Exploring the venture philanthropy ecosystem in India

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Contents

Preface

India faces several critical challenges in its social and development sectors in the 21st century. In the country's battle to overcome these challenges, there is growing recognition of the importance of professional management in social purpose organizations (SPOs) today.

Over the past decade, the venture philanthropy (VP) movement has gained significant ground in the US and Europe. It has adapted tools and techniques from the venture capital (VC) and private equity (PE) segments to invest in and build sustainable and scalable SPOs. The focus of venture philanthropists is on providing multi-year support to ensure organizational capacity-building in SPOs. High levels of management competence, an emphasis on strategic planning to achieve significant social change outcomes and concurrent measurement of the impact of every dollar spent constitute the hallmarks of the VP movement.

In India, VP and allied organizations are making long-term strategic investments to build for-profit and non-profit innovative SPOs that can make a mass social impact. VPs place emphasis on social returns, although some such organizations also demand muted financial returns in addition to social returns. The former acknowledge that investment for social purposes and professional effectiveness are not in conflict with one another, but can exist and work in synergy.

This paper presents the first primary assessment of the VP ecosystem in India. As part of this effort, we have determined the extent of VP activity in India and how other players in the country's social sector are complementing the growth of this movement. We have also focused our efforts on analyzing the extent of differentiation VP and allied organizations have introduced in the management of SPOs. Therefore, our research was designed to critically appraise provision of financial and non-financial support from VP and allied organizations. In doing so, we explicitly delineate the challenges the movement faces in the country and initiate a dialogue on strategies to overcome these challenges.

We hope this paper will help you understand the characteristics of VP models prevalent in India, and provide a foundation for Indian VP and allied organizations to further discuss and find workable solutions, and ensure that the current gaps in the country's VP ecosystem are bridged.

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Parul is the Practice Leader of the Development Advisory Services at Ernst & Young in Gurgaon, India. He has over 16 years of experience in providing strategic leadership to large development programs at the country and regional levels to national and international organizations. He has worked on a range of issues, including enhancement of women's entrepreneurship, economic empowerment, corporate social responsibility and the effectiveness of donor-funded programs. His forte is developing innovative methodologies for the Bottom of the Pyramid (BOP) and social development solutions. Parul is a founding board member of Save the Children-Bal Raksha, the Indian entity of the Save the Children International network. He is the Co-chair of the Access to Finance working group in the La Pietra Coalition (based in Washington D.C.), an organization working to promote women's economic empowerment worldwide. In addition, he is an Advisor to the Asian Venture Philanthropy Network in India.

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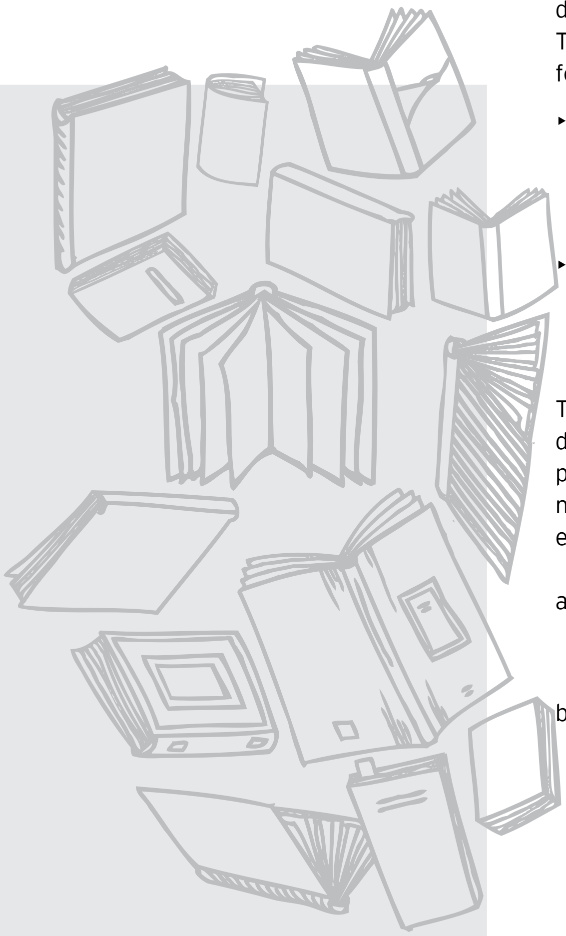
Stuti is a business researcher and consultant in the areas of generative thinking and performance management in innovative medium enterprises. An MBA from Lancaster University's Management School, she has previously worked with Citibank and Yes Bank Limited. With a strong background in financial management, Stuti has brought with her a unique blend of structured thinking and cross-functional project management skills to accomplish this research study.

Executive summary



This report is the first primary assessment of the VP ecosystem in India. Although VP and allied organizations have been in existence in the country since the late 1990s, roughly at the same time the trend was initiated overseas, there is inadequate documentation on the subject in the Indian context. Therefore, this report was commissioned with the following objectives:

- To collate and share knowledge about elements that exist in India's evolving VP domain To analyze and document existing gaps in the country's current VP ecosystem
- To initiate a dialogue for institutional strengthening of VP and allied models to help to augment the pace of socio-economic development in India

This research investigates, analyzes and documents the activities of the elements that are playing a critical role in the development of this nascent field. We define the elements of the VP ecosystem in India as follows:

a. Supply side: This constitutes VP and allied organizations that provide financial and non-financial support to SPOs.

b. Demand side: These include SPOs whose activities directly benefit the community and create a social impact. These may either operate as non-profit entities or may be for-profit social businesses or enterprises.

c. Financial intermediaries: These are relatively new players in the field and provide transaction advisory services (akin to those provided by investment banks) to enable a flow of institutional capital to credible SPOs.

d. Professional service providers: These organizations provide non-financial advisory services to the supply side as well as the demand side, and their services range from management consultancy to specific functional matters including performance measurement and evaluation.

e. Academic institutions: These mainly include institutes of higher learning that play an important role in training a pool of professionals, who can be expected to contribute to the further advancement of VP in particular and the social sector in general.

Our research focused on a concurrent exploration of all the elements operating in the VP domain, as compared to only a study of VP organizations in isolation. First, we conducted a secondary study on the activities of close to 300 national and international organizations that are associated with the social and development sectors in India. Thereafter, we selected 40 organizations out of these, which had the primary VP requirement of providing long-term as well as financial and non-financial support. Out of these 40 organizations, we surveyed 30 to understand their investment interests, scope of non-financial engagement, return

Inabililty to reach grassroot organizations Geographic concentration of investees	Inabililty to reach grassroot organizations Geographic concentration of investees
Capacity constraints of VP and allied organisations Low utilisation of paid professional services for managing investee portfolios Concerns relating to risk management	
Debt constraints for working capital finance for SPOs Issues related to Foreign Contribution Regulation Act, limiting the ability of domestic VP foundations to raise funds abroad	Absence of appropriate legislation for social businesses Relevance of SEBI's proposed regulations on social venture funds for VP funds Impact of proposed Direct Tax Code on management of non-profit SPOs

expectations, performance management and exit strategies. Next, we surveyed 20 SPOs that have benefited from VP funding. While our survey of these 20 SPOs may not seem extensive, as compared to the aggregate number of SPOs that are or have been supported by VPs and allied organizations, its only purpose was to obtain a representative view of them. The survey also focused on the benefits of the non-financial support offered by VP and allied organizations. It therefore comprised a mix of objective and subjective questions that sought specific comments on provision of non-financial services. In addition, we conducted semi-structured interviews with the officials of 15 representative organizations operating across the VP ecosystem in the country.

The results of this exercise have helped us to understand the salient features of VP and allied organizations in India and have also provided us with an insight into the gaps that currently exist in the country's emerging VP ecosystem.

These gaps, summarized in the figure above, lay the foundation for initiating a dialogue on institutional strengthening of VP and allied models in India. Strengthening VP within the country is likely to open up the scope for augmenting the pace of its socio-economic development. We conclude by offering some suggestions on how the gaps in the country's VP ecosystem may be bridged. Our proposal builds a case for elements in the VP ecosystem pooling their resources to enable the following:

- A strategic partnership needs to be established between VP and VC organizations in the country. Such partnerships are likely to not only provide the benefits of co-investment, but also help in the development of a managed pool of high-quality volunteers comprising senior resource personnel from the VC and PE industries. This can be expected to help VP and allied organizations address their internal capacity constraints and also implement best practices in portfolio risk management.
- The visibility and approachability of VP and allied organizations can be enhanced by the implementation of targeted training and educational programs to attract the attention and interest of grass-root organizations as well as young Indian professionals in the field.
- Furthermore, the legitimacy of this nascent field can be increased by identifying and partnering with the champions within the policy-making domain. This can help in the creation of laws that identify and incentivize the convergence of the hybrid model advocated by VP and allied organizations.

Introduction

In the past decade, philanthropy witnessed a differentiated approach that adopts leading practices from the VC and PE investment domains. Referred to as venture philanthropy, the advocates of this approach separate themselves from traditional philanthropists, since they seek to provide financial and non-financial support over an extended period of time stretching from two to over seven years. Their main objective is to help to ensure the sustainability and scalability of SPOs so that these can create the maximum impact with the limited resources at their disposal. This report provides an outline of the VP ecosystem in India.

Background

In its country overview of India, the World Bank acknowledges that the country has emerged as a global player in the past decade, and is today the world's fourth-largest economy in terms of its purchasing power. However, the bank's preliminary estimate of poverty in the country for 2009–10 stands at 32% . Furthermore, it questions the quality of service delivery of government programs when it states that "Most public programs suffer from varying degrees of ineffectiveness, poor targeting, and wastage of resources. In the current economic climate, India will have to dramatically improve the impact of every rupee spent."[1]

The United Nations Development Programme (UNDP) provides further analytical information on the co-existence of high economic growth with extreme poverty in the country, categorically stating that the high economic growth witnessed has not resulted in human development outcomes.[2]

Data from the World Bank on the effectiveness of aid indicates that the per capita net official development assistance received by India is US$19.[3]

1 The World Bank Group, (2011); India Country Overview; [online]; (Updated September 2011); Available at http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/0,,contentMDK:20195738~pagePK:141137~piPK:141127~theSitePK:295584,00.html ; [Last Accessed 20 February 2012].

2 Empowered People: Resilient Nation, Situation Analysis and Emerging Issues for India 2013 and Beyond, United Nations Development Programme, India, [online]; (November 2011); Available at http://www.undp.org.in/content/mdg/UNDP_India_Sitan.pdf ; [Last Accessed 20 February 2012].

3 The World Bank Group, (2012); Data: Aid Effectiveness; [Online]; Available at http://data.worldbank.org/topic/aid-effectiveness [Last Accessed 20 February 2012].

Simultaneously, it shows a grim picture of the parameters used to measure the effectiveness of aid, e.g., the achievement of millennium development goals, which underlines the gaps in the effectiveness of aid provided in the country. Advocating the concept of capacity development as a means of ensuring greater effectiveness of aid, UNDP categorically states that "while external assistance can have a catalytic effect on development outcomes, UNDP believe that official development assistance (ODA) is just one element of national public finance."[4]

As "income has become more concentrated among the top earners in the country",[5] there has also been increasing pressure on mainstream commercial businesses to adopt initiatives that may fall outside the scope of their core competencies. While corporate India has responded to the call for greater participation by increasing its investments in Corporate Social Responsibility,[6] the abilities, and at times, even the intention of mainstream commercial businesses to invest in serving the exclusive needs of the disadvantaged sections of society continues to be questionable. There is no doubt that the development of the market economy has brought about the commercialization of numerous innovations that have significantly improved the quality of life for many people in the country. However, when it comes to reaching out to those at the bottom of the pyramid, corporate sector organizations sometimes find it untenable to alter their business models so that their products and services meet the specific requirements of low income groups.[7]

[8]Streeten states society's "disillusionment with government,"along with unwillingness to "hand over all the activities" to private businesses, which are primarily governed by economic motives, as possible reasons for a rise in the activities of non-profit organizations (NGOs). However, he is equally skeptical about the sustainability of NGOs and their ability to fill the gap the Government and the private sector have left wide open. His paper offers statistical support for this argument when he states that as of 1997, NGOs failed to reach over 80% of the 1.3 billion estimated to be living in extreme poverty, although they reached around 250 million poor people in developing countries (ibid, p 197). He concludes by stating that irrespective of the growth of NGO activities, their impact is not likely to be substantially increased, given that most of them suffer due to the vagueness in their objectives, management issues and lack of scalability, which limits their reach to only a few, with the "poorest not being among them." [9]

The current development paradigm in India is dominated by the following two trends:

- There is an increasing interest in application of private wealth to eradicate poverty and related social evils. In 2010, private charity in India was estimated at between US$5 billion to US$6 billion, a three-fold increase from US$2 billion estimated in 2006.[10]
- An increasing number of individuals or institutions providing financial resources to SPOs are asking an equally increasing number of questions on the impact of each dollar spent on improving the quality of life in the country. This has resulted in advocacy of the need to apply the professional principles of investment and management to philanthropy, with the objective of building an inclusive society in India.

Globally, concerns relating to the issue of effective utilization of resources by SPOs have led to an orientation toward strategic philanthropy, which has metamorphosed into VP. While strategic philanthropy advocated application of scientific methods to measure the impact of every dollar

4 UNDP; (2011); "UNDP's Response to the 2011 Survey on Monitoring the Paris Declaration: Implementing The Paris Declaration on Aid Effectiveness"; [Online]; Available at http://www.beta.undp.org/content/dam/undp/library/capacity-development/English/Implementing-the-Paris-Declaration-on-Aid-Effectiveness.pdf [Last Accessed 20 February 2012].

5 Klugman, Jeni; 2011; "Human Development Report 2011; Sustainability and Equity: A Better Future for All"; Published by Palgrave Macmillan for United Nations Development Programme; Available at http://undp.org.in//sites/default/files/HDR_2011_EN_Complete.pdf ; [Last Accessed 20 February 2012].

6 Sheth, Arpan and Singhal, Madhur; (2011); "Indian Philanthropy Report 2011"; Bain & Company, Inc. [online]; Available at http://www.bain.com/bainweb/images/LocalOffices/Bain_Philanthropy_Report_2011.pdf [Last Accessed 20 February 2012].

7 Loseke, Donileen R; (1997); "The Whole Spirit of Modern Philanthropy: The Construction of the Idea of Charity, 1912-1992"; Social Problems; Vol. 44; No. 4; Pgs. 425-444.

8 Streeten, Paul; (1997); "Nongovernmental Organisations and Development"; Annals of the American Academy of Political and Social Science; Vol. 554; Pgs. 193-210.

9 Streeten, Paul; (1997); "Nongovernmental Organisations and Development"; Annals of the American Academy of Political and Social Science; Vol. 554; Pgs. 193-210.

10 Sheth, Arpan and Singhal, Madhur; (2011); "Indian Philanthropy Report 2011"; Bain & Company, Inc. [online]; Available at http://www.bain.com/bainweb/images/LocalOffices/Bain_Philanthropy_Report_2011.pdf [Last Accessed 20 February 2012].

spent, VP goes a step further to ensure the availability of adequate resources for professionally managed SPOs. Not only is there significant stress on measurement of performance, the VP approach emphasizes the importance of SPOs' performance management. Venture philanthropists have therefore adapted the rules of VC or PE investments to select and provide resources for long-term management of credible and innovative social purpose "investee" organizations to help them deliver their strategic social goals.

The VC model can be described as an orderly process involving sequential steps related to the origination of deals (active consideration of investment prospects), deal screening (in-depth evaluation of a few chosen investment prospects), deal evaluation (an assessment of the expected risk and return from an investment) and deal structuring (consummation of a deal by entering an agreement detailing the price of the deal in terms of equity and other covenants related to management structure and control of the business.[11] Once a deal is signed, the role of the venture capitalist expands from being an investor to that of a collaborator with an active interest in the performance of the newly formed organization. Venture capitalists nurture innovative but high risk businesses by providing capital as well as strategic advice and networking opportunities. The start-ups that perform receive further capital, whereas those with ideas that fail to take off are cut off from further investments.

The same principles, when applied to the field of philanthropic funding to reap social returns, can provide a better chance of success for leaders with innovative ideas on social progress. In the West, the rise of VP is attributed to Letts, Ryan and Grossman's 1997 article[12] — an article that does not mention the term "venture philanthropy," but which lists the need for philanthropic grant-making foundations to study VC techniques and principles to achieve enhanced social returns, as compared to traditional grant-making by philanthropic associations (Moody, 2008)[13] and Van-Slyke and Newman (2006).[14] Stating that the challenges faced by a VC firm and a grant-making foundation are similar, since both seek accountability and reliability in the performance of young organizations in implementing ideas, Letts et.al (1997) urge a more comprehensive and engaged relationship between grant-making foundations and recipient organizations on the lines of those existing between VC firms and investee companies.

Frumkin (2003)[15] provides a glimpse into the political and economic context leading to the emergence of the concept of VP in the US. According to him, the rise of the VC movement in the country in the1990s resulted in the emergence of a new class of wealthy individuals, who were successful in building large companies from scratch by using the principles of due diligence and long-term financial commitment, as well as by availing of strategic advice on managing young businesses. This led to a rise in investment, first in the political field, with the 1991 US presidential campaign of the Democrats focusing on the use of the term "social investments" in domestic health and education programs. Gradually, investments found their way into the field of philanthropic grant-making, with the aim of seeking a solution to issues relating to social impact and measurement.

In Europe, VP emerged in the first decade of the 21st century and now spans grant-making and investment activity in SPOs – from charities and NGOs to social businesses.[16] It spread rapidly in Europe with the formation of the European Venture Philanthropy Association in 2004, which has a member base of 140+ organizations today, which actively advocate and promote VP across 20 European countries.

India has not been untouched by the emerging VP phenomenon, and according to our research, there are 35–40 organizations operating in the country that have gained their learning from VC and PE industries to suit the varied needs of Indian SPOs.

11 Tybjee, Tyzoon T. and Bruno, Albert V.; (1984); "A Model of Venture Capitalist Investment Activity"; Management Science; Vol. 30; No. 9; Pgs. 1051-1066.

12 Letts, Christine; Ryan, William; and Grossman, Allen; (1997); "Virtuous Capital: What Foundations Can Learn from Venture Capitalists"; Harvard Business Review; Vol. 75; No. 2; Pgs. 36-44.

13 Moody, Michael; (2008); "Building a Culture: The Construction and Evolution of Venture Philanthropy as a New Organisational Field"; Non-Profit and Voluntary Sector Quarterly; Vol. 37; No. 2; Pgs. 324-352.

14 Van Slyke, David and Newman, Harvey; (2006); "Venture Philanthropy and Social Entrepreneurship in Community Redevelopment"; Nonprofit Management and Leadership; Vol. 16; No. 3; Pgs. 345-368.

15 Frumkin, Peter; (2003); "Inside Venture Philanthropy"; Society; Vol. 40; No. 4; Pgs. 7-15.

16 Balbo, Luciano; Hehenberger, Lisa; Mortell, Dierdre and Oostlander, Pieter; (2010); "Establishing a Venture Philanthropy Organisation in Europe - A Practical Guide; (2nd Edition); Published by European Venture Philanthropy Association.

Objectives/Purpose

The study has three main sections that are devoted to discussion on the following:

- Elements of the VP ecosystem in India
- Characteristics of Indian VP and allied organizations
- Gaps in the country's VP ecosystem

This study is the first conducted by AVPN's Knowledge Centre and complements its mission of promoting the cause of VP across Asia. The focus of the research is on the VP and allied organizations that have invested in SPOs in India. However, the intention is not to define a rigid perimeter relating to the principles of VP in practice. Instead, we present a concurrent exploration of the activities of VP players that are crucial to the development of an ecosystem, which is favorable for the spread of VP in the country.

This research report has been written with the following objectives:

- To collate and share knowledge on the activities of the large number of players in the evolving VP domain in India
- To analyze and document the gaps in India's VP ecosystem
- To initiate a dialogue for institutional strengthening of VP and allied models and facilitate the process of augmentation of the pace of socio-economic development in the country

Terminology

Frumkin[17] has provided the translation of VP terminology given below:

VP term	Translation
Investment	Grant
Investor	Donor
Social return	Impact
Performance measurement	Evaluation
Benchmarking	Standard-setting
Due diligence	Grant review process
Consultative engagement	Technical assistance
Investment portfolio	Grant list

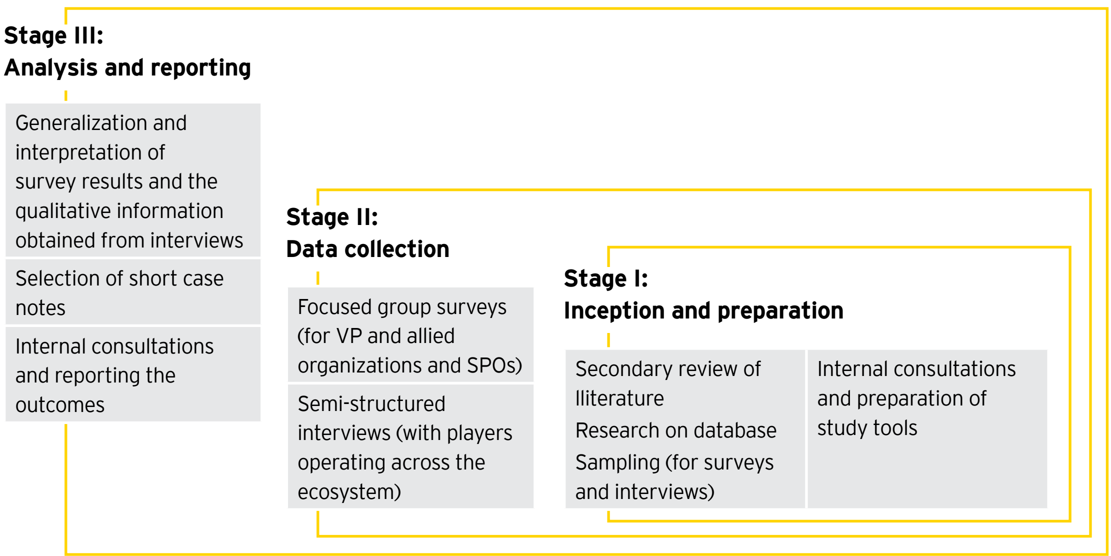
Taking this VP terminology as the base, we have expanded it, keeping in view the expansion the domain has witnessed in the last decade.

17 Frumkin, Peter; (2003); "Inside Venture Philanthropy"; Society; Vol. 40; No. 4; Pgs. 7-15.

Table 1: Terminology

Term	Description
VP and allied organizations	These organizations constitute the supply side of the VP ecosystem and include organizations that provide financial and non- financial support to SPOs. These may individually describe themselves as engaged grant-makers, venture philanthropists, impact investors or social venture capitalists.
Social Purpose Organizations	These entities constitute the demand side of the VP ecosystem and are engaged in activities that directly benefit society and create a positive social impact. These can be social businesses or enterprises that may generate financial profits (along with social returns) or non-profit entities that are commonly referred to as NGOs.
Investment	This includes grants, equity or debt or a hybrid of these.
Investee	This is an SPO that has received assistance from a VP organization.
Investee portfolio	This refers to a group of SPOs that have received financial or non-financial support from a particular VP organization.
Non-financial support or assistance	This includes strategic or functional support offered with the financial assistance of a venture philanthropist to its "investee" SPOs.
Due diligence	This is a comprehensive review process undertaken by a venture philanthropist before it invests in SPOs. The process may focus on the legal, governance, operational, social and financial aspects, along with other factors that may be deemed necessary by a venture philanthropist at the time it takes a decision on making an investment in an SPO.
Investors	These include individual or institutional investors, who contribute to the funds of venture philanthropists.

Methodology



As a descriptive research, this study undertakes a concurrent study of the views of the large number of players that play a significant role in the country's evolving VP ecosystem. Throughout the implementation of the research process, we have focused on a participatory approach to ensure that we receive the most comprehensive and unbiased responses from various respondent groups. Our research was directed at communities of organizations that comprise the VP ecosystem and was undertaken at the following three levels:

a. **A study of individual organizations constituting the supply side of the VP ecosystem:** At this level, we first conducted comprehensive secondary research on close to 200 national and international organizations that provide funds to SPOs in India, and selected 40 funding organizations that displayed the following characteristics:

- Provides capacity-building financial and non-financial support (and not project-based financial support) to SPOs
- Has long-term engagement horizon (usually lasting for >two years)

These organizations constitute the core of our study of the VP ecosystem.

b. **Categorization of supply-side organizations:** Next, we focused on segmentation of selected supply-side players to understand their degree of orientation toward application of VC principles to the social sector. We surveyed 30 out of our 40 focus group organizations and conducted detailed interviews with 7 of these (which were selected on the basis of their responses to our survey). The survey provided us with an insight into the activities of supply-side organizations on the following five broad topics:
    - Origination and management of VP and allied organizations
    - Investment interests, strategies and selection criteria
    - Scope of non-financial engagement and delivery channels
    - Return expectations and performance-measurement initiatives
    - Exit strategies

c. **A study of communities of organizations with functional characteristics that inherently inter-link them to VP organizations recognized during the first two stages:** At this stage, we conducted semi-structured interviews with two to three representative organizations from each of the following groups:
    - SPOs constituting the demand side of the VP ecosystem: Apart from conducting interviews, we also surveyed 20 SPOs that had already received financial support from VP and allied organizations. Our survey of the SPOs included a healthy mix of objective and descriptive questions to solicit qualitative information.
    - Financial intermediation organizations that are beginning to provide an important link in connecting VP and allied organizations with SPOs
    - Professional services and strategic advisory organizations that help supply-side and demand-side organizations develop knowledge-led solutions that are targeted at maximizing the latter's social impact
    - Academic (higher learning) institutions that are helping to merge inter-disciplinary fields of study to serve the increasing needs of skilled professionals in the social development sector

Thereafter, we analyzed the data we had collected to map the arguments provided by the various participants and arrive at the gaps in India's VP ecosystem. The final analysis presented in the report provides a synthesis of the arguments put forward by the various respondent groups across the categories mentioned above. In addition, we added illustrative case notes to provide our readers with a clear concept of the country's VP ecosystem.

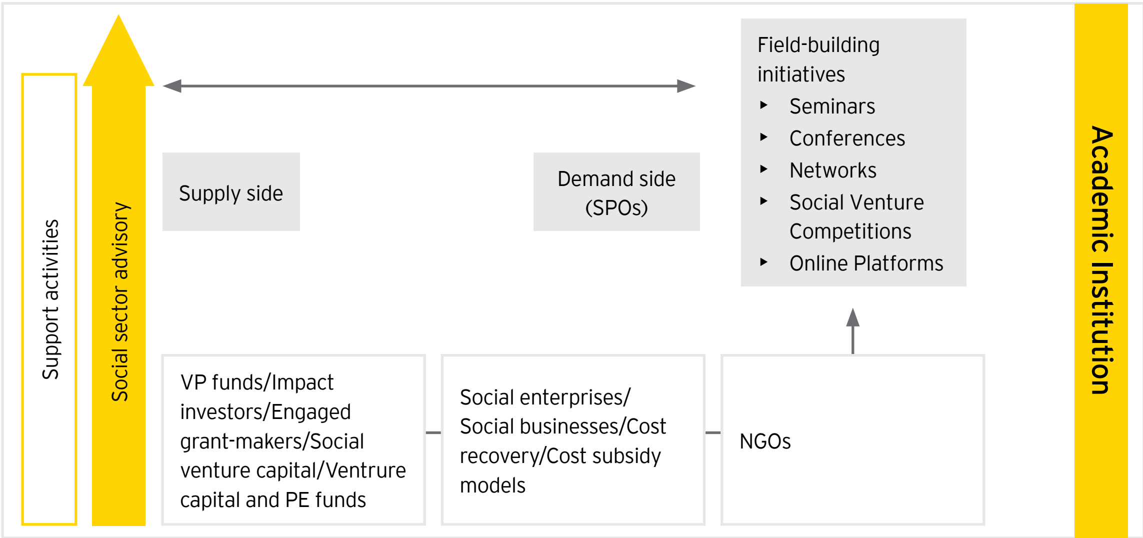
Elements of the VP ecosystem

This section presents a discussion on the various elements of the VP ecosystem in India.

Supply side

Supply-side players identify themselves in numerous ways — as grant-makers, VP funds, impact investors and social venture funds (SVFs). Some that only invest in social businesses were visibly concerned with the use of the word "philanthropy" because they do not want to be perceived as charitable organizations. For them, funding SPOs is an investment that can help to solve socio-economic issues in the country. However, those that describe themselves as VP players understand that while they may invest in SPOs that may generate commercial returns (along with social returns), they use the term to bring out the dual role they are playing. While they are meticulous in their due diligence procedures and adopt all the standard tools to manage their investee portfolios (like mainstream VC and PE players), they are extremely sensitive to the cause their investee SPOs seek to address. Therefore, they do not mind the use of the term philanthropy, because, in their pursuit of helping their investees achieve well-measured social returns, they are also ready to reap the financial rewards, which may well be lower than their mainstream investments. Says Molly Alexander

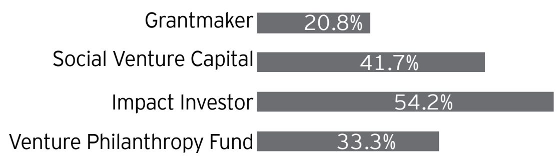
Figure 2: Venture philanthropy ecosystem in India



of the Acumen Fund, "Venture philanthropy as a phrase can be misleading. In essence, venture philanthropy is about deployment of capital to meet the specific resource requirements of social purpose organisations. It has application across grass root NGOs all the way through to social businesses. Within the broad spectrum of venture philanthropy, it's less about what terminology is being used; it's about how you partner with your investees. Do you truly understand the needs of an organisation? Where can you help it beyond just that capital? When you structure a deal with an SPO, are you doing it in a way that is most suitable for it and its mission? And how are you partnering with these investees on measuring the impact that reveals their success and growth?"

Balbo et al (2010) highlight the emergence of two directions within European VP, one with a focus

Figure 3: Supply-side players in the VP ecosystem: multiple identities

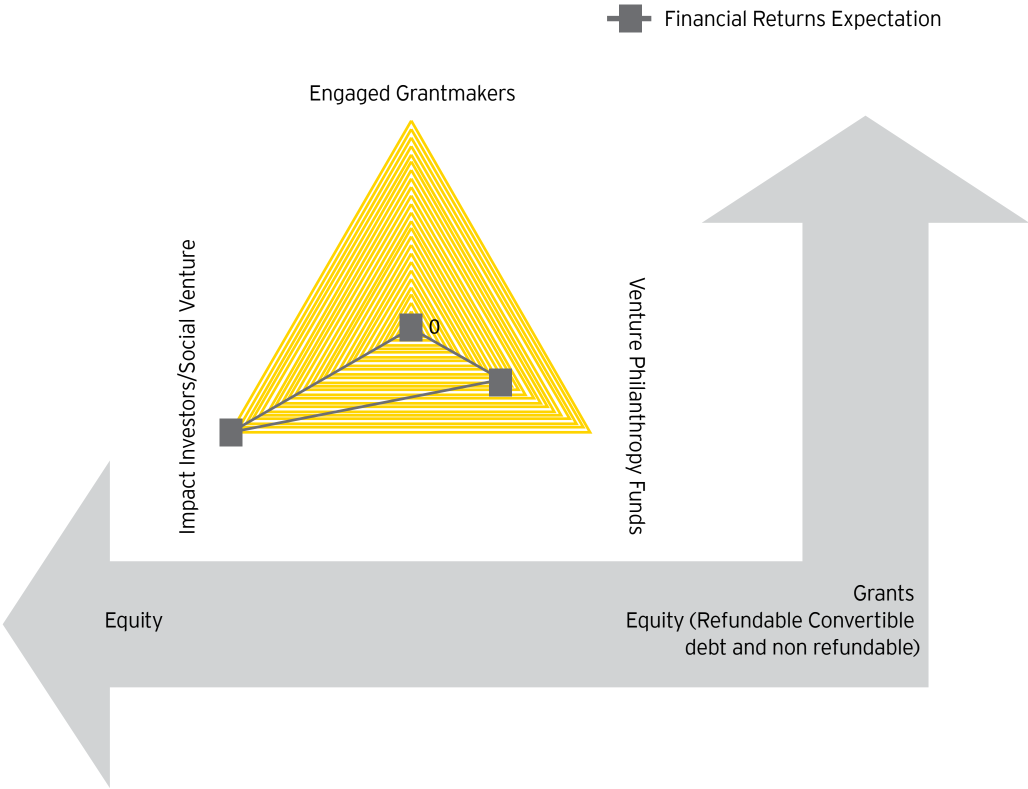


Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

on investment in social businesses that can generate financial returns over and above the invested amount, and the second, which focuses on provision of grants to charities that may not demonstrate direct generation of profits. Borrowing from directions in European VP literature, we have segmented supply-side organizations in India's VP ecosystem into three broad categories and collectively describe them as VP and allied organizations.

1. Engaged grant-makers: These organizations are usually registered as non-profit entities in India and use grants as their preferred mode to finance their investee SPOs. These are akin to traditional foundations as far as their use of grants as their preferred financial instruments is concerned. However, in their selection and management of the portfolios of SPOs, they are as diligent as mainstream venture capitalists. Their preferred mode of investment is long-term result-oriented funding of innovative non-profit SPOs, as compared to profit-oriented ones. Consequently, they only look for social returns from their investments in SPOs.
2. VP funds: These organizations are not averse to using any financial instrument — be it equity, debt or grant. Their preference for a funding instrument is dictated by the solution provided by SPOs, and within India, is limited by the country's legal and policy frameworks. Similarly, their expectation of financial returns is governed by the causes targeted by their investee SPOs.
3. Impact investors/Social venture capitalists: These are organizations that prefer to invest in market-oriented solutions to create a social impact. Their preferred financial instrument is equity and they are most inclined to invest in commercial SPOs that can generate financial returns over and above the invested amount. However, by no means are they relaxed in their pursuit of social returns and provide hands-on support to their investees, to ensure that they do not deviate from their targeted social impact. They are averse to the use of the term "philanthropy" and to any suggestion that there is a charitable element woven into their investments. They take it as a challenge to invest in businesses that have devised innovative models with interwoven cost leadership and product differentiation strategies, which enables them to serve disadvantaged sections of society.

Figure 4: Supply side: VP and allied organizations



The commonality binding these three segments is that while they may use different investment philosophies to articulate their approach to investing in SPOs, all are to some degree influenced by the practices of venture capitalists in selecting and managing their portfolios of social purpose investees.

Case notes
Supply side

01

Deshpande Foundation

Established in the US in 1996, the Deshpande Foundation commenced its India operations in 2005. Since then, the organization has funded more than 100 NGOs and for-profit organizations. The foundation has also instituted the Deshpande Centre for Social Entrepreneurship in partnership with the BVB College of Engineering and Technology and has developed a network of 40 colleges in Karnataka to promote social innovation through its flagship LEAD program.

Investment philosophy
Describing itself as an active practitioner of VP, the Deshpande Foundation provides access to human resource capabilities, networks and reinforcement efforts in addition to funding support for innovative NGOs. The foundation only expects social returns from its investments, since it seeks to build a large network of leaders, who can develop and implement relevant and scalable ideas that will benefit local communities.

Preferred investment instrument(s): grants (non-refundable)

Investment targets
The Deshpande Foundation has adopted innovation with a relevance approach and directs all its investments toward SPOs operating in five regions in Karnataka. The foundation considers that the role of NGOs is that of enablers, and therefore, transient in nature. It supports those non-profit social initiatives that can be expected to become self-sustainable over a period of time and can be replicated elsewhere.

Investment criteria
The foundation evaluates prospective investees on the basis of exhaustive qualitative criteria, taking into account the following:

- Their innovative organizational models and sound strategies
- Their prospects for organic growth and scalability
- Their social leadership capacity

Targeted investment per investees – need-based

Investment horizon – three to five years

Level of engagement
Investees of the Deshpande Foundation have benefited from the experiential engagement provided by its employees in domains ranging across:

- Strategy consulting
- Development of IT infrastructure
- Human capital management and leadership development
- Promotion and marketing
- Networking opportunities

"The Deshpande Foundation has invested in a strategic, interwoven portfolio of social investments in response to the needs and aspirations of local communities. We at the Deshpande Foundation consider entrepreneurial opportunities as the framework necessary for a sustainable and prosperous society. Our venture philanthropy approach towards SPOs combines the execution excellence of for-profit institutions and compassion for non-profit and social sector organisations. We believe that when an innovative approach, leadership abilities and infrastructure support are combined, change happens."

Naveen Jha, Deshpande Foundation

Case notes
Supply side

02

Acumen Fund

A pioneer in developing the "patient capital" investment model to support SPOs, non-profit and for profit enterprises, the Acumen Fund is a global organization with operations in India, Pakistan, East and West Africa. Its head office is in New York. Incorporated in 2001 with seed capital from the Rockefeller Foundation and the Cisco Systems Foundation, it has invested US$28,000,000 in 24 investees in India till date.

Investment philosophy

The Acumen Fund raises philanthropic capital from social investors to invest in innovative SPOs. It manages these investments for returns on its invested capital, while seeking to maximize the social impact (or social returns). The financial returns generated by the Fund are channeled to support more SPOs rather than being distributed among the social investors that have contributed to it.

Preferred investment instrument(s): – equity, debt, convertible debt or a hybrid of these

Investment targets

The Acumen Fund invests in SPOs that provide innovative products and services to disadvantaged people in areas including agriculture, education, access to energy, health, housing, sanitation and water.

Investment criteria

These include:

- Scalability of ideas and social innovation
- Financial feasibility and sustainability
- Skills, experience and commitment to the social impact of investees' management

Targeted investment per investees – US$1 million; range US$250k-US$2.5 million

Investment horizon – 7 to 10 years (may extend depending on the need for it)

Level of engagement

More than 80% of the Acumen Fund's investees have benefited from the hands-on engagement provided by its employees in domains ranging across:

- Strategy and change management
- Executive coaching and mentoring; recruitment of senior management
- Help with product and process innovation
- Functional improvement across domains such as IT, finance and governance
- Networking opportunities

"India was our first investment portfolio. We have been here for 10 years now with a presence on the ground for 6. Many of these companies, being our earliest investments, are now some of our most sophisticated investments and we are finding that some of the social innovations that have emerged in India can be replicated in other countries as well. For e.g., we invested in a drip irrigation company for small holder famers in India, and then worked with them to set up a joint venture, selling these drip irrigation kits in Pakistan. Currently, through the support of an Acumen Fund Global Fellow, we are supporting their expansion into East Africa."

Molly Alexander, Acumen Fund.

Case notes
Supply side

03

First Light Ventures India Accelerator

First Light Ventures is an Atlanta-based seed fund that is affiliated to Gray Ghost Ventures. It launched First Light India Accelerator in collaboration with the Shell Foundation in 2009. Since its launch, First Light India Accelerator has made nine social sector investments (amounting to a total of US$ 2.5 million) in the country.

Investment philosophy
Describing itself as a team of social venture capitalists, First Light India Accelerator invests in commercial businesses that have the potential to make social impact scalable. However, it considers itself a "financial first" investor operating in the impact investment space. Therefore, it does not invest in organizations that do not have in-built revenue models to generate financial returns along with social impact.

Preferred investment instrument(s): — strong preference for equity investments; may consider convertible debt in the case of companies based in India

Investment targets
Seed stage (pilot or proof-of-concept stage) for-profit businesses that have not received previous institutional funding worth more than US$100,000 .
Furthermore, First Light India Accelerator only invests in organizations whose end beneficiaries are from the low income segment. It does not invest in social businesses that have cross-subsidy models (revenue models that provide subsidized products or services to disadvantaged sections of society on the basis of profits generated from selling to economically sound consumers).

Investment criteria
These include:
- Market opportunity and size
- Integration of social innovation and sound business model
- Skills and experience of investees' management

Targeted investment per investees – US$100,000 to US$350,000

Investment horizon – – five to seven years

Level of engagement
More than 80% of First Light India Accelerator's investees have benefited from the hands-on engagement provided by its employees in domains ranging across:
- Strategy consulting
- Assistance and opportunities for product innovation
- Refining of investees' financial, operational and governance processes
- Legal advice
- Human resource management

"At First Light, our focus is on supporting entrepreneurs as they prepare for larger, more commercial rounds of funding. We believe that by hewing to commercial standards, social enterprises can have the widest possible impact."

Mark Hand, First Light India Accelerator

Demand side

The main demand for financial and non-financial support offered by VP and allied organizations is from SPOs, which can be generally categorized into non-profit entities and for-profit social businesses. India's social sector is crowded with NGOs, which have a significant presence (an estimated 3.3 million) in the country.[18] However, venture philanthropists show a clear preference either for for-profit social businesses or for those non-profit entities that have credible delivery models, which can help them maximize their impact over a period of time.

A short survey of 20 SPOs that have already received support from VPs indicated a positive preference for non-financial support and that the top ranking ones generally seek legal advice. SPOs are clearly looking for funding organizations that can adopt a partnership approach to help them address their governance and capacity-building challenges. Those that have been funded by VPs feel confident about adopting a professional management approach while experimenting with ideas to generate tangible solutions for the varied socio-economic challenges faced in the country.

Table 2: SPO perception relating to value addition from non-financial services

SPOs' perception of value addition from non-financial services	Response Percentage
We feel that these services add significant value to the financial support we receive.	62.5%
We feel that these services provide helpful additional support to the funding we receive.	37.5%
We feel that the financial support provided is of more value than the non-financial services we receive.	0.0%

Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

Table 3: Non-financial services: SPO preference ranking

Non-financial services: SPO preference ranking	Rating Average
Legal advice	3.50
Promoting and marketing investees' products and services	3.00
Change management	3.00
Executive coaching/mentoring	2.60
Human resource management (e.g., leadership development, headhunting, etc.)	2.33
Development of IT infrastructure	2.20
Networking opportunities	2.08
Help in refining investees' financial, operational and governance processes	2.00
Fund-raising strategy	1.83
Assistance and opportunities for product innovation	1.67
Strategy consulting	1.67
Other services	1.00
Special advice, e.g., mergers, franchising, etc.	0.00
Estate management (e.g., help in building, renting or buying office space)	0.00

Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

18 Shukla, Archana; (2010); "First official estimate: An NGO for every 400people in India"; The Indian Express [online]; Available at http://www.indianexpress.com/news/first-official-estimate-an-ngo-for-every-400-people-in-india/643302/ ; [last accessed 20 February 2012).

Financial intermediation

Within the VP ecosystem, an important and noticeable trend is the emergence of investment banking services for SPOs. Most VP organizations employ professional investment or portfolio managers to ensure adequate deal structuring at the time they invest in SPOs. However, demand-side players usually do not have adequate in-house resources to help them negotiate the terms of deals. As a result, there are only a few social investment banks in the country that provide technical assistance to SPOs in raising the required capital today.

Most transaction advisory services provided by these financial intermediaries have been for micro-finance institutions (MFIs) and social businesses. These intermediaries are now exploring ways to channelize the flow of money to NGOs with scalable and sustainable social impact models.

The emergence of such financial intermediaries is creditable, since provision of professional financial services will help SPOs focus on their core missions, rather than on devoting their resources to the constant task of fund-raising. In the case of venture philanthropists, provision of "buy-side" advisory by these dedicated social investment banking organizations can help the former conduct transaction sourcing at rational valuations efficiently and comprehensively.

Case notes

Financial intermediation: facilitating deal structuring for SPOs

Transaction advisor

"Intellecap" — Intellectual Capital Advisory Services Private Limited

Transaction description: Series A

Intellecap's role: Sell-side advisory including transaction sourcing and documentation, valuation, structuring and negotiation

Sell side: a for-profit social business

Buy side: an international private foundation

Transaction structure: Issue of Compulsorily Convertible Preference Shares (CCPS) with a pre-determined floor and cap price and the actual price between the floor and the cap to be determined after 15 months, based on a pre-determined formula

A

Challenges

After due diligence, the buy side communicated that they were not earlier aware that part of the equity held by the promoters of the SPO has not been issued for cash but in kind. According to the buy side, this increases risk in the business, since the promoter has less "skin in the game," and therefore, it demanded that the floor price should be reduced.

Suggested solution by Intellecap

The demand from the buy side was that the floor price should be reduced and the promoter of the company should be given a year's time to infuse further cash in the business as equity. Eventually, the floor price would increase, depending on the equity invested by the promoter. This could have been a deal-breaker, since this proposal for the floor price to be changed came at a crucial point when the promoters were expecting the transaction to be closed within a few days. Intellecap worked with the promoters and the investor, and restructured the proposal in a manner that bridged the expectation gap between the two parties.

B

Challenges

The negotiated term sheet offered certain rights to the buy side, but its legal counsel raised concerns regarding these rights, stating that those being offered by the promoter of the SPO were only theoretical in nature and might not be legally enforceable. The buy side wanted to walk off from the deal after getting it reviewed by its legal counsel.

Suggested solution by Intellecap

Intellecap initiated a dialogue with all the parties, and provided multiple alternatives and much-needed comfort to protect the interests of the investor as well as the promoter(s) of the SPO.

"The value of an advisor in a transaction goes well beyond simply making an introduction to an investor or negotiating the valuation terms in a transaction. The role of the intermediary becomes critical when there is a logjam between the investor and the social enterprise, particularly on non-financial issues. This is where the experience of doing multiple such transactions in the past, along with the ability to come up with innovative solutions, comes in extremely handy to navigate tricky solutions and arrive at a win-win solution, which protects the long-term interests of the business as well as its promoters."

Anurag Aggarwal, Intellecap

Professional service providers

These are organizations that have the potential to become the backbone of the VP ecosystem and provide expert services in fields ranging from legal matters to market sizing to supply-side and demand-side players. An increasing focus on accountability and efficient deployment of philanthropic and aid capital has led to companies offering strategic and expert advisory services that are tuned to the needs of the social sector. The various kinds of services offered by these organizations can be categorized as follows:

Table 4: Professional advisory services available for India's social sector in India

Strategic advisory	Research & Development	Measurement and evaluation
Organizational diagnostics (across the HR, IT, operational and legal domains)	Market assessment and intelligence	Governance and legal appraisal
Capacity development	Product evaluation	Financial audit
Growth and transformation planning and implementation	Cause-related publications	Measurement of social impact

While many small and niche players have been catering to the increasing demand from the social sector during the last five years, mainstream management consulting and advisory firms have also entered the arena. This has increased competition in the field. Today, strategic customers of these professional services companies include bilateral and multilateral aid agencies, international grant-making foundations, state and central governments and the CSR arms of corporate organizations. Only 37% of the VP organizations we surveyed rely on paid consultants to meet the specific needs of their investee SPOs. However, as VP and allied organizations see an increase in their number of portfolio investees, professional advisory firms (with wide experience in the country's grass root social sector) can be expected to become their preferred mode to provide non-financial services in a cost-effective manner.

Academic institutions

Academic institutions operate on the periphery of the VP ecosystem. At the undergraduate level, barring a few elite engineering institutes, there are not many tier 1 institutions in the country that are proactively directing their students' interest toward developments and innovations in the social sector. Among the postgraduate and professional institutions operating in India, we find the following noteworthy trends that can have an impact in shaping the country's VP ecosystem:

a. Most institutions of higher learning in the country have begun to sensitize their students on social issues, and are increasingly focusing on encouraging their students to volunteer and associate with SPOs during their academic years.

b. Teaching concepts such as CSR and the double bottom line have become an integral part of B-school curricula across the country.

c. Some institutions have also initiated specialized courses in social entrepreneurship and NGO management.

The academic fraternity members are of the opinion that they are helping students become aware of the need for professional management in the social and public sector. However, they concede that the number of students taking up jobs in the social sector immediately after they graduate is insignificant.

Supply side: Characteristics

VP organizations in India emerged at the same time as their counterparts in the West, i.e., in the late 1990s. The Charities Aid Foundation (CAF) and the Rashtriya Gramin Vikas Nidhi (RGVN) are the oldest practicing VP organizations in the country, and both have been extending financial (grant-based) and non-financial support to NGOs since 1998. While the CAF has its roots in the UK, the RGVN is possibly the first VP organization to be set up in India. It was promoted by IFCI Ltd. in 1990, with IDBI, NABARD and the Tata Social Welfare Trust as the co-sponsors. Subsequently, the RGVN adopted a capacity-building approach to nurture its partner SPOs in 1998, with the Ford Foundation providing the required financial assistance to it to launch the latter's capacity-building programs. The RGVN initiated its Fellowship Program as early as 1995, with the objective of "expanding the pool of capable people to enhance the capabilities of NGOs." In the last decade, many foreign VPs have also set up their operations in India and the sector has, on the whole, become clearer and more advanced in its search for and selection of credible SPOs that can make a scalable impact.

The following section documents the broad characteristics of this evolving sector in India.

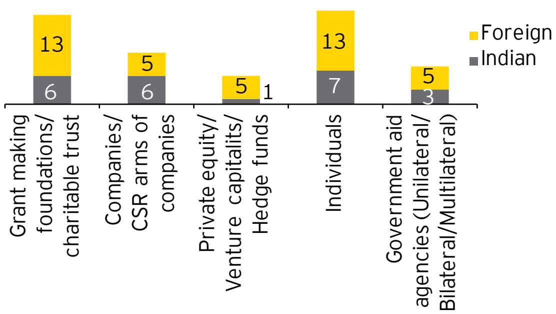
Market dynamics

At present, it is estimated that VP and allied organizations have invested US$600 million to US$800 million in SPOs in India, and 88% of the respondents are expected to increase their investments in the country in the next two years. (Source: Ernst & Young's AVPN India VP ecosystem mapping survey, January 2012)

Furthermore, VP and allied organizations have formed a collaborative relationship with established grant-making foundations and charitable trusts. In addition, foreign and Indian charitable foundations are making significant contributions to their resources (Figure 6). For instance, the Edmond de Rothschild Foundation earlier partnered with the Acumen Fund to support the latter's fellowship program and has recently funded UnLtd. India to test pilot its VP approach to supporting new social enterprises in the country. The Foundation's investment in UnLtd. India is in line with its global shift toward a more strategic approach to philanthropy, which it initiated in 2004–05. According to Pauline Cavillot, Project Manager, Social Enterprise Portfolio — India of the Edmond de Rothschild Foundation, "We believe that the venture philanthropic approach is quite interesting and needs to be explored further to complement the traditional philanthropic efforts of a foundations like ours. The social enterprise sector can prove to be an interesting addition to our other philanthropic engagements in India as well as globally."

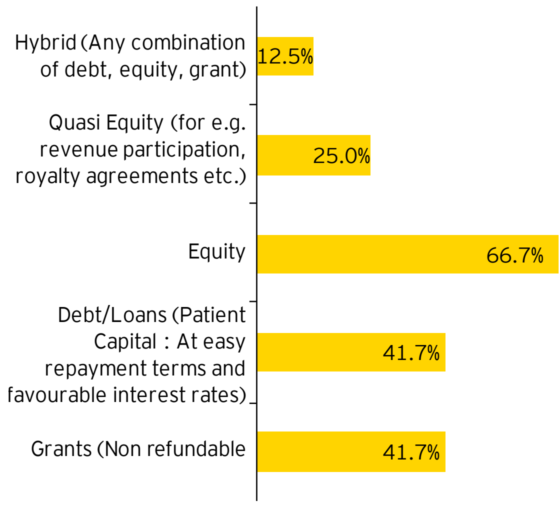
Furthermore, our research reveals that 84% of the promoters of VP and allied organizations have previous experience in the social sector. They have adopted the investment approach to select and manage their SPOs' portfolios as the best way of promoting social innovations that can help to alleviate the socio-economic conditions in the country. Irrespective of the terminology used in describing themselves, these organizations seek to nurture their investee SPOs by working in a highly focused and engaged manner. They focus on creation of social and financial value for their multiple stakeholders — be they the strategic customers of their investee SPOs, the management or employees of SPOs, contributors to their funds or society at large.

Figure 5: Investors in VP and allied organizations



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Figure 6: Financial instruments used by VPs and allied organizations in India



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

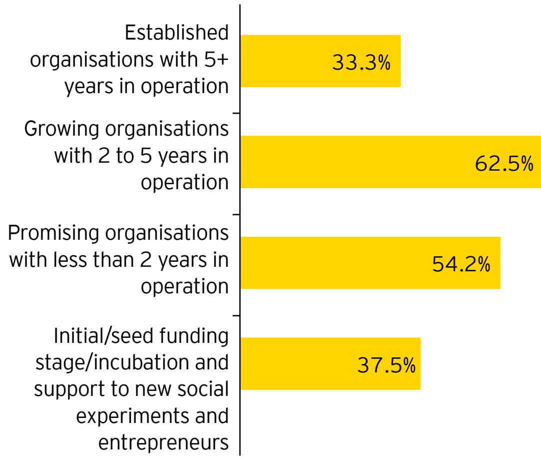
Investment preference and strategies

Investment instruments: Equity has gained the top spot as the preferred instrument for VPs to invest in SPOs, with grants and debt capital at the second spot. This preference for equity investments is in accordance with that of investment in commercially oriented SPOs.

Investment target

- SPOs, whose models have been validated by their on-the-ground existence of two to five years, command more interest than newer ones. Furthermore, although there is increasing interest in launching social sector incubators, given the scale of the Indian market, there is significant space for new entrants to invest in supporting start-up SPOs. (Figure 8).
- Underlining the importance of ensuring the long-term sustainability of their investee SPOs, the majority of Indian VP and allied organizations show a strong preference for SPOs that have in-built revenue models to help them recover costs and become scalable over a period of time. (Figure 9).
- Investors prefer innovations in education and health, followed by livelihood initiatives (Table 6). This indicates a clear inclination to deal with issues related to poverty in the country. The key issues driving the social impact debate in India continue to be inclusion and quality of life. On one hand, we see the emergence of an integrated approach to providing solutions to poverty, which can make economically less advantaged individuals become effective participants in the growing economy. On the other hand, the concept of social impact is widening, with many causes or ideas being generated and supported, which may not specifically target those at the bottom of the pyramid, but may be classified as social, since they aim to improve the quality of life of citizens in general. For example, Prof. Majumdar of the Tata Institute of Social Sciences points out that a group of his students is working on finding sustainable solutions for urban waste management. Their approach is not BoP-centric but is oriented to providing a safe and healthy option to those who can pay for disposal of the huge waste generated every day.

Figure 7: Preferred stage for investing in SPOs in India



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

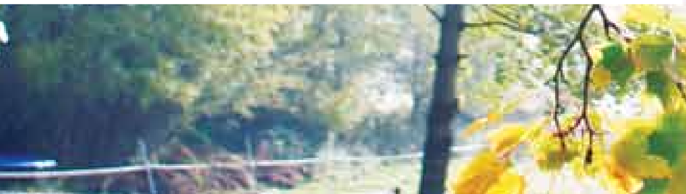


Figure 8: Preferred revenue model for social investment targets

Preferred revenue model for social investment targets

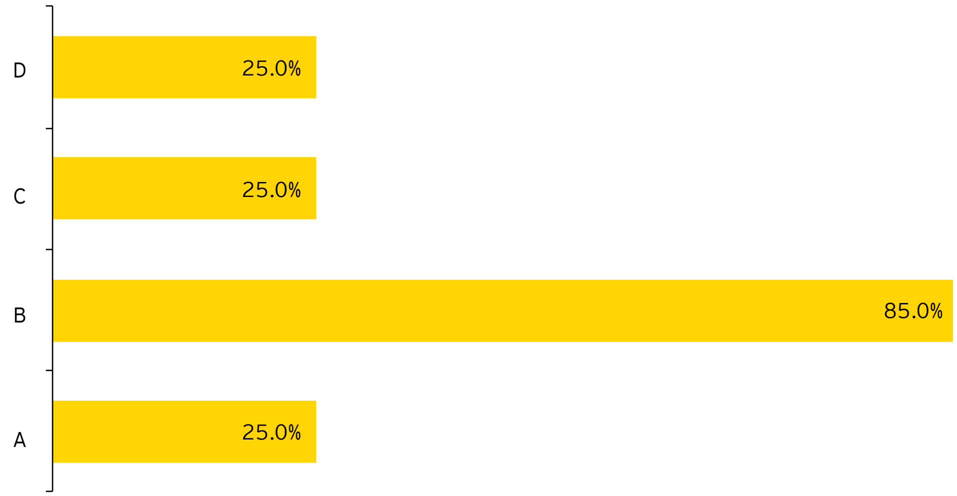
We prefer to:

A – To invest in charitable organizations that do not charge for their products and services

B – To invest in innovative organizations that can cover their cost and generate revenues to scale up

C – To invest in quasi-commercial revenue models

D – To invest in cross-subsidy models



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Table 5: Sector preference and targeted beneficiaries

Sector preference	Response percentage
Education	62.5%
Health	62.5%
Employment generation/Sustainable livelihood programs	58.3%
Agriculture	50.0%
Financial inclusion	50.0%
Water	41.7%
Access to energy	37.5%
Sanitation	37.5%
Targeted beneficiaries	
Rural poor	66.7%
Urban poor	54.2%
Children (0-14 years)	12.5%
Disabled	8.3%
Girl child	12.5%
Minorities/Tribal/Other ethnic or caste groups	4.2%
Women	25.0%
Youth (14-21 years)	12.5%

Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Provision of non-financial support and engagement level

VP and allied organizations provide a range of non-financial services to their investee SPOs. These services are customized to meet the specific needs and requirements of the SPOs and are delivered in consultation with their management. With VPs mainly providing high-end services in-house, they hope to meet the apparent gap in availability of skilled human capital in the social sector.

Table 6: Portfolio of non-financial services offered by VPs and allied organizations

Portfolio of non-financial services offered by VPs to their investee SPOs.	Response percentage
Networking opportunities	95.5%
Executive coaching/Mentoring	81.8%
Help with refining investees' financial, operational and governance processes	77.3%
Human resource management (e.g., leadership development, headhunting, etc.)	77.3%
Fundraising strategy	72.7%
Strategy consulting	59.1%
Legal advice	54.5%
Change management	54.5%
Assistance and opportunities to investees for product innovation	40.9%
Development of IT infrastructure	27.3%
Promotion and marketing of investee's products and services	27.3%
Special advice e.g. mergers, franchising etc.	18.2%
Estate management (e.g., help in building, renting or buying the office space)	9.1%

"We attempt to develop a deep understand-ing of the sector in which the organization is operating and the organizational model from multiple angles at the time of making the initial investment. Unless we deeply understand the business or work of the organization, we as a team won't be able to add non-financial value to the organization over the long term."

Inderpreet Singh Chawla, LGT Venture Philanthropy

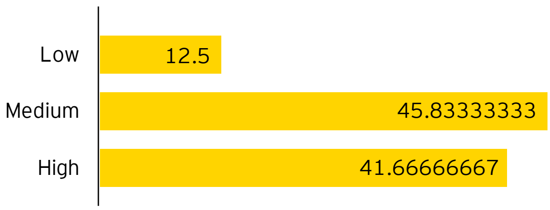
Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

Given below is an analysis of engagement levels across the following triple parameters:

4. Provision of non-financial services
5. Frequency of contact
6. Preference for board seats or for observer status in investees' boards

This reveals that most VP and allied organizations have an active portfolio management policy in place in India. They develop close working relationships with the employees and managements of their investees and are involved in activities ranging from selection of CEOs and strategic planning to development of the latter's IT infrastructure. This is the most positive aspect of the growing field of VP, since investee organizations are ensured of mentoring support, which provides them with the vital help required to further their objectives. Around 72% of the respondents provide non-financial support to more than 80% of their investees. This is ample evidence that venture philanthropists have a close hands-on relationship with the social entrepreneurs and ventures they support, and thereby, drive innovative and scalable models of social change. While around 40% of venture philanthropists prefer seats on the boards of their investee SPOs, all are intimately involved at the strategic and operational levels rather than merely in the role of traditional non-profit funders.

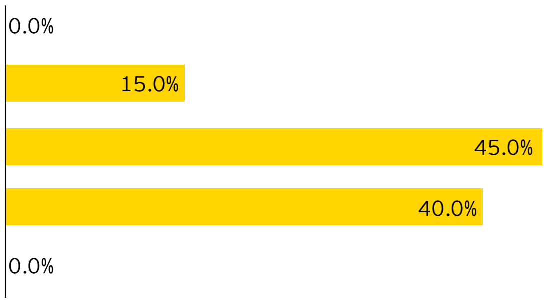
Figure 9: Level of engagement of VP and allied organizations with their investee SPOs



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Furthermore, the engagement horizon is essentially long term and is not less than two years in duration. This is in stark contrast to engagements entered by traditional grant-makers and aid agencies, which generally extend short-duration project-based support. VP and allied organizations understand the complexities of investing in the social sector, and are therefore not rigid in their approach to deciding on their investment horizon. They prefer to keep their options open and continue to review the length of their engagements, depending on circumstances relating to the SPOs under their management. Says Mr. Nimesh Sumati, Caring Friends, "Mostly, we partner with grass-root non-profit SPOs. So, in our case, the length of the non-financial support varies depending upon the targeted cause and the competence levels of the founder. The competence level of these founders is different. Some of them are from very modest families, so they need more handholding and their need for capacity-building is much higher. Some of them are educated, in their middle age and have more experience, and therefore, are more mature, so there is not much of hand-holding required in such cases."

Figure 10: Engagement horizon



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Selection criteria and due diligence

Most venture philanthropists place utmost importance on the quantum of social impact their prospective investees can make. Therefore, 65% of VP and allied organizations only make their investment decision after considering the market size of the social product or service offered by prospective investee SPOs. However, they are extremely concerned about the ability of their partner SPOs to deliver the promised impact. Therefore, the majority of them consider the sound strategies, skills and experience of their investees' managements and their prospects for sustainability and growth as the most significant criteria while making their investment decision. Some VP and allied organizations also reflect on their own abilities to add value to social ideas mooted by prospective investee SPOs, and accordingly, take a decision.

Table 7: Selection criteria for investment in an SPO

Selection criteria for investment in SPOs	Response Percentage
Sound business model and organizational strategy	87.0%
Skills and experience of investee management	82.6%
Financial feasibility and sustainability (e.g., stability of cash flow)	69.6%
Prospect for organic growth and scalability	69.6%
Market size of social product or service of investee	65.2%
Innovation (social /technological innovation, innovative revenue/ operational business models, etc.)	60.9%
Scope for earning financial returns for investors while creating a social impact	56.5%

Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Venture philanthropists and allied organizations make extensive use of their own networks or portals to solicit applications from prospective investees. Their selection process comprises multiple levels, and once initial selection criteria are met, prospective investees are subjected to comprehensive due diligence metrics. Venture philanthropists understand that any lapses relating to their investees may have implications on the credibility and reputation of their organizations. Furthermore, this focus on strict due diligence can be attributed to the inclination of venture philanthropists to get rid of inefficient SPOs operating in India's social sector, so that the former's investment enables their targeted beneficiaries to gain the maximum value.

Table 8: Preferred due diligence procedures

Preferred due diligence procedures	Response percentage
Meetings with investees' teams (individually with each key member) to identify and probe key issues	91.7%
Specific due diligence questionnaires	83.3%
Internal legal and financial team that helps with compliance issues and analysis of historical and projected information	83.3%
Reference checks on investee organizations and their teams	79.2%
Use of external consultants to help with comprehensive due diligence	50.0%

Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Return expectations and performance measurements against benchmarks

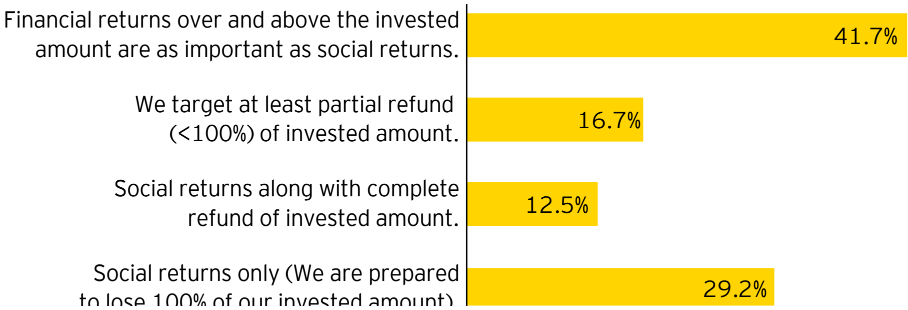
VP and allied organizations in India are increasingly gravitating toward advocacy to generate financial returns. According to them, this will help the social sector achieve the following:

- Profit-making SPOs will be able to attract the interest of a wide pool of investors, and thereby, be able to meet capital requirements for their future growth.
- They will also be able to attract the best talent, since they will have adequate resources (generated internally) to pay skilled professionals. The availability of highly skilled human resources will help them achieve growth and ultimately enhance their social impact.

However, VP and allied organizations are collectively not ignorant about the complexities of investing in the social sector, and therefore, are reasonable in their expectations on the quantum and duration of returns. Inderpreet Singh Chawla, LGT Venture Philanthropy, explains further, "We do not always expect the invested amount back with returns (e.g., in the case of grants). Similarly, we do not have a hurdle rate in mind when investing in a social business. At the same time, return expectation becomes commensurate with the risk involved, but we are mindful of not allowing a financial return expectation to destroy the fundamental social mission of an enterprise or to distort the markets by overvaluing companies, simply because they have a social mission or inclination."

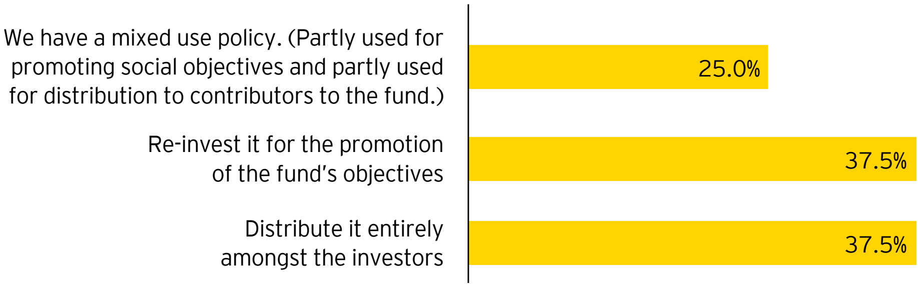
Furthermore, among those who advocate the policy of financial returns, there seems to be a preference for using the returns earned to further a fund's objectives or deploy it partly to further social objectives and partly to pay back investors in their funds. However, given the tough conditions in which these funds invest, there is as yet no evidence of significant profits being generated by any VP and allied organizations.

Figure 11: Return expectations of VP and allied organizations in India



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Figure 12: Profit utilization policy of Indian VP and allied organizations



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Table 9: Major reasons for measurement of social impact

Major reasons for measurement of social impact	Response percentage
Identification of best practices that can help to scale social impact	81.0%
Identification of non-financial support required by investees to enhance their reach and sustainability	57.1%
Investor reporting and use to raise future funds	57.1%
Targeted deployment of funds for maximum reach and sustainability	47.6%
Weeding out of ideas that fail to deliver	14.3%

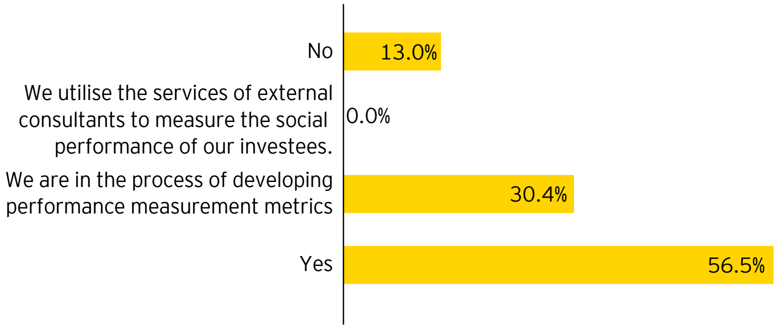
Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

As regards social returns, VP and allied organizations are explicit in their effort to develop metrics to measure the social impact of their investees. Table 9 provides the various reasons for measuring the social impact outcomes of VP and allied organizations. Although 56% claim to have developed social impact measurement metrics (Figure 13), they agree that measurement of social performance is the most challenging aspect of their work, given the varied social causes their investee SPOs serve.

Explaining the company's approach to measurement of social impact, Molly Alexander, Acumen Fund, stated, "We begin with a defined set of output for each company that is aligned with its business mission and from there work to extrapolate social outcomes. Take the case of clean drinking water. At the end of the day, the ultimate outcome of having clean drinking water is that people don't get sick and children take less time off school, so education indices rise, and employment and income numbers rise as well. Now, as a set of data, that's really difficult and expensive to access and therefore to measure. So, in the case of clean drinking water, what we do is that we measure the number of plants that our investee SPO has put up, so say 450 clean drinking plants across India serve up to 1000 people a day. That's 450,000 with access to clean, affordable drinking water that didn't otherwise have it. These are the measurable output and therefore the most concrete social impact outcomes."

What makes measurement of social impact a challenging and ever-evolving task is that a standard checklist may not be applicable for all SPOs. Furthermore, international standards, such as Impact Reporting and Investment Standards (IRIS), are usually not 100% applicable in Indian conditions, since these lack flexibility. Within India, the issue of measurement of social impact requires an integrated approach that takes into account the social, political and economic dimensions of the impact.

Figure 13: Availability of social impact measurement metrics with VP and allied organizations

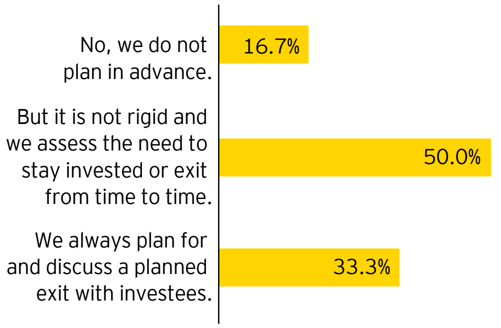


Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Exit management

Most VP and allied organizations incorporate exit clauses when they structure deals. This is a standard practice that has been borrowed from the mainstream VC and PE industries to provide intensive but time-bound support. However, the findings of the survey suggest that venture philanthropists in India are not rigid in executing their exit strategies. They are fairly open to reviewing their exit clauses in accordance with the growth requirements of their investee SPOs. The most preferred exit clauses are either management buy-backs or selling out to other investors. However, the inclusion of IPO as an exit clause has not yet gained momentum, given that the industry is still at a nascent stage.

Figure 14: Exit planning



Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Figure 15: Gaps in India's VP ecosystem

- Inabililty to reach grassroot organizations
- Geographic concentration of investees

- Limited availability of financial intermediation services
- Inadequate collaboration with academic institutions

Capacity constraints of VP and allied organizations
Low utilization of paid professional services for managing investee portfolios
Concerns relating to risk management

- Debt constraints on working capital finance of SPOs
- Issues related to FCRA limiting ability of domestic VPfoundations to raise funds abroad

- Absence of appropriate legislation for social businesses
- Relevance of SEBI's proposed regulations on social venture funds for VP funds
- Impact of proposed Direct Tax Code on management of non-profit SPOs

Source: Ernst & Young-AVPN India VP ecosystem mapping survey, January 2012

Analysis of gaps in India's VP ecosystem

This section elaborates on the gaps in India's VP ecosystem. We conducted a two-level analysis on the basis of standalone and comparative inferences drawn from the survey and interviews. This helped us identify the challenges faced by VP and allied organizations, and those that are being forced on it from outside. Identifying and recommending feasible strategic measures to solve these issues was however beyond the scope of our research. In our subsequent discussion in this section, we have initiated a dialogue to address these challenges.

Capacity constraints faced by VP and allied organizations

VP and allied organizations have been operating in India for around 10 years. This is an extremely short-time horizon as compared to the history of philanthropy, official development assistance and even CSR. While these organizations have been able to register themselves as being capable of delivering change, the real social change promised by the VP initiative has not been realized. In India, the VP "sector" is fragmented and there is a need to enhance the reputation, scale and effectiveness of SPOs. Furthermore, VP and allied organizations need to pay greater attention to the capacity and institutional progress of not only their "investee" SPOs, but of their own organizations as well.

Effective mobilization of human capital is the baseline for capacity-building in an organization. Our research indicated that VP and allied organizations that have more than five years of operational experience in the country have a total of 377 investees under their management. However, only 11% of these organizations employ 15 or more senior executives and most (66%) have less than 10 senior executives.

Table 10: Number of senior staff functionaries of VP and allied organizations with more than five years' operational experience

VP and allied organizations with more than five years' operational experience	Number of senior staff members	Number of SPOs currently under their management
11%	More than 15	26
23%	10 to 15	210
33%	6 to 10	69
33%	Less than 5	72

Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

This clearly shows that fewer senior-level professionals have been employed by VPs as compared to the number of senior employees engaged by the investees currently under their management. It is the value addition brought in by the strategic staff members of VPs that can help their investee SPOs achieve the quality standards the VP initiative promises.

Development of internal capacity and resources in the short run may not be feasible for VP and allied organizations. They should therefore make a concerted effort to develop a pool of volunteers, who are drawn from senior-level personnel employed in VC and PE industries in the country, to build capacity in their organizations. However, mobilization of senior employees from the corporate and VC sectors to develop a credible volunteer pool needs to be a managed process after taking into account the specific functional requirements of investee portfolios.

Low utilization of paid professional services for managing investee portfolios

One of the characteristic features of VP organizations is their provision of non-financial services to suit the capacity-building and growth requirements of their investees' portfolios. Around 92% of the respondents we surveyed agreed to provide non-financial services, and a very significant majority (91%) preferred to use their own employees to deliver non-financial ones. Only 36.4% were willing to employ paid external professional service providers to provide non-financial services to their investee SPOs.

Table 11: Provision of non-financial services

Apart from providing funds, do you offer any non-financial services to your investees?

Answer options	Response percentage
Yes	91.7%
No	8.3%

Table 12: Preferred channels for delivering non- financial servicesWhat are your preferred channels for delivering non-financial services? (multiple answers allowed)

Answer options	Response percentage
Your own employees	90.9%
A pool of unpaid volunteers	22.7%
Pro bono partnerships with various external service providers	40.9%
Paid consultants to meet the specific needs of your investees (experts, professionals, advisory firms, etc.)	36.4%

"It is important to continuously analyse what is not working in the organisation and how we can correct/ eliminate or change for improvement. I think we focus a lot on our presentation and what is working and all the positives that make us sellable vs where we are really having issues and need good advice/hand-holding. A lot of work is expected between meetings and we do not always have the support or the same understanding of the importance of the work done by fellow Board members or staff."

Dottie Wagle, Salaam Balak Trust

As mentioned earlier in this report, SPOs demonstrate a clear preference for non-financial support. However, they also pointed out that VP organizations are themselves in the learning mode. Therefore, they feel that the employees of VP organizations adopt an experimental approach in dealing with them sometimes.

The scope of this research was not to collect and analyze data to demonstrate the impact of the involvement of VP organizations in the management and operation of SPOs. However, given the fact that most of them have limited capacity, we believe that budgeting to enable the use of external consultants at the time investments are structured may help a great deal in strengthening and building the core competencies of the investees.

Concerns relating to risk management

In the case of traditional grant-making, a large amount of the social capital derived by a grant-giving foundation is enabled by virtue of its act of giving. The success or failure of projects for which foundations provide funds seldom has any effect (legal, financial or reputational) on the health of a foundation. In fact, VP and allied organizations make investments for a long period of time and take upon themselves the arduous task of ensuring a wide social impact. For VP and allied organizations, the challenge is not just to identify solutions, but to ensure that the identified solutions deliver the desired results. In their pursuit of desired social returns, it therefore becomes important for them to develop effective enterprise risk management solutions for their portfolio investees. The table below elaborates on the indicative risks that are part and parcel of investments in the social sector.

Table 13: Risk factors associated with social investment

Risk class	Associated risk factors
Customer risk	There is the risk of alienating the target customer due to the perception that high-quality services are not affordable (especially in the Cost Recovery or For Profit models).
	Most SPOs follow the hybrid strategies of cost leadership and product differentiation. However, their products or services may not meet required quality standards or "actual" needs, which results in their end beneficiaries being worse off. Furthermore, given information asymmetries in the BoP segment, the end beneficiaries may not have access to mechanisms to reverse the damage done. This can alienate their customers further.
Marketing and distribution and risk	These are issues relating to assessment of the true market size, since data may not always be available at the time an investment is made.
	This also relates to the establishment of a distribution and retail network that is targeted at the BoP segment. While most SPOs claim to serve the underserved, establishing a creditable distribution network that can help them enhance their impact by reaching a wide market continues to be a challenge for most of them.
Governance risk	This includes credibility, accountability and transparency issues. These are usually managed by means of extensive due diligence procedures adopted at the time investments are made. After that, VPs manage governance risk by measures such as holding seats on the boards of investees and through regular reporting.
Process risk	There is no consensus among industry players on the best practices for investment in the social sector. Furthermore, creating sustainable and scalable SPOs is not a scientific process that can be replicated across sectors or even organizations operating in the same sector.
	Quantification of the majority of risk classes associated with investments in the social sector may not be feasible. It leaves out a large number of qualitative risks that need to be analyzed and monitored on a regular basis.
	Moreover, the historical data available is inadequate for developing statistically relevant quantitative risk models that will help the decision and performance management process of SPOs.
Project risk	This pertains to the risk of intruding on an SPOs' objectives, especially when financial returns are expected.
	Furthermore, VPs can expect visible outcomes (social and financial) only in the long term, which can stretch beyond the planned period of investment.
	This includes the risk of investing in sectors or geographies about which adequate knowledge is not available in-house.

"In commercial investing, the goal is to increase profits of the company, and for the investors. In venture philanthropy, the question that we and our entrepreneurs ask ourselves is how can we innovate further to maximize the social impact? Increase access and distribution, sure; but also how can we lower the price to increase access for even more low income customers? At the end of the day, for us, it's about accessibility of these critical products and services to those that have lower and lower incomes."

Molly Alexander, Acumen Fund

"All angel and seed-stage investing demands an incredible appetite for risk, and to include the qualification that your investments deliver socially as well as financially is to incorporate yet another reputational risk. As an industry, our challenge is to demonstrate both financial and social returns that justify the amount of risk we take."

Mark Hand, First Light India Accelerator

Therefore, given the extensive set of risk factors involved, the task of continuous risk mapping and appraisal across a portfolio of investees is extremely complicated for VP and allied organizations. (Please note that the list provided above is in no way comprehensive, but is merely illustrative of the risks involved in investing in the social sector.)

In addition, SPOs face the same commercial risks as any mainstream organization. However, there are many diversified and structured risk "mitigants" that are available to a mainstream organization. This is partly due to the effective risk management products and services made available by financial institutions to mainstream organizations working across various sectors. However, the cost of such instruments is prohibitive for SPOs, and therefore, as compared to mainstream organizations, they are at a disadvantage in managing their risks.

VP and allied organizations therefore focus on making a significant social impact at the cost of high risks. Hence, it is essential that a culture of risk management is cultivated within VP organizations, as well as investee SPOs, to ensure the following:

- SPOs being able to self-identify pre-warnings on "what can go wrong" instead of reporting "what has gone wrong"
- Adequate information-capturing mechanisms in place to enable informed decision- making
- The twin ideals of continuous improvement and efficiency being incorporated within performance-measurement systems to pave the way for their future growth

Geographic concentration of investees

Out of the 28 states and 7 Union Territories in India, 11 states and 1 Union Territory have witnessed investments made by 50% or more of VP and allied organizations operating in the country. Our research suggests that there is a further need to expand the geographic presence of investee portfolios. Furthermore, given the fact that India is a diverse country, with its socio-economic and political landscape varying from state to state, reaching innovative SPOs in different states may require different strategies, and therefore, be directly linked to the institutional and capacity-building needs of VP and allied organizations.

Table 14: Geographic preference of VP and allied organizations in India

State	Preferred states for VP investment
Karnataka	75%
Maharashtra	75%
Orissa	60%
Bihar	55%
Madhya Pradesh	55%
Rajasthan	55%
Tamil Nadu	55%
Uttar Pradesh	55%
Andhra Pradesh	50%
Delhi (UT)	50%
Gujarat	50%
West Bengal	50%
Assam	35%
Uttarakhand	30%
Chattisgarh	25%
Haryana	20%
Kerala	20%
Jharkand	15%
Punjab	15%
Himachal Pradesh	10%
Jammu and Kashmir	10%
Manipur	10%
Puducherry (UT)	10%
Arunachal Pradesh	5%
Daman and Diu (UT)	5%
Goa	5%
Meghalaya	5%
Mizoram	5%
Nagaland	5%
Sikkim	5%
Tripura	5%
Andaman and Nicobar Island (UT)	0%
Chandigarh (UT)	0%
Dadra and Nagar Haveli (UT)	0%
Lakshadweep (UT)	0%

Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

Inability to reach grass root organizations

In India, VP is at a nascent stage of evolution. As mentioned earlier, a significant number of VPs operating in the country that have a limited capacity have not been able to cover the length and breadth of the country as yet. Furthermore, their deal-sourcing procedures are limiting their ability to reach grassroot organizations. Most of these source potential deals through websites and networks, and there are some that do not entertain unsolicited proposals at all. While VP respondents keep continuous track of their databases and screening tools, they agree that developing a credible deal flow and accessing additional grassroot organizations is a challenge in the country. They also acknowledge that the various forums and networks highlight the same set of SPOs and solutions year after year.

The selection criteria and due diligence procedures adopted by VP and allied organizations have helped them select the best SPOs. However, in the Indian context, such stringent procedures may filter out grassroot SPOs, which may have the potential of creating a substantial impact, but may be outside the network due their inability to "speak the right language."

Prof. Majumdar of the Tata Institute of Social Sciences recognizes the fact that the stress on scalability of SPOs restricts grassroot organizations from availing the support provided by VPs. Moreover, given that India is a diverse country, solutions applicable for one area may not be suitable for another, which renders the concept of scalability redundant. However, this does not mean that indigenous solutions to suit local problems should not be encouraged. In fact, supporting such solutions can have significant potential for creating the required social change in the country.

A focus on the commercial aspect (even if it is limited to cost recovery), rather than on whether a solution is the best fit for a problem, may result in areas of crucial social reforms being neglected. Says Inderpreet Singh Chawla, LGT Venture Philanthropy, "There are issue areas where markets seem to function quite well and social purpose organisations are actually up against serious competition, e.g., in the micro-drip irrigation sector, whereas there are other social contexts where markets do not function at all, e.g., girls' education in rural areas. To expect an organization to have a revenue model in such a context would be unfair."

It is not always the credibility issue that prevents a grassroot SPO from making an impact. Neither is it that the founders and managers of such SPOs are totally incompetent. In fact, in certain contexts, such as in building a relationship with targeted beneficiaries, they may be far more reliable and competent. However, the stringent selection criteria of VPs, as articulated on their websites, may be too intimidating for grassroot SPOs and make them uncomfortable about approaching the former. Furthermore, there may be lack of a personal touch and approach at the initial stages, which may discourage SPOs from seeking VPs. The solution is therefore to ensure that VPs proactively explore grassroot SPOs, impart adequate knowledge and provide guidance to help them develop their performance standards, and then expose them to the VP marketplace.

The benefits of close and enhanced association with grassroot SPOs may ultimately benefit social enterprises that are supported by VP and allied organizations. Moreover, a credible and cost-effective relationship with such organizations may help in the creation of robust distribution networks in hitherto unreachable regions in the country, to market the products and services of social enterprises funded by VP and allied organizations

Case note
Reaching grassroot SPOs by using “on the ground due diligence”

Caring Friends and Bhagini Niveditha Gramin Vigyan Niketan

Nilima Mishra

BNGVN

Caring Friends is an informal network of 300 individuals with a chapter in Mumbai and upcoming chapters in Pune and Bangalore. It provides financial and non-financial support to grassroot organizations working in rural areas, to help them maximize their social impact. As on date, Caring Friends manages 30 SPOs in 8 Indian states. It has chosen not to register itself under any Indian law and its due diligence procedure involves testing the social concept of an SPO on the ground rather than on paper. It constantly scouts for grassroot SPOs, familiarizes itself with their concept of social impact, provides them with initial grants and “keeps” them within a “probationary period” under appropriate guidance. If the performance of an SPO is satisfactory during the probation period, it becomes eligible to receive additional substantial support from the network.

Bhagini Niveditha Gramin Vigyan Niketan (BNGVN) is an NGO working in the area of women’s empowerment through income-generation programs, as well as holistic development of villages by the formation of self-help groups and microfinance for self-sustainability. It works in four districts including Nashik, Dhule, Nandurbar and Jalgaon in Maharashtra. Over the past 10 years, BNGVN has helped to create a village revolving fund that provides loans for farm input and emergency needs, has addressed health problems by constructing 300+ private and communal toilets, and most importantly, activated village assemblies to discuss and resolve local needs.

BNGVN’s Founder President,Nilima Mishra, won the Magsaysay Award for her work in 2011. With a Master’s degree in clinical psychology, Nilima founded BNGVN with the concept that the problems faced by villages must be addressed by the communities from within them. In 2000, when BNGVN was initiated, Nilima was struggling to organize resources — financial and non-financial — that would help to nurture her fledgling idea. In her initial effort to make the organization and its goals a success, she ended up incurring a personal debt of INR1, 50,000, but was still not successful in establishing the organization she wanted to set up. It was at this juncture that she got in touch with Ramesh Kacholia of Caring Friends. “I went to him and was pleasantly surprised when he gave a patient ear to my struggle at the village level. That moment, without actually visiting the project area, he sanctioned some token donation. Later, he sent his representative to inspect the initial results of our work and when he got a satisfactory report, he started supporting us wholeheartedly. Since that day, we have received constant support from Caring Friends, which has helped tremendously in shaping the success of BNGVN.”

Limited availability of financial intermediation services

India has seen the emergence of organizations that are serving as financial intermediaries or investment banks to enable flow of capital to SPOs. These social investment banks began by catering to the needs of microfinance institutions and moved on to provide buy-side advisory services to foreign social sector investors interested in innovative social ventures in India. Today, these financial intermediaries are increasingly providing sell-side advisory services to social enterprises that have been in existence for some time, and are looking at raising their growth capital to scale up their operations further.

Such services are indeed critical for social entrepreneurs, who, unlike VPs, may not understand the nuances involved in negotiating term sheets, shareholder's agreements, etc. For VPs and allied organizations, these institutions provide sector knowledge and enable expanded relationships, and sometimes, even help to bring in mainstream VCs as co-investors in social enterprises.

However, financial intermediaries are still few in number, and consequently, their collective reach in the VP ecosystem is fairly limited. Moreover, they have not yet tailored their services to suit the needs of seed-stage social entrepreneurs, since they have substantial business available to them from existing social businesses. They have yet to adapt their business models to provide services, e.g., raising philanthropic capital for non-profit SPOs in a professional manner. According to Anurag Aggarwal of Intellecap, "We believe that the evolving concept of venture philanthropy in India has multiple shades. The for-profit and the not-for-profit organisations are two ends of a spectrum that operates in a continuum, and it's not one versus the other. In both cases, the key issue is the governance, transparency and efficiency of capital deployment. At Intellecap, we find that there is a section of social investors that is not averse to making grants and donations to non-profits, and sometimes, they are willing to look at even giving the same grants to for-profit entities to help them achieve difficult social outcomes. I think this is where social investment bankers and transaction advisory consultants like us can help to bring in knowledge and relationships, to help social enterprises and investors/donors achieve their end objectives."

The following scenario prevails at present:

- Financial intermediaries are limited in number and small in size.
- Their services continue to be under-marketed to venture philanthropists and SPOs.
- They are still far from the stage when they can provide services including "underwriting" or "market-making" that mainstream investment banks normally do.

However, there is the increasing realization that creation of social change on a large scale requires an equally large amount of capital (routed through credible channels). Further development of such intermediaries is therefore required to help in maintaining a smooth flow in deployment of capital to SPOs.

Inadequate collaboration with academic institutions

One of the major concerns for the social sector has always been availability of talent. Even VP and allied organizations concede that it is difficult to access the right talent pool to build their internal capacity and meet the human resource requirements of their investees. Given the expansion of the Indian economy, it can be challenging to lure mid- level professionals from their assured and well-paying career paths to the social sector. Although there is no doubt that some mid-level professionals have made this career move in their search for higher goals, the mass deployment of professionally trained human resources the sector requires may not take place if proactive efforts are not made to attract young people qualifying from the country's academic institutions.

It is therefore of utmost importance that VP and allied organizations build strategic partnerships with higher learning institutes to tap young talent emerging from them. Such partnerships should be aimed at ensuring that the country's youth begin to seriously consider the social sector's potential to provide viable employment and professional growth opportunities to them. While these youngsters may be short on professional work experience, they have the right professional training, which can help them learn rapidly and render useful service in minimal time. Furthermore, in-house training and mentoring programs developed by VPs can help these young recruits contribute to the best of their ability to the mission espoused by VP and allied organizations.

Therefore, VP and allied organizations should focus their efforts on partnering with academic institutions, especially those in tier II and tier III towns. Their efforts need to be aimed at developing credible programs that pertain to investment in and management of such investments in the social sector. Moreover, most students studying in tier II and tier III institutes have real-time experience of the challenges being faced in the segment, and, with the right training and guidance, they can be valuable resources for bringing about desired social change in the country.

Debt constraints relating to working capital finance for SPOs

Obtaining working capital finance for their day-to-day operations continues to be the biggest challenge facing SPOs in India. The fact that the property or assets of a non-profit SPO cannot be offered as collateral limits its ability to raise funds from mainstream commercial sources.

A VP organization that is registered in India can provide funds to a non-profit SPO, but not for the latter to meet its working capital needs. Such finance can be availed by an SPO to build assets, but not for purposes such as paying staff salaries. VP organizations can only provide funds in the form of general donations to meet the working capital requirements of SPOs.

Furthermore, non-profit SPOs are not covered under the automatic route to raise external commercial borrowings (ECB) from foreign VP organizations. Under the approval route, only those that are engaged in microfinance activities are eligible for raising ECB. However, utilization of ECB is explicitly prohibited to meet working capital requirements as well as for general corporate purposes and repayment of existing rupee loans.

In the case of social businesses registered in India, a foreign VP organization can provide debt funding, but only after seeking the status of "recognized lender" according to ECB rules. The use of such funds as working capital is explicitly prohibited.

Issues related to Foreign Contribution (Regulation) Act, 2010 regulating ability of domestic VP organizations to raise funds abroad

VP organizations that want to register themselves in India as non-profit entities face procedural issues while registering under the Foreign Contribution Regulation Act (FCRA). Furthermore, it is not easy for such organizations to approach philanthropic investors outside the country, since the FCRA prohibits opening of accounts in foreign countries for the purpose of obtaining funds. Only two options are therefore available to them in this context:

- Setting up an independent sister organization abroad that will raise funds on behalf of the Indian entity and transfer these to the latter
- Making an arrangement with a fund-raising group or attorney abroad, who will raise funds on its behalf and transfer these to the designated Indian account of the VP organization (Such an arrangement requires mandatory clearance from the RBI and the FCRA.)

However, both these options are expensive, since separate arrangements may need to be made to tap and obtain funds from foreign countries.

A present, there is no separate legislation in India that governs VP organizations and social businesses.

Relevance of proposed Securities and Exchange Board of India's (Alternative Investment Fund) Regulations, 2011

The Securities and Exchange Board of India's (SEBI"s) (Alternative Investment Fund) Regulations, 2011 were proposed in August 2011 to "regulate the formation of investment funds that raise capital from a number of High Net Worth investors, with a view to investing in accordance with a defined investment policy." These regulations recognize social venture funds (SVFs) as featuring among the categories that will be covered under the proposed regulations and define these as being targeted at social investors, who are willing to accept muted returns of 10% to 12%.

The draft regulations propose mandatory registration of all types of alternative investment vehicles (including social venture funds) that raise their investment funds from the domestic market. Some of the prominent features of the proposed regulations relating to alternative investment funds (including social venture funds) are as follows:

- The draft proposes a framework for SVFs by defining them as funds that promise muted returns of 10% to 12% to their investors (by

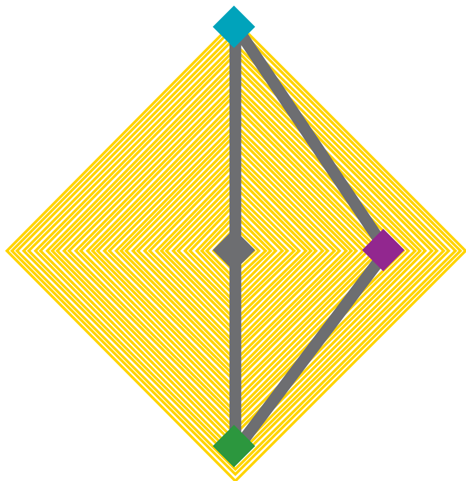
investing in areas such as microfinance to achieve the social performance requirements established by the fund).

- The funds are close-ended and fund management is required to seek the approval of SEBI for any revision made during its tenure, which is a minimum of five years. Any extension to its initial tenure is only permitted if 75% of the investors approve it. This can be extended for a period of up to two years at a time.
- The minimum investment an investor is required to make in a fund has been proposed at 0.1% of its size, but in no event is this amount to be less than INR10 million. A minimum investment criterion has been proposed to ensure that retail investors are not lured into investing in such funds.
- The maximum number of investors in a fund is not to exceed 1000, and if it is constituted as a limited liability partnership (LLP), the number of investors is limited to 50.
- SVFs have been exempted from the requirement of a lock-in period of one year in the case of pre-IPO investments.
- Alternative investment funds (including social venture funds) are required to raise a minimum of INR200 million. The total size of a fund is not to exceed INR2.5 billion.

Foreign alternative investment funds (i.e., those that have raised money abroad) seeking to invest in India will continue to be governed by SEBI's Foreign Venture Capital (FVCI) Regulations, wherein registration requirements are optional and the concerned entity can choose to avail of the benefits available under FVCI regulations or route their investments through the FDI route. The concept paper on proposed AIF regulations however mentions that these may be amended to enable FVCI to invest in different AIFs, such as the SME Fund and social venture funds, in addition to domestic VCFs.

It is commendable that SEBI has recognized the need to encourage socially relevant investments in the country. However, while devising these mandatory registration requirements, it has treated SVFs at par with other alternative investment vehicles.

Figure 16: Exit experience of investee SPOs failing to meet their targeted social impact



Source: Ernst & Young–AVPN India VP ecosystem mapping survey, January 2012

It should however consider the impact of the following proposals on the country's fledgling social venture funding scenario:

- The sponsor of a fund is required to make a compulsory investment that is equal to at least 5% of the investment. Furthermore, the sponsor's investment in the fund is locked in till its redemption by the last investor in it. This limit is fairly restrictive, particularly in the case of non-institutional sponsors.
- Given the fact that it is in any case difficult to raise funds for social investments due to muted returns and the long gestation period involved, the ceiling on the minimum investment criterion and the largest number of investors in the fund is restrictive for domestic social venture funds.
- The provision related to the fixed tenure of the fund and requirements for its extension does not match investment requirements in the social sector.

Our research revealed that 39% of VP and allied organizations operating in India exit their investees if the latter have failed to achieve defined social impact outcomes within the period set. However, 26% sensitively analyzed the situation responsible for the failure of their investees to meet social targets, and accordingly, extended their tenure. Given the regulatory requirement of a fixed tenure and the pressure on generating financial returns, it is quite possible that the fund managers of SVFs may have to make forced and premature exits, and thereby, jeopardize their primary social mission. Furthermore, India's capital market for social sector investments is yet to develop, which necessitates that the issue of SVFs exiting social investees is treated with the utmost sensitivity.

SEBI needs to recognize the fact that it is the mission of SVFs to make a social impact and generate financial returns. These funds often invest in businesses that operate in challenging socio-economic conditions. The financial resources available for investments in the country's social sector and subsequent returns that can be generated are far less, as compared to other alternative investment vehicles. Therefore, SEBI needs to make appropriate regulatory concessions to ensure the healthy growth of domestic social venture funds. While ensuring investors' interests, it should also ensure that mandatory registration requirements do not add to the administrative cost of SVFs. Furthermore, it remains to be seen what fiscal and tax incentives will be provided by the Government to SVFs registering under SEBI's proposed legislation.

Absence of appropriate legislation for social businesses

As far as social businesses are concerned, for-profit social businesses can be incorporated under the Partnership Act, 1934 or the Companies Act, 1956 under Indian law. Furthermore, in order to promote small and medium enterprises, the legislature has recently passed the Limited Liability Partnership Act, 2008, which provides for the establishment of an alternative corporate entity (with the limited liability benefits of a company, but the flexibility of a management structure that is similar to that of a partnership). However, none of these Acts currently make any special provisions for or classifications governing for-profit making enterprises that invest in social causes. Due to non-recognition of the statues of a hybrid form of business with special needs, the social business sector does not receive any special fiscal incentives under the provisions of tax regulations in India. Although there may be specific benefits and subsidies related to the sector in which the social business operates, these are only limited to a few sectors, e.g., solar energy. A social business already has the uphill task of proving its business model by generating returns while maintaining the sanctity of its social mission. With the absence of special fiscal incentives, these organizations face a further hurdle in achieving their objectives.

In their effort to develop special legislation for social businesses, policy framers can learn from similar legislation in countries such as Belgium, the UK and the US, the three countries that have already implemented laws for governing social businesses. In 1995, the Belgian Parliament passed a special legislation to create a new format called the Societe A Finalite Sociale (SFS) for commercially oriented social enterprises. The UK Government initiated the Community Interest Company (CIC), which is in essence similar to any other limited company, but restricts its activities to serve a social interest as part of the Government's Companies Act 2004. In 2008, the US enacted legislation allowing social businesses to register themselves as Low-Profit Limited Liability Companies (L3C). These enactments allow investment of private capital for social purposes and at the same time provide an uncomplicated regulation structure for governing social businesses. The UK's policy structure has been more successful than that of the other countries mentioned above, since it focuses on creating enhanced awareness of the social enterprise sector, and at the same time, has created additional capital sources for social enterprises.[19]

India's legislations recognize either for-profit or non-profit entities and accordingly prescribe rules, regulations and development schemes for these traditional forms. However, the country's current regulations inadequately recognize, understand and cater to the special developmental needs of this hybrid model, which clubs the commercial with the social.

Provisions of DTC and their implications on non-profit SPOs

The proposed Direct Tax Code seeks to simplify the current tax exemption regime for non-profit organizations. However, certain provisions of the proposed regulation are likely to place hurdles in the path of or pose challenges for the growth of non-profit SPOs in India.

Under the code, a non-profit organization is allowed to carry forward only 15% of its total income (gross receipts reduced by outgoings) or 10% of its gross receipts, whichever is higher. The income carried forward however needs to be utilized within a period of three years. While it can be argued that this will encourage non-profit organizations to be more proactive and efficient in their use of funds to promote their cause, it may limit their ability to undertake specific savings. This would in effect have a long-term effect on their scalability and sustainability efforts, and they will have to mobilize such funds year on year. The current provisions permit up to 100% carry forward of the current year's income (with the option of retaining 15% indefinitely). Furthermore, this is allowed for a period of five years as against the three-year period proposed by the DTC. Moreover, non-profit SPOs currently have the freedom to use receipts received at any time of the year during the subsequent year. However, the application of DTC will result in withdrawal of this flexibility and only the amount received in the last month of the year being allowed to be utilized during the following year.

To ensure their sustainability, non-profit organizations have been experimenting with cross-subsidy models worldwide. Consequently, there are examples of non-profit SPOs that sell accessories, booklets and other such items to augment their resources to support their mission. However, Section 102 and Section 103 of the proposed DTC prohibit such activities for a specific category of non-profit organizations engaged in "advancement of any other object of general public utility." Any such activity carried out by these SPOs in the nature of trade, commerce or business for a fee or any other consideration (irrespective of the use of the income to promote the cause of the non-profit organization) is taxable if the total receipt from such activities is in excess of INR1,000,000. However, there is no need to restrict the business activities of this section of SPOs, since the proposed code in any case restricts coverage of business activities and has only allowed those that are conducted by such SPOs while they are actually undertaking welfare activities.

An investment plan for financing SPOs by borrowing the principles of professional effectiveness from the VC or PE industries is not a conflicting approach

19 Doeringer, Matthew F.; (2010); "Fostering Social Enterprise: A Historical and International Analysis"; Duke Journal of Comparative and International Law; Vol. 20; No. 2; Pgs. 291-329.

Concluding comments

to socio-economic development. VP and allied organizations are helping to create the sensitive face of the capitalistic VC movement, and in the process, have opened up new dimensions of growth — for society as well as for capitalism. They ensure that on one hand SPOs are able to effectively compete for their huge requirement of resources in India's rapidly growing mainstream commercial segment. On the other hand, VPs ensure that SPOs are able to reduce the leakages that occur due to the latter's relatively inefficient pursuit of their socio-economic developmental goals.

However, in the Indian context, it is important that VP and allied organizations position themselves to achieve the intensity and speed required to meet the varied demand for social products and services offered by SPOs. As the gaps in the VP ecosystem indicate, there is significant scope for the different elements of the VP ecosystem to pool their efforts so that they can effectively fulfill each others' requirements (as mentioned earlier in this report).

Based on our study, we make the following recommendations to ensure that VP and allied organizations continue to move forward toward their goal:

- **Establishment of a strategic partnership with the VC and PE industry in the country:** Sorenson and Stuart[20] have studied inter-firm relationships among venture capital firms and conclude that "VC firms with a history of provincial investment patterns and those without central positions in the industry's co-investment network tend to invest locally; those who have established many and dispersed relationships with other VC firms invest across geographic and industrial spaces more frequently."

  The goal-oriented partnership of VP and allied organizations in India with the country's VC and PE industries is expected to translate into a cohesive endeavor to ensure that new grassroot initiatives continuously grow across the length and the breadth of the country. Such partnerships will not only add to the benefits enabled by co-investment, but should also be nurtured to develop a managed process of pooling high-quality volunteers comprising senior resource personnel from the VC and PE industries. This will help VP and allied organizations to effectively address their internal capacity constraints and adopt best practices related to portfolio risk management.

- **Need for knowledge-sharing initiatives to be strengthened between VPs and academia:** The major component of this partnership should focus on creating the enhanced visibility and approachability of VP and allied models by means of targeted training and educational programs. Such endeavors are expected to be helpful and attract the attention and interest of grassroot organizations as well as young professionals in the domain. Other components of this partnership could focus on the nature of non-financial services and explore the "collaborative" delivery mode for providing non-financial services to investee SPOs.

- Last, but not the least, we suggest that a concerted effort is made to achieve the enhanced legitimacy of this nascent field by identifying and partnering with its champions within the policy-making and governance domain. Such initiatives should be directed at creation of laws that identify and incentivize the convergence of the hybrid model advocated by VP and allied organizations.

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20 Sorenson, Olav and Stuart, Toby E.; (2001); "Syndication Networks and the Spatial Distribution of Venture Capital Investments"; The American Journal of Sociology; Vol. 106; Pgs. 1546-1588.

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Tidel Park,
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No. 4, Rajiv Gandhi Salai
Taramani
Chennai 600113
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Oval Office
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Hitech City, Madhapur
Hyderabad 500081
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Fax: +91 40 6736 2200

Kochi
9th Floor
ABAD Nucleus
NH-49, Maradu PO
Kochi 682 304
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Kolkata
22, Camac Street
3rd Floor, Block C
Kolkata 700 016
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Fax: +91-33-2281 7750

Mumbai
6th Floor Express Towers
Nariman Point
Mumbai 400021
Tel: +91-22-6192 0000
Fax: +91-22- 6192 2000

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (west)
Mumbai 400 028
Tel +91 22 6192 0000
Fax +91 22 6192 1000

5th Floor Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063, India
Tel: +91-22-6192 0000
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NCR
Golf View Corporate
Tower – B
Near DLF Golf Course
Sector 42
Gurgaon – 122 002
Tel: +91 124 464 4000
Fax: +91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi – 110 001
Tel: +91 11 4363 3000
Fax: +91 11 4363 3200

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
NOIDA 201 304
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Pune
C–401, 4th floor
Panchshil Tech Park
Yerwada (Near Don Bosco School)
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Artwork by RiS

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