Heart of gold, guts of steel

How the Government can support social investment through policy and not fiscal support

Late Prof CK Prahlad spoke of "The Fortune at the Bottom of the Pyramid" in a seminal article in 1998. Since then, fortune at the base of the pyramid (BoP) is being made by corporations, be it through selling shampoos in sachets, or offering pre-paid direct-to-home (DTH) TV channels to millions of urban and rural BoP households. While these make money for the companies and may improve the quality of life of the user, sachet-shampoo or DTH-TV do not help enhance incomes of BoP households.

Decades before Prahlad wrote the article, Dr Verghese Kurien replicated nationwide the successful Anand Milk Union (AMUL) model of linking rural BoP household dairy producers with distant urban markets, by investing capital and upgrading technology. Incomes of milk producers went up. Likewise, John Bissell set up Fab India and brought attractive handloom garments and handicraft utilities to urban upper-class households, thereby enhancing the incomes of thousands of rural BoP craft producers. This approach is decades old in India and needs to be tried out more widely. Social Entrepreneurs and Impact Investors in partnership with the Government and the Corporate Sector, can help to generate (not suck out) fortune at the base of the pyramid.

The BJP Government came to power with the inclusive electoral promise of "sabka saath, sabka vikas". The 2015 Budget has moved towards this goal in some measure. The Government established MUDRA (Micro Units Development and Refinance Agency) with Rs 20,000 crore and the SETU (Self-Employment and Talent Utilisation) Incubation program with Rs 1,000 crore. It has allowed foreign investment into Alternate Investment Funds (AIFs), given tax pass-through to Social Venture Funds (SVFs) and AIFs I & II, and permitted non-profits to earn up to 20% of their receipts as business income, without losing their tax-emption.

At the same time, there were budget cuts in social spending. To offset this, the Government needs the private sector to step-up and bridge the social investment gap. Recognizing that most private investment would flow towards the higher income clientele, to serve the BoP voters, the Government must ensure that investments in Social Enterprises are attractive to Impact Investors. But the Government also needs to spend well whatever funding there is through better execution. Better execution can offset reduced outlays to ensure that the Government meets the myriad needs of India's increasingly aspirational and assertive BoP households.

Social entrepreneurs require guts of steel because entrepreneurial risk is dramatically higher in serving BoP producers and consumers and takes a long time to breakeven and succeed, often a lifetime! Impact investors require a heart of gold as they commit capital to pursue an uncertain distant goal, when they can earn higher returns with greater certainty. In microfinance, this has led to Rs 30,000 crore of credit flow to the BoP through sustainable institutions. This unique juxtaposition of social entrepreneurship and conscious capital must be replicated widely.

Social Enterprises differ from regular enterprises in four key respects. They generally address an *unmet need of the BoP population*, often before the need is adequately backed up by willingness or ability to pay. They are often *pioneers in the product or the region or the segment* they serve. They use *innovative technologies and delivery channels* and they use *market knowledge, based on customer insight*, e.g., poor households are offered hire-purchase of a solar LED light at Rs 10 per day rather than buying it for Rs 3000 which they do not have.

Impact Investments differ from mainstream capital in four key respects. Impact capital is: *Social Capital* (intention of making a measurable, positive impact on the lives and livelihoods at the BoP); *Patient Capital* (equity investments up to 10 years); *Risk Capital* (e.g., invests in pioneer enterprises like tasar silk rearing in Jharkhand) and *Innovative Capital* (e.g., invests in bio-pesticides vs chemical pesticides).

What can the Government to do to Promote Impact Investment?

India's legal and regulatory framework does not recognize Social Enterprises and Impact Investments. This is necessary for Government to deliver social impact. Definitions can be easily crafted based on the above attributes and inserted in the Income Tax Act by adding a new sub-section under Section 10(23). This can be done as part of the Finance Bill which is with the Parliament now.

Impact Investors have used the power of risk capital and ingenuity of social entrepreneurs to grow at 27% CAGR over the last seven years and become a Rs 10,000 crore industry. They promise to bring in USD One Billion annually in investments to become a Rs 40,000 crore industry by 2020.

Towards, this, the Impact Investors Council (IIC) has sought definitional clarity and consequent recognition of social enterprises and impact investments. As suggested above this can be done even under the current Finance Bill. Three additional steps will help: (i) the RBI to allow access to External Commercial Borrowings (ECB) for Social Enterprises (ii) amending the section 11(5) (xii) of the Income Tax Act, 1961 to permit investments by charitable institutions in Social Enterprises, as is permitted by the US Tax Code, and (iii) amending the Corporate Social Responsibility (CSR) guidelines to permit companies to support or invest in Social Enterprises. All these steps will enhance the pool of Impact Investments.

*   *   *

Authors: Amit Bhatia, CEO-IIC & Founder –Aspire and Vijay Mahajan, Founder and CEO of the Basix Social Enterprise Group