Social Impact Investing: Enabling access to capital for India's next half billion

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The growth of the Indian economy will depend substantially on its ability to unlock the power of its human capital. For India to achieve its ambitious goal of a USD 5 trillion economy, it will need to focus on the aspiring 500 million people who are the backbone of the country's workforce. This is a demographic which will go online for the first time in the next few year. Unlocking the productivity and unleashing the consumption power of this demographic can truly give momentum to the country's economic growth.

Much needs to be done for this to happen. India ranks 117 (amongst 166 countries) as per Sustainable Development Goals index and scores a green (SDG achieved) for only one of the 17 targets. In fact, for 13 goals ranging across poverty, health, sanitation, environment and gender equality, the assessment is of "Significant/Major challenges remaining". There is clearly a need for private sector capital and efficiency to complement governmental efforts in these spaces. Impact investing can be that catalyst.

Impact investing is broadly defined as capital that is deployed to generate a dual objective of social impact and financial returns with a varying emphasis on either. This flexibility of structuring returns for both sets of objectives makes such capital critical and catalytic for a developing country. In some sectors, where development is nascent, the capital can take a much greater social impact focus. As the sector develops and there is a build up of an ecosystem and paying capacity for services, there could be a move towards greater financial returns. Indeed, once the flywheel gets going, it is entirely possible to see strong business models develop that may allow fund raising to move from the "impact investing" space to the wider arena of capital markets.

Financial inclusion in India, for instance, has made enormous strides on account of the Jan Dhan/Aadhar/ Mobile architecture and allowed better quality payment services to be more easily and cheaply available to large sections of India's vulnerable population. This has enabled private capital to support for profit entrepreneurs who service these markets and enabled them to build scale. A Dalberg survey of Covid Relief Direct Benefit Payments showed that almost 20% of payments were routed through Business Correspondents. As these business models evolve, they will be able to service other financial needs of this demographic. More importantly, it will enable access to the larger pools of for-profit funding that is available.

This ability to participate catalytically in social development makes impact investing compelling.

Globally, impact focussed investments have grown steadily and across a diverse set of market players. GIIN estimates (using a broader definition of impact focus) that over 1300 organisations manage $502 billion in impact investing assets globally. Debt remained the most used investment instrument. For close to 70% of investors, financial attractiveness relative to other investments was important.

The IIC/Asha Impact 2020 study reports that impact enterprises in India have collectively raised $10.8 billion over the last decade (2010- 2019) and supported over 550+ for-profit social enterprises impacting 490 million beneficiaries, mostly low income communities who are underserved by traditional businesses as well as public sector social service delivery. This suggests that the capital flowing into impact investments has steadily grown. Of the $10.8 billion invested over the last decade, approximately $3.5 billion of the total has come from mainstream VC and PE investors (who may not have any impact criteria), mostly in the last few years, demonstrating the success of impact investment in crowding in commercial capital. The amount of funding coming from impact investors (including club deals) has also increased dramatically from $860 million in 2010-12 to $4.9 billion in 2016-19, showing a commitment by impact investors with increasingly larger fund sizes to invest in follow-on rounds through early stages and growth stages, and a much greater degree of collaboration in deal-making between impact investors and commercial venture funds.

A majority of impact investors in a Brookings 2019 survey achieved above market returns, defined in the Indian context as beating the Sensex, which is India's weighted stock-market index of 30 companies listed on the Bombay Stock Exchange. This can really strengthen rvthe case for social impact investing in India. The large gap between global numbers of impact investing and AUM in India points to the fact that there is a potential supply of global capital that can support social outcomes even as they seek financial returns.

What are the challenges for this capital to flow in ?

A common theme reported in both the global and Indian surveys is the central challenge of how impact is measured. There are a number of measurement frameworks currently in use, both proprietary as well as some that are set up by Development Financial Institutions/ Industry Associations & academia. However, "Impact washing" is still a concern as investors worry about the potential of reported impact not matching up with real progress.

Hence, a common understanding of measurement and transparency remains one of the key challenges to attract more funding into social impact investment.

The other significant challenge is then directing the appropriate type of capital towards a certain goal/sector.

The launch in June of SEBI's draft Report on the Social Stock Exchange is both timely and constructive in this regard. Three of its suggestions can particularly help the country in regard to increasing the flow of funds to social impact investments :

1.Transparency in measurement of impact:

Clearly, measuring social impact is not easy especially compared to the clear calculation of financial returns. There are also numerous externalities and difficulties in correlating interventions and outcomes. At the same time, too much focus on measurement of social returns could have unnecessary consequences in terms of the desired social change.

The Report addresses this by suggesting, firstly, self-reporting by social enterprises and lays down a minimum set of standards for that.

a. Strategic intent and goal setting: covering vision of the organisation, the social problem it is trying to address and the target segments that it will serve. This will include the approach proposed for its work and risks/mitigants.
b. Social impact scorecard : This framework will measure the coverage/ reach, the depth of impact on the target segment and the nature of increased inclusion/ social equity.
c. General information : This will relate to legal structure, governance, funding and statutory filings.

More importantly, the Report also articulates a pathway for the future and moves from self- reporting to limited third party verification (over a 4 year period) to an end state of full third party verification over a 7 year horizon.

It also envisages that these standards should first apply to only those entities seeking to raise money through the SSE and gradually cover all social enterprises over the same 7 year period.

2.Transparency and standardization of financial reporting:

The report has also recommended setting up new, uniform financial reporting standards as non-profits currently face an array of different reporting requirements and norms based on a variety of criteria such as their nature of registration and whether they accept foreign funds. Having such norms in place can make non-profit financials more transparent and easier to compare and understand. Such standardization of practices in other sectors has led to greater investor trust and therefore a greater ability to raise funds.

3.Choice of instruments to enable appropriate matching between need and investment product :

The report has highlighted the various instruments that could be used to channelize funds by standardising and rationalising funding structures. This will also result in greater awareness of some existing means of accessing funds.

a) Non Profit Organisations : Access could be through Mutual Fund structures (like the HDFC Cancer Fund), Pay-for-success structures (like social impact bonds) and Grants-in, grants-out structures that build on existing AIF guidelines.
b) For Profit Enterprises: In addition to the above, there could be a possibility to list these entities equity offerings.

Covid has highlighted the need for momentum in moving ahead on all of the Sustainable Development Goals. It has also been evident that social enterprises (both for profit and not for profit) have played a crucial role in supplementing and complementing governmental action in terms of relief, recovery and rebuild.

This can be a watershed moment for all social enterprises to channelize more funds into the sector and to do it with greater transparency and trust.