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Impact Investing in India has the potential to grow from US$ 1 billion in 2015 to US$ 6-8 billion by 2025, according to McKinsey research

November 16, 2016, Delhi: New research suggests that Impact Investments in India has reached over US$ 4.1 billion in cumulative investments over the last 6 years and is growing at 15% annually. At least 60-80 million lives were touched last year across socially relevant sectors such as, financial inclusion, agriculture, healthcare and education.

The research indicates that in 67% of social enterprises, focused social impact funds have led the first investments, demonstrating the vital importance of impact investors in helping socially relevant enterprises grow and prosper. In fact, impact investors have played a critical "seeding" role accounting for 60-70% of investments in deals with ticket size less than US$ 5 million.

Conventional PE/VC funds have also been active participants in Impact Investing with 44% of deals by value and 32% deals by volume as sole investors. These investments have largely been focused in clean-tech (77% by value), followed by financial inclusion (14% by value). On the other hand, dedicated Impact Investor funds have invested in 22% of deals by value as sole investors. The funds have been invested in a broader mix of sectors, financial inclusion (51% by value), cleantech (31% by value), education, healthcare, agriculture etc. (18% by value).

The research, conducted by McKinsey & Company's private equity practice, uses extensively mined proprietary data that was supplemented by a comprehensive survey of stakeholders. This effort was supported by the Impact Investors Council (IIC), a member-based industry body for development of the Impact Investing eco-system in India, focused on growing investments, advocacy, research and self-regulation.

Toshan Tamhane, Senior Partner, McKinsey & Company, is positive about the future potential of impact Investment in India. Toshan said*, "India is one of the world's biggest markets for Impact Investing, given the nation's many pressing social needs and an abundance of global capital. Assuming a growth of 20-24% based on global rates and strong growth of underlying sectors, we estimate that India's Impact Investing sector could absorb US$6-8 billion of capital annually by 2025, provided some critical barriers are addressed by the industry and the government."*

Based on interviews with experts, survey results and experience in global markets, the industry and its stakeholders could focus on the following measures to expand Impact Investing in India:

- **Demonstrate and track performance – both financial and social.** Industry bodies and global organizations may have a key role to play to create and use standard social impact metrics. They may have to collaborate with institutions, such as credit rating agencies, that measure other types of impact.

- **Galvanize domestic capital** by raising awareness and making targeted propositions. The government may consider allowing corporate social responsibility funds to flow to appropriate causes and enterprises, such as approved fund of funds for social enterprises, even those that generate profits. Government schemes may also provide more support to socially relevant enterprises, such as job training. Additionally, retail investors could contribute through instruments such as mutual funds with social themes and social-sector unit trusts.

- **Create markets for new instruments** such as social impact and development impact bonds that can help match capital demand with supply. In time, the industry could also create new capital market platforms such as 'social stock exchanges'. Equity investors need to get more comfortable with 'pay for performance' structures (including earn-outs) that account for dual performance, which are common in the PE/VC space.

- **Strengthen governance and talent**. The sector needs to apply the same standards of diligence, post-diligence and portfolio monitoring as in traditional investing. This will require talent. The industry could benefit from professional certification programs, especially on the social side, and targeted support for social sector CEOs such as incubation, coaching and board advisory services.

- **Ease debt for SMEs.** Banks, RBI and credit rating agencies need to work together to help small and medium-sized enterprises manage their debt. Investors may need to guide the enterprises in improving credit ratings, complying with accounting standards and so on to give lenders more confidence. Venture debt and crowd-funding platforms could also be developed.

Vivek Pandit, Senior Partner, McKinsey & Company said, *"As the first institutional investor in nearly 70% of their deals, Impact Investors in India play an unequivocally critical role in seeding early stage social enterprises, supporting their ability to scale and create financially sustainable business models. With median returns at 10-12% for nearly 50 exits analysed, top tercile deals delivered an enviable 34% median IRR. Given the vast opportunity for social and financial dividends in India, Impact Investment is an asset class with enormous unlocked potential."*

How the research was conducted

This research included interviews of General Partners (funds), Limited Partners (investors), social enterprise leaders and other collaborators. McKinsey & Company analysed impact-investing deals, to understand the nuances of the industry and its potential. The full report "Impact Investing in India – Has the Time Come?" will be published later. Once released, the report can be downloaded from the McKinsey & Company website (http://www.mckinsey.com)

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