# Representation to the Government of India for strengthening the Impact Investing Industry in India

Submitted by: Impact Investors Council

# IIC REPRESENTATION TO MINISTRY OF FINANCE

28 January 2015

To,

Shri Arun Jaitley,
Hon'ble Finance Minister of India

Shri Jayant Sinha,
Hon'ble Minister of State for Finance,

**Subject: BUDGET 2015-16 REPRESENTATIONS ON PROPOSED AMENDMENTS REGARDING INDIA'S "*IMPACT INVESTING*" INDUSTRY**

Dear Sirs,

Thank you for your Ministry's time and kind attention to our requrests. I am writing to you on behalf of the Impact Investors Council (IIC) - an industry body of the impact investing community of India. IIC aims to work towards nurturing the impact investing ecosystem in India by channelizing increased capital flow to the sector. A vibrant impact investing community will contribute to India's growth story by facilitating economic growth and job creation at the Bottom of the Pyramid (BoP).

IIC has over 30 member funds currently. Impact Investors have cumulatively invested over US$1.6 billion in India across 300+ social enterprises[1] and funds across a range of high impact sectors such as financial inclusion, agribusiness, healthcare, education, clean energy, water and sanitation, etc. We believe that Government can tremendously help IIC foster a favorable environment and impact-investment eco-system in India and to further catalyse the capital flow, we are submitting three specific and independent representations as ideas for your consideration. These key amendments can provide a great boost to the impact investing community and are outlined below:

1. Recognition of Social Enterprises and Impact Investors
2. Review Guidelines for Social Venture Fund
3. Extending Priority Sector Lending to Social Enterprises
4. Increasing Access to ECB Funding for Social Enterprises
5. National Standards for Social Impact Assessments

Attached documents have all details of IIC's five representations. We look forward to your support encouragement in creating a vibrant impact investing sector in India.

Thanking you,

Sincerely,

Amit Bhatia
CEO – Impact Investors Council (IIC)

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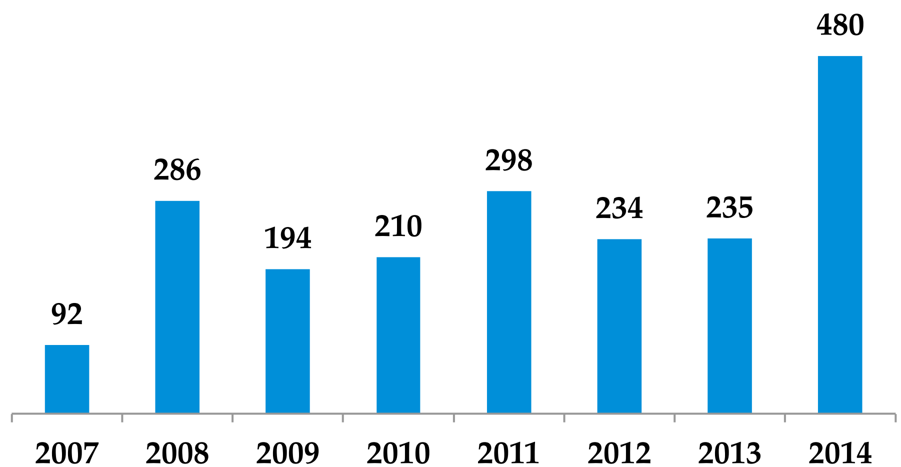
[1] Invest. Catalyze. Mainstream: The Indian Impact Investing Story by Intellecap

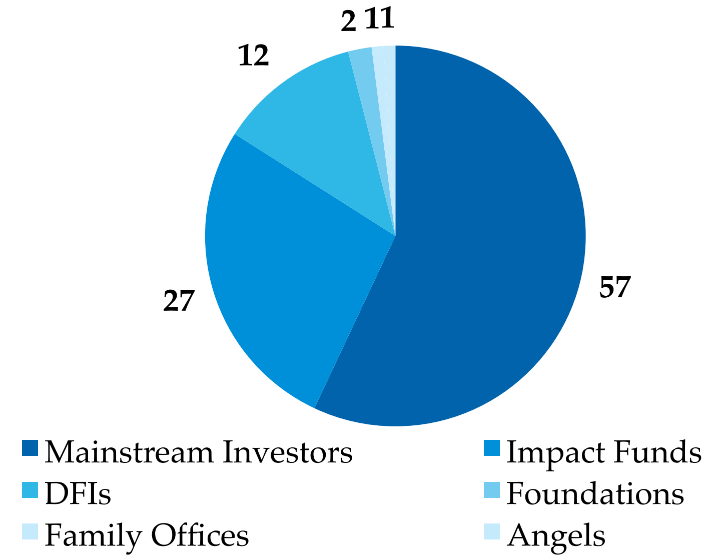
# EXECUTIVE SUMMARY

# Cumulative impact investments of US$ 1.6 billion across 300+ impact enterprises across India till date

**Annual Impact Investments in India (US$ million)**




**Mainstream investors and Impact funds attribute to ~85% of total investments**




**Equity** the dominant source of capital; Majority **Foreign** Capital

**75%** of all impact investments are in **Financial Inclusion** sector

Other important sectors **Healthcare (11%)** **Agri-business (7%)**, **Clean Energy (5%)**;

**20** documented **exits** at a premium by impact investors

# IIC has been established to build the (social and environmental) impact story and establish the significance of impact investing

**Stated objectives of IIC**

- **I** — Industry Advocacy and Policy Support
- **M** — Membership Services
- **P** — Press Relations & Research
- **A** — Attract Capital
- **C** — Create scale
- **T** — Target Self-Regulation

# IIC - Impact Investing Definitions

## Definition of impact investment

**Impact investment is a for-profit enterprise that:**

- Serves underserved beneficiaries who are producers, consumers, suppliers, employees or users ; Underserved beneficiaries could also be enterprises as defined by the MSME Act 2006; Underserved beneficiaries should comprise super-majority (two-third or more) of the beneficiary base
- Is willing to carry out third party reporting/ assessment in conjunction with investors$
- Follows all compliance and regulatory norms as prescribed by the authorities
- Demonstrates high standards of corporate governance and consumer protection

$ The responsibility of social impact and third-party reporting lies with investors

## Definition of impact investing at an investor level

**An impact investor is defined by:**

- Super-majority (two-thirds or above) of total invested capital is in impact investments
- Public commitment to and reporting of impact assessment and measurement
- Super-majority (two-thirds or above) of capital deployed via the Venture approach to investing*

***Investment in unlisted securities (equity, debt, and other financial instruments) of early and growth stage enterprises that also fulfil the impact investment definition**

# Representation #1: RECOGNITION OF SOCIAL ENTERPRISES, IMPACT INVESTORS AND THE IMPACT INVESTORS COUNCIL AS A SELF-REGULATORY INDUSTRY ASSOCIATION

## Recognition of and notification of the definition of a Social Enterprise

- “Social Enterprises” missing from SEBI definitions of SVFs and Social Ventures
- IIC definition: **Social enterprise** is a for-profit enterprise that serves underserved beneficiaries (two-third or more of the beneficiary base) who are producers, consumers, suppliers, employees or users
- IIC seeks appropriate consultation on the same for national adoption

## Recognition of Impact Investors

- Insinuated by the SVF but not formally articulated
- Government must recognize Impact Investors as a unique “investor-class” focused on social impact
- Will lead to wider adoption of this noble profession, widen & deepen the impact investment industry, secure valuable foreign investments, and, bridge the social investment gap in India

## Recognition of the Impact Investors Council

- Representative body for impact investors
- Self Regulatory Organization
- Standard Charter for impact investing community in India
- Promote engagement between the impact investing community and policy makers
- Ambassador for Brand India in Impact Investing

**REQUEST TO THE GOVERNMENT OF INDIA**

**i. Recognition of and notification of the definition of a Social Enterprise**
**ii. Recognition of Impact Investors**
**iii. Recognition of the Impact Investors Council**

# Representation #2: REPRESENTATION TO SEBI ON SOCIAL VENTURE FUND GUIDELINES IN ALTERNATE FUND INVESTMENT REGULATIONS (AIF), 2012

## Definitional Clarity of Social Venture Fund Guidelines

- Need to broaden definition of ‘Social Venture’
- Need to acknowledge co-existence of for-profit “social enterprises” and not-for-profit “social ventures” that promote social welfare, solve social problems & provide social benefits
- Impact investors only invest in for-profit social enterprises
- Need to define social performance norms that social ventures should satisfy

## Tax implications for Social Venture Funds

- VCFs are subset of Category I AIFs
- Current restriction on tax pass-through status does not incentivize investors registering as SVFs
- Aim of AIF guidelines is to support structures that create a positive spillover effect on the economy

**RECOMMENDED AMENDMENTS**

**i. Muted returns constraint on SVFs should be revoked**
**ii. Minimum investment limit of INR 1 cr by an investor or LP should be reduced**
**iii. Fund minimum limit should be relaxed from INR 20 cr to INR 10 cr**
**iv. SVFs should be eligible for “tax pass through” under Category I AIF guidelines**
**v. Grant investments to a fund should be tax exempted under Section 80G**
**vi. CSR guidelines should allow for financing to a SVF**

# Representation # 3: EXTENDING PRIORITY SECTOR LENDING TO SOCIAL ENTERPRISES

### Financing challenges for Social Enterprises in India

- Nascent VC and angel investing space in India
- Preference of investors for growth stage enterprises
- Non-Recognition of SE by banks and emphasis on collateralized lending

### Need for Priority Sector Lending to Social Enterprises

- SEs being one among MSE could be eligible for PSL
- Clear directive from regulatory bodies will increase capital infusion in SE

### RECOMMENDED AMENDMENTS

- **PSL should be extended to all relevant SEs irrespective of size in sectors such as:**
  - ✓ **Agriculture**
  - ✓ **Livelihoods**
  - ✓ **Renewable Energy**
  - ✓ **Water and Sanitation**
  - ✓ **Healthcare**
  - ✓ **Affordable Housing**
  - ✓ **Education**
  - ✓ **Financial Services**
- **Execution of the above: through a self-declaration by the SE conforming to IIC's definition of SE and a certification from a credit rating agency**

# Representation # 4: INCREASING ACCESS TO EXTERNAL COMMERCIAL BORROWING (ECB) FUNDING BY SOCIAL ENTERPRISES

### Reason for increasing inclination of SEs for ECBs

- Lack of access to finance, especially debt
- Risk averse lending practices
- Higher rate of interest on domestic bank loan vis-à-vis overseas loan

### Challenges in accessing ECB Debt Clearances

- Limited use of ECBs
- Expenditure in hedging the foreign exchange
- Lack of definitional clarity on some of the socially relevant sectors

### RECOMMENDED AMENDMENTS

- **Extension of ECBs to SEs* through automatic route across all sectors**
- **Execution of the above: through a self-declaration by the SE conforming to the SE definition of IIC and a certification from a credit rating agency**
- **All follow-on tranches should be considered under the automatic route after receipt of ECB approval from RBI – revoking of requirement for multiple approvals from RBI**

** conforming to IIC definition*

# Representation # 5: NATIONAL STANDARDS FOR SOCIAL IMPACT MEASUREMENT

*(Representation for IIC participation on the Government's High-Level Committee for Social Impact Assessments for CSR, Social Enterprises, Non-Profits and others in social sector)*

### Social impact measurement for all social investments

Consider social impact measurement for all kinds of social investments including but not limited to:

- CSR
- Social Enterprises
- Non-Profits or NGOs
- Government Initiatives

### Include IIC in the Panel

IIC be included in the panel as we bring insights from over 300+ social enterprises across a variety of social sectors like Education, HealthCare, Water & Sanitation, Clean Energy, Financial Inclusion, Livelihoods, etc. and are incentivized to measure by our investors, i.e., Limited Partners

### Ideally, a horizontal cross-ministry body like Niti Aayog should lead

The newly formed Niti Aayog or another horizontal body be given this role as the social investments cut across multiple ministries

**REQUEST TO THE GOVERNMENT OF INDIA**

**To participate in the proposed High Level Committee for proper assessment and progress of CSR work and Impact investment assessment metric to be set up under the new NITI Aayog or another "across-ministries" regulatory /advisory body in order to share its learning and contribute to the process of developing national standards.**

# DETAILED REPRESENTATIONS

## INTRODUCTION

Impact Investing – or investing in enterprises that work with low-income populations is a $1.6 billion industry in India today. Impact investors specifically seek to deploy capital in enterprises that are traditionally not considered investment-worthy by mainstream venture capital and private equity funds. By investing in such enterprise impact investors help to create positive socio-economic impact – the enterprises that these investors invest in empower low-income populations by serving them as consumers, distributors, suppliers or employees.

Since 2000, when the first impact investment fund was established in India, $ 1.6 billion of capital has been invested in 300+ enterprises across India. These enterprises vary across high impact sectors such as financial inclusion, healthcare, agriculture, water and sanitation, education and skill development, affordable housing, clean energy, etc. While choosing to invest in enterprises in the afore-mentioned sectors, impact investors ensure that these enterprises (also known as social enterprises) engage low-income populations in their main lines of business. Also, where possible these investors seek to invest in remote geographies – outside of Tier 1 cities where most mainstream venture capital and private equity is concentrated.

Impact investment is also sometimes referred to as 'patient capital' - this is so since impact investors tend to stay invested longer in their investee enterprises than their mainstream counterparts. The longer holding period is a direct result of the facts that impact investors do not merely seek to create financial returns but also positive socio-economic outcomes. These outcomes could be in the form increased financial discipline, access to livelihood opportunities, improved education and health indicators etc. Impact investors understand that in order to achieve positive socio-economic outcomes they need to support their investee enterprises by displaying 'patience'. Thus, despite high impact investment activity in India, there have only been approximately 20 exits till date.

There are over a 100 funds in India today, who are actively working towards changing lives of low-income populace through the length and breadth of the country. These funds combined are leading India to the global forefront. It is estimated that global impact investment industry could amount to $9 billion annually and it is predicated that a significant amount of that capital shall be channelled to India.

It is thus important to recognize the impact investment industry both for the contributions it has made to India's socio-economic landscape and the role this industry can play in supporting India's development goals. With greater attention to the impact investing ecosystem, the industry can clearly grow to $1 billion annual investment run-rate by 2020, thus helping bridge the national social investment gap and positively impacting the lives of millions below the poverty line. India is ground zero and a world leader for innovations in impact investing; we now need a partnership between the Government and the Impact Investing sector to retain and extend our global lead!

## #1: RECOGNITION OF SOCIAL ENTERPRISES, IMPACT INVESTORS AND THE IMPACT INVESTORS COUNCIL AS A SELF-REGULATORY INDUSTRY ASSOCIATION

The Impact Investors Council (IIC) is an industry body that was established in 2014 to build a compelling and comprehensive India Impact story and strengthen the significance of impact investing in India. IIC is the only representative body for all the impact investors in India with a focus on impact measurement and standardization, research and policy support and self-regulation. IIC operates through democratically-elected Board and Committees. **The IIC is seeking the following recognition from the Government of India through appropriate channels:**

- ***Recognition of and notification of the definition of a Social Enterprise***- SEBI has already notified a definition of Social Venture Funds (SVFs) charged for investing in social enterprises. However, social enterprises have yet to be defined in India. SEBI has however defined a social venture as follows which is a very limiting definition: *a "social venture" is defined as a trust, society, company, venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,- (i) public charitable trusts registered with Charity Commissioner; (ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts; (iii) company registered under Section 25 of the Companies Act, 1956; (iv) micro finance institutions.* Most importantly, this definition misses the for-profit social enterprises, the only focus of all impact investors. IIC has helped establish a working definition of impact investing and seeks appropriate consultation on the same for national adoption:

  ***Social enterprise*** is a for-profit enterprise that:

  - Serves underserved beneficiaries who are producers, consumers, suppliers, employees or users; Underserved beneficiaries could also be enterprises as defined by the MSME Act 2006; Underserved beneficiaries should comprise **super-majority (two-third or more)** of the beneficiary base
  - Is willing to carry out third party reporting/assessment in conjunction with investors[2]
  - Follows all compliance and regulatory norms as prescribed by the authorities
  - Demonstrates high standards of corporate governance and consumer protection

  We are keen that Government notifies the definition of Social Enterprise as a "Corporate Class" as accepted around the world and we hope you can use our working definition as a starting point.

- ***Recognition of Impact Investors****:* Second, as insinuated by the SVF but not formally articulated, we'd like the Government to accept Impact Investors as a unique investor class, focused on social impact. This recognition will allow wider adoption of this

[2] The responsibility of social impact and third-party reporting lies with investors

noble profession, more attention for Indian Impact Investing at G8 in the world (G8 has recently started consultations on Impact Investing), and widening & deepening of impact investments since they not only help get valuable foreign investments and bridge an important social investment gap in any economy, especially India.

- ***Recognition of Impact Investors Council***: Finally, we are seeking recognition of Impact Investors Council as the representative industry body of all impact investors with several self-regulatory goals. IIC will perform the following functions amongst others:

    - *Representative body for impact investors*: There are multiple bodies catering to various constituents of the investing ecosystem such as MFIN for microfinance institutions, NASE for social enterprises and IVCA for venture capitalists and private equity providers; however there is no single representative body for the impact investing community in India. Given our unique mandate and work, investing for social impact, we would like to represent ourselves to the Government and the Society

    - *Self Regulatory Organization*: Just as MFIN is a primary representative body and the Self-Regulatory Organization (SRO) for Non-Banking Finance Companies (NBFC) Microfinance Institutions (MFIs) regulated by the Reserve Bank of India (RBI), IIC too can act as an SRO for the impact investing community in India. We are keen to make social impact audits mandatory for all investee companies in our members' portfolios

    - *Standard Charter for impact investing community in India*: There is a need for a representative body which can closely work with the regulators as well as the industry stakeholders to create and then ensure that all members follow industry standards and guidelines: for example, sectors qualifying for impact investments, holding period, impact measurement standards, definitions and processes, research and new thinking, innovations, etc. Such standard-setting will be a first for any grouping in the impact investing space in India.

    - *Promote engagement between the impact investing community and policy makers:* IIC will act as a bridge between policy makers and regulators and industry stakeholders and will play an active part in facilitating dialogue between the two.

    - *Ambassador for Brand India in Impact Investing:* India is Ground Zero in the world for impact investing given our needs and 300 million poor. Consequently, we receive a very high share of global impact investments and given our 15 years history in the sector, we are world leaders in this nascent industry. IIC will continue to promote Brand India for growth of impact investments in India.

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## #2: REPRESENTATION TO SEBI ON SOCIAL VENTURE FUND GUIDELINES IN ALTERNATE FUND INVESTMENT REGULATIONS (AIF), 2012

A favorable policy environment for impact investors necessarily precludes clarity on the exact structure of the investment vehicles impact investors should adopt and the tax implications of the structure. While there are no direct regulations in place for impact investors in India, IIC looks to address ambiguities in two areas that are related to impact investing. These are:

1. Definitional Clarity of Social Venture Fund Guidelines
2. Tax implications for Social Venture Funds

### 1. Definitional Clarity of Social Venture Fund Guidelines

Impact investors can currently adopt a Social Venture Fund (SVF) legal entity under Category I of SEBI's Alternate Investment Fund (AIF) Regulations. A *Social Venture Fund (SVF) is an AIF that invests 75% or more of its corpus in unlisted securities or partnership interest of social ventures that satisfy social performance norms defined by the fund. The fund may accept from and give grants to social ventures and may accept restricted or muted returns.*

- **Definition of Social Venture:** Currently a *"social venture" is defined as a trust, society, company, venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,- (i) public charitable trusts registered with Charity Commissioner; (ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts; (iii) company registered under Section 25 of the Companies Act, 1956; (iv) micro finance institutions.*

  This definition of Social Venture is limiting as social ventures are commonly associated with not-for-profit entities. However, majority impact investments have been made in for-profit enterprises that address social problems. Suggested legal structure for Social Ventures currently are predominantly not-for-profit entities such as charitable trusts, societies, Section 25 companies etc. and a few for-profit structures such as venture capital undertakings. It is therefore important that the current scope of definition of the term 'Social Venture' be broadened. There is also a need to clearly delineate the specific enterprises that constitute those promoting social welfare or solving social problems or providing social benefits. Additionally, in order to ensure standardization it is important to define the social performance norms that these social ventures should satisfy

- **Social Performance Norms:** The SVF definition states that social ventures should satisfy performance norms defined by the fund. However, there are no guidelines on what these suggested norms could be. This is not surprising as world over, there has been no agreement yet on the most appropriate ways to measure "social impact". However, it is important to clarify the expected performance norms else each individual fund can adopt norms to suit their own interests. This can also adversely impact the social ventures landscape with greater flow of capital towards ventures that confirm to the specific standards set by individual funds. As the nodal agency for impact investments, IIC would like to undertake an exercise to define national standards for social impact measurement and we have engaged with Prof. (Dr.) Abhijit Banerjee of MIT, a noted economist and famed author of "Poor Economics" who is perhaps the pre-eminent authority on the subject. We are hoping to build standards, which are applicable across social enterprises, NGOs and non-profits, CSR programs as well as Government's welfare programs (e.g., SSA or MNREGA). We very much hope Government can join in this initiative.

- **Muted/ Restricted Returns:** It is suggested that an SVF may accept restricted or muted returns, though SEBI does not provide a rationale as to why this should be the case or what the definition of muted returns itself is. Adopting a return-based definition is limiting and could deter mainstream capital from turning towards impact investing. Impact investors take on higher risk than mainstream investors due to the nature of the geographies and sectors that they operate in– they should be compensated for this risk by ability to accept similarly high returns. However, it is a well-known fact that many IIC members are as a policy, seeking impact first. Therefore, each individual SVF should be able to structure their own risk-return profile and thus, the muted returns constraint on SVFs should be revoked.

## 2. Tax Implications for Social Venture Funds

Social Venture Funds fall under Category I of the AIF Regulations. *Category I funds are those that invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. These are Alternative Investment Funds which are generally perceived to have positive spillover effects on economy and for which the Board or Government of India or other regulators in India might consider providing incentives or concessions.* The AIF guidelines further clarify that *such funds which are formed as trusts or companies shall be construed as a Venture Capital Company or a VCF as specified under sub-section (23FB) of Section 10 of the Act.*

- **Tax-pass through status:** Section 10 (23FB) of the Income Tax Act, 1961 affords a "tax pass through" to all Venture Capital Funds (VCF) registered under the erstwhile VCF Regulations. Post the change of regulations to the pass-through status should be applicable to Category I AIFs– VCFs are a subset of Category I AIFs. However, given the current wordings of the provisions, Category I AIFs that do not fall under the sub-category of VCFs and are not eligible for a tax pass through. The current restriction on the tax pass-through status does not incentivize investors registering as SVFs. We request you to revisit this since only a handful of funds have registered as SVFs to date.

- **Tax benefits:** The aim of the AIF guidelines is to support structures that create a positive spillover effect on the economy. The guidelines also state that the regulator may consider providing incentives or concessions to such funds that are able to generate these positive spillover effects. Social Venture Funds by virtue of investing in social ventures promote economic growth and job creation at the Bottom of the Pyramid. Thus in addition to clarifying the status on existing benefits such as tax-pass through there is a need to identify specific concessions for SVFs and the Limited Partners that support these SVF.

### Recommended Amendments

Based on the combination of factors discussed above, there is a need to address ambiguities in the SVF guidelines. Keeping this in view, IIC proposes the following amendments on the SVF guidelines in alternate fund investment regulations:

- ***The muted returns constraint on SVFs should be revoked***
- ***The minimum investment limit of INR 1 crore by an investor or limited partner (LP) should be reduced***
- ***The fund minimum limit should be relaxed from INR 20 crore to INR 10 crore***
- ***SVFs should be eligible for "tax pass through" under Category I AIF guidelines***
- ***Grant investments to a fund should be tax exempted under Section 80G***
- ***The Corporate Social Responsibility (CSR) guidelines should allow for financing to a Social Venture Fund***

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## # 3: EXTENDING PRIORITY SECTOR LENDING TO SOCIAL ENTERPRISES

Social enterprises (SE) are enterprises that provide access to basic product and service at the Bottom of the Pyramid (BoP) and help generate livelihood opportunity creating significant social and environmental impact. Social enterprises by virtue of the sectors[3] they operate in and the target segment they address tend to have different characteristics in terms of unique risk-return and social-impact profile, base of the pyramid focus and a mission-driven approach. Many developed countries provide special recognition to these enterprises due to the positive role they play in the society- in USA they are classified as B-Corps while in the UK they are recognized as Community Investment Companies. Similarly there is a need for recognition of social enterprises in India as well.

### Defining Social Enterprises

The Impact Investors Council (IIC) defines ***social enterprise*** as a for-profit enterprise that:

- Serves underserved beneficiaries who are producers, consumers, suppliers, employees or users; Underserved beneficiaries could also be enterprises as defined by the MSME Act 2006; Underserved beneficiaries should comprise super-majority (two-third or more) of the beneficiary base
- Is willing to carry out third party reporting/assessment in conjunction with investors[4]
- Follows all compliance and regulatory norms as prescribed by the authorities
- Demonstrates high standards of corporate governance and consumer protection

### Financing challenges for Social Enterprises in India

Access to finance is the biggest challenge for social enterprises in India today; however there are limited sources of institutional finance available to them. The social enterprises have access to early stage equity from impact investors however the supply is constrained due to the nascent venture capital and angel investing space in India and preference of existing investors for growth stage enterprises.

While access to equity funding for social enterprises is limited; access to finance from banks is an even bigger challenge due to the following: (a) Non-Recognition of Social Enterprises by banks (b) Emphasis on Collateralized Lending (c) Non-viability of Product Innovation in Social Enterprise Lending- small ticket sizes of Social Enterprise loans limit the scope of innovation in product structures for this segment

Initiatives such as the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) set up by Government of India and SIDBI and Innovation Branch promoted by SIDBI do highlight attempts in innovative lending by the banking system. However, social enterprises are yet to benefit from these initiatives.

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[3] Agriculture and livelihoods, Clean Energy, Education, Financial Inclusion, Healthcare, Water and Sanitation, Technology for Development

[4] The responsibility of social impact and third-party reporting lies with investors

## Current Guidelines for Priority Sector Lending

Policy makers in India have always retained a focus on Micro, Small and Medium Enterprise (MSME) finance, as indicated by the RBI's Priority Sector Lending (PSL) norms for commercial banks. In India, the Micro, Small and Medium Enterprise Development Act 2006 (MSMED Act) of the Government of India defines the MSME sector based on the initial investment in plant and machinery[5]. In India there are no separate recognitions of social enterprises, such enterprises are mostly considered as a part of the MSME sector.

Advances to micro and small enterprises sector is reckoned in computing performance under the overall priority sector target. Within advances to micro and small enterprises, RBI has put the following mandates –

- There must be 20% y-o-y growth in MSE lending,
- 60% of the total advances to MSE must go to micro enterprises segment, and
- There must be 10% y-o-y growth in the number of accounts of micro enterprises

Very recently, The Securities and Exchange Board of India (SEBI) has also proposed that bank funding to listed small and medium enterprises (SMEs) be given a priority lending tag.

## Need for Priority Sector Lending to SEs

Social enterprises by virtue of being one among the micro, small or medium enterprise could be eligible to access debt under the PSL guidelines. However, most of social enterprises tend to be asset light, service-oriented companies that make them distinct from more established brick and mortar or manufacturing enterprises in the same category. It is observed that debt is limited in most social enterprise sectors with exceptions to sectors such as agriculture and rural development and vocational education where debt flow is higher due to government interventions *(Priority sectors under PSL directives include Agriculture and Rural Development, Micro and Small enterprises, Education among others)*. Lack of access to finance coupled with lack of directives from regulatory bodies to increase capital infusion in the social enterprise sector indicate the need for an independent recognition of social enterprises. IIC proposes that by extending PSL to social enterprises can help mitigate a lot of the financial challenges that these enterprises face today.

[5] MSME definition provided as part of annexure

## Recommended Amendments:

Based on the combination of factors discussed above, there is a need to amend the Priority Sector Lending definition and bring in inclusivity towards social enterprise sector. Keeping this in view, IIC proposes for the following amendments in the definition of the priority sector lending guidelines:

- ***PSL should be extended to all the Social Enterprises- Social Enterprise as defined by IIC guideline (Refer Appendix), to include all the socially relevant sectors such as Agriculture, Affordable Housing, Education, Financial Services, Healthcare, Livelihoods, Renewable Energy, Water and Sanitation irrespective of the size of enterprise***
- ***The above can be executed by a self-declaration filed by the respective SE conforming to the SE definition of IIC and a certification from a credit rating agency***

## Appendix:

a. *MSMED Act Definition of MSME*

| Initial Investment in Plant and Machinery in INR Million* | | | |
|---|---|---|---|
| **Category/Enterprise Size** | **Micro** | **Small** | **Medium** |
| **Manufacturing** | <2.5<br>(<50,000) | 2.5 – 50<br>(50,000 – 1 Million) | 50– 100<br>(1 Million – 2 Million) |
| **Services** | <1<br>(<20,000) | 1 – 20<br>(20,000 – 0.4 Million) | 20– 50<br>(0.4 Million – 1 Million) |

**Figures in brackets are in USD; Source: MSMED Act*

b. ***Definition of Underserved Beneficiaries:***

Underserved beneficiaries have to satisfy the income- based definition

- Income-based definition: Beneficiaries with annual household incomes less than  3 Lakh*; these are vulnerable due to lack of access to basic needs
- Marginalized Beneficiaries: Individuals with physical disabilities

The geography and sector-based definitions of underserved beneficiaries provide a secondary dimension but is not a necessary criterion

- Geography-based definition: Beneficiaries in under developed geographies (districts) as defined by bouquet of development indicators
- Sector-based definition: Beneficiaries in priority or impact sectors as defined by the Government of India

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## #4: INCREASING ACCESS TO EXTERNAL COMMERCIAL BORROWING (ECB) FUNDING BY SOCIAL ENTERPRISES

Access to finance is the biggest need for a social enterprise, however there are limited sources of institutional finance available to them. Social enterprises, especially startups and growth stage companies, have access to early stage equity through impact investors however have limited access to debt. In addition to risk-averse lending practices, the rate of interest on the domestic bank loan is distinctly higher than the overseas loan. This propagates a natural inclination by the enterprises (startups and growth stage companies) to explore the possibility of mobilizing funds through the external commercial borrowing (ECB) route to benefit from the lower interest burden. However, here too there are disbursement constraints as there is specific circular by the Reserve Bank of India stipulating various conditions and covenants that need to be satisfied for each funding under this route.

### Defining External Commercial Borrowing

Commercial loans (in the form of bank loans, buyers' credit, suppliers' credit, and securitized instruments) availed from non-resident lenders with minimum average maturity of 3 years with advantage of

- Lower rates of interest prevailing in the international financial markets
- Longer maturity period
- For financing expansion of existing capacity as well as for fresh investment

### External Commercial Borrowings can be accessed under two Routes

i. **Automatic Route** i.e., no prior approvals, under delegated powers exercised by the Reserve Bank of India (RBI); Eligible borrowers under automatic route includes:

   i. Corporates including hotel, hospital, software sectors (registered under the Companies Act 1956)

   ii. Infrastructure Finance Companies (IFCs) except financial intermediaries such as banks, FIs, HFCs, and NBFCs

   iii. Units in Special Economic Zones

   iv. NGOs engaged in micro finance activities (subject to certain conditions)

*Trusts and Non-Profit making organizations are not eligible to raise ECB.*

ii. **Approval Route** i.e., requires permission by Reserve Bank of India and by the Government through the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance; Financial sector including Banks, Non-Banking Financing Companies (NBFCs), Housing Finance Companies and Corporates engaged in industrial & infrastructure sector comes under approval route

### Challenges in accessing ECB Debt Clearances

ECBs provide an additional source of funds for the enterprises allowing them to supplement domestically available finance. The ECB policy is monitored and updated by RBI on a regular basis; however there remain a considerable number of challenges coupled with regulatory hurdles which hamper the access of ECBs to enterprises. Some of the challenges include:

- **ECBs can be utilized for limited purposes** such as capital expansion, and cannot be used for working capital, real estate or discharge of rupee loans

  If ECBs are allowed to pay-off existing rupee loans, it would help in lowering the cost of borrowing and channelize long-term and low cost funds into projects that require long-term and large capital investments

- In ECBs, the funds are raised in foreign currency along with the interest and redemption, the issuing company has to hedge its foreign exchange, which involves expenditure constraining the flow of capital

- **Lack of definitional clarity on some of the socially relevant sectors:** Recent changes in the definition of eligible borrowers led to the inclusion of "Power" under infrastructure which means (i) electricity generation, (ii) electricity transmission, (iii) electricity distribution (iv) oil pipelines, (v) oil/gas/liquefied natural gas (LNG) storage facility (includes strategic storage of crude oil) and (vi) gas pipelines (includes city gas distribution network).

However, given the broad definition of power sector, most banks have already reached their exposure limits in power sector set by them in pursuance of the RBI guidelines. Given the strong fillip of Indian government for harnessing renewable energy potential in India and lack of access to debt to the enterprises operating in this sector, there is a need to consider renewable energy as a separate sector for increasing sectoral exposure limits by banks.

**Recommended Amendments:**

Towards its aim of working towards positive policy reform favorable to the sector, IIC believes the following policy amendments may enable flow of impact capital (particularly debt) to the enterprises in the socially relevant sectors:

- ***External Commercial Borrowings (ECBs) through the automatic route should be extended to ALL Social Enterprises (SE) across all sectors, who conform to the IIC definition (Refer Appendix)***

- ***The above can be executed by a self-declaration filed by the respective SE conforming to the SE definition of IIC and a certification from a credit rating agency***

- ***Once an enterprise or a fund receives ECB approval from the RBI all follow-on tranches should be considered under the automatic route– requirement for multiple approvals from RBI by the same entity should be revoked***

## Appendix:

a. ***Definition of Underserved Beneficiaries:***

Underserved beneficiaries have to satisfy the income- based definition

- Income-based definition: Beneficiaries with annual household incomes less than  3 Lakh*; these are vulnerable due to lack of access to basic needs
- Marginalized Beneficiaries: Individuals with physical disabilities

The geography and sector-based definitions of underserved beneficiaries provide a secondary dimension but is not a necessary criterion

- Geography-based definition: Beneficiaries in under developed geographies (districts) as defined by bouquet of development indicators

Sector-based definition: Beneficiaries in priority or impact sectors as defined by the Government of India

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## #5: NATIONAL STANDARDS FOR SOCIAL IMPACT MEASUREMENT

*(Representation for IIC participation on the Government's High-Level Committee for Social Impact Assessments for CSR, Social Enterprises, Non-Profits and others in social sector)*

Social investment activity and philanthropic capital in India is expected to increase in the next few years. It is anticipated that factors such as increased government expenditure due to a rapidly growing economy, growing corporate investments due the new CSR (corporate social responsibility) legislations, growing philanthropy contributions from high net-worth individuals (approximated to account for 0.6% of GDP) shall spur this social investment activity. However, there are no existing standards of measuring the positive socio-economic outcomes that these investments generate thereby acting as a detriment to the growth of social investments.

We, at IIC believe, that India must have national standards for measuring social impact, which are applicable to social enterprises, non-profits & NGOs, CSR (corporate social responsibility) initiatives of corporations and even, Government initiatives. Unless, the standards are easy and universal for all social investments, they will not be popular and we will never be able to measure efficiency or effectiveness of capital addressing social problems. **Therefore, we are requesting the following**:

- The Ministry of Finance recently announced a high-level committee on social impact measurement for CSR initiatives of corporations. We request that the committee's terms should consider social impact measurement for all kinds of social investments including but not limited to:
    - CSR
    - Social Enterprises
    - Non-Profits or NGOs
    - Government Initiatives
- We are further requesting that IIC be included in your panel as we bring insights from over 300+ social enterprises across a variety of social sectors like Education, HealthCare, Water & Sanitation, Clean Energy, Financial Inclusion, Livelihoods, etc. Since our investors must keep proving to their investors (called Limited Partners or LPs) and the social enterprises in turn to impact investors, we are greatly incentivized in building great national standards. Infact, we have taken initiative to partner multiple organizations, jointly with Aspire Circle, like GIIN, MFIN, NASE, etc. to work with Prof. (Dr.) Abhijit Banerjee of MIT to start this initiative. Moreover, our members have over a decade of experience with multiple kinds of indicators and metrics to report social impact and we'd like the nation to benefit from these huge investments made in social impact research and analytics.
- We are further requesting that the newly formed Niti Aayog or another horizontal body be given this role as the social investments cut across multiple ministries and the definitions and standards need to be adopted and applicable to all.

We very much hope that you will notify this panel with a broader objective and include IIC in the high-level committee given our unique and compelling experience in social impact measurement.

*   *   *

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