

**Social Stock Exchange for
Social Enterprises and Social Incubators:
*An Exploratory Study for India***

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Discussion Paper # 243



RIS

Research and Information System
for Developing Countries

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Social Stock Exchange for Social Enterprises and Social Incubators: *An Exploratory Study for India*

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“It is time to take our capital markets closer to the masses and meet various social welfare objectives related to inclusive growth and financial inclusion. I propose to initiate steps towards creating an electronic fund raising platform - a social stock exchange - under the regulatory ambit of Securities and Exchange Board of India (SEBI) for listing social enterprises and voluntary organizations working for the realization of a social welfare objective so that they can raise capital as equity, debt or as units like a mutual fund”

- Hon'ble Finance Minister, Smt. Nirmala Sitharaman
(2019-20 Budget Speech)

Introduction

The Government of India has shown strong inclination towards pursuing the idea of Social Stock Exchange (SSE). Several countries either have or are mulling their own Social Stock Exchange (SSE) models. Brazil, Canada, Mexico, Kenya, Portugal, Mauritius, Singapore, South Africa and the UK have already institutionalised SSE models while Colombia, Germany, India, New Zealand, Thailand along with the US are at various stages of planning. Social enterprises looking at being listed in these SSEs aim to raise money to scale up their operations, while retail and institutional investors passionate about social enterprises consider

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purchasing the shares of the firms listed on an SSE. The priority for such investors is not to make huge financial returns from their investments in the social purpose organizations (SPOs), but to ensure Social Rate of Return. Nevertheless, financial viability remains an operational necessity. What encourages these ethical investors are provisions in the listing norms on corporate governance including code of ethics, accountability and transparency guidelines as well as disclosure requirements such as the one on related third party transactions to curb wrongdoings. The social enterprises need to be accredited by globally accepted certification bodies such as B-Corp certification, and have a triple bottom line strategy that focuses on 3Ps (People, Planet and Profits) - or in other words returns including on the social, environmental and financial aspects. Social enterprises preferring the SSE route to the traditional stock exchanges do so as they want to ensure that the noble social and/or environmental objectives of their entities are not diluted or adversely impacted due to investors and shareholders not sharing similar objectives.

Countries have relied upon various traditional sources to finance the social sector, especially education and health. In France, the main source of finance was initially local taxes till it shifted to a central government funding model to bring down regional disparities in expenditure on this crucial sector. The U.S., where property taxes account for a majority of local revenue for schools, is also seeing a trend towards greater federal-level spending to similarly reduce public school funding disparities. Some studies observe that in rich countries households shoulder a major share of expenses for tertiary education and the least share for primary education. This can be attributed to a greater number of students from wealthier background going in for tertiary education as they see greater returns from higher education. In rich countries, in some cases public funding is the dominant source of finance for primary and secondary levels of education. However, the opposite may be true in the case of poor countries, where households account for a fifth of the costs in primary education and the government almost entirely subsidising tertiary education in such countries (Roser and Ortiz-Ospina, 2019).

While the Government of India has consistently increased its social sector spending, it is seriously concerned about the quality of outcomes.

In an encouraging sign, new forms of partnerships are evolving in the development space that combine the strengths of the government, the private sector and the civil society organisations to not only cater to the needs of scale but also to improve the quality of outcomes. In this regard, of the various modalities that are currently in practice, the scope for impact investment (which is linked with independent evaluation of outcomes) and social enterprise development in many cases supported through social innovations/incubators have received considerable attention. At the micro level, social entrepreneurship and social investments are being promoted in several countries to strengthen private sector participation in development.

A British Council study estimates that there are around two million social enterprises in India. Of the 258 social enterprises surveyed, 57 per cent are under five years old, with young leadership (average age being below 44). More than half of these units employ people from disadvantaged groups and skill the vulnerable, and 80 per cent of them reinvest to take forward environmental or social objectives. Most of these social enterprises were found in Maharashtra (16 per cent), Karnataka (15 per cent), Delhi and Telangana (8 per cent each), and Uttar Pradesh and West Bengal (7 per cent). Half of the social enterprises were headquartered in Bengaluru (Karnataka, South India), Mumbai (Maharashtra, West India), and New Delhi (Delhi, North India), while 21 per cent of them operate globally, 32 per cent regionally and 46 per cent nationally. The sectors they work in included skill development (53 per cent), education (30 per cent), agriculture, fisheries and dairy (28 per cent), financial services and energy and clean technology (26 per cent each). British Council (2016).

Unlike NGOs and non-profits, the for-profit social enterprises tend to be more innovative, attract better talent with higher pay, in addition to focusing on sustainability and scale (Ganapathy, 2018). With the objective of experimentations for innovative solutions and technologies to improve delivery, method and products for social sector interventions, social incubators have come up in a big way in India. There are several examples of social incubators in India like Action for India; Centre for Innovation, Incubation and Entrepreneurship; (CIIE), Dasra; Deshpande

Foundation, Ennovent, Marico Innovation Foundation, Rural Technology and Business Incubator (RTBI), Khosla Labs, Upaya Social Ventures, UnLtd India Villgro and Cowrksfoundry; to name a few, that support social entrepreneurship.¹ These incubators, in turn, support start-ups including those in the social enterprises category. Financial support by firms and companies for social enterprises through the Corporate Social Responsibility (CSR) route could ensure that the reach and benefits of social enterprises are maximised (Badani, 2018). Also, India is a country with a dynamic business community and a vast pool of entrepreneurs. New progressive legislations in India encourage businesses to mandatorily and directly contribute to social sector development through CSR funds.

Following the introductory Section I, in Section II we discuss the emerging paradigm shift in social sector financing and its rationale. This section also highlights the newly proposed idea of Social Stock Exchange (SSE) in the Indian context. In Section III, the paper elaborates the new instruments of financing and specific experiences with regard to social impact bond and social incubators in India. Section IV discusses the scope of social stock exchanges, scaling-up social enterprises and the associated institutional framework and resource issues. Finally, Section V provides some suggestive ideas by means of way forward and policy choices.

Emerging Paradigm Shift in Social Sector Financing

The Government revenues have been crucial for core social sector programmes globally. Governments are, therefore, keen on using their resources wisely in the face of huge unmet needs. Ensuring efficiency of social sector spending by the Government is also an important determinant of ‘quality’ of social sector outcomes in India. Rising societal concerns about returns to the society and demand for sustainable pathways with less carbon footprint are increasingly influencing decision making globally as well as in India. A recent analysis found that the states in western India, including Maharashtra, Gujarat and Goa show greater efficiency in public spending than the other regions in the country, while the states in the north-east and the eastern regions fared poorly in terms of efficiency. Besides, it was also seen that states spend more efficiently on education than health and overall social sector public expenditure.

The factors that contribute to greater efficiency in public spending include good governance, better institutional capacity, lesser leakage in public spending, and superior budget management (Mohanty and Bhanumurthy, 2018). There is a plethora of studies looking at efficiency of public sector spending globally (del Granado et al, 2007; Canagarajah and Ye, 2001; Hauner, 2007; Pessino et al, 2018; Antonelli & De Bonis, 2019) as well as in the Indian context. Several countries are focusing on efficiency through better systemic design, establishment of expenditure management frameworks as well as performance-linked payments so that they are able to create extra fiscal room and prioritise spending on sectors such as health (Behera and Dash, 2018).

An important factor that led to a significant inflow of global finance into the social sectors like education and health through development aid is the implementation of the Millennium Development Goals (MDGs), and the low-income countries were a major beneficiary of this trend (Roser and Ortiz-Ospina, 2019 and Ortiz-Ospina and Roser, 2019). Healthcare sector across the globe has seen greater public spending by high-income countries than the low-income nations, and higher Out-Of-Pocket spending in poor nations than their rich counterparts. (Ortiz-Ospina and Roser, 2019). It was found that in order to realise the goal of universal health coverage, it is important for nations with low tax base to raise domestic tax revenues through progressive tax policies especially since most nations, including those from the developing world, rely on tax revenues to fund their healthcare system and its expansion. The sources of the domestic tax revenues include consumption taxes, corporate earnings, profits, capital gains and income (Reeves, et al., 2015).

The new sources of finance for social sectors may also include blended finance.² For instance, blended finance structures are being used in areas such as education as well as pharmaceuticals/ vaccination in the health care sector (Convergence, 2018). In several countries, the public sector would need substantial support from the private sector to bridge the funding gap. The Addis Ababa Action Agenda (AAAA) for Financing for Development (FfD), which lays down the framework for financing the Sustainable Development Goals (SDGs), had emphasised

on the concept of an integrated national financing framework to boost ‘cohesive nationally owned sustainable development strategies’. The AAAA places multi-stakeholder partnerships at its core to pool resources and knowledge from the private sector, philanthropy and foundations, and the larger civil society.

The growing interest in this emerging area of social entrepreneurship is owing to its unique feature, where investments can be made to generate a positive impact and at the same time operate on a viable commercial model.

Analysis of the core purpose of social businesses shows that their mission has more depth than that of a commercial enterprise or a non-governmental organization. Social enterprises not only aim to achieve a social mission, but also discard prejudices of NGOs or community organizations against capitalism to blend their social objectives with market strategies and innovative measures to ensure financial viability. The funding agencies take note of this distinction including the fact that while social enterprises are comfortable with achieving profitability, such a goal is not their sole objective. One example that can be taken note of in this regard is the seasonal markets that spring up in areas that face challenges regarding achieving food security. In such seasonal markets, social enterprises come up to sell fresh vegetables and fruits directly to consumers. These enterprises use innovative methods in aspects including production, distribution, and awareness creation, to provide fresh food to marginalized populations. They also encourage local people to participate in the whole process and even get gainful employment. (Audet et al., 2017).³

The inadequacies and deficiencies in the frameworks and understandings of investment and return led to the concept of Blended Value Proposition (BVP). The BVP aimed to integrate “the greatest maximization of social, environmental, and economic value within a single firm (whether for-profit or nonprofit), investment opportunity, or community.” In order to take forward the BVP concept, as termed by Jed Emerson, it was important to go beyond the conventional belief that “an organization’s Economic Value is separate and at odds with

its Social Value”, and instead integrate both to maximize social and financial value creation and shareholder returns. This would then lead to a Blended Return on Investment, which “may not ultimately be assigned to any single investor, but is held by individual investors as a part of a common trust.” The BVP concept, according to Emerson, would also need the setting up of a Social Management Information System (Social MIS) infrastructure and information dissemination system. The Social MIS would, in turn, have to incorporate Socio-Financial Ratios that allow investors to understand and quantify a Blended ROI (Emerson, 2003).

The broad range of investor class that are looking at the Blended ROI concept includes philanthropic foundations, Development Finance Institutions (DFI), commercial banks, pension funds, investment banks, hedge funds, wealth management firms and multinational corporations depending on their ‘social orientation’ and their appetite for investing in ideas and fresh initiatives. Networks like the Global Impact Investing Network (GIIN)⁴ serve as important information base. For example, *ImpactBase* is a ‘searchable, online database of impact investment funds and products designed for investors’⁵, while *Impact Reporting and Investment Standards (IRIS)* is a ‘catalog of generally accepted performance metrics that leading impact investors use to measure social, environmental, and financial success, evaluate deals, and add to the sector’s credibility’.⁶ The effort is to tap the huge business opportunities at the ‘base of the pyramid’ across the world, which is currently underserved. The potential in this segment is overlooked by conventional businesses as they lack affordable and innovative solutions to convert the perceived drawbacks into business opportunities. (Morgan, 2010).

While there are not many studies looking at this emerging field exclusively focused on the Indian context, by some estimates India received impact investments worth USD 5.2 billion between 2010 and 2016 (projected to increase to USD 8 billion by 2025) (Pandit and Tamhane, 2017). The global experience, scope and modalities of Impact Investment is briefly captured in Box 1. India is also emerging as a leading hub for social enterprises (that consider revenue generation, market rate returns, efficient operation and commercial sustainability) and has a large pool of vibrant civil society organisations, micro-finance institutions

etc. with potential for social entrepreneurship. Social enterprises are essentially for-profit business entities, but also have a ‘shared value’ approach as they operate to make a positive impact on the society and the environment and reinvest their profits for the same cause.

Box 1: Scope and Modalities of Impact Investment: Global Experience

According to UNDP, ‘impact investment’ is differentiated from other forms of investment on account of three distinct features. First, impact investors accept lower, equal or higher return (vis-à-vis market rate) on the capital they invest. Second, the core objective is to achieve positive impact with regard to slated social and environmental objectives. And third, impact investors would commit to performance review using standardized metrics. Globally, at least 226 entities have impact investment assets under management (AUM) to the tune of USD 228.1 billion. Of these the maximum (19 per cent of AUM) is in financial services (excluding micro-finance), followed by energy (14 per cent), micro-finance (nine per cent), housing (eight per cent) and food and agriculture (6 per cent). Most of the investors were located in the developed world - with 47 per cent based in the U.S. and Canada and 30 per cent headquartered in Western, Northern and Southern Europe. Other estimates say the impact investment market currently is around USD 1.3 trillion, including “direct and indirect investments by over 450 signatories to the United Nations’ Principles for Responsible Investing.”

Countries are expected to ensure a regulatory environment that facilitates and strengthens social impact investment, including through dedicated advisory boards for the purpose at the national level as well as by enacting laws for greater ease of doing business. Already, there is the Global Steering Group for Impact Investing to help set up the National Advisory Boards. Countries, including from the developing world such as Vietnam, the Philippines and Thailand, have brought out legal definitions for social enterprises. Malaysia, has started a Social Outcome Fund by its national innovation agency overseen by the Prime Minister, as a financial tool to address the supply side concerns. On the demand side, what would help are fiscal incentives that encourage social entrepreneurs and investors to build a sustainable SII ecosystem, including financial markets and innovative models. Also crucial would be data-reporting norms for all SII transactions, financing for creation of data infrastructure as well as impact measurement methods.

Source: Authors’ compilation from GIIN (2018), IFC (2019) and OECD (2019)

One of the factors that is helping channelise private sector funds to social enterprises in India is the Companies Act, 2013 amendment mandating companies with an annual turnover of Rs 1,000 crore or more, or a net worth of Rs 500 crore or more, or an annual net profit of Rs 5 crore or more, to set up a Corporate Social Responsibility (CSR) committee and spend towards CSR at least two per cent of the average net profits made during the three immediately preceding financial years (British Council, 2016). The CSR activities can be undertaken, through a (separate) trust, society or company (that is, not established by the company funding the CSR activity, or its holding or subsidiary or associate company). It has also been specified that the trust, society or company have an established track record of three years in undertaking similar programs or projects (GoI, 2014a). CSR activities can also be conducted through group entities, and by collaborating or pooling resources (Rishi et al. 2014). The government has stated that ‘expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so’ (GoI, 2014b).

As per the Government data, the amount spent by Public Sector Undertakings (PSUs) and private companies on CSR activities for the financial years 2015-16, 2016-17 and 2017-18 (upto October 20, 2018) was INR 14,527.59 crore, INR 14,242.41 crore and INR 8,365.35 crore respectively. Among the leading sectors that received the CSR funds in all the three financial years included education, health care, rural development projects, environmental sustainability, livelihood enhancement projects, vocational skills, ‘poverty, eradicating hunger and malnutrition’ and sanitation. (Govt. of India, 2019a). Initially, several companies were partnering with non-government organisations / not-for-profit entities to carry out CSR activities. However, with CSR activities expanding and getting mainstreamed, companies are keen to analyse their CSR-spend to ensure positive results. With the Companies Act not barring CSR support to experienced for-profit entities (with over three years of CSR-related project work), companies are increasingly

looking at collaborating with for-profit social enterprises as well that utilise market-based mechanisms to address social and environmental challenges.

While the private sector participation in development is often contested if price based mechanisms are relied upon too much to ease supply constraints in provision of merit goods, there is a renewed focus on leveraging the private sector to achieve efficiency in delivery of public sector programmes, and also utilise technical skills and innovative solutions offered by the private sector in mitigating select development challenges. This would necessarily mean improvement in the quality of outcomes. As discussed, a new breed of businesses in the form of social enterprises and social incubators are gaining popularity that are designed to directly operate in the development sector and combine both commercial sustainability and social objectives. The resources at disposal for such socially oriented business models may be in the form of impact investment, a separate class of asset under commercial finance. With the proliferation of numerous possibilities of private sector participation for sustainable development, the Government needs to consider appropriate policy space to promote and regulate such partnerships and also define the scope under public sector programmes with allocation of funds based on outcome linked milestones. This would also be useful in streamlining the legal contours in matters of definition, etc. and provision of direct and indirect incentives to this sector. Additionally, opportunities may be created for civil society organisations, with established credentials to diversify into social enterprise based operations and help existing social enterprises to achieve scale. Finally, with improvement in opportunities, social enterprises may attract commercial finance.

Outcome-based Instruments of Financing and Specific Experiences

Efforts are being made across the world to develop an outcome-based framework to finance the social sector that includes social enterprises and incubators. Such frameworks could be context-specific taking into account the unique challenges being faced by countries, including those

relating to demographics and infrastructure deficiencies. There are several factors that influence the financing of the social enterprises and incubators. These include their legal structure (for-profit/ non-profit/ cooperatives/ community-based organisations/ trusts), the sector of operation, the stage in which they need financing and their governance model. The types of financing could include: (i) membership funds that are easy to raise and are simple in nature; (ii) grants from governments, foundations, trusts and other financial institutions that come with several conditions; (iii) debt finance from microfinance institutions, cooperative banks, credit unions and social banks that offer some flexibility to social enterprises and incubators including collateral free loans but is short term in nature; and finally the sophisticated and medium to long-term finance instruments such as equity and quasi-equity finance.⁷ The dangers regarding equity finance include pressure from the financiers on the social enterprises and incubators to deviate from their original social and environmental objectives for enhanced financial returns. While seeking finance, it is therefore important for these enterprises and incubators to incorporate norms that prevent ‘mission drift’ (Ojong, 2015).

Short-term financing can be useful in the early stages (or the pilot phase) of a social entity. However, getting access to ‘growth capital’ or ‘expansion capital’, which helps in addressing the risks (and is long-term in nature), is important for such entities to grow and expand operations (EU, 2012). Social entrepreneurs across the world are using various strategies to raise resources including sale of products and services, membership and licensing fees, franchising their models, as well as forming partnerships with governments, communities and businesses (Schöning, 2003).

Social Bonds and Impact Bonds

Social bonds, as per the International Capital Market Association (ICMA), are debt instruments where the proceeds will be exclusively applied to finance or re-finance eligible social projects with positive social outcomes. The sectors include essential services such as healthcare and education, basic infrastructure including drinking water and electricity

as well as affordable housing (ICMA, 2018). Global institutions such as the International Finance Corporation (IFC) of the World Bank Group have aligned their social bond programme with the ICMA's Social Bond Principles. Since the social bond market is still in its infancy, care is taken to ensure transparency and integrity to help the market grow. IFC's social bond programme, launched in 2017, has so far resulted in the issuance of 16 social bonds in six currencies and has helped raise close to a billion USD.

In a parallel development, global trends suggest emergence of Impact Bonds falling primarily under two categories – Social Impact Bond (SIB) and Development Impact Bond (DIB). However, unlike the social bonds Impact Bonds are not necessarily financial sector bonds that generate commercial return. The SIB/DIB is a multi-stakeholder model that has an investor, service provider, independent evaluator and an outcome payer. The projects are modelled on results based framework with returns linked with quality of outcome. Depending on whether the outcome payer is a Government/ public sector or private sector/ philanthropy/aid agency entity, the model may be called SIB or DIB. (UNDP; Brookings, 2017) The private sector is usually encouraged to take the initial risk. In a SIB, the government is necessarily the outcome payer.⁸ It is interesting to note that the world's first DIBs in Education and Health have been launched in India in recent years. In fact, the Health sector DIB is touted as the largest ever DIB so far globally.

The social sector in India, particularly the education and health sectors, are hampered by various challenges including low levels of skill, poor quality of trainers and educators, gender disparities, large number of school dropouts and under-nutrition. Traditional approaches have not been able to entirely address these problems in their multi-dimensionality. Therefore, initiatives such as Social Impact Investment (SII), blended finance and social enterprises may be useful to catalyse innovative approaches that can tackle these problems. Though there are actors providing concessional finance entirely for social impact, there is an attempt to bring in a paradigm shift through a focus also on commercial sustainability. This is also aimed at attracting fresh capital

into such projects. The objective in these approaches is also to ensure an independent evaluation of outcomes of all the initiatives as well as encourage transparency in operations and data sharing. The mechanism being deployed here is ‘pay-for-success’ tools such as Development Impact Bonds (DIB) and Social Impact Bonds (SIB). In these models, government agencies or philanthropic bodies pay the social enterprises for meeting the pre-defined social or environmental outcomes. The working capital of the social enterprise is provided by the investors, who in turn get their initial principal with interest (from the outcome payer) if the project is able to surpass the pre-defined target (OECD, 2019).

The world’s first operational DIB, known as ‘Educate Girls’ DIB, was launched in India in 2015. Of concern here was the problem of 3.7 million girls in India who are out of school. It was noted that 42 per cent of girls are told to quit school by their parents, and that 47 per cent of children in grade five cannot even read a paragraph, while 30 per cent of children in grade five fail to do a simple subtraction. The objective of the Education DIB was to ensure higher enrolment and improve learning outcomes for girls in Rajasthan, and boost education for 18,000 children. The project ran from mid-2015 to mid-2018. Its partners included UBS Optimus Foundation (or UBSOF, the socially-motivated investor), Instiglio (project manager, designer of the DIB’s outcomes, payment structure and financial model), Children’s Investment Fund Foundation (or Children’s Investment Fund Foundation (CIFF), the outcome payer that would pay back the investor - UBSOF - the original amount plus extra returns if agreed targets are met) and IDinsight (outcome evaluator) (Instiglio, 2015). The project is considered a success as it met 116 per cent of the enrolment target and 160 per cent of the learning target in its final year. UBS Optimus Foundation, which gave the upfront working capital of USD 270,000 for the project, got back its initial funding and an additional 15 per cent return from the outcome payer, the Children’s Investment Fund Foundation (CIFF) (UBS, 2018).

The education sector in India has witnessed the launch of another DIB in the form of the BAT Education DIB. It was launched in February 2018 by the British Asian Trust (BAT) set up by Britain’s Prince Charles.

The objective was to improve education for over two lakh marginalised children in India by funding Indian not-for-profit delivery partners for four years. Its areas of operations include training of principals and teachers, direct school management and supplementary programmes that in turn boost literacy and numeracy learning levels for primary school students from the country's marginalised communities. The USD 10 million DIB developed by the BAT, was launched with the UBS Optimus Foundation and with technical support of the UK government's Department for International Development (DFID) (British Asian Trust, 2018; PTI, 2018).

The world's first health DIB, the 'Utkrisht' (the Hindi word for 'excellence') was also launched in India. It is attempting to address the problem of maternal and newborn mortality. The target area is Rajasthan, which is among the States in India with one of the highest maternal and newborn mortality rates, with 244 maternal deaths per 100,000 births and 47 infant deaths per 1000 live births. The USD 3.5 million Health DIB, launched in November 2017, is a partnership between UBS Optimus Foundation (the investor or the upfront funder), Palladium (the entity that designed the bond, and the project implementation manager), Population Services International and Hindustan Latex Family Planning Promotion Trust HLFPPPT (both service providers), USAID and MSD for Mothers (outcome payers). The Health DIB's objective is to improve the quality of maternal care in Rajasthan's health facilities by supporting up to 440 Small Healthcare Organizations, and thereby bringing down the number of mother and infant deaths in the state. The programme aims to help around six lakh (0.6 million) pregnant women with improved care during delivery and save up to 10,000 lives over a five year period. The Rajasthan Government has an oversight role and aims to be the outcome payer in the second phase of the impact bond (USAID, 2017a, b).

Social Incubators

Social incubators are entities that help develop and provide support to Social Purpose Organisations (SPO) in their initial stages in a manner that provide their operations a viable model for long-term sustainability.⁹

Effectiveness of social incubators lie in their ability to spot scalable SPOs with long-term commitment to ensure lasting social impact, transfer of incubation skills and expertise and then their effectiveness in helping the SPOs secure early stage and follow-on funding through their networks. The incubators also need to have customised and structured programmes to cater to a diverse group of SPOs and their needs, in addition to impact measurement support. However, social incubators can be distinguished from purely commercial incubators as the former is less selective, and focus more on the level of ambition of the SPOs in wanting to meet the social and environment objectives. However, the effectiveness of social incubators is directly proportional to the size of their networks and partnerships as well as the level of funds they have at their disposal. Some of the social incubators in India include the Centre for Innovation Incubation and Entrepreneurship (CIIE) IIM Ahmedabad, Tata Institute of Social Sciences (TISS) - DBS Incubation Centre at the Centre for Social Entrepreneurship, Sandbox Startups, created by the Deshpande Foundation, Villgro Innovations Foundation and UnLtd India (AVPN, 2016). Another category are organisations such as Cowrksfoundry that are startup accelerators that help build businesses that are long-lasting and scalable. Cowrksfoundry provides ‘technology credits’ of upto USD 75,000 and ‘smart seed capital’ of up to USD 50,000 in the form of convertible preferred shares. This is in addition to mentors such as Google, Microsoft, Amazon, Cisco, Intel, Uber, Samsung etc.¹⁰

In order to ensure commercial returns, the social incubators with a profit motive identifies several social enterprises with a business model that has the potential to ensure financial return on investment, high growth and/or technologies that can help in bringing out commercially successful products and services. Such incubators include Morpheus, IAN, Hatch, India Quotient and Venture Nursery (NEN, 2013).

Global organisations such as the UNICEF are looking at ways to collaborate with the private sector to find innovative strategies and solutions that not only help companies to expand their operations but also address social challenges. For instance, in the field of ‘improving

access to essential services for children’, the UNICEF has identified organisations such as ‘Khushi Baby’ (an intervention that promotes use of specially designed necklace with micro memory chip storing children’s immunization records till the age of two years) and SoaPen (a soap crayon encouraging handwashing among children) for “facilitating access to funding, development tools and expert mentoring that will help take these inventions from paper to production”. Khushi Baby operates in the Gogunda Block of Udaipur, Rajasthan and more than 90 front line health workers in over 350 villages make use of its platform to track the health of around 15,000 mothers and children across 33,000 checkups and for over 80,000 vaccination events as per their official record. The plan is to replicate this model across Rajasthan and rest of India, and in turn scale up its operations. Khushi Baby’s aim is to achieve 80 per cent of its revenue from commercial level adoption of the platform alone by 2021.

According to the UNICEF, thanks to partners such as UNICEF India, GAVI, the Vaccine Alliance and Johnson & Johnson, as well as local private sector and government partners are helping the scaling up of Khushi Baby and SoaPen in India and beyond. SoaPen was able to expand its operations by selling more of their products in schools in India and the US, and thereby scaling up their business, get recognised, raise more funds and continue as a for-profit entity. The UNICEF Office of Innovation is continuing to scan the globe for such partnerships with social enterprises that offer innovative solutions that improve the lives of children and have the potential to be scaled up as well as replicated in many countries. Khushi Baby is supported by leading university groups such as Yale’s Code4Good and MIT Sloan’s India Lab. Since 2014, Yale has backed Khushi Baby mentoring the social enterprise on strategy and platform development. Khushi Baby is supported by the Yale School of Public Health for its upcoming projects on immunisation efficacy tracking.

Social Stock Exchange and Social Enterprises

Social Stock Exchanges (SSE) are being seen as an important tool with potential to put social enterprises firmly on a path to scale up their

operations without compromising on their core social and environmental objectives. The emphasis and mainstreaming of social and environmental causes in the corporate world has even led to the leading traditional stock exchanges introducing Environmental, Social and Governance (ESG) reporting (ESG) as a good practice to ‘attract and retain long-term investors’.¹¹ What has also helped in driving this cause was the inception of Principles of Responsible Investment (PRI) at the UN level. The PRI lays stress on inclusion of ESG issues into investment analysis and decision-making processes in addition to giving a push for disclosure on ESG issues. Since the launch of PRI in April 2006 at the NYSE, it has garnered over 2,300 signatories from the investor class. The PRI’s partners include the UN Environment Programme Finance Initiative and the UN Global Compact.¹² Moreover, since 2009, the UN has a Sustainable Stock Exchanges initiative to promote sustainability initiatives - including ESG practices such as ESG indices, ESG listing rules, ESG training, ESG guidance and listing of green bonds - of stock exchanges and regulatory bodies across the globe, (UN, 2016).

The concept of SSE can be developed in India using this basis provided by the UN as well as the experiences of other countries (See Box 2) in formulating SSEs. The capital markets regulator SEBI already has detailed norms mandating listed entities to include Business Responsibility Reports (BR reports) as part of the Annual Reports. This was in line with the July 2011 ‘National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business’ of the Ministry of Corporate Affairs, Government of India as well as the “larger interest of public disclosure regarding steps taken by listed entities from an ESG perspective” (SEBI, 2012).

Bringing the SSE within the ambit of the capital market regulator has its pros and cons. The listing criteria should ensure that only social enterprises that have a track record of achieving measureable positive social and/or environmental impact are listed on the SSE. The categories of securities on the SSE could include common equity, bonds or preference shares in the case of for-profit entities, while not-for-profit

impact entities could go for listing of bonds and impact investment funds. The SSE norms would also need to have impact requirements and financial requirements. Impact requirements relate to preparation of an ‘impact report’ for at least a year by the listing entity, obtaining an impact certification by an independent body at least a year prior to listing and ensuring the primacy of social / environmental mission, etc. Financial requirements would include meeting a minimum market capitalisation amount, publishing financial statements that meet certain specified standards at least a year prior to listing and demonstrating a financially sustainable business model). Besides, there can also be shareholder requirements. In addition to detailed norms regarding the listing process, the entities can also be asked to meet periodic and continuous disclosure requirements in order to operate as a listed entity.¹³

Box 2: Social Stock Exchange – Global Examples

The first SSE came up in 2003 as Bolsa de Valores Sociais (BVSA) in Brazil. Though the BVSA uses Brazilian Stock Exchange Bovespa as its trading platform, it functions more or less like a match-making and/or crowd-funding platform rather than a platform for investment. Business-model of the social enterprises is evaluated by Bovespa by conducting an on-site inspection. In this model, investors buy “social equity units” in social enterprises and also carry out their own evaluation of social enterprises on the basis of their social returns. Financial profit is not the main motive. The SSE’s aims include boosting social enterprises in the field of youth and children, especially those working on literacy, education, health, and environment. The SSE offers investors a credible and certified portfolio of social enterprises. The BVSA has the approval of UNESCO and the UN Global Compact.

The South African Social Investment Exchange (SASIX) came up in June 2006 and was the second SSE after Brazil. It functions like a platform for research, evaluation and match-making to facilitate investments into social development projects. Its core social investment principles include a results-driven approach, prioritisation of sustainability and a comprehensive strategy to solve a precisely defined social issue. In order to get listed, entities have to achieve a measurable social impact.

Box 2 continued...

Accountability and transparency are also given importance. Guidelines for listing sought compliance with SASIX's good practice norms for each sector. NGOs can also list their social projects on the exchange. Value of the projects assessed and then divided into shares. Following project implementation, investors were given access to financial and social reports. Ethical investors could purchase shares of social enterprises listed on the basis of region/province and sector. The sectors included food security and agriculture, small business development, animal protection, vulnerable people, environment and conservation, health and education. While social enterprises are required to have a social purpose as their primary aim, they are also expected to have a financially sustainable business model. It has not flourished despite the government support. Another unique initiative was that of the Impact Exchange (IX), which got the regulatory approval in 2011. It is a collaborative effort of a South African social enterprise advisory firm NeXii and the Stock Exchange of Mauritius (SEM) and is billed as the world's first impact investment-dedicated stock exchange.

The Austrian SSE Imfino is an online platform with an objective to link impact investors with and sustainable entrepreneurs. It was also called the Global Impact Investing Vienna Exchange (GIIVX) and it relies on UN SDGs. The Canadian SSE came up in 2013 as Social Venture Connexion. It was supported by the Government of Ontario and functions almost like a stock exchange. It is open only for institutional investors. The SSE has a platform that connects social enterprises, investors and service providers, and ensures easy registration for social enterprises. It uses the standard used by B-Corporations to assess social and environmental impact.

The UK got its SSE in 2013. It is under the regulation of the UK Financial Conduct Authority (FCA). The London-based SSX was seen as a mix of market-oriented and social-cause model. Rockefeller Foundation helps it with research on social enterprises, investors as well as assessment of social and financial returns. Its stated mission was "to create an efficient, universally accessible buyers' and sellers' public marketplace where investors and businesses of all sizes can aim to achieve greater

impact either through capital allocation or capital raising.” Though the SSE is yet to start share trading, it is a provider of information on social enterprises as it has a directory of firms that have cleared the test on ‘social impact’ conducted by independent experts. It also carries out research for prospective investors including on the social and environmental objectives of the social enterprise, target beneficiaries, methods of implementation and results of social and environmental impact. Social enterprises are only required to have a social purpose as one of its core objectives and not a primary aim. This provides the leeway for social enterprises to combine social and commercial aspects.

The SSE in Singapore came up in 2012-13 as Impact Exchange (IX) with the backing of Rockefeller Fund and the Stock Exchange of Mauritius. It is the only public SSE and is an independent Impact Exchange platform. Social enterprises, both for-profits and non-profits, permitted to list their project. NGOs are allowed as issuers of debt securities (such as bonds). Social enterprises are required to bring out their social and financial returns, which investors then assess. The SSE is therefore based on a market-oriented model. Investors are also accredited on the basis of their track-record. It is mandatory for social enterprises to have a social purpose as its primary aim. It has a platform called Impact Partners which provides information on social enterprises to investors in addition to IIX Growth Fund, which is an equity investment fund, as well as a public trading platform called IX.

The U.S. does not have a full-fledged SSE. However, an organisation called Mission Markets, which is B-Corporation, has an information portal with details about linking impact investors to social enterprises with accreditation. Its services include due diligence and information on transactions in structured debt and notes, purchase of equity and private placements. It also has partners to help close deals. In addition, the California Stock Exchange was mulling to be the first ‘social good impact’ stock exchange in the U.S. What can help in setting up SSEs in the U.S. is the readiness of its regulatory framework as well as several states either passing or working on a B-Corp legislation.

Source: Authors’ compilation from various studies and articles including Antonella, N. (ed.). (2009); Boguslavskaya and Demushkina, 2013; Chhichhia, 2014; Chhichhia, 2015; University of Pennsylvania, 2016; Wendt, 2017.

In order to help social enterprises scale up, it is important to first identify the factors that act as impediments. These could be lack of access to affordable finance (which can be addressed through mechanisms to pool such funds) and technology (which can be solved through local solutions and technology transfer) as well as regulatory restrictions (that can be eased through incentives such as tax rebates for investments). It is also important for social enterprises to consider ways to share their operating costs through collaborations and strategic partnerships with other large or small enterprises regarding the use of facilities, technology and knowledge resources, logistics or other services (A.T. Kearney, 2015). The next phase of scaling up could be through mergers and acquisitions, franchising arrangements, replication of operations and diversification into related areas. Governments can help through good infrastructure, subsidies, skill development programmes, and policies including reserving a fraction for social enterprises in public procurement activities and enhance capabilities of these enterprises to take part in tenders or to apply for projects (European Union/OECD, 2016).

It is important to identify social enterprises that have strong leadership, a capable team and are using innovative, scalable and strong business models to address problems that are considered challenging. Additional qualifications can be assessed in terms of possessing track record of technically validated positive outcomes in relevant areas. The scope for scaling up of potential social enterprises, however, would invariably be linked with the extent of current and future demand in a particular sector. Meanwhile, the funding agencies need to undertake due appraisal of the unique functional models driving social enterprises to invest in scaling up and replication of the business model to cater to similar local and global needs. India is suitably placed to attract potential investors from across the world due to the unmatched scale that it offers thanks to its large population and associated development challenges.

In addition, in the context of India, suggestions have been made for financing social enterprises through pooling of resources and collaboration at the level of investors as well as outcome payers both

in the public and private sectors. Such outcome payers from both India and overseas could pool their funds into an India-based non-profit tax-exempt entity, that is allowed to take contributions from overseas funders as well. Simultaneously, for investors keen to invest in social enterprises, an Impact Bond Fund (IBF) could be set up in the country with contributions from local investors, while foreign investors could pool in their funds into an offshore entity that then puts the money in the IBF. An independent agency appointed by the non-profit tax-exempt entity (which is handling the funds of outcome payers) could then carry out the evaluation of outcomes based on certain pre-determined stringent parameters.

The IBF can then allot funds to entities carrying out specific projects (grants to non-profit entities and services arrangements with for-profit entities) while simultaneously the non-profit tax-exempt entity could enter into agreements regarding impact bonds with project-specific entities. Once the agreed outcome is achieved by the entity carrying out the projects, the payment towards initial capital and interest can be made by the non-profit tax-exempt entity.¹⁴ However, in order to qualify for obtaining funds for scaling up, an assessment has to be carried out to see if the model followed by the entity carrying out the project is scalable or not. Following the models of SIB and DIB, discussed earlier there could be further innovations in the way outcome payment is made by pooling resources of all the donors and not limiting to individual agencies. Similarly, resource pooling may be effective at the level of initial investor as it would help not only in reducing the transaction costs involved in each contract but also in scaling up. (Boggild-Jones and Gustafsson-Wright, 2017)

Way Forward and Policy Choices

The social sector investment and enterprises are still in their infancy. Definitional issues and data gaps lead to the difficulties in identifying the enterprises with the potential for scaling up as well as pooling of various sources of finance towards these activities. Efforts are being made to address this challenge, though they are in their early days. This sector

faces additional constraints as Social Entrepreneurship by definition has to adhere to norms of good governance and directly contribute to welfare and sustainability objectives, limiting options for raising resources from sources that may not entirely comply with accepted principles of social and climate justice. It is in this context that the utility of formalised institutional mechanisms like social stock exchange (SSE) has been discussed in the paper.

A stable and credible regulatory environment has to be created by emphasising on a clear legal definition of social enterprises and impact investment as well as by focusing on factors that take into account specific development challenges of the country to ensure an inclusive approach. In India ‘social enterprise’ is not defined under the Companies Act and does not get special or separate treatment. Social enterprise can be formed under various categories such as for-profit, not-for-profit (under the Companies Act - Section 8 Company), cooperative society, and charitable public trust. In the for-profit category, it can be founded as a partnership, Limited Liability Partnership, private / public limited company or sole proprietorship under the Companies Act. While such a move might ensure attention from investors and access to formal sources of finance, the focus on profit maximisation and return on investment might result in conflicts with the original mission of these units that in most cases have to adopt a balanced approach of seeking profits vis-à-vis positive social and environmental impact. The non-profit route also has its pros and cons. Although in this case there might be operational freedom to pursue social and environmental goals, the downside could be difficulties in attracting commercial finance and skilled manpower (Banerjee, 2017).

Further, the regulatory barriers have to be identified and removed for greater ease of doing business as well as to make sure that the pre-defined outcomes can be met by the service providers through better delivery of services without having to encounter red-tapism. This would also require a focus on norms for cooperation between various regulators. Besides, sectors and activities within those sectors best suited for social

impact investments have to be identified. Though the paper has focused on education and health in general within the social sector, there could be segments that provide opportunities for incubation and growth of social enterprise. For example, social enterprises may play effective roles in interventions related to livelihood security, climate adaptation as well as other specific areas including education and health among the vulnerable and marginalised sections of people.

We have highlighted the issues relating to scaling up of the best performing social enterprises, and in this regard the relevance of new instruments like social bonds, resource pooling mechanisms and social stock exchange. Also, it would be critical to build capacity in activities linked with social impact investment and entrepreneurship, including the need for sensitising existing pool of specialists, i.e. financial experts, lawyers, managers and other intermediaries. Another critical challenge is in terms of inadequate information base and lack of data. This would require creation of hard and soft infrastructure that facilitates consolidation and sharing of data with regard to activities undertaken by social enterprises.

In addition, the policymakers will have to take into account the criticism being faced by social impact investments and enterprises, especially that it amounts to covert privatisation where it involves Government agencies as the outcome payer. Impact investment and social enterprise may lead to over spending and misallocation of tax revenues in the process of achieving pre-defined outcome. Apprehensions have also been raised on the feasibility of blending social objectives with market rate returns (Brest and Born, 2013). The role of the Government may evolve from direct funding of social sector programme to that of an outcome payer in some cases in the near future with social enterprises taking up the role implementing socially oriented projects. To sustain the participation of social enterprises and impact investors, the Government could explore providing sovereign guarantee for risk mitigation purposes. However, it is important that social welfare remains at the core of such partnerships to avoid inadvertent slippage into over-financialisation.

Endnotes

- ¹ Jumde (2016) captures several of these recent examples.
- ² ‘Blended finance’, as per OECD, is defined as “the strategic use of development finance for the mobilisation of additional finance towards sustainable development - that is, to achieve SDGs - in developing countries”. Here, the term ‘additional finance’ mainly refers to commercial finance (OECD, 2018).
- ³ However, there are inherent dangers and costs as well in adopting a market-based approach if and when the social business gradually drifts away from its social mission. In the case of the U.S. mortgage providing companies Freddie Mac and Fannie Mae, which were hybrid public-private ventures with a social mission, their ostensibly positive blend went kaput as the government supervision, market discipline and the civil society values were unable to correct their course before the events that led to the 2008 financial crisis. In the case of these two business entities, they used the money that they had borrowed at a cheaper rate than their competitors to in turn issue riskier mortgages, while the investors thought that the government was always there to bail them out. Another danger in adopting market strategies is that social business could be forced to eliminate programmes that are not valued by market, though such programmes are in line with the social mission. It is, therefore, important to identify priorities and stick to them even while blending social mission with market-based models. Social business could face these challenges especially when they are going in for funding to scale up their ventures. The rise of social capital markets can help in weeding out inefficient and ineffective social enterprises. However, for that to happen, it is important to have dependable methods to measure Social Return on Investment. This is a challenging task given the difficulties in quantifying and measuring social and environmental impact. (Edwards, 2010).
- ⁴ A not-for-profit entity dedicated to increasing the scale and effectiveness of impact investing’ and focusing on ‘reducing barriers to impact investment.
- ⁵ Information accessed from ImpactBase (official website)
- ⁶ Information accessed from IRIS (official website)
- ⁷ Quasi-equity, which is a combination of grant and loan or equity, is referred to as or “patient capital” as it is long-term in nature, gives social entities flexible repayment options and helps them to scale up while simultaneously focusing on social returns.
- ⁸ The first SIB was introduced in the criminal justice sector (Peterborough Prison) in the UK in 2010.
- ⁹ Funding for scaling-up of Social Purpose Organisations (SPO) usually seek greater details about the unique selling proposition of the products of the SPO including affordability, effectiveness and category of customers as well as the

ease of replicability in other regions. The funders then assess the return on their investments based on the SPOs' cash flow and profitability, clarity in projections, sustainability of their operations, social impact, and whether they operate on the basis of a lean and green business model (AVPN, 2018).

- ¹⁰ For details, see the website of [cowrksfoundry](#).
- ¹¹ For details see London Stock Exchange Group's Guide to ESG Reporting
- ¹² For details see UN Principles for Responsible Investing
- ¹³ Impact Exchange Board Listing Guide, 2017.
- ¹⁴ See Nishith Desai Associates, 2018.

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