India’s Social Enterprise Market Landscape

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INTRODUCTION

Social enterprises (SEs) have the potential to make India’s spectacular growth story work better for its poor citizens. Currently, India’s rapidly growing economy has not managed to alleviate the extreme poverty of nearly half the country’s population that lives below the $1.25 per day poverty line. There are several reasons for this, including non-uniform infrastructure, low quality public good provision by the government (especially in health and education), and resource limitations.

By employing innovative business models, SEs are addressing India’s vast development needs, while maintaining sustainability through viable revenue models. Simultaneously, this space is witnessing an increasing number of impact investors who are interested in supporting businesses with triple bottom line returns – that is, profits (or financial sustainability at the least), social impact, and environmental impact.

This paper provides a broad overview of the SE landscape in India. It covers different sectors and for each highlights social and environmental needs, how SEs are addressing these needs, key barriers confronting SEs, and different enablers that facilitate the activities of SEs. Key insights from this report follow from the profiling of 120 Indian SEs.

DEFINITION OF SEs

SEs are defined as organizations that have triple bottom line returns: namely they address social and environmental needs such as affordable health services and energy, and have a financially sustainable revenue model (or plan to become sustainable in the near future). It is important to note that the definition is not limited by legal structure. SEs may be registered as private limited companies, cooperatives, not-for-profits, trusts or other types of legal entities. However, the legal structure of an SE may have a bearing on the type of funds they can attract. Not-for-profits, for instance, cannot solicit equity investments, but can have access to debt capital.

INDIA AND IMPACT INVESTMENT

India is the world’s second most populous country in the world, and the fifth largest economy in terms of GDP when adjusting for international price differences. However, its per capita income in 2011 is only $3,600, placing India 129 out of around 184 countries. Despite this, India’s economy grew at a pace of 7.45% between 2000 to 2011, making it the world’s second-fastest growing major economy.

More than three-fifths of India’s population lives in rural areas. Approximately 53% of the country’s total employment is in agriculture, yet only 19% of India’s GDP is created by this sector. Manufacturing accounts for 26% of India’s GDP and the remaining 55% is from services. Around 41% of India’s population lives under the poverty line of $1.25 per day, and the adult literacy rate is only 63%. Average life expectancy is 64 years, and infant mortality is at a very high 50 in 1,000 births.

Impact investing in India has roots extending back to 1982, when the Ashoka Foundation provided grants to Indian social entrepreneurs. However, it was not until recently that India has witnessed an increase in the number and size of investments in businesses with a clear triple bottom line.

In 1997, Grassroots Innovations Augmentation Network (GIAN) became India’s first non-profit socially minded venture capital fund (VCF), and in 2001 Aavishkaar became the country’s first
for-profit counterpart. Early growth in the impact investor community was slow; it took Aavishkaar seven years to accumulate $14 million for its first fund. Since then, the number of players and the size of each fund have increased considerably. Some of the largest actors in the field include the Omidyar Network, Aavishkaar, Acumen Fund, and Elevar Equity. Additionally, the Indian Government is considering setting up a VCF of $200 million.

The recent growth in capital available to SEs indicates that the market is far from saturated. The number of SEs seeking capital at various stages of development is also increasing at a rapid pace. There is great optimism amongst development finance institutions and large private foundations regarding the role of SEs in alleviating global poverty.

This enthusiasm stems from the demonstrated success of existing models, and is translating into more equity and debt sources for SEs. While India is one of the world’s most advanced impact investing markets in terms of number and size of investments, it is important to note that the country’s impact investment space is still nascent. Very few funds have managed successful exits from their investments. For example, Aavishkaar has only partially exited one of its investments, while Acumen Fund in India has exited only one of its debt-based investments. However, as business models evolve and mature, this situation is likely to change.

INDIA’S SOCIAL ENTERPRISE MARKET LANDSCAPE

SEs are reaching hitherto underserved markets and are doing so with innovative business models that ensure affordability for the end consumer without eroding sustainability for the enterprise. Key SE sectors include: agriculture, education, energy, financial services, healthcare, housing, sanitation, and water.

India’s vibrant SE space is young in terms of years of operation, and nascent in terms of revenue size per enterprise. According to the Beyond Profit 2010 survey, about 68% of SEs have been in existence for five years or less. Furthermore, annual revenue for about 90% of SEs is $500,000 or less (see Figure 1). Given the youth of the space, it is not surprising that one in three SEs experience losses in their current operations. Having said this, SE revenues are growing rapidly; for instance nearly one-third of the enterprises surveyed by Beyond Profit grew by over 50% between 2009 and 2010, while only 6% of the surveyed enterprises had negative growths.

DIFFERENT TYPES OF SOCIAL ENTERPRISE MODELS:

SEs that adopt innovative business models with for-profit entities account for three-fifths of all SEs. For-profit models also include collective ownership structures such as cooperatives and producer companies; Waste Ventures is one such organization that “incubates solid waste management companies owned and operated by waste pickers.

About one-fifth of SEs adopt not-for-profit structures, such as Aravind Eye Care Hospitals, which is registered as a trust, and sustained by charging users for affordable eye care. About 20% of the models can be categorized as hybrid, wherein two or more entities, while not legally bound, work in close synergy with each other, usually because they are both founded by the same individual or individuals. The Cashpor Group, which comprises both for-profit and not-for-profit entities, is a prime example of this.

A growing trend observed in the Indian SE space is the transformation of many not-for-profit models into for-profit models, as these are in a better position to secure financing and scale over time. This was especially true of non-profits in microfinance, where the revenue model was clear early on. Many leading microfinance institutions (MFIs), such as SKS and Spandana, were registered initially as non-profits and subsequently transformed into for-profit companies.

An initial assessment of the SE financing landscape indicates that the key sources of capital for SEs are non-institutional debt, equity (mostly self-finance), institutional debt, and grants (see Figure 2). The key sources of equity in the SE space are early stage impact investors or entrepreneurs’
capital (both equity and debt). Traditional private equity investments in SEs are rare, and are largely limited to the more developed sectors such as microfinance, health, and agribusiness.

This is primarily due to the fact that the markets are developing, business models are just starting to show proof of concept, transaction costs are high for investors, and there is limited data available to help understand the space. Although debt is a major source of capital for many SEs, access to institutional debt (such as bank loans) is limited. With improving access to equity financing, access to institutional debt is also expected to improve over the next few years.

In order to sustain their growth, SEs need to access mainstream capital. Investor interest is gradually increasing as early investors are starting to see returns, and high growth is seen across sectors. SEs that are successful both from profitability and impact points of view now exist across key sectors. Examples are presented in this report.

ROLE OF GOVERNMENT AND POLICY FOR SOCIAL ENTERPRISES IN INDIA:
There is increasing recognition within India’s central and state governments about the usefulness of engaging or facilitating the private sector to address some of the country’s pressing developmental needs, although the specific nomenclature of “social enterprises” is not often used. The Government has been involved in three main categories: Micro, Small, and Medium Enterprises (MSMEs) engagement, government-backed venture capital funds, and policy formulation.

First, the government has initiated various public–private partnerships in key development sectors, such as health. For example, many state governments have invited private sector players to provide emergency health care services in urban areas. MSMEs have been identified as a priority lending sector. This increases the availability of capital through government provisioning of grants, equity, and subsidized loans for companies in this category. This clustering includes all enterprises with an initial outlay below $2 million. Since almost all for-profit SEs fall into this category, they will benefit from this policy. Recently, the Prime Minister of India also commissioned a special task force to provide a set of recommendations on further developing India’s MSMEs. The task force recommended that the government should spend around $1.1 billion over the next 3 to 5 years on augmenting infrastructure and technological support for MSMEs; of these funds, around 20% should be earmarked for incubation centers within reputable educational institutions.

Secondly, the National Innovation Council, set up by the Prime Minister in 2010 to catalyze innovation in India, is considering establishment of a government-backed venture capital fund. The size of this fund will be in the ballpark of $200 million. The primary focus of this fund would be to address developmental needs in education, health, infrastructure, and sanitation.

Thirdly, the government is involved in formulating and changing policies and regulations that can affect the SE space. Most recently, the Securities and Exchange Board of India (SEBI), the country’s financial market regulator, floated a policy paper suggesting the need to separately recognize and regulate “Social Venture Funds”. It outlined that these funds are for investors seeking “muted” returns in their investments in return for social gains. SEBI sought public comments on its note and the final recommendations are yet to be finalized.

SOCIAL ENTERPRISE SECTORS:

- Healthcare
- Housing
- Education
- Financial inclusion

1. HEALTHCARE

   **Overview:**
   Poor households in India spend approximately $6.2 billion annually on healthcare services; in-patient care and pharmacy drugs account for 30% and 33% of the total healthcare expenditure, respectively.
The primary reason for such high expenditure by the poor is inadequate public healthcare infrastructure and poor access to existing facilities. Given the potential demand, there is an immense need for healthcare enterprises that provide affordable and quality primary, secondary, and tertiary medical services.

SE Involvement In The Sector

The affordable healthcare sector in India is still nascent. The average size of enterprises by revenue is approximately $1.1–$2.2 million. In order to address the market need, affordable healthcare providers use innovative operating models such as leased premises and hub-and-spoke setups in order to minimize the cost of service delivery across primary, secondary, and tertiary care. In the past, affordable healthcare initiatives were largely structured as charitable institutions run by large industrial houses or government operated institutions. With the recent wave of entrepreneurial activity in affordable healthcare, most new initiatives are structured as for-profit enterprises. Because affordable healthcare initiatives are young and utilize innovative operating models, many have yet to prove their financial viability. The flow of equity capital has thus been limited to micro-venture capital, with few private equity transactions.

The flow of equity to the sector is approximately $118 million with an average deal size of less than $5 million. However, the flow of equity capital to enterprises in affordable healthcare is expected to increase over the next few years as the sector is exhibiting immense growth and first movers are expected to break even in the near future. Given the untapped market potential in tier-two and -three cities, the affordable healthcare market is expected to growth rapidly over the next few years.

POLICY ENABLERS AND BARRIERS

The Government generally encourages enterprises in affordable healthcare. For instance, publicly funded healthcare micro-insurance initiatives, such as RashtriyaSwasthya and Bima Yojana, create an incentive for enterprises to deliver healthcare to the poor. However, licensing requirements for all hospitals are cumbersome; hospitals require about 18 licenses prior to commencing operations.

2. HOUSING:

Overview

The formal real estate and housing finance markets traditionally cater to middle and high-income customers, while the government is generally expected to serve the housing needs of the poor. Despite several government initiatives, there exists a huge gap in the supply of affordable housing. The gap in the urban housing market is estimated at 25 million units, virtually all of which is accounted for by the working poor. The estimated gap in the urban housing translates into a market potential of approximately $280 billion.

SE Involvement In The Housing Sector

Given the initial success of housing for low income populations and the potential demand, the market witnessed the entry of specialized enterprises that focused on affordable housing projects and affordable housing finance.

Today, India has more than 25 developers involved in affordable housing projects that offer apartments in the price range of $6,600–$15,500. In affordable housing projects, developers create economic value by minimizing construction cost and time to completion through integrative technical solutions and process innovations.

Despite the immense potential demand, the key challenge in developing affordable projects is the unavailability of land close to business districts. The location of an affordable project has an impact on the uptake of housing units, which consequently affects the financial viability of the project. Similar to traditional real estate projects, affordable housing projects are funded through a combination of equity, debt, and pre-construction finance by potential buyers.
Although the flow of equity to the sector is gradually increasing, debt continues to be a key source of finance for housing projects. The other key stakeholders in the affordable housing space are the micro-housing finance companies that address the consumer finance needs. The key challenges to serving the micro-housing finance market are lack of consumer credit history and absence of asset collateral. Housing finance companies mitigate the credit risk through stringent project screening and collateralizing the purchased housing unit.

POLICY ENABLERS AND BARRIERS:
In order to address the gap in housing supply, the government has instituted various incentive schemes like slum re-development initiatives that attract private capital. However, in order to make affordable housing projects financially attractive, the government will need to provide additional benefits such as tax incentives for developers. The housing finance companies are structured as Non-banking Financial Companies (NBFCs) and have access to wholesale debt funds from commercial banks and the National Housing Bank (apex body in housing finance operated by the Reserve Bank of India).

3. AGRICULTURE:
Overview
Agriculture and allied sectors provide livelihoods to more than 70% of the rural population in India. Despite this, agriculture accounted for just 14.6% of GDP in 2009–10 as compared to 17.8% in 2007–08. The decline in growth of agriculture and allied sectors is a result of multiple factors, including small farm holdings, poor access to credit, dependency on monsoons, lack of adequate capital investments, poor knowledge of modern agricultural practices, misaligned government policies, and other institutional inefficiencies.

SE Involvement In The Agriculture Sector:
Social enterprises that operate in the agriculture space create economic and social value by eliminating inefficiencies that exist in the current value chains. These enterprises can be broadly categorized into those supporting the value chain pre-harvest, those supporting post-harvest operations, and those that work with the dairy value chain.

The products and services offered by SEs operating in the pre-harvest category attempt to increase agricultural yield in an economically and environmentally sustainable manner. Aakruti Agricultural Associates and Janani Foods are examples of SEs in this category. These SEs collectivize small/ marginal farmers, distribute information and advisory services, supply farm equipment, ensure access to quality inputs, and teach organic farming practices.

The business models of enterprises operating in the pre-harvest space vary based on products or service offered and legal structure. These enterprises are structured as both for-profit and not-for-profit entities. Enterprises in the post-harvest space attempt to eliminate supply chain inefficiencies while ensuring economic profits for all value chain actors. Field Fresh Food, Mother Earth, and Star Agri are SEs operating in the post-harvest space. SEs in this space are actively involved in procurement, storage, transport, processing, and retailing. Operations in the post-harvest space require a substantial amount of capital and operational expenditure, causing most business models to be structured as for-profit entities.

Dairy farming is a growing activity for SEs in the agricultural space. These SEs are typically involved in aggregation, procurement, and processing and are structured as for-profit entities. Many for-profit dairy enterprises also have substantial farmer ownership. Those that are focused on capacity building and training of the dairy farmers are typically structured as not-for-profits. Despite attractive business economics, the dairy farming sector is in its early stages of development and has not attracted significant investor interest.
Policy Enablers And Barriers
The government has instituted several schemes, such as a capital subsidy scheme, to promote investment in the post-harvest space. One of the key challenges facing SEs operating in the post-harvest space is the high level of market regulation, especially in the procurement and pricing of agricultural commodities. The flow of equity capital to the sector is limited to micro-venture capital and impact investments. However, mature companies in the organic agriculture space, such as Suminter Organics, are able to attract substantial investor interest.

4. FINANCIAL INCLUSION
Overview
Access to finance by the underserved is an essential prerequisite for inclusive growth. Currently, only 10% of the total demand for microcredit is met by MFIs. Moreover, this gap is concentrated in India’s northeastern Hindi-speaking belt. In the Indian state of Uttar Pradesh, only 1.5% of total microcredit demand has been met. The underserved also have limited access to other financial services such as micro-savings and micro-insurance products.

SE Involvement in the Financial Inclusion Sector
Microfinance Institutions (MFIs) act as financial intermediaries with products and processes geared towards serving vulnerable sections of the society. MFIs in India started out as not-for-profit entities that provided standardized credit products. As the credit portfolio of MFIs grew rapidly, access to capital became vital. Since not-for-profits cannot legally attract equity investments, most MFIs transitioned into a for-profit model, usually structuring themselves as Non-banking Financial Companies (NBFCs). The NBFC structure enabled access to both debt and equity funds. Currently, an estimated 300 institutions provide loans to low-income households for income generating activities, with a client base of 27 million active borrowers and $4.5 billion in outstanding loans.

The Self-Help Group Bank Linkage Program promotes financial transactions between commercial banks and self-help groups (SHGs). In addition to the commercial banks, the other key stakeholder in the SHG Bank Linkage Program is a not-for-profit organization that promotes the members of the SHG. The bank linkage model works on the principle of community ownership; no profit-oriented delivery model exists in this space. Currently, there are about 7 million SHGs linked to banks through this program.

Branchless banking is another relatively new strategy in the financial inclusion space. Enterprises in the branchless banking space use technology (smart cards or mobile phones) to facilitate access to finance for under-banked populations. Branchless banking SEs are structured as for-profit entities as the technology infrastructure and management require significant capital.

The rapid growth of the financial inclusion space has attracted the attention of equity and debt investors. Over the last three years, many mainstream investors actively invested in large for-profit MFIs. SKS Microfinance was the first MFI to go public; it raised $367 million through a public issue. Bank lending to MFIs increased 2.8 times from $1.1 billion in March 2009 to $3.2 billion in March 2010.

Policy Enablers And Barriers
In order to improve access to finance in India, the Reserve Bank of India (RBI) has made financial inclusion an integral part of its future banking outreach strategy. The RBI has instituted a number of policy measures to promote financial inclusion initiatives; the key initiatives in the financial inclusion space are the Self-Help-Group Bank Linkage Program, microfinance, and branchless banking through a business correspondent model. Regulatory provisions made by the RBI are also one of the key enablers for financial inclusion in India. Some of key policy initiatives of the RBI include priority sector lending, no-frills accounts, branchless banking, and mobile ATM.
CONCLUSION:
Over the last decade, the scope of SEs and impact investors in India has expanded beyond financial services and agriculture to include other sectors such as energy, sanitation, and health as businesses and entrepreneurs have come to recognize the triple bottom line value created by such enterprises. SEs have adopted different business models across and within each sector. Despite the variations in the sector and business models, there are some design elements that have shown success in multiple SE markets. Common practices among successful SEs are:

- Customization of product and service to meet the needs of target market
- High product and service quality
- An asset-light infrastructure to minimize capital expenditure and maintenance costs
- Innovative outreach or distribution models to deliver products and services in a cost effective manner
- Usage of appropriate technology in design, production, and service delivery to improve efficiency
- Consumer ability to pay via variable pricing or financing
- Aggregation of multiple suppliers, especially in rural areas

The number of investment-worthy SEs is on the rise, but limited access to growth capital remains a key constraint. As the SE space in the country continues to grow, the ecosystem to support it will need to grow as well. With a rise in the number of interested investors and deals, SE-focused trading platforms are all the more relevant, as are impact assessment standards, measurement tools, and financial advisors to support such transactions. As SEs in India continue to grow and increase their impact, it would be beneficial for them to gain a more regional perspective. SEs should not only look to raise capital from local investors, but should also look to attract more regional and global capital to grow their impact. In order to gain this regional perspective and attract regional capital, innovative investment vehicles (such as the regional platforms being developed by IIX Asia, based in Singapore).

Since India is one of the centers of innovation for SE development in Asia, Indian SEs should also consider franchising so that SEs in other countries may utilize their successful models. By creating replicable and effective models, SEs can further scale their impact. Furthermore, SEs and investors should consider forming an Indian SE network so that they can have a community in which to share their ideas. This will in turn help the entire Indian SE space expand. By accessing outside growth capital and collectively pushing the SE space forward, India can continue to be a pioneer in the SE and impact investment space.

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