The landscape and challenges of impact investments in India

The interest of impact investors is shifting from micro-finance and energy to education, health, and agriculture

Achieving the ambitious sustainable development goals (SDGs) by 2030 will take an estimated $5 to $7 trillion per year, with a financing gap of $2.5 trillion in developing countries. In India alone, the outsize challenge has been translated into a financing gap of $565 billion. Closing this gap requires action on several fronts; efficient and effective domestic resource mobilisation, outcome-focused donor efforts to ensure that money is spent well, and harnessing private capital. In recent years, interest has grown globally to develop new investment approaches, such as impact investing or purpose-driven finance.

Typically, impact investing does not take place in large-cap markets, but in areas that have service provisioning gaps. In India, impact investors are committed to solving development problems, given the sheer size of populations in need but there is also a strong financial motivation to invest in ideas that serve dual bottom-lines.

In a recently released state of the sector report on impact investing, the size, scale and scope of the impact investment market in India was highlighted. Anchored on a primary survey conducted by scholars at Brookings, the report is structured around four key tenets of impact investment market activity — market trends in India, sector-level analysis, innovative financing and measurements. The empirical focus of this study is on industry trends within the key development sectors of health, education and agriculture, and the scope of innovative instruments such as impact bonds. By identifying common challenges faced by impact investors and highlighting the Indian ecosystem for impact bonds, the study offers specific policy recommendations.

Indian impact investing began in earnest in 2001 with the establishment of Aavishkar, India's first for-profit impact fund, alongside the entry of the non-profit Acumen Fund, becoming initial examples of early-stage seed impact investing. Eighteen years down the line, the sector has just about expanded to around 25 firms registered with the Impact Investors Council (IIC), an industry body managing these funds. The reasons to invest in social enterprise or business portfolios come primarily from three broad motivations: financial, social and value-driven. Impact investors in India differ in their motivations and expectations, ranging from those who emphasise impact, to those who are primarily motivated by financial returns.

However, on average, internal rates of return beat market returns, even in sectors that are traditionally social sectors with low returns. Many impact investors deviate from typical venture capital or private equity models playing more hybrid roles — both as investors in businesses and accelerator/incubator style mentors and managers — helping their investees improve business models, go to market and leverage technologies. What remains a striking feature of many of the investments we studied was the strong focus on tech-enabled and focused solutions. Technology helps investors achieve scale and reach in highly fragmented markets, especially when serving middle or low-income groups. While financial access, micro-finance and energy remained top sectors of interest and investments from impact investors until recently, the study finds more impact investors interested in making investments in health, education and agriculture.

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While the size of the impact investing industry is only a fraction of the amount of money devoted towards environmental, social and governance (ESG), socially responsible investing (SRI) or corporate social responsibility (CSR), the impact investing sector in India attracted over $5.2 billion between 2010 and 2016, with over $1.1 billion invested in 2016 alone. (McKinsey, 2017). Impact investors managed assets between $0.15 million to $88.97 million averaging at $36 million (IIC) as of 2018. Of these, half the funds made average investments above $20 million, mostly (75%) by buying equity in portfolio companies.

Since a majority of Indian impact investors use proprietary indicators to measure the impact of their investments, social impact ends up being loosely and opaquely defined. Confusion over terminology and indicators is rife within the industry and there remains a lack of cohesion in what to report and to whom. While impact investors do not make tall claims of social good, impact is devilishly difficult to ascertain in social programmes as well.

Some of the novel findings from the survey refer to the scope of innovative financing tools such as impact bonds. While the impact bonds market in India is still young, it is arguably the most active among developing countries. With three contracted deals and several more in design, there is an appetite for using impact investment to test and drive these new forms of innovative financing. The investment environment for impact bonds in India remains largely driven by international foundations on the investor and outcome-funder side. Much movement has been built around creating a landscape and supporting ecosystem, however, most of these efforts are industry-led, with little inclination of government interest and impetus. Going forward, the impact bond model must be further tested, and more evidence must be collected before impact bonds attract Indian investment.

Building a strong, data-centric evidence base will be crucial to ensure that capital is put to work on investments that achieve the intended impact. These measures will raise transparency and the long-term credibility of the sector — and eventually facilitate the "mainstreaming" of impact investments in the Indian economy.

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The views expressed are personal