Reflections on Strengthening the Impact Capital Ecosystem

From 30 In-depth Interviews with Social Enterprises
Hypothesis

Mismatch in what current impact investment ecosystem offers that affects social impact and financial sustainability of social enterprises and thus, ultimately sustainability of solutions being deployed for the poor

Objectives

- Elevating the experiences of social enterprises scouting and receiving impact capital
- Exploring “impact” of impact capital on social impact + financial sustainability within enterprises
- Recommendations for different stakeholders to better design and deploy impact capital that better serves communities
Methodology

- **Interviewed social enterprises:**
  Selection criteria - underserved segments, experience with raising impact investments, key development sectors, for-profit enterprises. Sourced pipeline from referrals, portfolio companies of incubators/impact funds networks.

- **In depth phone interviews** 45 mins-1 hour with a semi-structured questionnaire over 3 months period

- Surfaced many recommendations from interviews itself
**NO. OF INTERVIEWS**
30

**SECTORS**
- Agriculture and Food: 3
- Health: 6
- Energy: 9
- Livelihoods: 2
- Housing, Sanitation & Waste Management: 4
- Skill Building & Education: 3
- E-Commerce & Finance: 3

**MANUFACTURING**
19

**SERVICE**
11

**YEAR OF INCEPTION**
- '09: 3
- '08: 4
- '07: 4
- '06: 3
- '05: 3
- '04: 4
- '03: 4
- '02: 2
- '01: 1
- '00: 1
- '99: 1

**LEGAL STRUCTURE**
- Private Limited: 23
- NGOs: 4
- Proprietorship/Partnership: 1
Key emerging themes

Capital Raise
- Pipeline Channels
- Mismatched fund flows
- Power Imbalance

Terms of Capital
- Domestic capital
- Internal Rate of Returns and Exits

Social Impact Interpretations
- Depth vs breadth of impact
- Impact Business Models
- Scale
"I am told that there are patient and philanthropic investors, but I don’t know where they are or how to reach them."

**Capital Raise Process**

**Pipeline Channels**

**Responses / Observation**

Challenges in tapping into “impact” investor networks

- Visibility asymmetry skewed towards major cities (18/30 enterprises were in Tier 1 cities, and the others in Tier 2 or 3)
- Featured in awards or articles (27/30 of the thirty enterprises we interviewed had featured in some or the other news article, or had won awards, competitions at some level)
- Influential connections via alumni or board members (20/30 enterprises)

**Recommendations**

- Matchmaking platforms that cast a wider net
  - Leverage existing incubators or local partners
  - Host events in Tier 2-6 cities
  - Sponsorships
- Innovative pipelines
  - Deal flow from unusual sources like enterprise lists from MSME schemes
  - Referrals closer to operational areas of enterprises
- Exposure to networks baked into agreements
Capital Raise Process

Mismatched Fund Flows

Responses / Observation

Investor Profile and Enterprise phase mismatch (15/30)

- Funding gap between prototype and growth stage
- Funding gap for supporting conditions/ecomystem
- Predetermined investment sizes

Recommendations

- Pilot ideas/iterate models with grants before seeking investments
- Layering- Diversify sources of funds via Individuals, impact funds, crowdfunds, banks schemes, govt. programs.
- Restricted : unrestricted funding composition, external partners
- Well designed milestone based funding structure (open to iterations without mission drift), syndications among investors
## Capital Raise Process

### Power Imbalance

#### Responses / Observation

Power Imbalance in negotiation during and post investment *(20/30)*

- Long due diligence process (1.5-2 yrs; Rejections at the last moments)
- Hierarchical questioning
- Financial metrics driving conversations

#### Recommendations

- Trust and transparency practices such as sharing expectations on IRRs, fund ticket size, past investees
- Estimation of realistic due diligence timeframes (1-1.5yrs) and start planning backwards
- Legal counsel- that is sensitive to social missions while representing investors and enterprise protection
- Adequate board representation and teams with ground expertise
- Insertion of clauses like reinvesting profits, drag along rights at 3 levels

“Board meetings are filled with discussions around reporting requirements that benefit the investor but I often do not leave the discussions with a feeling that my enterprise benefited from advice/counsel/ flexibility on investment terms etc, especially when discussions are around the “reasons” for delayed achievement.”
Terms of capital

Domestic Capital

Responses / Observation

Challenge to access domestic Investors and locally tailored solutions

Recommendations

- Awareness on impact business models by similar forums for primary investors, target upcoming portfolio managers
- Frontline investment and incubation teams with more field experience
- Policy change to remove unfair advantages re: dual offices by structures to unlock domestic finance
**Terms of capital**

**IRRs and Exits**

<table>
<thead>
<tr>
<th>Responses / Observation</th>
<th>Recommendations</th>
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<tbody>
<tr>
<td>• Follows same rules as mainstream finance (22/30)</td>
<td>• Calculating financial returns keeping in mind</td>
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<tr>
<td>• IRRs and Exits at almost commercial numbers (18-26% &amp; 4-5 yrs exits)</td>
<td>• Enabling environment</td>
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<tr>
<td>• There are tradeoffs in social and financial returns- who decides these tradeoffs?</td>
<td>• Social impact across different levels</td>
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<td>• Benefits related to source of funding are not passed on to the enterprise (in cognizance of the conditions of the operating environment and end users)</td>
<td>• Plough back profits towards long term growth and sustainability</td>
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<td>• Longer exit horizons of at least 8-10 years</td>
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“Failed enterprises result from trying to focus on too many things (or being advised to by investors), quick profitability expectations at early stages vs building blocks for strong foundation of enterprise growth.”
Social Impact Interpretations

“Impact” Business Models

Responses / Observation
Significant high costs associated with CACs- to disrupt markets in challenging conditions such as awareness creation, end user financing, tech development, knee jerk policies (15/30)

Recommendations
- Require components of soft funding to build ecosystem
- Policy- legal structures that allow for soft funding
- Ratio of restricted and unrestricted funding composition
- Crucial to understand gaps in the ecosystem to temper return expectations
- Need more investors to fund ecosystem builders / stakeholders

“Social change is not overnight. It takes time to change behaviours, to engage long term partners, to develop indigenous technologies”.
## Social Impact Interpretations

### Scale

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<tr>
<td>“Excel vs. Realities” (17/30)</td>
<td>3 scenarios plan A/B/C</td>
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<tr>
<td>Belief that BoP = large market = scale is wrong logic</td>
<td>Realistic exit periods aligned to A/B/C</td>
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<td>Assessing different levels of financial sustainability in operations and associated timelines</td>
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<td>Temper expectations with good mentors with field experience on boards of enterprises/investors</td>
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“Don’t want to compromise on values, like increase in bag weight, timings and safety, do not want to compromise on those for giving higher unit metrics”
Social Impact Interpretations

Depth of Impact

Responses / Observation

- Questions predominantly around “high level” end user unit metrics (14/30)
- However also depends on stage-

Recommendations

Explore metrics at three levels- depth & breadth:

- End-user
- Enterprise
- Ecosystem

“Asking an early stage enterprise for a lot of impact metrics is like asking a 3 yr old what they want to be when they grow up?”

“Impact numbers are an additional metrics, they are the not the decision making criteria”.
Next Steps

1. Continue the study with more enterprises AND investors to build more evidence and for a 360° view

2. Look at streamlining key buckets and emerging sub themes

3. Develop more tools and recommendations that can be used by stakeholders re: Inclusion framework, sample SHA language, specialised capacity building workshops, policy changes

4. Global Commission Study anchored by Oxfam USA