mature enterprises enjoy access to capital, and there exists a clear gap in the market for investments into seed- and venture-stage organizations that find it difficult to prove their business models.

**Furthermore, given that non-DFI investors are the ones with the bandwidth and ability to provide smaller investments to younger organizations, and that they are most interested in equity investments, there is a further challenge for seed- and venture-stage organizations to access debt.** Without sufficient domestic impact investment funds that can provide debt capital at small ticket sizes, access to working capital loans for small and young enterprises is difficult and is one of the biggest challenges in the impact investment market in India.

## SECTOR

**The majority of investments by impact funds have been made in the financial services sector, primarily in microfinance institutions (MFIs).** According to a recent Intellectap report, the largest percentage of investments into impact enterprises have been in the financial inclusion sector (into both MFIs and non-MFI enterprises) at 70%. Furthermore, within the financial inclusion sector, the share of capital invested in MFIs is 77%.<sup>20</sup>

**Almost all fund managers either have funds specifically focused on financial inclusion, or have made most of their initial investments in financial services organizations.** Even for DFIs, who tend to have a diversified portfolio, the financial services sector tends to be a top sector destination.

**The degree of impact as a result of investing in microfinance is a topic of continued debate.** Some stakeholders do not believe that simply lending money to low-income populations is impactful. Others contend that access to finance is a critical pillar of economic development, and that financial exclusion is emblematic of the broader exclusion of low-income populations from economic systems. The relationship between financial returns and social impact in an investment will be discussed later in this report. The high percentage of investments in financial

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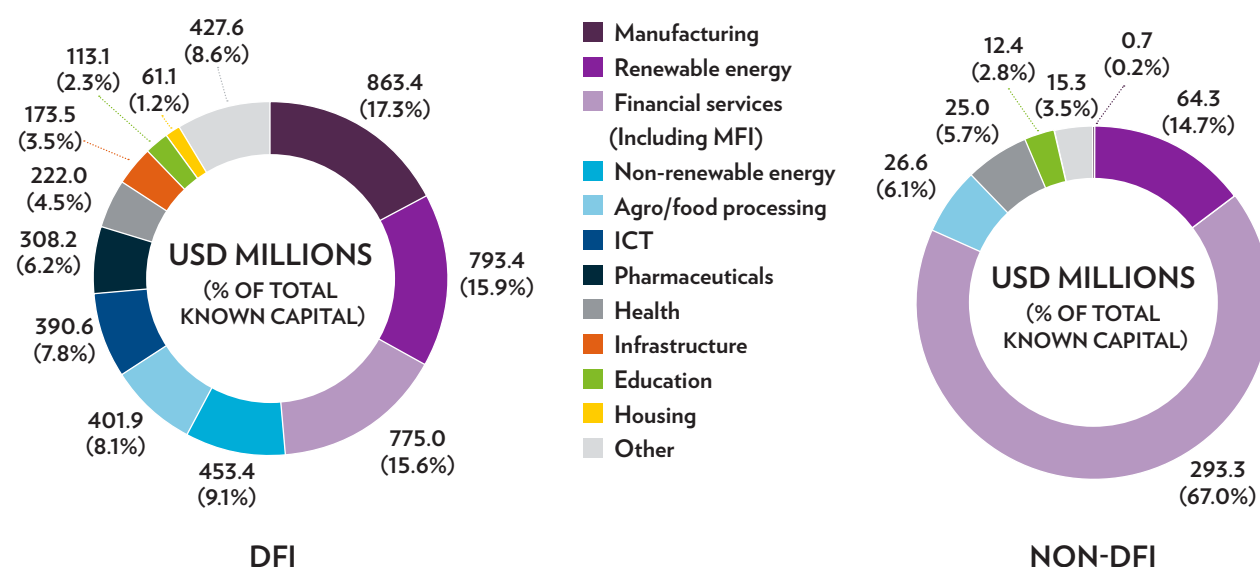
<sup>20</sup> "Invest. Catalyze. Mainstream: The Indian impact investing story," Intellectap, 2014.



inclusion, and further in microfinance, is driven by the high expected rate of returns, and oftentimes a lack of sector-specific expertise in other sectors.

**The sectors receiving the most impact capital are manufacturing, energy (renewable and non-renewable), financial services, and agri-business.** As seen in Figure 14, DFI investors have invested 17.3% in manufacturing, 15.9% in renewable energy, 15.6% in financial services (including microfinance), 9.1% in non-renewable energy, and 8.1% in agriculture and food processing. On the other hand, two-thirds of capital deployed to date by non-DFI investors has been into the financial services sector (including microfinance). Non-DFI players have invested approximately 14.7% of total known impact capital into the manufacturing sector. Agriculture/food processing companies and enterprises in healthcare have received close to 6% each.

FIGURE 14: IMPACT CAPITAL BY SECTOR



Sources: Stakeholder interviews; Investor websites; Dalberg analysis.

**Two key trends among impact investors in India are a movement from an opportunistic selection approach to a hypothesis-driven one, and as a result, an increase in the presence of sector-specific funds.** To date, investments across the board have been largely opportunistic: impact funds have often chosen portfolio companies from the many that reach out to them directly to seek funding. However, now, impact investors are eager to take on a more proactive approach when selecting investees. Investors wish to be more deliberate in identifying a sector focus, a key problem area that they wish to address, and, even further, a hypothesized mechanism through which to address this problem. With a clear problem and potential solution in mind, they seek organizations that provide this particular solution. Along these lines, while traditionally impact investment funds have been generalist funds focusing primarily on financial inclusion with limited expertise in other sectors, we are now starting to see sector-specific funds take prominence. These impact funds have a more narrow focus in their selection of investees, and provide the added value of specific, technical expertise and content experience.

## Exit possibilities

As noted above, investors are beginning to diversify the sectors in which they invest. Contributing to this shift are the dual factors of the microfinance crisis in 2010 and a few successful exits in microfinance that have freed up capital. Investors are confident in possibilities for sustainable exit models over the next five years, while acknowledging that India's impact investing market is still in early stages in sectors outside of financial services. While most of the early investments have been in financial services (particularly microfinance), investors are now showing a greater inclination to make investments in other sectors. In particular, the sectors that investors identify as being most attractive in the near future include energy, education, water and sanitation, and technology-based solutions across sectors. There is also interest in agri-business, healthcare, and manufacturing.

There have been at least 17 profitable exits by impact investors, boosting investor confidence and signaling that the industry can generate strong returns. These profitable exits have been critical in building industry confidence, providing a push to further capital flow into impact enterprises. Over half of these exits have been in the MFI sector, while livelihoods,<sup>21</sup> renewable energy and agri-business have seen some exits more recently. For example, 2014 saw Lok Capital's exit from Rural Shores, a rural business process outsourcing center, and Aavishkaar's exit from Milk Mantra, an agri-business company. While there have been a few losses made on exits as well, investor perceptions are largely positive.

INVESTOR	ENTERPRISE	SECTOR	YEAR	EXIT MODE
Unitus Equity Fund	SKS Microfinance	MFI	2010	IPO
Aavishkaar	Rangсутra	Handicrafts	2012	Trade Sale
Aavishkaar	Naveen Gram	Agri-business	2012	Buyback
Aavishkaar	Tide Technocrats	Consulting services	2012	Buyback
Lok Capital	Satin Creditcare	MFI	2013	Trade Sale
Aavishkaar	Milk Mantra	Agri-business	2014	Trade Sale
Lok Capital	Rural Shores	Rural business process outsourcing center	2014	Trade Sale

<sup>21</sup> While "livelihoods" is strictly not a sector, the term broadly refers to a set of businesses which help provide employment or generate livelihoods.

## Impact measurement

**A debate between the tradeoff, or lack thereof, between financial returns and social impact is the driving reason for erratic impact metrics among impact investors in India.** Several players in the market contend that a tradeoff always exists between an enterprise generating a profit and creating social impact. Investors who hold this view, typically foundations or others who self-characterize as “impact first,” are more conscious about putting impact metrics in place. These metrics will be discussed subsequently.

Conversely, a growing set of impact funds and enterprises believe that there is no tradeoff, and that financial returns and social impact are positively linked. For some of these funds, the same metrics can be tracked, by definition, to measure performance on both the financial and non-financial sides. Investors in this scenario believe that the due diligence process is sufficient for understanding whether the enterprise’s business model will create impact; social impact, therefore, is assumed to be reflected in financial indicators and hence the design of separate social impact metrics is not prioritized. Enterprises that hold this view tend to be those who focus on income generation for the base-of-pyramid (BoP) population, rather than organizations whose aim is to increase affordability of certain goods or services.

It is difficult to generalize the presence of these views in any specific sector or enterprise or investor group. However, investors and enterprises that have a similar set of beliefs on measurement tend to align and move forward with investment deals.

**While by definition all impact investors express impact intent and attempt to measure social impact, investors often do not design impact metrics at launch, and metrics vary by investor.** Given the time and resources invested in the selection and due diligence process, putting into place methods for impact measurement typically falls secondary to managing the investment itself; as a result, metrics are often still being developed much after the launch of a fund or finalization of a deal. Furthermore, several impact investors that act as limited partners do not have standardized indicators for measuring impact, and allow individual fund managers into which they invest, or even investment managers within those organizations, to determine the metrics used to measure success for an investee.

**Investors measure social impact using both quantitative metrics and anecdotal assessments.** Key outcome indicators tend to be developed on the basis of the assumption that economic impact will have social benefits, and common metrics include number of jobs created by the enterprise, amount of income generated for beneficiary families, and number of products sold to the BoP population. These metrics are typically in addition to a measurement of the overall reach of the business, including the number of families engaged in the organization’s activities or, more specifically, the number of women engaged. Most impact investors also supplement these metrics with anecdotal assessments (in some cases, for smaller or newer funds, anecdotal impact assessment comes first, before more rigorous measurement tools are in place). In this case, investors aim to capture stories of individuals and families that have been supported by the investment. Another approach is to capture the indirect impact on the investee or industry through knowledge creation and public visibility for a specific problem or solution.

**Although investors and enterprises are aware of formal, standardized measurement tools, the use of these is not widespread.** Global and national initiatives towards standardization of metrics used in impact investing include IRIS,<sup>22</sup> Global Impact Investment Rating System (GIIRS), and Portfolio Risk, Impact, and Sustainability Measurement (PRISM). IRIS, managed by the GIIN, is a catalog of standardized metrics to measure social, environmental, and financial performance that can be tailored by impact investors to measure performance of their investments and to increase credibility within the industry. GIIRS, managed by B Lab, uses a rating system to assess the social and environmental performance of companies and investors but does not incorporate financial performance. PRISM, launched in 2014 by Intellectap, is a rating and reporting framework specifically designed to measure the impact of investments in the Indian context and is also applicable to other emerging markets. Whereas IRIS is a set of metrics, GIIRS and PRISM are ratings systems that assign values and weights to an organization's performance on metrics. Both GIIRS and PRISM use IRIS metrics in their assessment questions where possible. Furthermore, the Indian Impact Investment Council (IIC), which will be discussed subsequently, has come together with a mission to infuse standardization in the Indian impact investing market.

Despite these available resources and tools for standardization, many impact investors have not established a standardized mechanism and a set of metrics to measure impact across investees or even investee types; they pursue impact measurement on a case-by-case basis, working with the entrepreneur to determine metrics that make sense. For impact funds where a DFI acts as the limited partner, metric-based reporting is more closely followed, including compliance with environmental, social, and governance standards.

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<sup>22</sup> IRIS (formerly known as Impact Reporting and Investment Standards) is a set of standardized metrics for impact measurement managed by the Global Impact Investment Network ([iris.thegiin.org](http://iris.thegiin.org)).

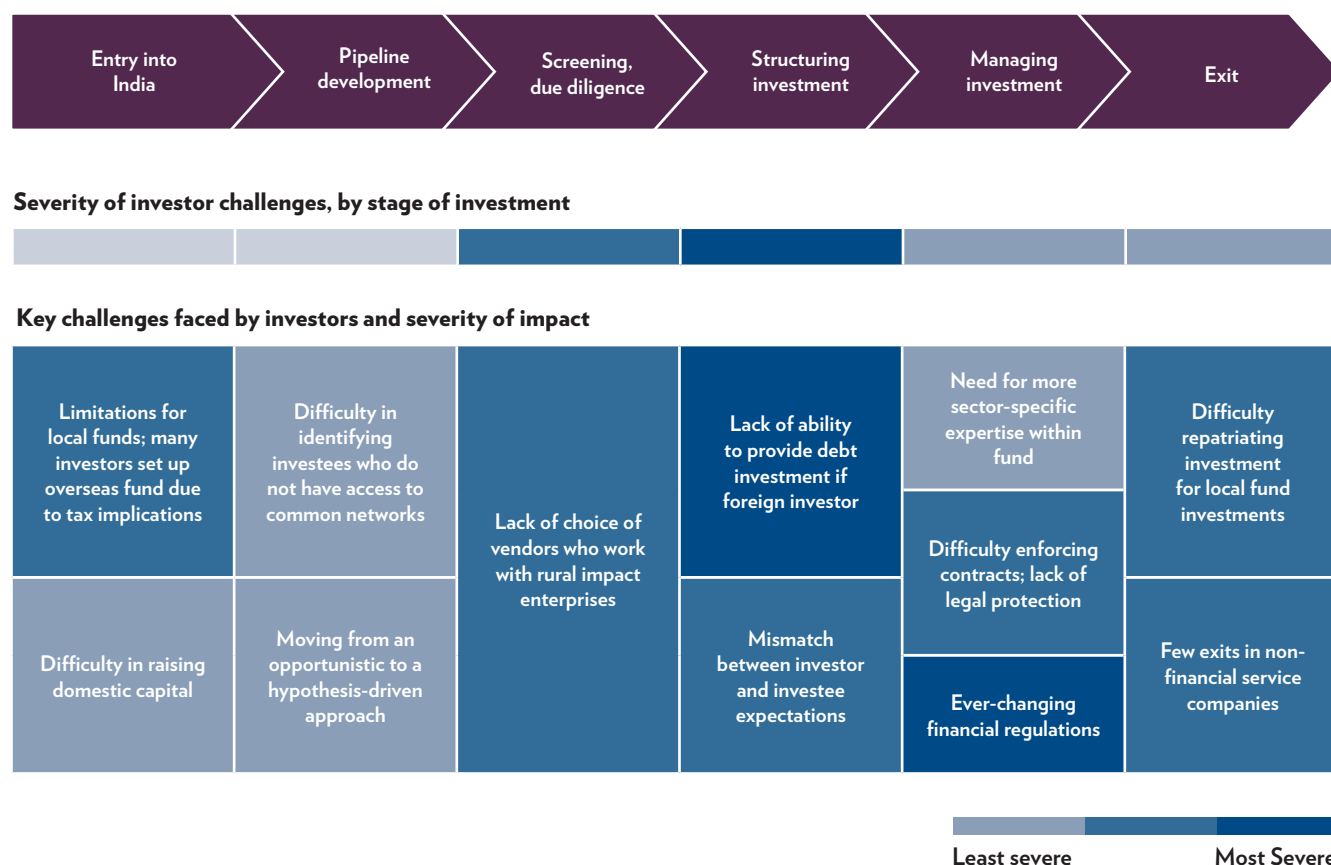
## Challenges facing impact investors in India

Overall, India presents a relatively favorable market for the entry and sustainability of impact investors, given its consistent economic growth, rich entrepreneurial culture, robust impact enterprise ecosystem, and demonstration of successful exits. Investors generally believe that, while certain challenges do exist, none are prohibitive to initiating an India-focused fund or making an impact investment in India. Nevertheless, these challenges are outlined below.

**Regarding entry into India, most challenges surround establishing an India-based fund.** Funds based in India are subject to unfavorable and inefficient tax implications; as a result, due to tax treaties between India and other countries (for example, Mauritius or Singapore), fund managers often opt to establish these funds in foreign countries. Furthermore, in order to be an India-based fund, regulations require a minimum percentage of funds to be raised domestically (this percentage varies based on size of the overall portfolio). Raising domestic capital has historically been difficult, particularly when compared with raising foreign capital. While most fund managers find it an appropriate and manageable set-up to be based off-shore, a key drawback includes the lack of ability to provide debt financing as a foreign fund, which will be discussed further in this section.

**Given a robust impact enterprise landscape, pipeline development in India is, on the whole, not seen as a major hurdle for investment; in fact, investors are becoming more proactive and strategic about their investments.** Investors do not see a challenge in finding a sufficient number of investible enterprises in India. However, they do believe that there are a significant number of enterprises who do not have access to common investee/investor networks and therefore, do not receive equal chance of accessing funding as those that do. This differential access is likely to be driven by a variety of factors including language skills (those less comfortable with English are more disadvantaged) and location (rural entrepreneurs probably have less exposure to networks). As a result, investors are planning and willing to be more proactive in their search for investee organizations—not only moving towards a hypothesis-driven approach, as discussed above, but also committing a significant amount of resources to identify relevant organizations through field visits and active engagement on the ground.

FIGURE 15: CHALLENGES FACED BY INVESTORS IN INDIA



Source: Stakeholder interviews; Dalberg analysis

**The primary concern at the screening or due diligence stage of an investment is the lack of affordable and experienced vendors.** While several large consulting companies offer due-diligence services, investors find that these organizations do not always have sufficient experience working with impact enterprises, particularly those operating in rural areas.

**Structuring and managing an investment pose the greatest challenges to impact investors in India.** At the deal structuring stage, the lack of ability for foreign investors to provide debt capital inhibits their engagement with investees, particularly early- or growth-stage organizations, who are seeking debt financing. Furthermore, potential mismatches between investor and investee preferences, particularly in terms of the investee diluting its ownership and relinquishing substantial control to the investor who takes a seat on the board of directors, often arises as a result of a lack of intermediary support. Support from chartered accountants and due diligence consultants has gone far in bridging the gap, and is likely to go even further as more players enter the market.

While managing the investment, several additional challenges arise. First, given that many investors do not have sector-specific expertise within their teams, they are unable to provide sector-specific technical assistance to their investees. Second, due

to the inefficiency of the Indian legal system, investors cite difficulty in enforcing contracts. Lastly, tax laws affecting impact investors in India change often, with varying implications for investments.

Finally, while several exits in India have increased investor confidence, exits are not entirely without challenge. First of all, there have been few exits in sectors other than financial services, suggesting that sustainable models for exits in these sectors are yet to be seen. A significant amount of impact capital is tied up with these enterprises even beyond the planned exit timeline. Further, related to other issues for domestic funds that receive an initial capital investment from foreign investors, the repatriation process for capital upon exit is often difficult. Applications for repatriation need to be made to the Reserve Bank of India following an approval for disinvestment, and a “no objection” tax clearance certificate must be obtained from the Indian Income Tax Authorities.

## Beyond the impact investing market

While beyond the scope of this particular study on India—especially given the deliberate focus on impact investors in this market—it is important to acknowledge a considerable amount of activity peripheral to the impact investing space. As in other countries, the presence of other institutional investors, banks, private equity (PE) and venture capital (VC) funds, angel investors, pension funds, and other conventional investors is strong in India. These conventional investors often invest alone or alongside other impact investors into impact enterprises as well as other enterprises (without impact intention) in sectors with potential for positive social or environmental impact. More so than in other countries under study, in India, we see a potential blurring of the lines between impact investing and conventional investing, as an increasing number of impact enterprises are seen as financially viable investments, where financial profitability inherently drives impact.

## Looking forward

While a quantification of future committed funds is not within the scope of this study, all evidence points toward an impact investing market that will continue to grow and be robust in the future. Several existing fund managers are currently raising new funds for investments in India, and DFIs have already announced plans to commit additional impact capital for future deployment in the range of hundreds of millions of dollars, through both indirect investment into funds and direct investments into enterprises.



# NEEDS AND OPPORTUNITIES: THE DEMAND SIDE

## Overview of impact enterprise ecosystem in India

The impact enterprise landscape in India has been described by various studies, including Intellectap's 2012 Social Enterprise Landscape Report, GIZ's 2012 Market Landscape of the Indian Social Enterprise Ecosystem, and ADB's 2012 India Social Enterprise Landscape Report. Given the extensive literature already discussing the demand for impact capital in India, our aim is not to provide a comprehensive overview of the impact enterprise landscape, but to acknowledge the critical role that these enterprises play in driving trends and opportunities in impact investing in India.

**The rapid growth of impact enterprises in India began in approximately 2005, with a particularly high growth in the number, scale, and prominence of for-profit impact enterprises having occurred since 2010.** Correspondingly, the last decade saw a similar growth trajectory of the amount of impact capital within the country.

**Most impact enterprises in India are in their growth stage, but the sector is relatively mature in comparison with its South Asian counterparts.** Although examples of mature impact enterprises are limited, growth-stage companies have begun to achieve scale. In order to keep up with the growing sector and create a more formal establishment of impact enterprises in India, leading organizations came together in 2012 to create the National Association for Social Entrepreneurs (NASE) as a platform for advocacy.

**A majority of impact enterprises today operate in the following four sectors: financial services, renewable energy, agri-business and livelihoods.** The single largest sector within which impact enterprises operate (approximately 21%) is the financial services sector.<sup>23</sup> The demand for capital within the financial services sector is largely what has driven the flows of capital into the sector over the past decade, as outlined in the section above. The financial services sector has received a significant policy push from the RBI and the government, and should continue to grow rapidly. Aadhaar, the unique individual identification scheme of the government, and the RBI's bank-led initiative for "a bank account for every Indian" might unlock potential for enterprises in this sector. Further, the adoption of technology-based services by the BoP, such as mobile payments, might also improve sector prospects. This is reflected in the optimism shown by impact investors towards this sector.

The renewable energy, agri-business, and livelihoods sectors each account for 15% of the total number of impact enterprises in India. Solar energy has been backed strongly by policy at the state and central levels in India, with the availability of attractive financing mechanisms. This has led to a growth in decentralized renewable energy and consumer product companies providing solar energy solutions. In the agri-

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<sup>23</sup> "Invest. Catalyze. Mainstream: The Indian Impact Investing Story," Intellectap, 2014.

business space, impact enterprises have tried to plug the severe inefficiencies in the agricultural supply chain in India, with a focus on empowering the smallholder farmer. Livelihoods companies such as rural business process outsourcing centers have tried to equip rural individuals with jobs and disincentivize migration to urban areas.

**Healthcare, education, and technology-based services are trending sectors for the growth of impact enterprises in the future.** In addition to other sectors in which impact enterprises operate, such as affordable housing and water and sanitation, the affordable healthcare space has seen a few impact enterprises achieve scale and maintain financial viability. Education represents a large opportunity; however, the sector is still being explored beyond vocational training. Challenges in the sector include difficulties caused by changing government regulations and poor infrastructure. Lastly, with the high level of mobile connectivity in India, enterprises that can deliver services via mobile devices are likely to have a huge opportunity to scale. This is likely to attract a large number of enterprises to this space.

**Many impact enterprises now adopt the philosophy of impact as inextricably linked to profitability in their business models.** Certain enterprises reject the label of a “social enterprise” or “impact enterprise” because of the association of these terms with the idea of not seeking profits. Some enterprises believe that the label reduces the attractiveness of a company seeking equity or debt from conventional financial institutions. As such, the boundaries between traditionally labeled impact/social enterprises and mainstream enterprises may become increasingly blurred.

## Access to finance

**Impact enterprises seek different financing instruments at various stages of their lifecycle.** Grants and working capital loans are prioritized at an early stage, equity at early and growth stages and long-term debt at growth and mature stages. Due to availability of capital, however, enterprises are often forced to engage in investments that may not be optimal for their business, such as taking on equity at an earlier stage than is preferable because they cannot access debt.

**Depending on their stage of lifecycle, entrepreneurs face varying difficulties in accessing finance.** In particular, seed-stage enterprises find it very difficult to secure finance, particularly in the form of working capital debt. As the impact investing sector matures, with a greater number of profitable exits and increasing investor confidence over time, the perceived riskiness of these seed-stage impact enterprises is likely to fall. Even for growth-stage enterprises that have received equity infusions, access to long-term debt is challenging. This is primarily due to the lack of lender-accepted collateral, and the inability of these enterprises to meet the three years of profitability criterion of banks. Furthermore, in sectors that banks do not understand very well, such as renewable energy and sanitation, this issue is exacerbated.

**Given the difficulty of working in rural areas and with BoP customers and producers, impact enterprises aim to grow revenue and profitability over a longer period of time than do conventional enterprises.** Impact enterprises catering to BoP customers often have difficulty in payment collection. This is largely because their customers are unable to pay regularly and reside in hard-to-access rural areas.

As a result, these enterprises require a significant amount of time to achieve scale and ensure stable revenue flows. “Patient capital,” often provided by impact investors, is the best fit to address this need.

**Although a fair number of impact enterprises have remained financially viable, fewer have achieved profitability.** An Intellect survey<sup>24</sup> found that half of the enterprises surveyed had annual revenues of over INR 50,00,000 (approximately USD 83,000), in the financial year 2010-2011. A quarter of all enterprises in this sample reported being profitable over the same period. However, this is in part attributed to the fact that a majority of surveyed enterprises had been in operation for less than three years.

**Limited financial knowledge as well as a lack of adequate support in structuring financial deals are key constraints for impact entrepreneurs in India.** Financial experts, such as chartered accountants and investment bankers, are beginning to support impact enterprises in the process of seeking capital, and structuring deals in a way that is most beneficial and least harmful to the enterprise. However, with few intermediaries such as these engaging in the process to date, impact enterprises often negotiate on their own and thus, lack the financial expertise that comes with having advisory support. In addition, with the lack of access to debt financing at an early stage in their lifecycle, impact enterprises often receive equity early on, which significantly dilutes their ownership and results in lower valuations than they might have achieved at a later stage. Impact enterprises openly advise that giving up controlling shares may lead to disagreements between the investor and the investee, and as a result, a loss of motivation and potentially a faltering business. Therefore, an opportunity exists for additional intermediary support organizations to bridge the gap between investors and enterprises.

The investor-investee relationship, beyond the point of deal structuring, experiences further tension at later stages during the relationship. Enterprises sometimes feel as though investors have expectations of returns that are difficult to meet, and that they play too heavy a role on the company board. However, while there is room for improvement, most impact enterprises, particularly those at early and venture stages of growth, prefer receiving investments from impact investors over conventional investors given mission alignment.

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<sup>24</sup> “On the path to sustainability and scale,” Intellect, 2012.

## Constraints to enterprise growth

**Acquiring operational and managerial skills, as well as recruiting and retaining quality talent, are key constraints acknowledged by impact enterprises in achieving scale and profitability.** In several cases, entrepreneurs have deep content expertise and passion for their work, but may not have the business skills or experience required for financial success. Incubators and even investors who provide support and hand-holding often play a significant role in supporting organizational scale-up. A skill deficit in the talent pool, as well as a potential lack of focus on human resource development within impact enterprises, is another challenge to achieving growth and scale.

**The policy environment under which impact enterprises operate offers financial and technical support, but awareness about how to access this support is low.** The Small Industries Development Bank of India (SIDBI)<sup>25</sup> and the National Bank for Agriculture and Rural Development (NABARD)<sup>26</sup> are two domestic development banks that offer a variety of financial schemes for micro and small enterprises. However, knowledge of these schemes is low among many impact enterprises. Enterprises that are aware of these schemes are unsure of how to access them, or find that bureaucratic processes in their implementation restrict access.

**Lastly, while India does provide a nurturing environment for impact entrepreneurs, the enabling factors for success are not necessarily accessible to everyone.** India enjoys a far-reaching entrepreneurial spirit, opportunity for innovation across sectors, and several networks and forums for technical and managerial support. However, many entrepreneurs remain unreached, particularly those residing and working only in rural areas, those who have poor English language skills, those who do not have access to networks of well-connected individuals and organizations, and those who have simply not sought involvement from incubators or investors. To date, enterprises that are identified, funded, and showcased are often those who already are well connected or who specifically seek out funding. As a result, there exists significant untapped potential in identifying innovation through more proactive and different channels, given an investor's appetite to do so.

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<sup>25</sup> SIDBI is a public sector financial institution set up to aid the development of MSMEs

<sup>26</sup> NABARD is the apex development bank in India. Its main focus is to uplift rural India by increasing the credit flow to the agriculture and rural non-farm sector. It is also active in developing a financial inclusion policy.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

**Support services for impact investors and enterprises have evolved greatly with the entry of new types of players and the formation of platforms.** Intermediaries and incubators focusing on impact enterprises have entered the market and have been growing in number and in scale. These intermediaries include (i) investment bankers, such as Unitus Capital, who help broker deals between funds and enterprises; (ii) specialized chartered accountancy (CA) companies that are in high demand in the market; and (iii) incubators such as Unltd India, Dasra and the Centre for Innovation, Incubation and Entrepreneurship that provide support to enterprises early on in their lifecycle. The intermediaries' expertise lies in analyzing enterprise data and business models, conducting field visits to verify their information and completing the due diligence process. Incubators are instrumental in providing advisory services, such as developing a business pitch, and in connecting impact enterprises to the right networks. However, some experts believe that incubators should shift their focus to provide operational, management, and mentorship support to impact enterprises, in order to make the most impact.

Portraying the maturity of the space, various platforms have been set up to connect impact investors, enterprises, DFIs and other relevant financial institutions. These platforms bring stakeholders to the table to share information and to plan advocacy efforts. For example, the formation of IIC and NASE has shown how investors and enterprises are organizing themselves to meet common goals. This is discussed in detail below. In addition, the Sankalp Forum has facilitated a common platform for stakeholders, from investees to investors to ecosystem players, within the impact investing landscape to interact with one another.

Figure 16 provides an overview of players who support the overall impact investing landscape in India.

FIGURE 16: ECOSYSTEM STAKEHOLDERS IN INDIA

#### Incubators/Accelerators



#### TA Providers



#### Credit Rating Services



#### Intermediary Support Providers



Source: Dalberg analysis

**Domestic development banks SIDBI and NABARD also play a role in boosting SME financing activity. However, awareness of their programs remains low among some impact enterprises, while others believe that they are hard to access.** Among SIDBI's various activities, the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) scheme and its subsidiary venture capital arm, hold significant potential to scale up finance to impact enterprises. SIDBI's CGTMSE scheme provides credit guarantee support to collateral-free and third-party guarantee free loans. This enables SMEs, who usually struggle to have adequate collateral, to access unsecured loans of up to INR 10,000,000 (approximately USD 167,000). However, financial institutions are often apprehensive to provide loans under the CGTMSE scheme. This is largely due to the lengthy process involved in claiming their loan amount in the case of a default. In these cases, bank branch managers have no incentive to take accountability for defaults on loans their branch disbursed. Another shortfall is that many impact enterprises are unaware of the scheme. Of the few that are aware, most do not know how to access it, or perceive the process to be too lengthy. An improvement in these mechanisms would enable a scale-up of enterprise debt financing.

SIDBI VC, a key SME financing player, was set up in 1999 to provide capital and strategic advice for micro, small, and medium enterprises (MSMEs). Under SIDBI VC, a number of funds have been created to provide support to various sectors. Most notably for impact enterprises, the Samridhi Fund, created in association with DFID, aims to provide finance to sectors in which impact enterprises typically operate. The life of the fund is due to extend to June 2020.

As the apex development bank in India, NABARD has the opportunity to play a significant role in improving access to finance for impact enterprises, for example in the provision of soft loans. However, most impact funds and enterprises perceive NABARD to be a bureaucratic government organization from which it is difficult to obtain financing. Some impact enterprises are not even aware that they can get support from NABARD. Similarly, funds believe that NABARD's sector involvement has been too limited.

**The current regulatory environment, while not prohibitive to conducting business in India, does pose several constraints.** First, investors find it difficult to operate with tax laws that change often, and with little to no prior notice. This affects investor profitability and financial activity. Adding to their concerns, under the General Anti-Avoidance Rules (GAAR) of the Indian Government, investors can be taxed retroactively. Considering these factors, impact funds operate in an uncertain environment. Moreover, the RBI regulations do not cover the deployment of certain instruments, such as non-convertible preference shares, and foreign investors are limited in providing debt to Indian enterprises. In addition, market players express concerns over policies and regulatory requirements that differ across states in India, which force funds and businesses to incur seemingly unnecessary costs of compliance.

In terms of implementation, bureaucratic processes and red tape create significant costs and delays in opening and operating a business. According to the World Bank Doing Business Rankings 2014, India ranks 158th in the world in ease of starting a business, suggesting a potentially discouraging environment for new entrepreneurs. Subsidies and government schemes can also sometimes be deterrents to investing in and operating impact enterprises primarily due to delays in disbursement and bureaucracy in the selection processes for enterprises. Many funds are unwilling to invest in subsidy-dependent businesses for this reason. In the case of funds, challenges around enforceability of contracts and resolving insolvency if a portfolio company was to fail are a cause for concern. Many impact funds are concerned about the slow judicial process when resolving such disputes. As a reflection of these issues, India ranks 186th and 137th in enforcing contracts and resolving insolvency in the Doing Business Rankings for 2014. This makes funds particularly cautious when deciding whether to invest in a particular enterprise, as they perceive a higher risk on investments, reducing the number of deals they close.

**While posing some constraints to the growth of the impact investing industry, the regulatory environment in India also offers several opportunities for impact investors.** The SEBI has taken several measures to improve the regulatory framework for funds, and the financing avenues for SMEs. SEBI, as the capital market regulator, has been the focal point for improving investment conditions and the modernization of the Indian financial system. In 2012, SEBI approved the creation of Alternative Investment Funds (AIFs) in India for the purpose of pooling capital from Indian and



foreign investors for investing as per a pre-decided policy. “Social venture funds” (SVF) fall under the first of three categories of AIFs, entitling them to certain incentives from the government, SEBI, or other regulators as they are perceived as making a positive impact beyond financial returns.<sup>27</sup> This provides a pathway for the creation of more domestic funds. For example, the domestic Incube Connect Fund is registered as an SVF.

Further, in 2013, SEBI amended the policy to mandate the creation of angel funds, paving the way for a formal framework under which angels can operate as an investor group. SEBI is also leading the establishment of an SME stock exchange with the primary aim of funneling more equity investment to SMEs. However, experts believe that awareness about SEBI’s schemes remains low among impact entrepreneurs and needs to be improved for impact enterprises to benefit from them.

**Another incentive for foreign impact funds to operate in India is the tax treaty between India and Mauritius, which allows foreign direct investors to avoid certain taxes.** As a result, a few leading impact investors with an India focus have their funds registered in Mauritius. This, however, prohibits the funds from engaging in debt transactions in India, as discussed above.

**In order to further advocate for a supportive regulatory environment, set industry standards and achieve common goals, impact funds and enterprises have organized themselves into separate organizations—IIC and NASE—as discussed above.** In 2013, leading impact investors conceptualized the IIC, a non-profit organization that aims to serve as a self-regulatory initiative and provide more information, standards and transparency for impact investing in the Indian context. This council comprises approximately 25 members of the industry including Omidyar Network, Caspian, Acumen Fund, and Elevar Equity. The expectations from this industry body will be (i) to collaborate to provide a unified view of the space and the impact being made, (ii) to address policy issues to provide a conducive market for investors to get consolidated information, and (iii) to set up a platform for dialogue. Currently, many impact funds see the IIC as a very effective localized body for policy advocacy and for sharing information. However, they note that the IIC is still in its early phases and has yet to establish a formal working body. Experts believe that the IIC’s success will hinge on building consensus among investors, which they believe could prove difficult.

Established in 2012 by successful social entrepreneurs across sectors, NASE has pioneered the creation of a platform that represents entrepreneurial interest. It was founded by Indian enterprises including Vaatsalya, RuralShores, EnglishHelper, and Husk Power Systems, with the goal of advocating, lobbying, and partnering with key stakeholders to improve the ecosystem for impact enterprises. NASE is also focusing on setting standards for impact enterprises in India and helping entrepreneurs scale rapidly. Identified by experts and market players as a key need, NASE aims to bring entrepreneurs together, share their learnings and help each other grow. These entities believe that if NASE can develop bargaining power for advocacy, it can improve the industry to a great extent.

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<sup>27</sup> Other types of funds that fall under AIF are SME funds, VC funds, and infrastructure funds.

**Overall, a rich entrepreneurial ecosystem makes India an attractive destination for impact capital, with a relatively mature enabling environment and bright prospects for the future.** Compared with emerging economies, India's impact investing industry is robust and growing. Since 2004, India has witnessed rapid growth in the inflow of impact capital and the number of funds with Indian investees. DFIs invest billions of dollars each year, and approximately 20 out of the 50 impact funds included in the study have allocated the majority of their portfolio (or, in some cases, their entire portfolio) to investing in Indian enterprises. These fund managers remain bullish on future prospects, while many plan to set up new India-specific funds in the near future. Co-investments from conventional investors demonstrate the feasibility of earning market rate returns on impact investment and suggests a potential mainstreaming of the sector in the next decade. Leading impact enterprises have achieved scale, and in the recent years, there have been at least 17 profitable exits from impact investments. These developments, along with a supportive macroeconomic environment, have built India's reputation as a vibrant destination for impact capital.

# ANNEXES

## Annex 1—Interview participants

### FUND MANAGERS

- Vikas Raj, *Accion Venture Lab*
- Payal Shah and Suzanna Thekkekerla, *Acumen Fund*
- Rema Subramanian, *Ankur Capital*
- Mona Kachhwaha, *Caspian Impact Investment Advisors*
- Sandeep Farias, *Elevor Equity*
- Venky Natrajan, *Lok Capital*
- Anand Chandnani, *responsAbility*
- Karthik Chandrasekar, *Sangam Ventures*
- Eleanor Horowitz, *Unitus Seed Fund*
- 1 Anonymous Private Equity Investor
- 1 Anonymous Venture Capital Firm

### DFIS

- Tracey Austin, *CDC*
- Kunal Makkar, *DEG*
- Tony Bakels, *FMO*
- Jan Stilke and Florian Arneth, *KfW*

### FOUNDATIONS

- Abhijit Nath, *Michael Susan and Dell Foundation (MSDF)*
- Govind Shivkumar, *LGTVP*
- Badri Pillapakkam, *Omidyar Network*

## ECOSYSTEM ACTORS

- Megha Jain, *Dasra*
- Pooja Warriar and Tej Dhami, *UnLtd*
- Anuj Sharma, *ASCo*
- Usha Ganesh, *Intellectap*
- Amit Kumar Rathi, *Unitus Capital*

## ENTERPRISES

- Sonali Mehta-Rao, *Mela Artisans*
- Rajeev Kher, *Saraplast*
- 1 Anonymous Education Enterprise
- 1 Anonymous Financial Inclusion Enterprise