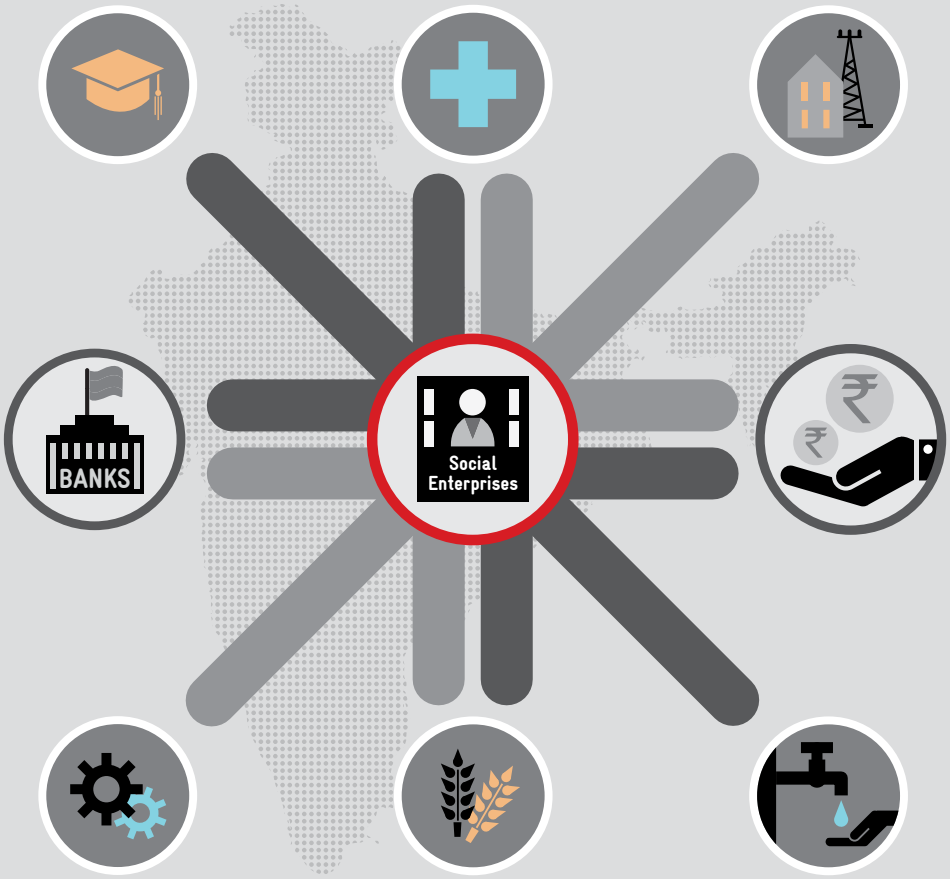

Beyond Equity:

Financial Innovations for Social Enterprise Financing

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SIDBI भारतीय लघु उद्योग विकास बैंक Small Industries Development Bank of India We empower Micro, Small and Medium Enterprises
YES BANK

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2014

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Executive Summary

Motivation of this Study

An increased focus of governments, private sector actors, and the development community towards market-based solutions to social and environmental challenges has led to the rise of "social entrepreneurship" in recent times. Even though a multitude of definitions exists, there seems to be a consensus that "social enterprises" find new ways of addressing gaps in underserved markets through innovative business models, contributing to inclusion of the excluded – the often so called "Base of the Pyramid". They are hence an innovative sub-set of the micro, small and medium enterprise (MSME) sector, often driving change and creating disruptive solutions.

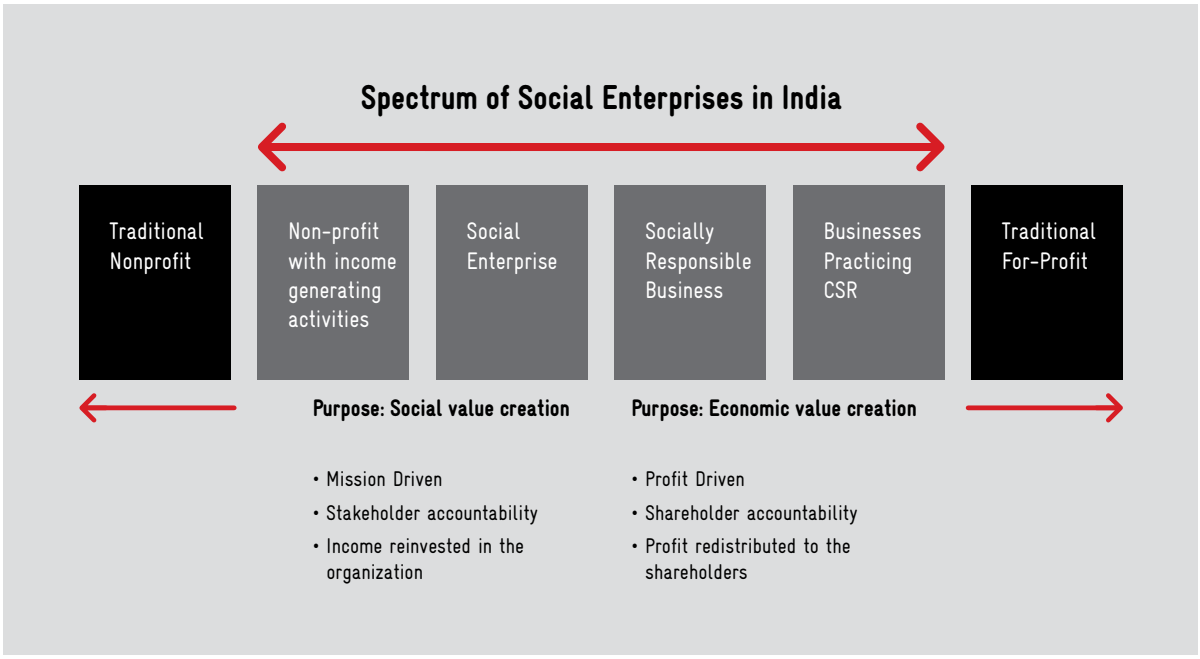
With India's *Decade of Innovation* (2010 – 2020) announced by the Prime Minister and the quest to find a new innovation paradigm that helps to unleash innovation for the benefit of the poor and excluded, approaches to foster social entrepreneurship gain relevance in India. While until recently it has been mainly foreign capital in the form of so called "social impact investments", providing capital for these innovators to grow, domestic actors are increasingly searching for ways to unlock domestic capital for social enterprises. The India Inclusive Innovation Fund (IIIF) is one recent initiative by the government to address the financing gap for social innovators. Banks like YES Bank are starting to look at social enterprises as a new customer segment, aiming to provide capital "beyond equity". The recently passed Companies Bill with its mandatory 2% spending of corporates in Corporate Social Responsibility might act as an additional driver for financial innovations to unlock patient capital, especially for early stage innovators.

The increased importance that social entrepreneurs play in the development agenda of the Government of India, the need for more domestic capital for these enterprises, and the increased interest of domestic financial institutions were key drivers for GIZ to conduct this study under the framework of Indo-German bilateral development cooperation, supported by the German Ministry of Economic Cooperation and Development (BMZ) as the implementing partner. The study aims to increase the understanding about the social enterprise segment among financial institutions, assesses the financing needs in the sector and describes the current market for finance from a demand and supply perspective, especially the demand for beyond-equity finance (debt and blended debt products). After the gap analysis, the report assesses potential financial innovations that could address this financing gap and analyzes the feasibility of their implementation in the Indian context.

GIZ and SIDBI, through their Responsible Enterprise Finance Project, have joined hands with Yes Bank to explore avenues that improve access to finance for innovative businesses that aim to create social and environmental impact in underserved markets. This first mapping is a step towards this larger objective. In the meanwhile, SIDBI has recently launched their Innovation Debt Finance Line, towards the same aim.

Social Enterprise Overview

While there is no legal definition of social enterprises in India, this report defines social enterprises as mission-driven entities that aim to generate positive impact at the Base of the Pyramid. These enterprises operate on a risk-return-impact framework i.e. they are high risk businesses offering low-to-medium return but creating high impact. Based on this definition it is estimated that there are *approximately 7500 social enterprises across India.*



Characteristics of Social Enterprises

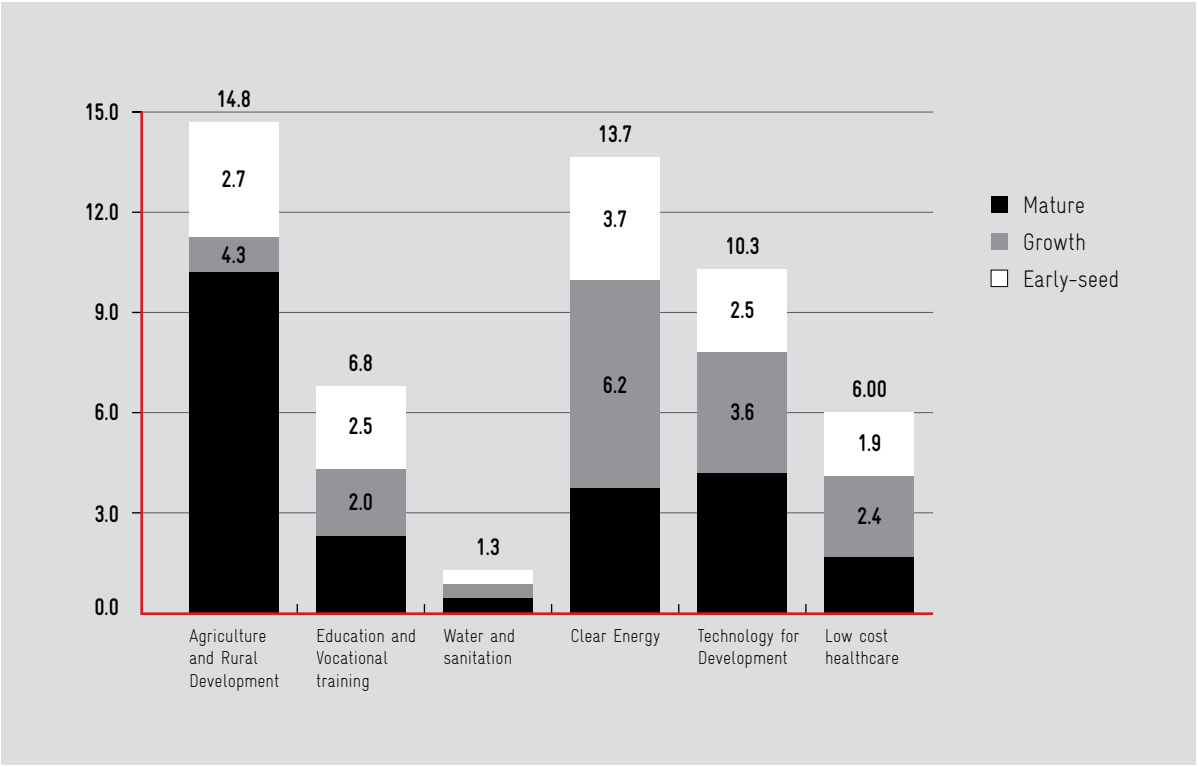
While from a policy perspective, social enterprises fall under the larger MSME-definition in India, a deeper analysis of social enterprises shows that there are key differences between "mainstream" MSME and social enterprises. These include: (a) Legal structure – Most MSMEs are proprietorship firms while most social enterprises are private limited companies (b) Access to finance – because of the legal structure unlike most MSMEs social enterprises have access to both equity and debt (c) Professionally managed – Social enterprises are more professionally managed and maintain transparency in financing (d) Fragmented – while sometimes MSMEs operate in clusters social enterprises are generally fragmented. Social enterprises tend to be *asset light, services oriented companies with few exceptions. Typically social enterprises* act either as service providers, system integrators, traders or distributors of services and products in low-income communities.

Financing Needs for Social Enterprises

Most social enterprises need finance for fulfilling working capital needs. While early-seed stage enterprises are more inclined towards raising equity or grants for fulfilling their needs, mature and growth stage enterprises are looking for debt to fund their operations. According to this study, the access to *'Beyond Equity' finance via debt and debt-like instruments is limited* in most sectors with exceptions to sectors such as agriculture and rural development and vocational education where debt flow is higher due to government-supported interventions. *Lack of collateral* and long gestation periods have been identified as the top reasons for limited access to debt in the sector.

Demand for 'Beyond Equity' Financing among Social Enterprises

The study estimates that the social enterprise sector needs *INR 53 billion (approx USD 880 million) as debt in the immediate future*, with a majority of this debt requirement (88%) in enterprises in the growth- and mature stages of operations. Agriculture and Rural Development (28%) as well as clean energy (26%) are the sectors with the highest demand for debt. The majority of the debt requirement (78%) is for short-to-medium debt products, primarily used for fulfilling working capital needs.



Supply of 'Beyond Equity' finance to social enterprises:

Social enterprises in India have access to finance from *3 main sources: Banks, Venture Capital Funds and Non-Banking Financial Companies (NBFC)*. Internationally, Social Enterprise Financing 'beyond equity' is often referred to as to as Social Finance or Social Enterprise Lending. Patient lending can mean offering loans or other financing vehicles below current market rates and on 'soft' terms.

In India, the banking sector does not specifically recognize social enterprises and prefers conventional collateral backed lending. Despite the acknowledgement of the sector by government, there is limited innovation in banks' product offerings and most of the lending to the identified social enterprise sectors is driven by the Priority Sector Lending (PSL) norms specified by the Reserve Bank of India (RBI). Initiatives such as the *Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)* have been set up by Government of India and SIDBI. The Innovation Branches promoted by SIDBI highlight attempts at innovative lending by the banking system. However, social enterprises are yet to benefit from these initiatives.

Venture funds do recognize the significance of social enterprises for the economy, but are limited by regulations in their product offerings, thus making largely equity investments and providing limited finance 'beyond equity'. As per the analysis, NBFCs in India champion beyond-equity/ debt access to social enterprises by means of product or process innovations. These NBFCs are exploring new models of lending such as venture debt, non-collateralized lending, customized repayments as well as process innovations such as customized risk assessment.

Social Enterprise Financing: International Landscape and Innovations

While globally, social entrepreneurship is in the limelight, social enterprise financing is in a nascent stage—with UK and US markets having the most innovative financial instruments. Among the BRICS and other emerging economies countries analyzed (Brazil, China, Indonesia, Malaysia, Philippines, Russia, South Africa, Taiwan, Thailand, Vietnam), there are few government policies to support the growth of the sector. Most emerging economies have a few sector-specific policies to encourage enterprise activity, whereas agriculture is the most popular sector for government policy support, followed by the clean energy sector.

The greatest success in financing social enterprises globally (specifically in the developed economies) has been through specialized institutions. Specialized channels include, for example, those banks that commit themselves to the "Sustainable Banking Principles": Banks like Triodos Bank or Germany-based GLS Bank direct patient capital to social enterprises, following three key criteria: (a) Triple bottom-line (environmental, social and economic) criteria as measure for success (b) Transparency of operations and (c) Human development. As specialized institutions, they differ from mainstream banks in their processes, e.g. when it comes to risk assessment and due diligence. In doing so, banks such as GLS-Bank and Triodos have not only contributed to advance social enterprise financing, but have also demonstrated better financial performance compared to their traditional peers. In India, NBFCs closely resemble these specialized channels in their operations.

Apart from specialized channels, a range of product innovations has been introduced globally to provide patient capital 'beyond equity' to social enterprises. These include Program Related Investment (PRI) loans given out by private foundations, social impact bonds and equity-like debt products such as convertibles, and warrants as well as instruments that help reduce the risk involved in lending to social enterprises such as loan guarantee funds, securitization and pooling. Indian eco-system players have started introducing some of these innovations such as venture debt, loan guarantees and securitizations.

Potential Interventions to Increase 'Beyond Equity' financing to Social Enterprises in India

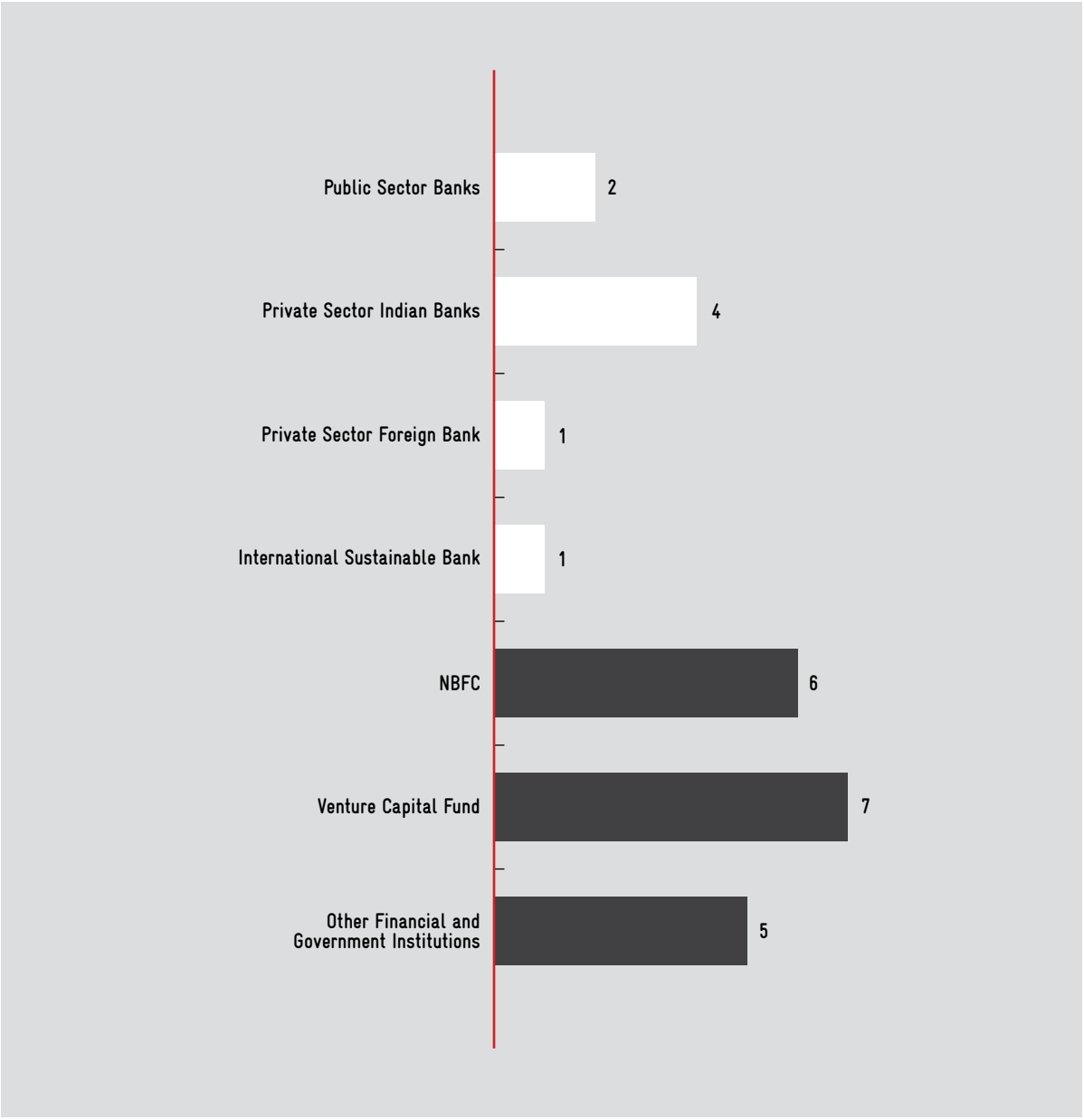
The study demonstrates that an innovative and dynamic sub-group of MSME requires finance; yet, the current financial system is not catering to the demands due to various reasons. Indian financial institutions as well as eco-system players hence need to come together to address the following:

- *Widening of the Supplier Base:* Market development efforts need to increase to expand the number and variety of suppliers of social enterprise financing (e.g. specialized NBFCs, venture debt firms, and specialized bank branches). The innovation branches supported by SIDBI in partnerships with other established banks could be a channel to provide patient lending.
- *Introduction of innovative products and instruments:* The degree of innovation in designing financial and risk mitigation products is currently limited; existing products such as venture debt and optionally convertible debt are being used sporadically. There is a need for greater encouragement to promote these products. Those who have piloted and introduced these financial innovations should be engaged in peer-learning activities.
- *Identification of stronger risk mitigation tools:* There is a need for innovation in key processes, such as risk management. New risk mitigating tools such as credit guarantee agencies and schemes need to be strengthened, innovative risk appraisal models need to be developed, existing collateral registry system need to be strengthened the and a uniform format for reporting data to a credit bureau such as CIBIL needs to be introduced.
- *Encouragement of foreign capital entry through different routes:* In order to set incentives for investors, improving the entry of foreign capital in social enterprise lending is crucial to the sector's development. Potential routes could include loan guarantees, direct lending via NBFCs and issuing Standby Letters of Credit (SBLC). In addition to foreign capital, domestic capital needs to be unlocked for the social enterprise sector: Companies CSR-funds could be one potential source.
- *Other Regulatory Changes:* There is a need for several regulatory changes in directing credit. These include reforms in NPA and liquidation norms, clarity on regulations with respect to debt provision by Indian and foreign venture capital funds, including on-lending by NBFCs to priority sector under RBI's PSL targets, easing minimum capitalization norms for foreign investments in for NBFCs.

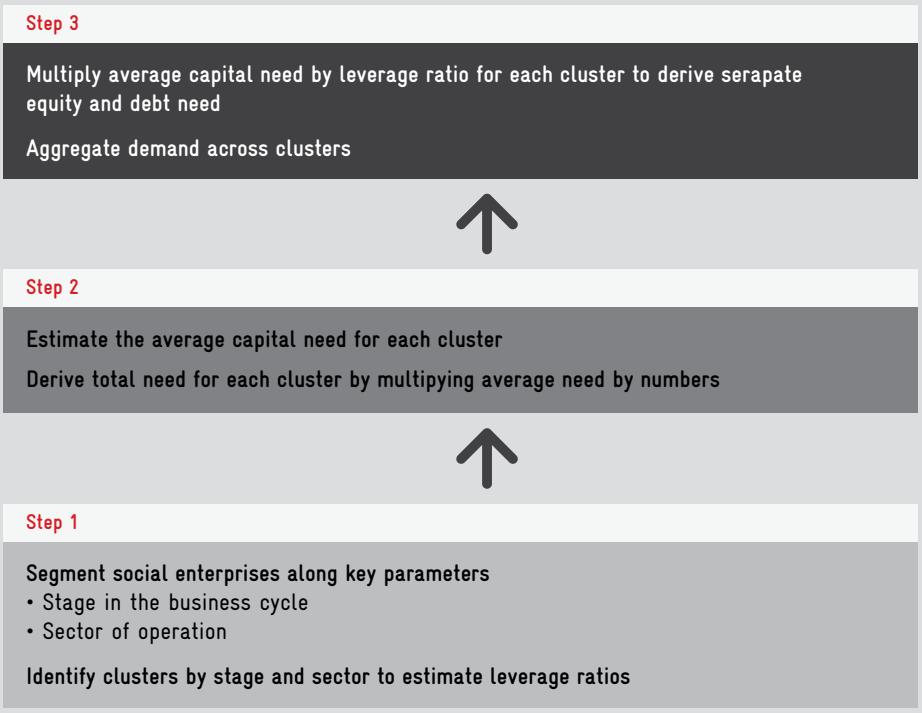
Methodology

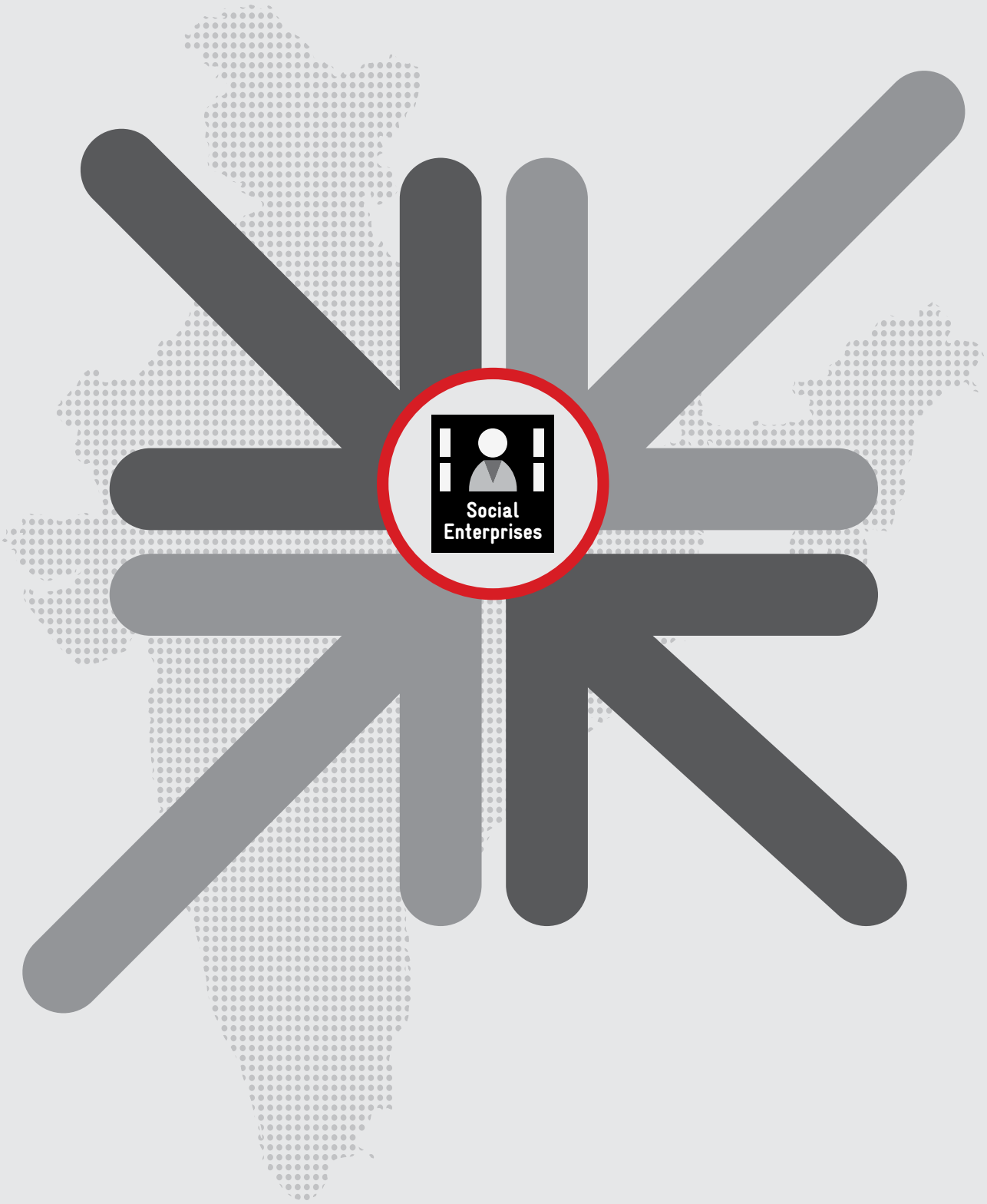
While conducting the study, the research team has referred to credible sources of data, including xisting research literature and industry publications. In addition, a series of primary interviews were carried out with both social enterprises and key players in the social enterprise financing ecosystem to corroborate the findings. The interviews include a sample of 35 social enterprises and 26

financial institutions and other ecosystem players conducted in person or telephonically (See Appendix 2 and 3). Additionally, it incorporates feedback from the panel discussion titled 'Beyond Equity - Innovation in financing social enterprise' organized at the Sankalp Forum on the 17 April 2013.



The report first suggests a definition of social enterprises and differentiates them from MSMEs. The report then estimates the current debt demand by social enterprises in India1 and enumerates challenges from the demand and supply perspective2. The report also includes a review of the social enterprise financing market (channel, process and product innovations) in other emerging economies and from across the globe. The report ends with recommendations on increasing patient credit flow to social enterprises via various routes.


Step 3
Multiply average capital need by leverage ratio for each cluster to derive serapate equity and debt need
Aggregate demand across clusters
Step 2
Estimate the average capital need for each cluster
Derive total need for each cluster by multipying average need by numbers
Step 1
Segment social enterprises along key parameters
• Stage in the business cycle
• Sector of operation
Identify clusters by stage and sector to estimate leverage ratios

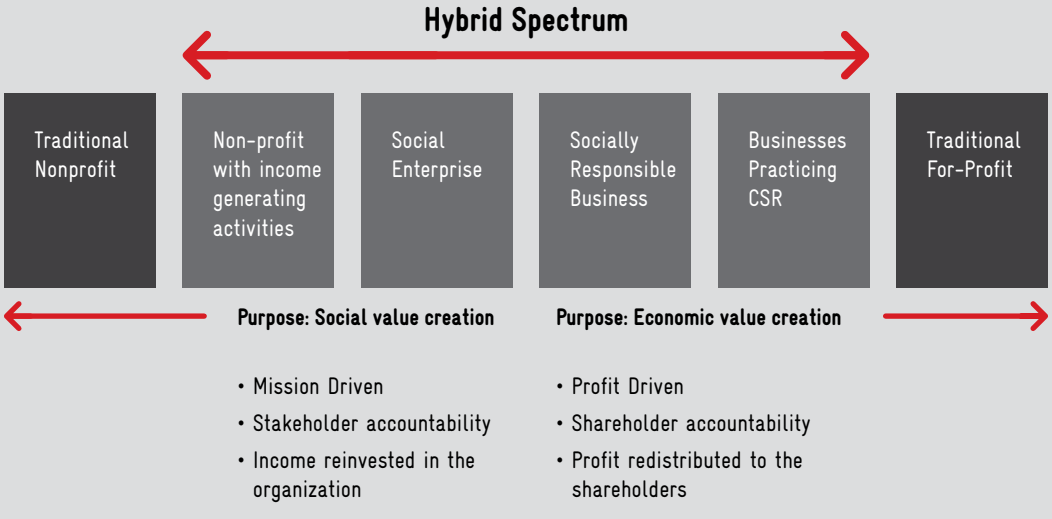

Social
Enterprises

1 Social Enterprises – A new target segment for financial institutions?

Globally, market-based approaches to social and developmental challenges are on the rise and private-sector solutions to shortcomings in the provision of basic services such as education, health, energy, water and sanitation are in focus. It is in this context that 'social enterprises' are in the limelight. While in most countries regulators have not yet come up with a clear definition for the term 'social enterprise' or 'social entrepreneurship', different stakeholders are dealing with this new niche segment of enterprises. In the absence of a universally accepted definition, practitioners, funders, scholars and social entrepreneurship networks attempt to set the boundaries of a social enterprise in accordance with the context of the region, culture, evolution of socio-economic systems and enterprises in their respective countries.

Definitional disorientation about social enterprise derives largely from the fact that social enterprises are hybrids in several dimensions. One can argue that hybridity is an essential characteristic of social enterprises.[1] The spectrum includes four types of hybrid practitioners (Figure 1),[2] The spectrum ranges from traditional nonprofit enterprises (on the left), engaging in commercial activities that generate economic value in order to fund social programs but whose main motive is social value creation as dictated by the stakeholder mandate, to traditional for-profit entities (on the right) that do create social value but whose main motives are profit-making and distribution of this profit to shareholders.

Figure 1 **Hybrid spectrum**

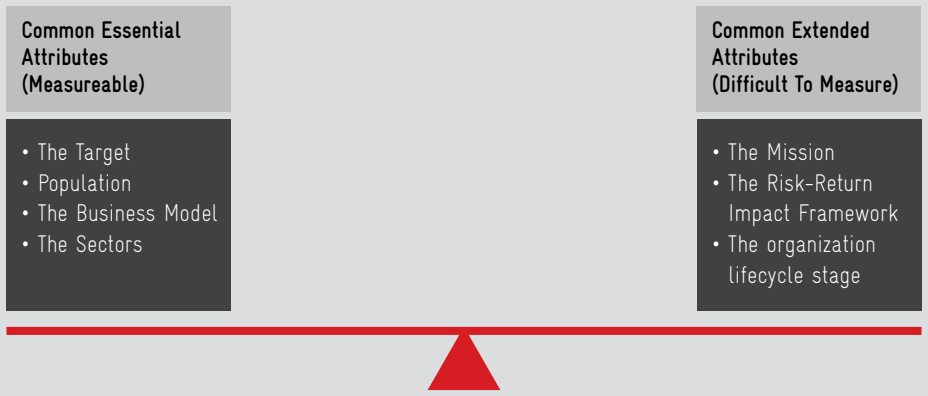


Source: Intellecap Analysis

Setting the boundaries for the definition of a social enterprise (Figure 2)

In the absence of a single definition, the following sections suggest common characteristics of social enterprises in the Indian context, based on an analysis of a sample of enterprises that create measurable social and environmental impacts through their core business operations and innovative business models.

Figure 2 Attributes based definition of a social enterprise



Source: Intellecap Analysis

1.1 Common Essential Attributes (Measurable)

1 **The Target Population:** There is a large consensus that social enterprises can be characterized by their target group, the underserved population. A large part of this population lives in rural, resource-poor regions, although in times of increasing urbanization the number is increasing in cities. Based on the geography of operations, two categories of social enterprises can be identified in India:

- **Operating in the rural area:** Social enterprises that operate in geographically remote, underserved and resource-poor regions of the country, where the population has lower income levels and lacks access to basic services. By focusing on such regions, social enterprises contribute to improving the overall living conditions and livelihood of the population residing in these areas.
- **Operating in the Semi Urban or Urban area:** Social enterprises that operate in developed region of the country but who address the population living at the base of the socio economic pyramid. As income disparities are higher in these regions as a result of urbanization and inequitable development, social enterprises can contribute to improving the lives and livelihoods of the population who is left out from receiving the fruits of development.

2 **The Business model:** Analyzing different social enterprises, four business models can be identified:

- **Offering products and services to underserved population:** Social enterprises customize products or services that specifically cater to the needs of underserved population. Social entrepreneurs look at underserved population as an untapped market that has the potential to be transformed into a ready consumer-base for a range of products as long as the pricing is economical. Vaatsalya, the pioneering low cost hospital chain in tier II towns, and Embrace, the company that designed cost-efficient baby warmers, and Karadi Path, the enterprise that teaches English course for students from government schools in India, are some of the great examples of enterprises that have modified their business models to cater to the unmet needs of underserved segment.

- **Creating livelihood opportunities for underserved population:** Social enterprises provide job opportunities to people residing in difficult geographies. One example is the Rural Business Process Outsourcing (BPO) enterprise B2R (Business 2 Rural) that has taken jobs to people based in the northern state of Uttarakhand, when most BPO businesses in India are concentrated in Tier I cities. The company is setting up small rural BPO centers in the Himalayan state of Uttarakhand to take advantage of a captive employee base, lower capital cost and lower employee cost to provide effective services to domestic Indian markets.
- **Including underserved population in the supply chain:** Social enterprises provide livelihood options to underserved communities by including them in the supply chain. Social enterprises operate in difficult geographies and provide assistance to people who are otherwise excluded from regular supply chains. For example, Milk Mantra has established state-of-the-art dairy operations in the low income state of Orissa, to collect 1,00,000 litres of milk per day from tens of thousands of poor dairy farmers. The enterprise has built village infrastructure to facilitate collection of milk from poor farmers, and then processes and distributes the milk to end consumers.
- **Creating business ownership:** Social enterprises form organizations that are co-owned and operated by the underserved community to improve livelihood options. For example, Rangasutra, a company working in remote parts of Rajasthan, was formed to generate sustainable livelihood for craftspeople. The company is owned by more than 5000 poor artisans, who are themselves involved in sourcing yarn, designing, producing and marketing textiles to urban markets. These artisans not only own the company but are also the producers and suppliers of the product.

3 **The Sectors:** Most social enterprises operate in essential services sector, viz:

- Agriculture & rural development
- Financial inclusion & Technology
- Education & vocational training
- Low cost healthcare delivery
- Water and sanitation
- Clean Energy
- Affordable Housing
- Rural Tourism

For the purpose of this project, we will focus on the first six critical needs sectors.

1.2 Common Extended Attributes (Difficult-to-measure)

1 **The Mission:** The mission or intent differentiates many social enterprises from other enterprises. Social enterprises directly address social needs through their products and services or through the numbers of disadvantaged people they employ or include in the value chain. Creating social impact hence often becomes core of their business model. Based on the results of a survey conducted by Intellecap in 2012, only 4% of the social enterprises said they were purely profit-oriented enterprises while over 30% of enterprises said they are solely focused on impact.

2 **The Risk-Return-Impact Framework:** Social enterprises often take high risk, venturing into new target segments and geographies with innovative business models, and hence they are only able to offer low-to-medium returns while creating high measurable social impact. This unique risk-return-impact framework differentiates social enterprises from mainstream businesses.

3 **The organization lifecycle stage:** The social enterprises' evolution in India shows that most of the enterprises are in the seed, early and early growth stage. Typically, early stage businesses are those that have an idea, product/service or business model that are yet to prove its viability in the market. These businesses need capital to test and expand their business. Growth stage businesses, on the other hand,

are in the scale up mode has stabilized the operations and has positive EBITDA[3]. Many founders of social entreprises in India are first generation entrepreneurs. This is in contrast with many traditional MSME in India that operate as family businesses.

1.3 Exclusions

Often social enterprises are located somewhere in between a spectrum (Figure 1) that spans from traditional non-profits, which focus on social value creation, to traditional for-profit enterprises, which only focus on economic value creation. Many times boundaries become blurred in the spectrum and it is important to highlight the cases which are excluded from definition of a social enterprise. Many multinational companies and Indian Conglomerates have also taken cognizance of the market potential at base of the pyramid (BoP) and created products to serve this target population. For example, Hindustan Unilever Ltd. and Tata group have launched low cost water purifiers, 'Pureit' and 'Tata Swach'. ITC limited, a Indian multi-brand business conglomerate has launched ITC 'e-Choupal', an agriculture supply chain initiative. Tata global beverages and Pepsi Co. have jointly launched, 'Tata Gluco Plus', a low cost energy drink targeting at daily wage earners and manual workers. While many attributes of these products are similar to products offered by social enterprises (e.g. affordability, target group), they are only one vertical of a larger business. As part of this study we only include enterprises, for whom the majority of their business efforts targets the BoP-market in underserved geographies – most of these enterprises are part of the micro, small and medium enterprise segment.

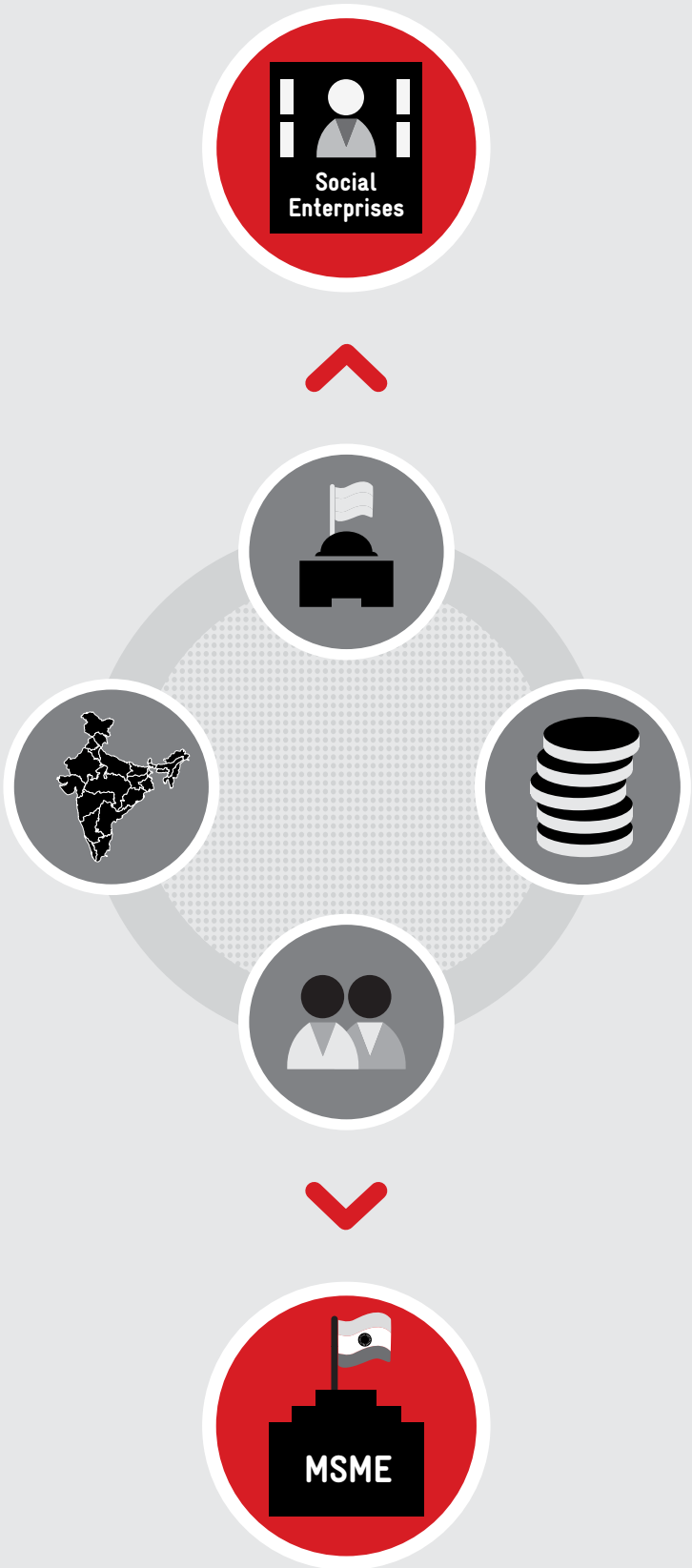
Footnotes

1 ACRN journal of entrepreneurship perspective - Business models of social enterprise: A design approach to hybridity by Wolfgang Grassel

2 Social enterprise typology *(http://www.4lenses.org/setypology)*

3 Earnings Before Interest, Taxes, Depreciation and Amortization


Social
Enterprises


Social Enterprises
MSME

2 Indian Social Enterprise and MSME: Similar yet so different

The definition of social enterprises described in the previous chapter was prepared based on interactions with practitioners, impact investors, research organizations and other stakeholders. The Government of India does not recognize social enterprise as a separate legal entity and instead, classifies them under the Micro, Small and Medium Enterprises (MSME) sector which are defined as per the MSMED act (Refer Table 1)

Table 1 Definition of micro, small and medium enterprises according to MSMED Act

Category	Micro	Small	Medium
Manufacturing	Less than 2.5	2.5 - 50	50 - 100
Services	Less than 1	1 - 20	20 - 50

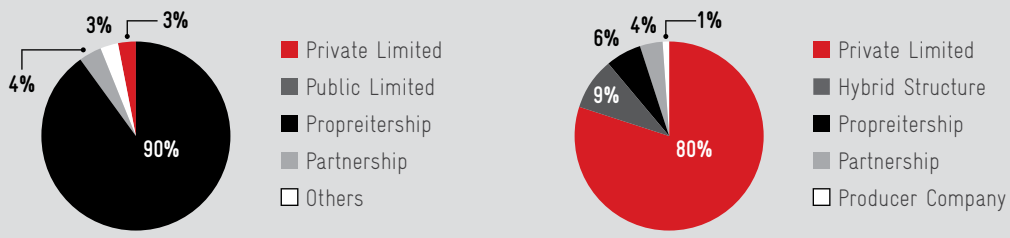
Source: Development Commissioner, Ministry of Micro, Small and Medium Enterprises

Most social enterprises are asset-light services-oriented businesses and hence they would fall under the services category of MSMEs (Refer Table 1). Based on the asset size, Social Enterprises would further fall under the Micro-Small enterprise category, as there are very few social enterprises which can classify as Medium enterprises.

However, based on our analysis Social Enterprises and MSMEs differ on the following factors:

1 **Legal Structure:** As per a recent survey,[4] 80% social enterprises are structured as Private Limited Companies[5] (PLCs), while only 10% are Partnerships[6] or Proprietorships[7]. This is in stark contrast to the legal structures MSMEs in India where 90% of MSMEs are structured as proprietorships, and only 3% are PLCs. (Refer Figure 3)

Figure 3 Legal structure of enterprises in india



Source: Intellecap Social Enterprise Landscape Report (2012)

2 **Access to finance:** Access to modes of finance is directly correlated to the legal structuring of an enterprise. Private limited companies find it easier to raise capital from multiple sources and to transfer ownership, which allows for faster growth and ensures continuity beyond the founder's involvement. As social enterprises are mission-oriented, they also have access to alternative funding sources such as philanthropic capital or impact funds.

3 **Management team:** Many social enterprises have a professional management team, as almost all the social entrepreneurs completed at least a college degree and over 70% of them have completed their post-graduation. This management team improves the access to finance. As per a recent study conducted by Intellecap and IFC,[8] the lack of any documented financial information was one of the major challenges identified in the underwriting process for banks when lending to MSMEs.

4 **Fragmented:** Conventional MSMEs often operate in geographic proximity with enterprises with similar business lines. These so called clusters have often evolved historically. Social enterprises are mostly fragmented. They might include clusters in their value chain, e.g. artisan clusters.

Footnotes

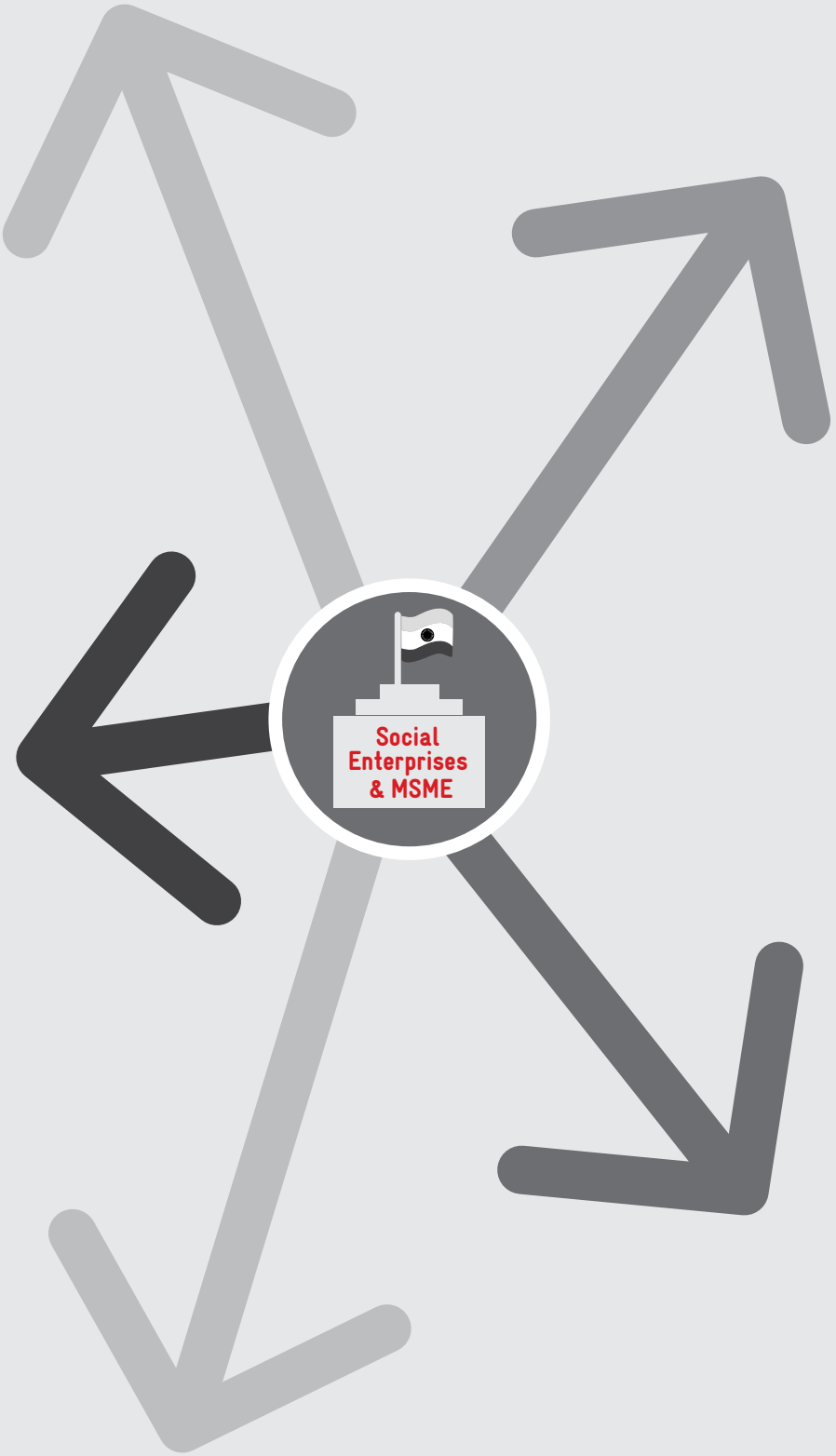
4 Intellecap Social Enterprise Landscape Report (2012)

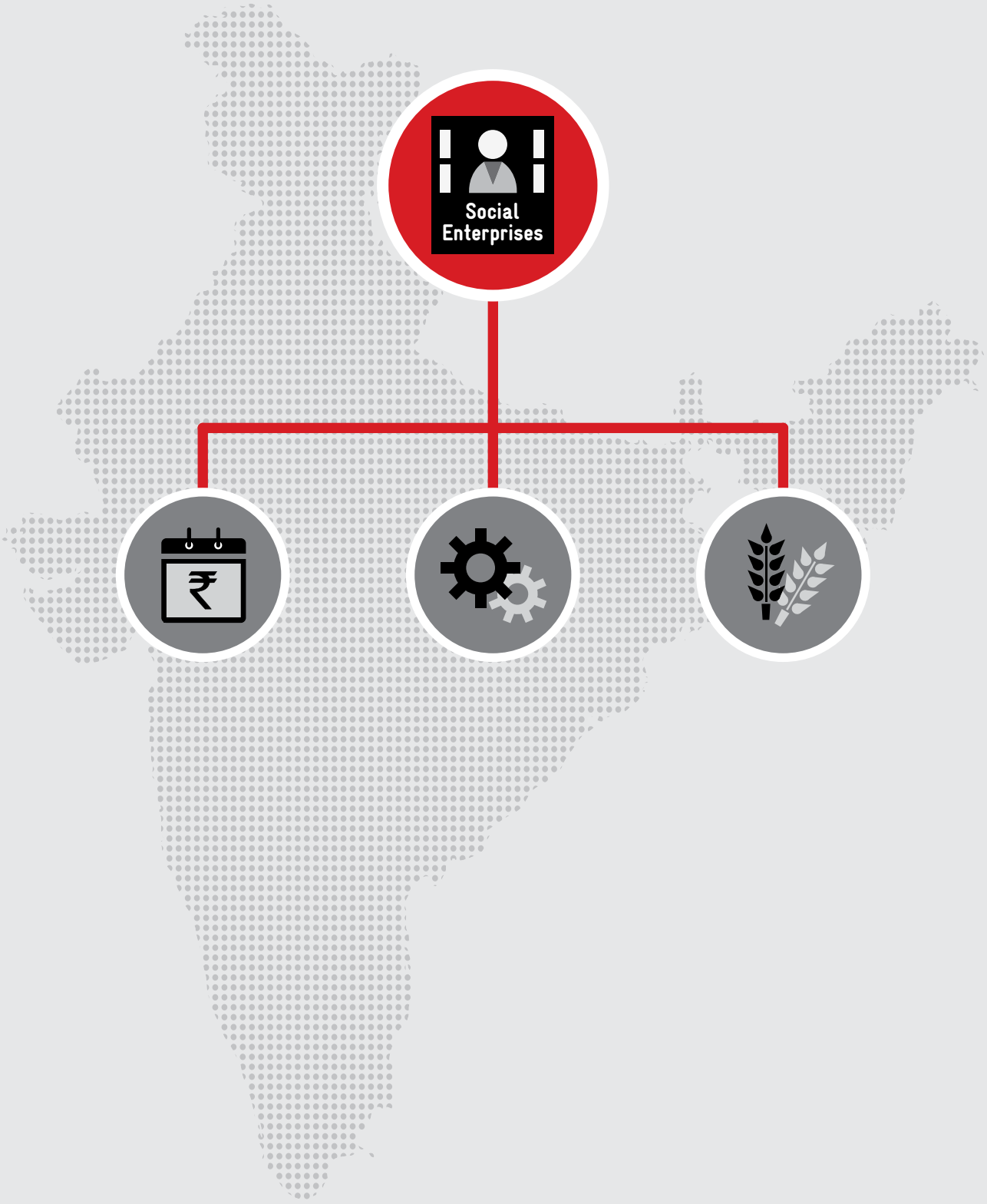
5 A Private Limited Company is an independent legal entity with between two and 50 shareholders who have limited liability in the company

6 Partnerships are owned by two or more person where at least one person has unlimited liability, and profits and decision-making authority are shared among the owners

7 A proprietorship is a business owned fully by a single person who has unlimited liability for the business, and sole control of profits and decision-making

8 Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)


Social
Enterprises
& MSME


Social
Enterprises

3 Social Enterprises and Access to Finance 'Beyond Equity': Demand-side Perspective

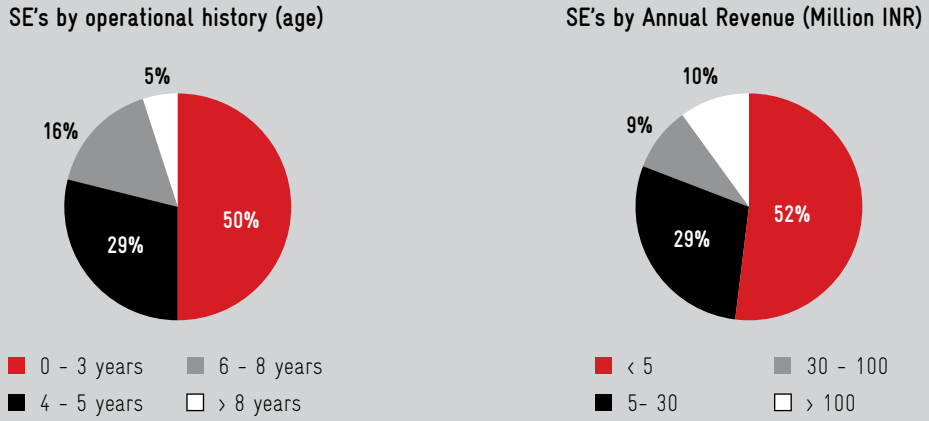
3.1 Landscape of Social Enterprises in India

As the previous analysis shows social enterprises are a very small subset of the larger MSME sector with its 29.8 million enterprises. As there is no official Social Enterprise Category, there is no formal database or census that tracks social enterprises. Hence, this study used the Sankalp Forum's database[9] to estimate the total number of social enterprises. As per the estimates across various stages there are ***approximately 7500 social enterprises***[10] in India.

3.1.1 Social enterprises by annual revenue and operational history

As per a World Bank definition of MSMEs, enterprises with annual sales between INR 0.5 to 150 million are termed as small enterprises. Hence, based on annual revenues,[11] the majority of social enterprises can be classified as ***"Small enterprises"***. As seen from Figure 4, 81% enterprises have revenues less than 30 million and would therefore fall in the lower end of the small enterprise spectrum. Social enterprises are very young enterprises with often less than 5 years of operational experience. It is also interesting to note that ***50% of these enterprises have less than 3 years*** of operations, the minimum years of operational experience required to qualify for loans from formal financial institutions such as banks.

Figure 4 Segmentation of social enterprises by revenues and age



Source: Intellecap Social Enterprise Landscape Survey, 2012

3.1.2 Social enterprises by stage of operations

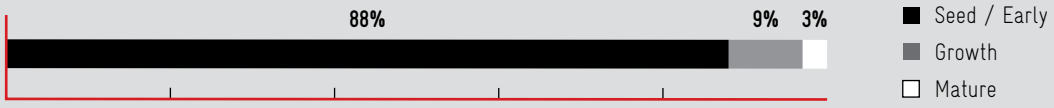
As the financing needs for enterprises vary across various stages of its evolution, social enterprises are further segmented into four stages namely seed, early, growth and mature. These stages are defined as follows:

- **Seed stage:** Enterprises which have a business idea but the operations are still in very early stages (pre-revenue)
- **Early stage:** Enterprises which have a business model and stabilized operations but negative EBITDA[12]
- **Growth Stage:** Enterprises which are in scale up mode and the company has stabilized operations with positive EBITDA
- **Mature Stage:** Enterprises which have stabilized at scale with positive EBITDA

As per the report, "On the path to sustainability and growth", Intellecap 2012:

- 88% of social enterprises (As seen in Figure 5) would qualify as seed stage or early stage enterprises while 9% would qualify as growth stage and 3% as matutre stage enterprises

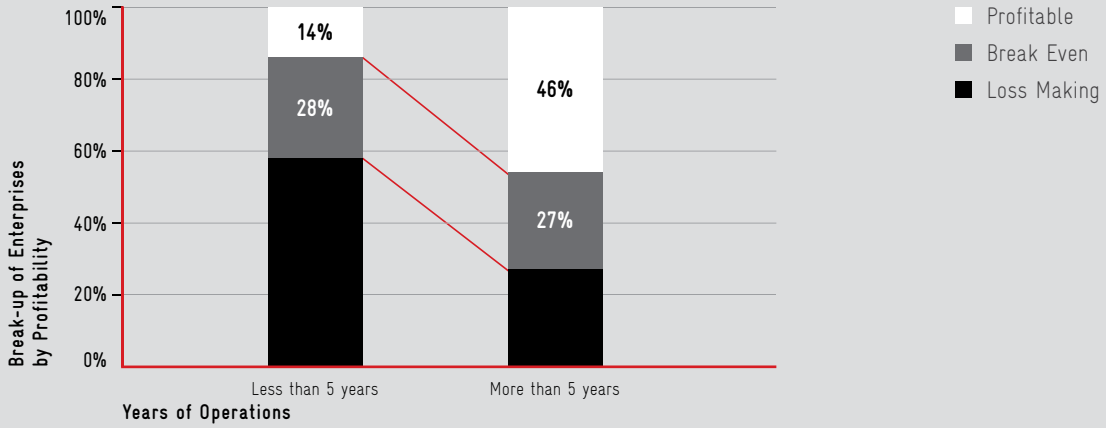
Figure 5 Segmentation of social enterprises by stage



Source: Intellecap Analysis and Sankalp social enterprise survey, 2012

- Further, Figure 6 highlights that while 14% of the social enterprises with 0-5 years of operations are profitable, the percentage of profitable enterprises shoots up to 46% in enterprises with more than 5 years of operations. Hence it can be concluded that ***gestation period (time taken for breaking even) for social enterprises is between 5-8 years.***

Figure 6 Profitability by years of operations

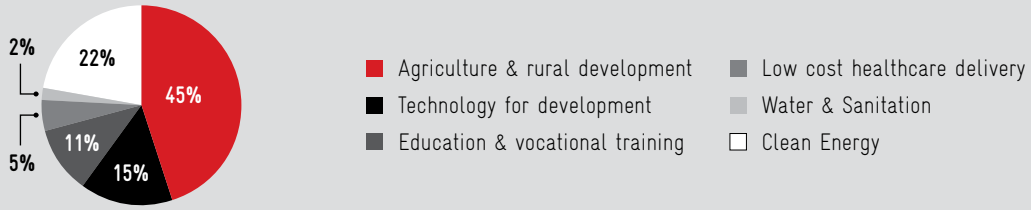


Source: Sankalp Forum Database of Enterprises, 2012

3.1.3 Social enterprises by sector

This report covers 6 sectors, namely (a) Agriculture & rural development (b) Technology for development (c) Education & vocational training (d) Low cost healthcare delivery (e) Water and sanitation and (f) Clean Energy. The majority of social enterprises from our sample are in Agriculture & rural development (45%) and Clean Energy (22%). Water and Sanitation (2%) and Low cost healthcare (5%)[13] are the sectors with the least number of enterprises (Refer to Figure 7). Apart from these 6 sectors this report briefly touches upon the financial inclusion sector. Though there are several other sectors such as affordable housing and rural tourism we have considered only the above mentioned six sectors for the purpose of this study. Hence the overall social enterprise debt requirement estimated in the report is primarily derived from these 6 key sectors.

Figure 7 Segmentation of social enterprises by sector

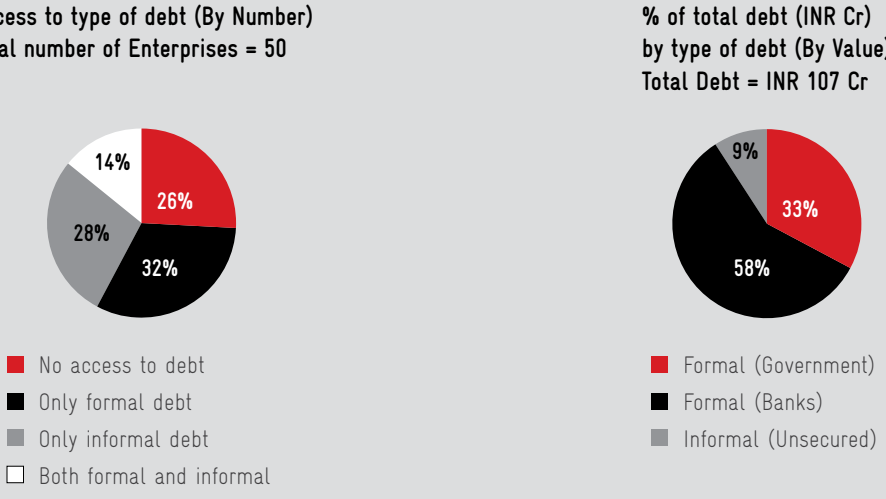


Source: Sankalp Forum Database of Enterprises, 2012(Intellecap Analysis)

3.2 Understanding the existing debt flow to social enterprises

The analysis of reports of 50 social enterprises highlights that 26% of enterprises have no access to any form of debt. Of the remaining enterprises, around 40% had access to informal unsecured debt from either directors or friends and family (Refer Figure 8). The quantum of funds raised through such informal sources though is low and ranges between INR 0.4-13 million per enterprise. Out of the total debt (INR 1.07 Billion) that these 50 enterprises had access to, only 9% (Refer Figure 8) was from informal sources.

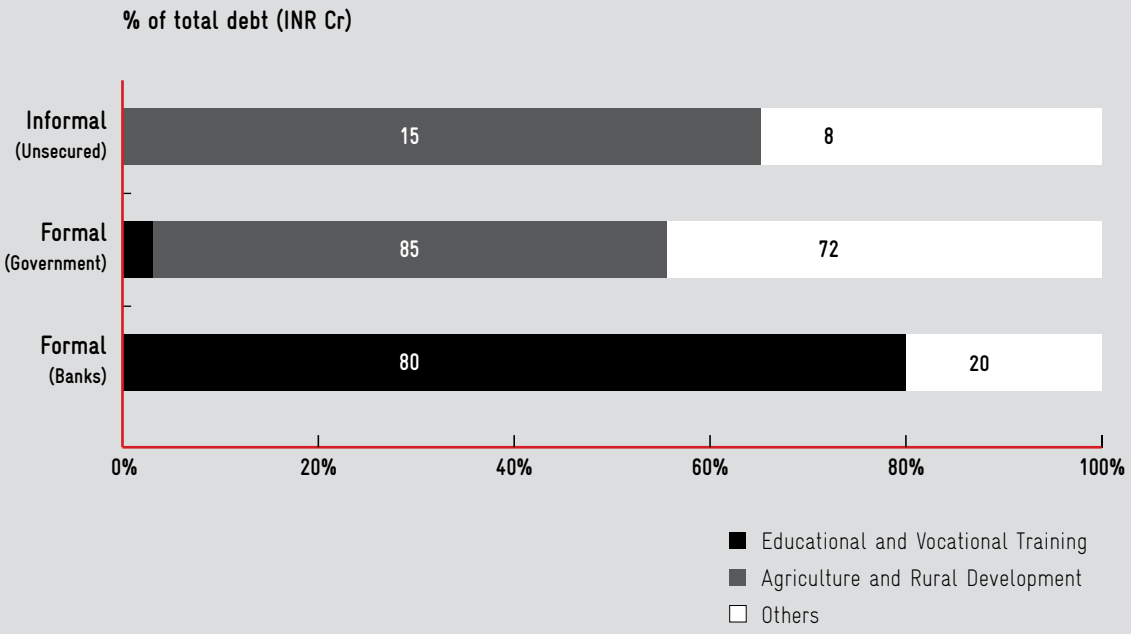
Figure 8 Types of debt accessed by social enterprises



Source: Intellecap Analysis

As mentioned above, despite the large number of informal loans, they are smaller in total quantum. This is both because of the small ticket size of informal loans and large contributions from either formal banks or from government schemes. This is especially true for the education and vocational training segment where the flow of debt via government channels is highest.

Figure 9 Debt split by sectors



Source: Intellecap Analysis

3.3 Financing needs of social enterprises

- **Methodology:** To understand the financing needs of social enterprises we have surveyed and interviewed 35 social enterprises (24 telephonic and in-person interviews, 11- social enterprise surveys). Out of the 35 enterprises 19 were in early-seed stage while the remaining 17 were in growth-mature stages. Due care was taken that enterprises across all the sectors were captured.
- **Primarily working capital needs:** As mentioned in the above section, the majority of social enterprises are asset-light, services-oriented businesses. Hence the financing needs for such enterprises are primarily for fulfilling working capital needs such as paying salaries, marketing, distribution, vendor payments among others. Most social enterprises, hence, need ***short-to-medium-term finance for addressing working capital needs.***

Since the financing needs for enterprises vary by stage, the following section of this report presents the debt need by enterprise growth stage.

3.3.1 Financing needs of early-seed stage enterprises

Early-seed stage enterprises depend on grants and angel-seed equity investments to fund operations; debt is secondary preference for early-seed stage enterprises.

Some key insights on how social enterprises in early-seed stage funded their operations in the past and how they plan to fund their operations in the future are presented below.

- **Grants and equity funded growth:** Post promoter's personal equity infusion, early-seed stage operations are fueled by funds raised through grants, winning business plan competitions followed by equity investments made by angel investors and incubators.
- **Limited access to debt:** Only 10% of the enterprises interviewed in early-seed stage had access to debt. Further, these enterprises accessed low cost debt from an incubator and a trust respectively and none of the enterprises had access to debt from banks and other formal sources. However, vocational training institutions in the early-seed stage did have access to debt from the government backed National Skills Development Corporation (NSDC).
- **Debt is a secondary preference:** Enterprises which raised some form of equity in the past are looking for a mix of both debt and equity to fund working capital needs, while enterprises which haven't raised equity investments in the past prefer equity over debt. Hence, debt is definitely a secondary preference for these enterprises.
- **Access to formal debt is challenging as most companies are not bankable:** Many enterprises in early-seed stage tried to access formal debt in the past but their loan applications got rejected either because of lack of collateral, negative cash flows or insufficient years of operations. As most formal banks and NBFCs look for stabilized cash flows and minimum of 3 years of operational history access to formal debt is a major challenge for early-seed stage enterprises.
- **Preference for blended equity:** Most early-seed stage enterprises find it challenging to have a fair valuation from the investors and hence prefer blended equity financing options such as convertible debentures and convertible preference shares that will help postpone valuation to a later date.

3.3.2 Financing needs of growth-mature stage enterprises

Enterprises in growth-mature stage primarily used equity to fund operations in the past; these enterprises clearly prefer debt over equity for future growth:

Some key insights on how social enterprises in growth-mature stage funded their operations in the past and how they plan to fund their operations in the future are presented below.

- **Equity-fueled growth:** Most enterprises in growth-mature stage had access to some form of equity in the past. Majority of the capital raised in the past for these enterprises has been through equity.
- **Access to debt limited:** Though many enterprises have accessed debt, amounts raised through debt were not adequate and access to debt was challenging. Enterprises accessed debt from various sources such as public sector banks; independent financial institutions such as SIDBI and NABARD; donor agencies (World Bank, IFC) and India based angel investors and venture capitalists.
- **Prefer of debt over equity:** Most enterprises in these stages prefer debt over equity or prefer a mix of both for financing their future financing needs. The requirement for capital is mostly for fulfilling working capital needs.
- **Lack of collateral as major challenge:** Lack of collateral is the biggest challenge that social enterprises face for accessing debt (Refer to case study below on a mature-stage enterprise). For instance one enterprise which was unable to raise unsecured loan under the national government's CGTMSE had to leverage upon multiple loans against the personal guarantee of the promoter to fulfill their working capital needs. Even schemes like CGTMSE[14] which are supposed to tackle the collateral challenge are unable to cater to the needs of social enterprises.

Box 1 | **Case study of an established, profitable and bankable clean energy enterprise which failed to access formal debt**

Social enterprises even in mature stage find it difficult to access debt. There is no better case than a mature stage clean energy company with over 10 years of operational experience, annual revenues of INR 150 million (USD 2.7 million) and positive cash flows which was unable to leverage formal debt to prove this fact. The company operates

in the sustainable energy space and acts as a system integrator in setting up solar home systems in rural India. The company needs finance to fulfill its working capital needs as there is a delay is receiving payments through government subsidies and from banks which lend to its customers.

To fulfill these working capital needs the company evaluated the option of raising debt but because the company had an asset light business model it was tough to raise secured loans from banks and as unsecured loans are expensive the company decided not to take them up. The only loan that the company had access to was a USD 1 million loan which the company raised from IFC. As debt was not accessible they decided to raise further rounds of equity to raise funds for expansion and over the last 10 years the company has raised multiple equity investments and in the process diluting 97% of promoter equity.

3.3.3 Challenges in accessing debt

Since most social enterprises find it challenging to access debt across growth stages, we asked some social enterprises to rank their biggest apprehensions or challenges for accessing debt. Here are the results of the short survey conducted:

1. **Lack of Collateral:** Lack of collateral was the topmost challenge that social enterprises faced while accessing debt
2. **High interest rates:** The second biggest concern for the enterprises was the high interest rates of commercial debt. Social enterprises are looking at lower interest debt (<10% interest per annum)
3. **Lack of access:** Lack of access was another big concern that social enterprises faced as they felt there was limited access for affordable unsecured loans in the market
4. **No flexibility in repayment cycles:** This was the least concern for social enterprises, only agriculture-based social enterprises rated non-flexibility in repayment cycles as their biggest challenge as they preferred having seasonal repayment cycles. For enterprises in other sectors, this was not a challenge.

The next section of this report estimates the demand for debt for social enterprises across various sectors and stages.

3.4 Demand for debt among social enterprises

This study aims to demonstrate that social enterprises could be treated a new target segment of financial institutions, largely ignored until now by the financial sector in spite of its social relevance. The following section presents the key findings of the estimation of demand for finance "beyond equity".

3.4.1 Approach and methodology used for estimating debt demand

Step 1: Segmentation of social enterprises by stage and sector:

In order to estimate debt demand across different stages and sectors, the first step was to estimate the total number of enterprises in each sector by stage

- Sankalp Forum's database of social enterprises was the base to segment the overall number of enterprises by sector. This study looks at 6 specific sectors.
- Data from Intellecap's Landscape survey of social enterprises (2012) was used to further segment enterprises by stage (based on revenues and profitability status of the enterprises)
- Given that Sankalp Forum does not cover all the enterprises in India, the following assumptions on coverage ratios by sector and stage were made:
    - Agriculture and rural development: Early: 5%, Growth: 20% and Mature: 50% (As Agriculture has been a traditional sector in the Indian economy it is possible that Sankalp's coverage might be lowest in this sector)

- Education and Vocational Training: Early: 20%, Growth: 50%, Mature 70% (Assumption is that Sankalp Forum's coverage in Education sector is high as the forum covers most enterprises funded by NSDC
- All other sectors: Early:10%, Growth: 30% and Mature 70% (For all other sectors are assumed to have coverage higher than Agriculture sector but lower than education sector)

Step 2: Estimating demand for debt across various sectors and stages

The second task was to estimate the average debt per enterprise in each sector by stage of enterprise. This was achieved by the following process:

- First analyzing the annual reports of 7-10 companies in each sector to derive average current debt to equity ratios across sectors
- Interviews with social enterprises, social venture capitalists and bankers and analyzing leverage ratios (debt to equity ratios) of listed companies in various sectors to derive most representative leverage ratio by the stage of enterprise
- Based on the steps mentioned above the following leverage ratios were assumed by enterprise stage to derive the average debt need per enterprise based on current equity
    - Early (1:3), Growth (1:1), Mature (1:1) for all sectors except agriculture
    - Early (1:2), Growth (2:1), Mature (3:1) for enterprises in agriculture sector

(For agriculture businesses a higher leverage ratio was assumed for two reasons (a) agriculture businesses act as manufacturing businesses which need higher working capital for buying raw materials and (b) as the businesses generate finished products, stocks can be hypothecated to provide loan and hence can leverage more debt when compared to other social enterprises that are asset-light services companies)

- The current equity of the enterprises was multiplied with the representative leverage ratio to derive debt need per enterprise
- After deriving debt requirements by applying leverage ratios, we triangulated the findings by interviewing
- 4-5 social enterprises in each sector and also validated the findings by interacting with social venture capital firms and other players from the supply side.

Step 3: Estimating overall debt demand and segmentation by product type

- Multiplying the average debt per enterprise by the total number of enterprises in that segment gives the estimated aggregate debt demand per stage
- To further segment the demand by product type (short term v/s long term loans), the following process was followed
    - Analyzing the business models of 40-50 enterprises in each sector to classify them as either asset-light or relatively asset-heavy companies
    - Based on multiple interviews, establishing the following aggregate assumptions: Asset-light companies would need 85% of capital for working capital while relatively asset-heavy companies would need 60% for working capital and remaining 40% for capital expenditure

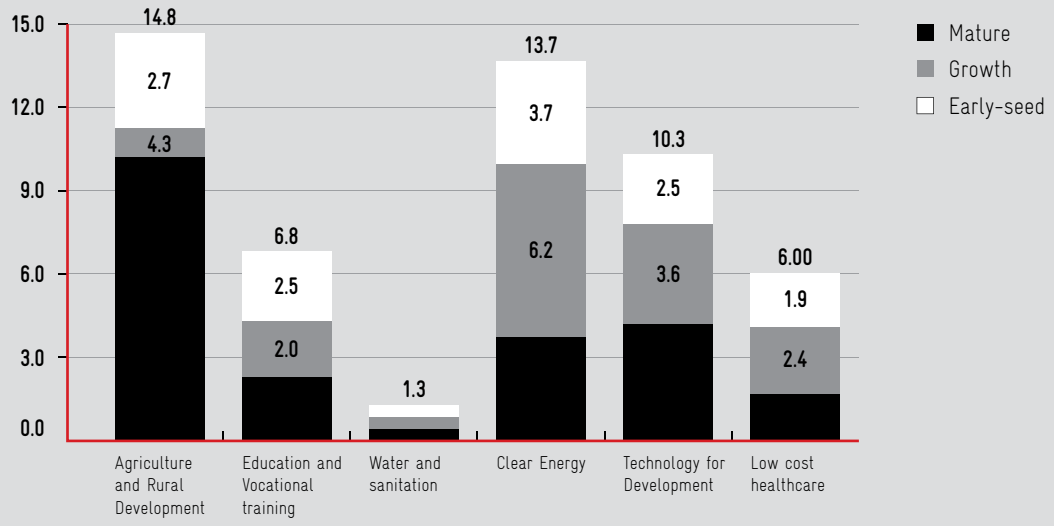
Other sector specific assumptions:

- **Agriculture and rural development:** The agriculture sector has access to debt from both public and private sector banks. Hence, the overall debt need in the sector has been discounted by assuming that 20% of early, 40% of growth and 60% of mature stage companies have access to debt and don't need debt in the immediate future
- **Education and Vocational training:** As vocational training institutions have access to debt from NSDC the assumption is that 50% of vocational training companies have access to debt and don't need additional debt in the near future.

3.4.2 Overall debt demand by social enterprises in India

Using the above mentioned approach and methodology, this study estimates the overall demand for debt in the social enterprise sector. As per the analysis, ***the sector needs approximately INR 53 billion or USD 960 million as debt in the immediate future.***

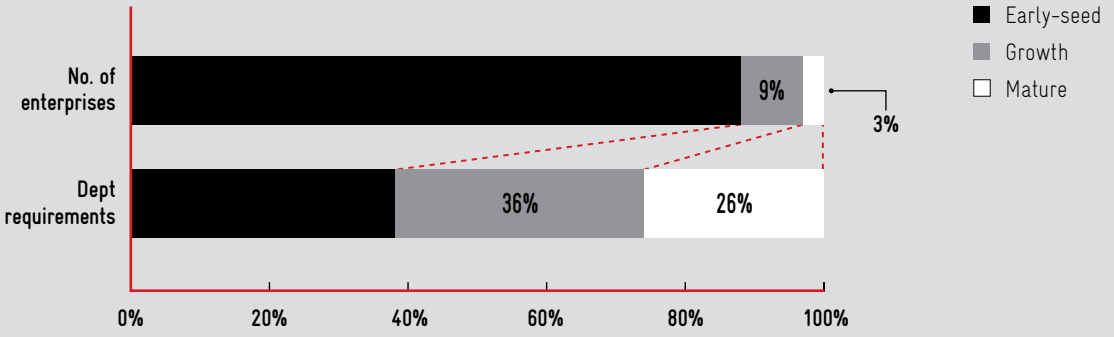
Figure 10 Segmentation of debt by sector and stage (INR Billion)



Source: Intellecap Analysis

- While most companies (88%) (Refer to Figure 11) are in early stages, demand for debt from such companies contributes to only 38% of the overall debt demand. Enterprises in early-seed stages prefer equity over debt and hence the debt requirement per enterprise is much lower in these stages.

Figure 11 Debt demand by stage of enterprise



Source: Intellecap Analysis

- Clean energy, technology for development and agriculture and rural development sectors contribute to approx. 73% of the overall debt demand

Figure 12 Debt demand by sector

Source: Intellecap Analysis

- Type of demand (Short term working capital v/s long term capital expenditure):
  - The debt requirement of social enterprises is ***majorly (78%) for fulfilling short-to-medium-term working capital requirement***, while only 22% of the overall debt demand is for fulfilling medium-to-long-term capital expenditure needs.
  - Of the 6 sectors, agriculture and rural development (27%), clean energy (25%) and affordable healthcare (23%) are the top sectors which contribute to the overall long term capital expenditure debt demand

In the immediate future there is a need of INR 53 billion or USD 960 million of debt in the social enterprise sector of which 78% of the debt demand is for fulfilling short-medium term working capital loans. Most of the debt demand is in growth-mature stage enterprises.

3.4.3 Debt demand by sector

AGRICULTURE AND RURAL DEVELOPMENT

Historically, the Indian economy is predominantly dependent on agriculture. Even today, the sector supports an estimated 70% of the country's population, and accounts for 14% of the country's Gross Domestic Product (GDP).[15] Over the years, the sector's contribution to GDP has been decreasing while on the flipside, a fast-growing population has ensured a rapidly-increasing domestic demand for food. In the last few years, the sector has seen a number of positive developments such as adoption of advanced technology, increase in private sector investments, improved inputs (such as seeds and fertilizers) and increased access to information on farm prices and weather conditions. The sector has also seen an increase in access to credit as the government implemented and distributed over 107.8 million Kisan Credit cards for providing timely access to credit for farmers, and established a fund of INR 50 billion (US$ 921 million) through NABARD to finance the construction of warehouses and cold storage units. The sector ranked the highest in terms of attracting capital in the form of debt. Key contributors to this trend are the Priority Sector Lending (PSL) norms specified by the RBI and the manufacturing nature of some the agri-businesses. The study estimates a need for INR 14.79 billion of additional debt for the sector in the near future.

Box 2	Government Support Scheme: National Mission on Food Processing (NMFP)
Role / Mission	The main objectives of the scheme are to increase the level of processing, reduce wastage, add value, enhance the income of farmers and increase exports, thereby resulting in overall development of the food processing sector. The scheme envisages extension of financial assistance towards setting up of new food processing units as well as technological up-gradation and expansion of existing units in the country.
Support to Private Sector	**Financial Support:** The scheme envisages financial assistance to food processing units in the form of grant-in-aid @ 25% of the cost of plant and machinery and technical civil works subject to a maximum of INR 5 million in general areas and @ 33.33% subject to maximum of INR 75 million in difficult areas such as Jammu & Kashmir, Himachal Pradesh, Uttarakhand, Sikkim and North Eastern States, Andaman and Nicobar Islands, Lakshadweep and Integrated Tribal Development Project (ITDP) areas. Government / NGOs / Private Sector Organizations are all eligible for the scheme.

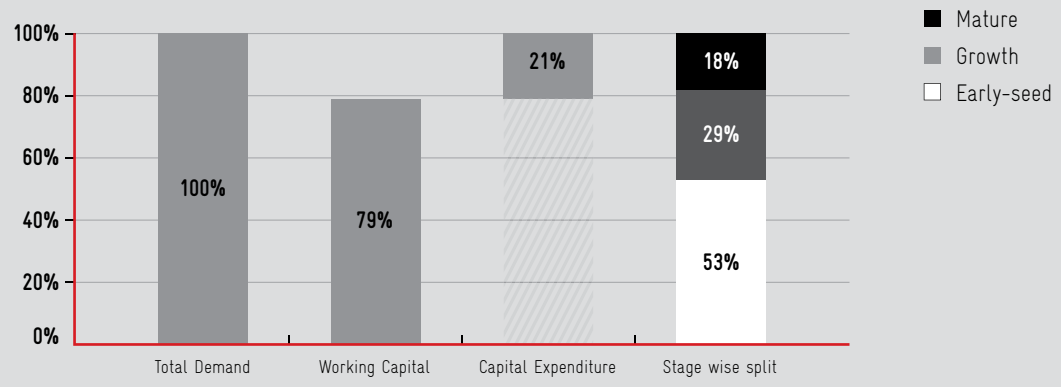
Type of enterprises covered:

The sector has a mix of both services and manufacturing companies. Majority of the social enterprises in agriculture and rural development space are service-oriented companies as they provide services such as capacity building, fair trade and market-linkages. Some of the enterprises in the sector are manufacturing companies such as e.g. a dairy company.

Specific sources of debt for the Agricultural and Rural Development Sector:

This sector has access to loans from both private sector and public sector banks due to the PSL norms. NABARD through Regional Rural Banks (RRB) and other regional banks extends financial support to agriculture-based companies as well. Even fair trade companies qualify under PSL in the small business lending segment. Hence, while estimating the debt gap in the sector we have discounted the availability of debt in the sector by assuming that 20% of early, 40% of growth and 60% of mature stage enterprises had access to debt and don't need additional debt in the immediate future.

Figure 13 Segmentation of debt demand in agriculture and rural development sector



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- Out of the addition debt required in the near future (INR 14.79 billion), 79% of the need is for
- addressing working capital needs while 21% of the debt need is for addressing capital expenditure needs.
- Around 53% of the debt demand is from early stage enterprises, but the average debt requirement per enterprise in early stage is INR 3 million while that in the growth and mature stages are INR 24 million and INR 85 million respectively.
- The agricultural sector can accommodate several for-profit legal structures such as producer companies and cooperative societies that cannot access equity and hence are solely dependent on debt. Social enterprises in agriculture space adapt ***hybrid legal structures*** e.g. a company may have a cooperative society arm, producer company arm and private limited company arm to access various forms of capital such as grants, soft loans, equity and commercial debt.

Box 3 | **Case study of a growth stage agriculture enterprise that used multiple legal entities approach for accessing various forms of capital**

One of the surveyed enterprises is a producer company with over 2500 individual producers. Individual producers raised capital to buy the equipment through government schemes. The producer company, in which every individual producer is a stakeholder, provides the much needed technical support and negotiation power for the individual producers while buying raw materials and selling finished goods. The company also brings in access to debt for fulfilling the working capital requirements since banks like NABARD and other private limited banks are more willing to lend to collective models such as producer companies and cooperatives. Moreover, the company is also a stakeholder in a private limited entity which acts as the marketing and sales arm for their products. The private limited arm provides access to other forms of capital such as pure equity and convertible debentures. Hence, by taking an ecosystem approach, the enterprise was able to access various forms of capital.

- Social enterprises in the sector which are more services-oriented still find collateral as the major challenge. Social enterprises focusing on manufacturing, find non-flexibility in payment terms (some of them prefer season repayments) and high interest rates as the top challenges while accessing debt.

Non-financing challenges:

- Changing existing farm practices are challenging and hence enterprises that are focused on providing capacity building and extension services find it difficult to scale sustainably. These enterprises have not yet established their revenue models and have low potential for growth.
- Inadequate infrastructure and fragmented supply chains is another major challenge for enterprises that are focused on processing and other value additions post-harvest.
- As farm sizes are small in India, organizing farmers becomes challenging especially for enterprises that are focused on procuring and distributing organic goods. Though the demand for organic food is increasing, convincing farmers and farmer groups to adopt organic practices is still a major challenge for such enterprises.

Conclusion:

Agriculture and rural development sector have greater access to debt capital when compared to other sectors studied. Policy and regulatory support from the government has been one reason for the

availability of debt capital for such companies. Despite all the policy support there is still unmet debt demand in the sector. Enterprises involved in food processing and food packaging have a great growth potential and the newly introduced Foreign Direct Investment (FDI) in retail might have a positive impact on this segment.

EDUCATION AND VOCATIONAL TRAINING

Half the Indian population is under 25 years of age and providing access to quality education is one of the major challenges that the country faces today. The Government has recognized this as an urgent need and has taken several steps such as the introduction of the Right to Education (RTE) act (where it mandates schools to reserve 25% of its seats for poor students) and increases in the budget allocation for the sector (USD 61 billion or 3.3% of the GDP in 2012-13 from 2.59% in 2007-08).[16] Education as a sector is primarily regulated by the Government and it mandates that only educational trusts or non-profit entities can run schools (K-12[17]) and colleges (for higher education). The government programs such as RTE Act and the Sarva Shiksha Abhiyan have increased the enrollment level in schools and as of September 2012, 0.33 million new primary schools have been opened and 1.25 million teachers were appointed under these schemes.[18] For-profit social enterprises have played a major role especially in creative innovative pedagogy, supplementary post school education and pre-school education.

This study estimates that enterprises in the education and vocational training sector need **INR 6.8 billion** of additional debt in the near future. As the sector is completely services-oriented, the need for capital is primarily for addressing working capital needs. **Vocational training institutions have access to debt** from the National Skill Development Council, a national government agency mandated to promote skill development and business-based approaches.

Box 4	Government Support Scheme: National Skills Development Corporation (NSDC)
Role	• The NSDC aims to facilitate or catalyze initiatives that can potentially have a multiplier effect as opposed to being an actual operator in the vocational education space. In doing so, it strives to involve the industry in all aspects of skill development. The approach will be to develop partnerships with multiple stakeholders and build on current efforts, rather than undertaking too many initiatives directly or duplicating efforts currently underway
Support to Private Sector	• **Funding and incentivizing** involves financing either through loans or equity, providing grants and supporting financial incentives to select private sector initiatives to improve financial viability through tax breaks etc. Through this support, the NSDC aspires to create strong viable business models and reduce its grant-making role. • **Enabling support services:** NSDC aims to provide inputs or support services such as curriculum, faculty and their training, standards and quality assurance, technology platforms, student placement mechanisms and so on. • **Private Sector Engagement:** NSDC will proactively seed and provide momentum for large scale participation by private players in skill development. NSDC will identify critical skill groups, develop models for skill development and attract potential private players and provide support to these efforts.

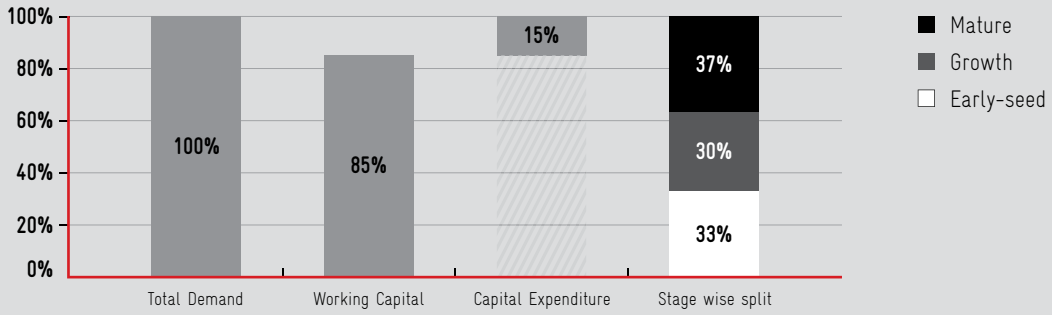
Type of enterprises covered:

The sector is primarily services oriented with most enterprises working in the space of pedagogy development, pre-school setups, post school supplementary education and vocational training. As per government regulations only non-profit structures or educational trusts can run schools or educational institutions in primary and secondary education space (K-12). Hence as part of this study we have only looked at for-profit social enterprises which operate beyond the K-12 space or provide services in the K-12 space.

Specific sources of debt for the Education and Vocational Training Sector:

For education, service providers such as pre-school education providers, supplementary education providers or other pedagogy developers, the access to debt is either limited or doesn't exist. On the other hand, the central government through NSDC has been trying to promote sustainable models in the vocational training or job-skill development space by providing access to debt and equity investments. Hence, while estimating debt need in the sector, the assumption is that 50% of the vocational training institutions have already accessed debt through NSDC and hence do not need additional capital in the immediate future.

Figure 14 Segmentation of debt demand in education and vocational training sector



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- The sector needs INR 6.8 billion of additional capital in form of debt in the near future. Out of this 85% of the debt need is for addressing working capital needs such as paying salaries, vendor payments and marketing costs (Refer Figure 14).
- The need for debt is higher in the growth-mature stages (67%). The average debt requirement is approximately INR 3.7 million, INR 30 million and INR 75 million for early, growth and mature-stage enterprises respectively.
- Social enterprises in the sector that are asset-light services companies find lack of collateral as a major challenge. Educational service providers hence find it extremely challenging to access low cost unsecured loans.

Non-financing challenges:

- Finding quality teachers is one of the major challenges which social enterprises face, especially enterprises which provide supplementary post-school education.
- Some technology-based enterprises in the sector count the Government as one of its major clients; due to administrative procedures recovering money from governments requires more time, creating a major need for working capital.
- Post-implementation of the RTE, schools now provide free education for 25% of its students, which is impacting their sustainability. In this scenario, schools are cutting costs by compromising on expenditure on innovative teaching solutions from service providers. This in turn might impact the revenues of social enterprises which are working in this space.

Conclusion:

With the exception of vocational training institutions, the sector has received limited debt from financial institutions. There is a great demand for high quality affordable education and with limited trained teachers in the country, technology is expected to play a major role. At the same time it is not very clear how the newly introduced RTE act will impact the growth of education technology and service

providers in the near future. Vocational training institutions might look to focus on low income states and states with most dropout rates as there would be a great need for employment skills development in those states. Overall, enterprises in the sector have not scaled to an extent that they have to and are currently operational only in few major cities.

WATER AND SANITATION

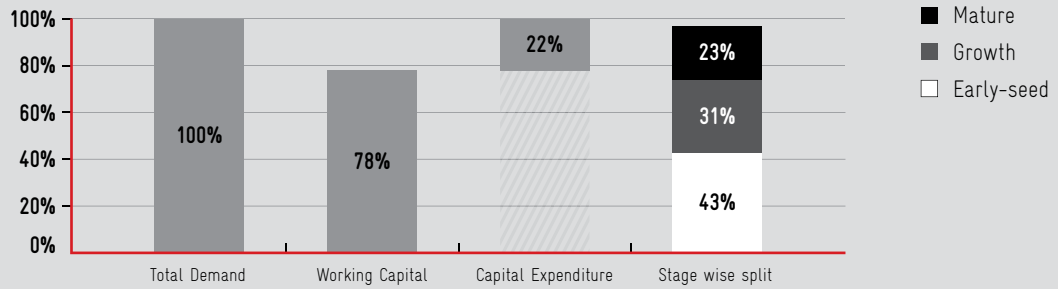
Water and sanitation services have traditionally been considered as the Government's responsibility. However, the penetration of these services has been low. As per the 2011 census, over 66% of the households had a telephone, only 50% of households had a basic toilet and 33% of the households had access to safe drinking water. 60% of India still defecates in the open.[19] The lack of proper sanitation facilities leads to diseases such as diarrhea, which, in turn, increases the healthcare costs of poor households. The lack of proper sanitation facilities led to an annual loss of USD 53 billion[20] to the nation; most of these losses are related to health. Social enterprises in the water and sanitation space are quite nascent and their path to scale is yet to be ascertained.

This study estimates that enterprises in the water and sanitation sector require INR 1.27 billion of additional debt in the near future. There is limited or no access to debt in this sector and neither are there specific policy measures that infuse debt into the sector.

Type of enterprises covered:

In India, the water and sanitation services are generally provided by local governments or by non-profits that operate in the space. Overall, there are very few enterprises that have adapted a for-profit structure for providing water and sanitation services and hence, the overall debt demand in the water and sanitation space is lower when compared to other sectors. In terms of the business models adopted, there are several business models ranging from community water providers and distributors of affordable water solutions to affordable toilet providers. The sector is primarily services-oriented.

Figure 15 Segmentation of debt demand in education and vocational training sector



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- The sector needs INR 1.27 billion of additional capital in the form of debt in the near future. Out of this 78% of the debt need is for addressing working capital needs such as paying salaries and vendor payments and the remaining 22% is for fulfilling capital expenditure needs such as investing in water purification plants and community toilets.
- The need for debt is evenly distributed across all stages. The average debt requirement in the early stage is approximately INR 3.5 million, growth stage is INR 20 million and mature stage is INR 55 million.[21]

- Similar to the challenges faced by every services company, lack of collateral is the major challenfor accessing debt.

Non-financing challenges:

- Since provision of water and sanitation is considered to be the duty of the government, convincing individual customers to pay for such services is a major challenge for such enterprises; especially enterprises operating in the sanitation and waste management space.
- Lack of customer awareness about the need for better sanitation facilities and the need for safe drinking water is another big challenge that these enterprises face.

Conclusion:

The government and NGOs have been the biggest players in the Water and Sanitation sector and for-profit social enterprises in this space are still in nascent stages. Enterprises that have either the government as a client or other businesses as clients have performed well as compared to enterprises that depend on the end customer for payments/ revenue generation. The sector is still in nascent stage and though there is a great need, limited customer awareness and willingness to pay impacts its growth potential.

CLEAN ENERGY

India is an energy-deficient country with its share in the global energy consumption at 4.2%,[22] as compared to its 17.5% share in the global population. Though the installed capacity of power has been steadily increasing, access to energy has been the poorest in remote rural areas in India - only 56%[23] of the overall rural households are currently electrified. Even in areas that are electrified, lack of reliable power adversely affects the productivity of small and medium industries and farmers. Though traditionally India has been focused on conventional energy sources, the focus on renewable energy has increased over the past decade in the period of 2007-11 the installed capacity of renewable energy increased by 2.5 times. 97% of this installed capacity is grid-interactive, with only 3% of the installed capacity being off-grid. The private sector, through subsidies received from the Government, has played a major role in providing energy in off-grid remote rural areas through products such as solar lanterns or by setting up power generation plants such as bio-mass or solar based mini-grid plants. Overall the clean energy sector in the country received great support from the Government through schemes such as the Jawaharlal Nehru National Solar Mission (JNNSM) which gave financial support to private players for spreading the reach of renewable energy in the country. Under the JNNSM, RRBs were able to access an exclusive refinancing facility from NABARD that provided capital at 2%. RRBs used this facility to provide financing for solar home systems. However, NABARD discontinued this refinancing facility in early 2012.

Clean energy (22% of overall enterprises) is one of the largest sectors second only to agriculture and rural development (45%). The enterprises in the clean energy sector need ***INR 13.6 billion*** of additional debt in the near future and contribute to approximately 26% of the overall debt demand for social enterprises. The sector has grown with the support of subsidy from the Ministry of New and Renewable Energy (MNRE) over the past few decades but there is limited or no access to formal debt in the sector.

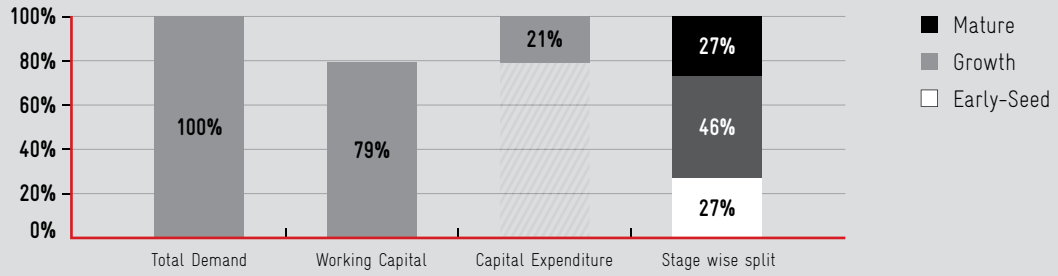
Box 5	Government Support Scheme : The Jawaharlal Nehru National Solar Mission (JNNSM)
Role / Mission	The objective of the National Solar Mission is to establish India as a global leader in solar energy, by creating the policy conditions for its diffusion across the country as quickly as possible. The immediate aim of the Mission is to focus on setting up an enabling environment for solar technology penetration in the country, both at a centralized and decentralized level.

Support to Private Sector	Under Phase 2 of the JNNSM, the Government of India plans to install 750 MW of solar energy capacity. To enable private sector engagement, the Government plans to provide Viability Gap Funding (VGF) for project installment. Currently the Government provides VGF up to either 30% of project cost or INR 25 million per MW whichever is lower. In Phase 2, the Government also plans to promote local manufacturing of solar parts by mandating that a certain percentage of the overall capacity be built using domestically manufactured content. JNNSM Phase 1 played a major role in promoting the renewable energy mission of the country by providing subsidies and VGF but untimely payments and politics over project allocation have impacted the program.

Type of enterprises covered:

Most social enterprises in the clean energy space act as system integrators or distributors of clean energy products and hence the need for finance is majorly for addressing working capital needs. Some enterprises are involved in power generation such as off grid bio mass generation or off-grid solar power generation which need long term capital for expansion. The government subsidy plays a major role in most business models and hence the delays in recovering subsidy from the government create cash crunch and increases short term working capital needs for the enterprises.

Figure 16 Segmentation of debt demand in clean energy sector



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- The clean energy sector **contributes to 25% of the overall long term debt demand** for capital expenditure needs among social enterprises. The sector needs **INR 13.6 billion** of additional capital in the form of debt in the near future. Out of this, 79% of the debt need is for addressing working capital needs, while the remaining 21% is for fulfilling capital expenditure needs such setting up off-grid bio mass or solar energy plants (Refer Figure 16).
- The need for debt is higher in the growth-mature stages (73%). The average debt requirement in early stage is approximately INR 2.6 million, growth stage is INR 35 million and mature stage is INR 70 million.
- Mirroring every other services company, **lack of collateral** is the major challenge for accessing debt. Even companies that are generating assets such as off-grid energy plants are not able to access debt from formal financial institutions as the assets are considered as assets that cannot be easily liquidated by the banks.

Non-financing challenges:

- Barring a few social enterprises that operate in the business-to-business (B2B) segment, most social enterprises directly deal with the end customer and finding reliable sources for consumer financing is a major challenge that these social enterprises face.
- Lack of trained manpower especially for handling post-sales servicing and maintenance is another challenge which impacts the scale of social enterprises.
- Difficulty in finding the right village-level entrepreneur to take up the franchise for selling products and services is another hurdle which many enterprises are facing.
- Lack of customer awareness of the benefits of such products is another major challenge for enterprises operating in remote villages.

Conclusion:

Social enterprises in the clean energy space are taking the various challenges head-on and are acting as catalysts for improving the access to energy in the country. Enterprises in the sector are still figuring out a way to sustain their operations without depending on government subsidies and external donor grants. Grant funding over the years has shifted to Low Income States and it will definitely increase the social enterprise presence in these states. Enterprises that are focusing on both big business and direct consumers as clients are expected to be more sustainable in the longer term. The impact of the recently launched JNNSM Phase 2 program on these social enterprises is as yet to be ascertained.

LOW COST HEALTHCARE DELIVERY

Affordable healthcare is another major social challenge that the country faces. The Government spend on healthcare has been low, estimated at around 4% of GDP, compared to the global average of 9.7% of GDP.[24] Healthcare delivery penetration is also low as the country currently has 0.6 doctors for 1000 population when compared to a global average of 1.23 per 1000 doctors[25]. The healthcare delivery is majorly concentrated in urban areas especially the major cities and that leaves majority with limited or no access to quality healthcare delivery. The government has launched several programs such as the National Rural Healthcare Mission (NRHM) to strengthen the public healthcare systems across the country but there is still a huge gap left for private players to fill and some social enterprises have taken the right steps in this direction by setting up healthcare delivery centers in Tier-2 and Tier-3 cities.

As per our estimates, the enterprises in the affordable health sector need INR 6 billion of additional debt in the near future and contribute to approximately 23% of the overall debt demand for long term capital expenditure loans among social enterprises. The sector has limited or no access to debt and does not have any benefits from government programs as well.

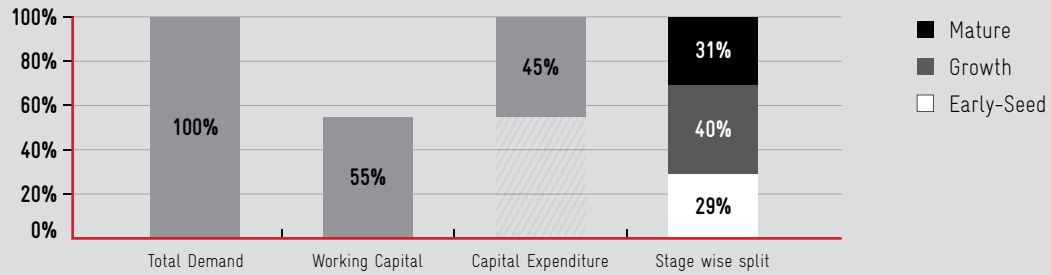
Box 6	Government Support Scheme : Small Business Innovation Research Initiative (SBIRI) – Department of Biotechnology
Role / Mission	The scheme will provide early stage funding to able scientists in private industries for high risk, innovative and/or commercialized product proposals. The SBIRI aims to: • Strengthen existing private industrial units • Create opportunities for starting new technology-based or knowledge-based businesses byscience entrepreneurs • Stimulate technological innovation and product commercialization • Use private industries as a source of innovation and enhance greater public-private partnerships, and • Increase product development and commercialization in public-private sector derived from Government funded R&D projects

Support to Private Sector	SBIRI provides support to early stage technology based startup enterprises in two phases. **SBIRI Phase – I:** The funding in this stage will be provided for highly innovative, early stage, pre-proof-of-concept research. Preference will be given to proposals that address important national and social needs **SBIRI Phase – II:** The funding in this stage will be provided for development and commercialization of available innovative research leads. Projects wherein proof-of-concept is already established with R&D institution or R&D unit of the industry could be eligible for direct

Type of enterprises covered:

Typically, low cost healthcare delivery is provided either with the aid of technology or by setting up primary or secondary healthcare centers in low income communities in large or secondary cities and towns. The technology based healthcare delivery models such as tele-medicine and medication through video conferencing are asset-light service models when compared to secondary healthcare centers which are relatively asset-heavy. There are some social enterprises that are involved in developing low-cost diagnosis devices as well. Overall, in the sector, 35% of the enterprises are relatively asset-heavy models while the remaining 65% of the enterprises are asset-light services-oriented businesses.

Figure 17 **Segmentation of debt demand in low cost healthcare delivery sector**



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- The sector needs INR 6 billion of additional capital in form of debt in the near future. Out of this 55% of the debt need is for addressing short term working capital needs and the remaining 45% is for fulfilling long term capital expenditure needs such as setting up secondary healthcare centers in tier 2 cities.
- The need for debt is higher in the growth-and-mature stages (71%). The average debt requirement in early stage is approximately INR 5.5 million, growth stage is INR 60 million and mature stage is INR 160 million. The average debt requirement per enterprise in the affordable healthcare sector is the highest when compared to social enterprises in other sectors.
- Low cost healthcare delivery sector contributes to 23% of the overall long term debt demand for capital expenditure needs among social enterprises. Though social enterprises do not invest in fixed assets such as buildings they have significant capital needs for payment of advance on leasing premises and setting up medical equipment.
- Similar to every services-oriented sector, lack of collateral is the major challenge for accessing debt. The companies generate limited assets in the form of medical equipment that can be liquidated.

Box 7 | **Case study of an early stage healthcare enterprise that was able to leverage various sources of financing with support from incubator and other enabling organization**

An early stage social enterprise which is into the business of developing and selling low cost medical equipment was able to access various sources of financing with the support from its incubator and other enabling organizations such as Echoing Green. The enterprise needed patient capital during its initial product development phase and the incubator (CIIE, Ahmedabad) provided long-term patient debt with very low interest rates and moratorium period of 1.5-2 years. The enterprise also received grant money of USD 90,000 from Echoing Green Fellowship program. Post product development phase, the enterprise, with the support of the incubator, was able to raise equity investments from angel investors and venture capital firms that helped improve its market access to sell medical equipment.

The support system that the incubator and the fellowship program provided helped the enterprise scale and even for future funding needs, the entrepreneur plans to use a mix of grants, debt and equity to fuel the growth of the organization.

Non-financing challenges:

- Providing affordable healthcare requires lower cost structures and hence scaling up enterprises with limited capital costs and overheads is a major challenge that these enterprises face.
- Attracting qualified doctors and other staff is also a big challenge, as these enterprises typically scale up in smaller towns.
- Lack of customer awareness about healthcare practices is another challenge that healthcare enterprises face as they scale to rural parts of the country. Building customer awareness through low-cost innovative marketing campaigns is required.
- As the penetration of medical insurance is low and customers have to depend on out-of-pocket payments for availing healthcare, it makes healthcare unaffordable to the poor - the target market for most social enterprises.

Conclusion:

Social enterprises in this segment attract only a limited amount of debt. However, the healthcare sector has huge potential for growth, with the success of a few companies in the sector triggering more debt funding in the near future. Low-cost hospitals in urban areas and tele-medicine services in rural India have the highest potential for scale. While small clinics in urban areas are still in their nascent stage, it will be interesting to see what impact the newly introduced National Urban Healthcare Mission (NUHM) would have on these social enterprises. Overall, social enterprises are expected to play an important role in the growth of the healthcare sector.

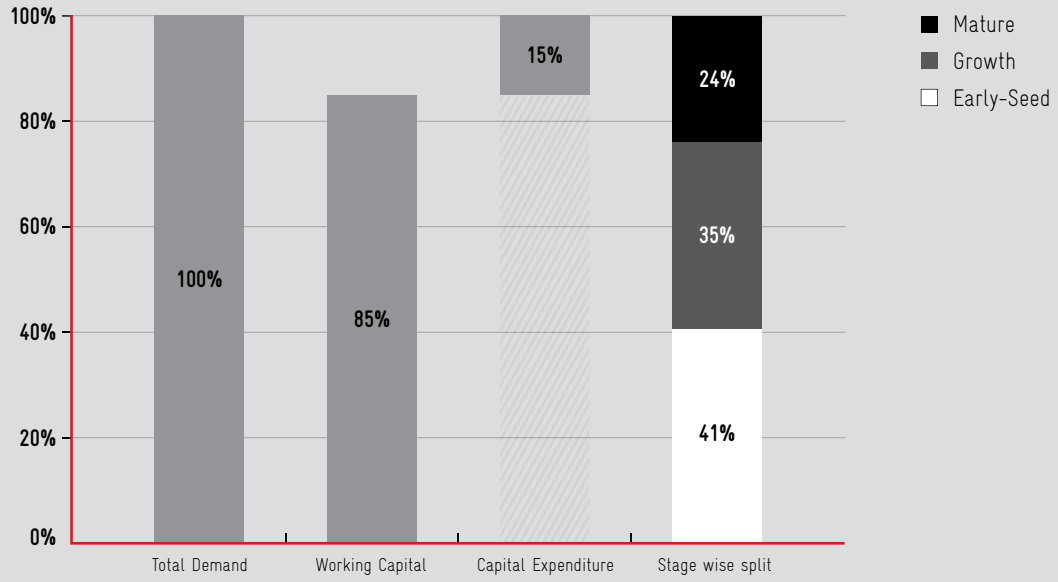
TECHNOLOGY FOR DEVELOPMENT

The enterprises in the technology for development sector need **INR 10.3 billion** of additional debt in the near future and contribute to approximately 20% of the overall debt demand for social enterprises. The sector has limited or no access to debt and does not have the benefits from government programs as well. Some enterprises have support from industry bodies such as The National Association of Software and Services Companies (NASSCOM).

Type of enterprises covered:

Technology for development includes enterprises providing technology-based solutions at the bottom of the pyramid (BoP) across sectors. This includes enterprises ranging from a rural BPO center and a job portal for low-skilled workers to several technology companies providing essential information such as weather reports, health tips and educational content. The sector is completely services-oriented and has enterprises that operate on asset-light business models.

Figure 18 Segmentation of debt demand in technology for development sector



Source: Intellecap Analysis

Debt gap and challenges for accessing debt:

- The sector requires **INR 10.3 billion** of additional capital in the form of debt in the near future. Out of this 85% of the debt need is for addressing short-term working capital needs.
- The need for debt is uniform across various stages. The average debt requirement in early stage is approximately INR 4.5 million, growth stage is INR 30 million and mature stage is INR 70 million[26].
- Similar to every services oriented sector, **lack of collateral** is the major challenge for accessing debt too as these companies are technology oriented and hence asset light.

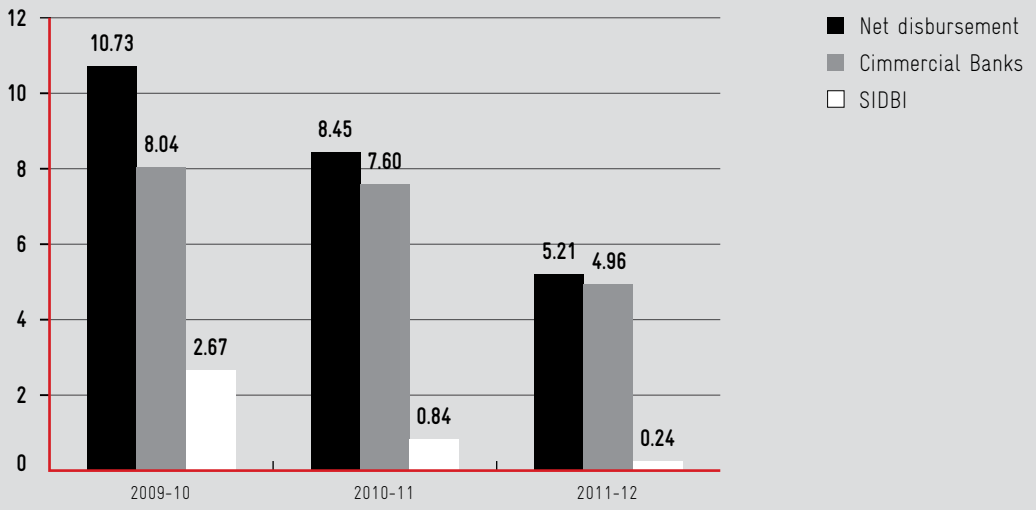
Conclusion:

Given the wide range of social problems this sector aims to solve, the growth potential of the sector as a whole is not possible to assess, without evaluating each business model individually. Rural BPOs have not scaled up to the extent they were anticipated to and though some of them had received support initially from private sector banks, the training challenges and automation of low-end BPO jobs have impacted the growth potential of this segment. Some urban enterprises focusing on organizing informal jobs have great potential as they tackle an important challenge of connecting the informal workers to employers.

FINANCIAL INCLUSION

Improving the financial inclusion level in the country has been both a national commitment and a public policy priority of the country. Commercial banks are unable to reach out to low income markets with loans of a ticket size less than INR 50,000. Nor are they able to reach out to micro and small enterprises (MSMEs) effectively. NBFCs have thus moved in to address this very important need. Micro-finance Institutions (MFI) played a major part in achieving the financial inclusion goal set out by the national government until the Andhra Pradesh Microfinance crisis occurred in 2010. Post MFI crisis, the sector has been going through a consolidation phase and is in recovery phase. Over the past few years, the sector has seen bank loans and equity investments drying up. However, investments have recently started picking up. As part of this study we have consciously decided not to estimate the debt requirement of MFIs in India but will present some findings which would give a rough estimate of the kind of investments needed in the sector.

Figure 19 **Disbursement of debt from banks to for-profit MFIs (INR Billion)**



Source: NABARD Microfinance sector report 2011-12

Net disbursement of debt from Banks to for-profit MFIs has fallen by over 50% in two years between 2010 and 2012. Earlier commercial banks were securitizing loans of microfinance institutions to fulfill their priority sector lending targets but over the last few years even commercial banks have reduced their exposure to the sector. Over the last couple of years (2011-2013), close to INR 11 billion of equity investments have been made in the sector[27] in approximately 20 enterprises. Assuming that MFIs should ideally have a leverage ratio of 5-8[28], the debt requirement for these 20 enterprises alone - based on only the fresh equity investments - would be around INR 55-88 billion.

Other NBFCs and service providers:

In the financial inclusion sector, there are other non-MFI Non-banking financial companies (NBFCs) such as Kinara Capital and Vistaar, which cater to the needs of MSMEs. The focus on MSME financing has increased in the last few years but the non-MFI NBFC's catering to MSME's have not scaled as much as the MFI sector. The MFI crisis also had an impact on Non-MFI NBFCs as banks turned averse to lending to MFI-like models. On the other hand, there are technology-based service providers such as companies which set up ATM machines in rural India and companies which provide access to finance in remote areas through the business correspondent model such as FINO which are trying to fill the major financial inclusion gap in the country.

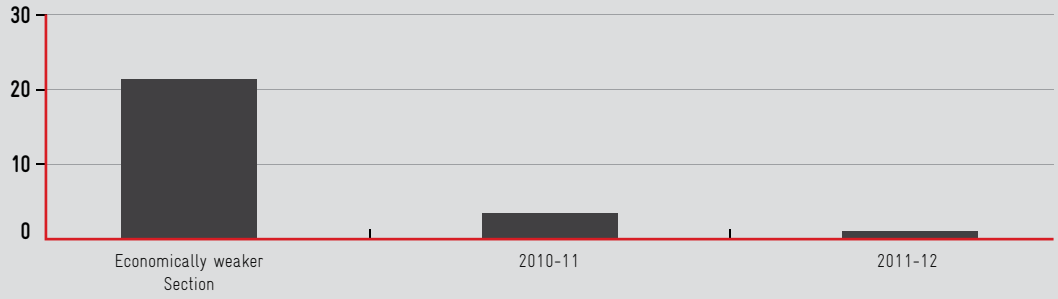
Largest sector in terms of financing needs:

The financial inclusion sector is definitely the largest sector when it comes to financing needs. The growth of the sector is directly related to the capital raised and though we are unable to provide clear numbers at this point of time, going by past numbers the debt requirement for the immediate future would be ***at least twice the debt requirement of social enterprises across all the other sectors.***

AFFORDABLE OR LOW COST HOUSING

Rapid urbanization is a major challenge that India faces today. With an estimated 200-250 million people expected to migrate to urban areas in the next 20-25 years, providing the right urban infrastructure for this population will be challenging. Providing affordable low cost housing for this population is one such challenge and it is estimated that there is a short fall of 24 million[29] houses in urban areas in India. As shown in Figure 20, majority of the shortage is seen in the economically weaker sections[30] of the population.

Figure 20 **Disbursement of debt from banks to for-profit MFIs (INR Billion)**



Source: MHUPA – Working Group on Urban Housing, 2007-2012

While the Government of India was active in the affordable housing space as an implementer in the earlier years, their current role is to provide policy support, with the private sector engaging in affordable housing infrastructure provision. Though majority of the housing shortfall is in for the economically weaker sections, housing is not affordable for this segment of population (assuming 40% of the income can be spent on housing). Hence, the real immediate demand for affordable housing is in the low-income and middle-income segment. Average loan requirement for housing in the low income group is between INR 0.25- 0.27 million and that in the middle income group is between INR 0.3 to 0.5 Million. With an overall gap of 2.93 million houses in these segments, it can be estimated that the overall debt requirement in the affordable housing segment would be approximately **INR 730 - 800 billion.**

Supply of housing:

There are several real estate companies which have entered the affordable housing space and most of them are focused on developing housing for the middle or high income group. Developing affordable housing at a cost of INR 0.25-0.27 million is very challenging and though there is a huge demand for housing in this segment, there are very few companies that are actually catering to the needs of the low income groups.

Financial Supply:

Unlike other sectors, the affordable housing sector has a distinct advantage of using the houses already developed as collateral, which makes banks more willing to provide financing to these customers. Banks look for the salary statement from the buyers or proof or income from the end customers who will be eventually buying the property. In the development phase, the affordable housing developers might require short-to-medium term loans for funding project development costs.

Overall the sector is expected to grow rapidly. While challenges such as high land costs sometimes makes such project unviable in Tier-1 cities, it is a very attractive space for banks and other financial institutions that can provide long term (10-15 year) loans to the end customers of these affordable housing companies

Debt Demand and Geography:

As described through the sections above, the debt access challenges - lack of collateral, high rates of interest, limited avenues of financial access; lack of flexibility in repayment cycles- broadly remain the same across social enterprises in different sectors. These challenges also remain common across geographies, though the intensity of the challenge may vary by region. This section of the report attempts to draw inferences between the financing needs of social enterprises and their geographic distribution. A preliminary analysis of the corporate headquarters of interviewed enterprises (Refer Figure 21 below)

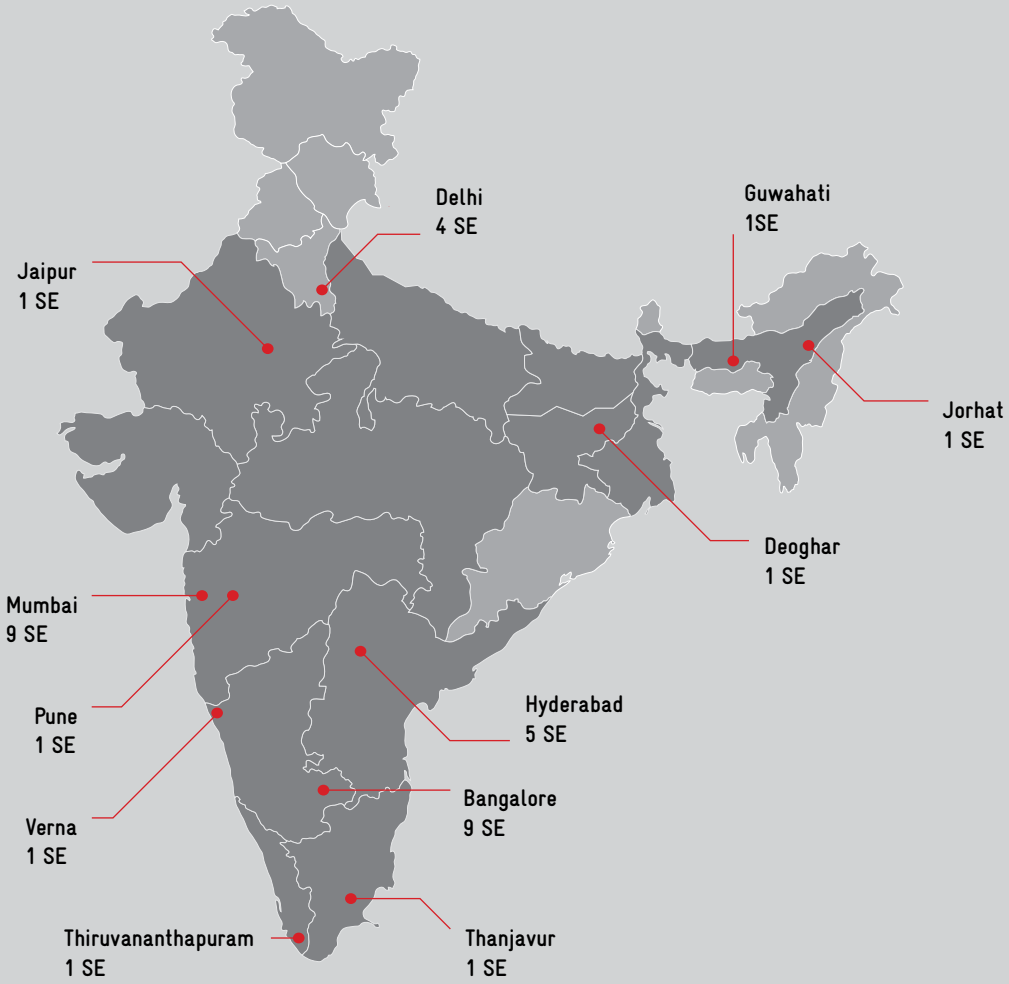
highlights that most enterprises (approximately 50% of the enterprises interviewed) are headquartered in either the financial capital –Mumbai – or the startup capital of the country –Bangalore. Only the enterprises in the agriculture sector seem to be based out of other remoter geographies.

The location of an enterprise is, however, not always correlated to their area of operation. For example, Claro Energy, though headquartered in Delhi, operates in Bihar, Jharkhand, Uttar Pradesh and Madhya Pradesh. Similarly, Eco Tasar Silk, headquartered in Delhi, operates in Assam, West Bengal and Bihar. Banka BioLoo, headquartered in Hyderabad, runs projects in Lakshwadeep. B2R, a rural BPO with operations in Uttarakhand, is also headquartered in Delhi.

Understandably, headquarters are chosen based on locations where access to finance can be easier. Since Tier 1 cities such as Delhi, Mumbai, Bangalore and Hyderabad have a far evolved financial ecosystem compared to the rest of India; social enterprises choose to set up their headquarters in these cities.

Some enterprises such as Frontier Markets and DesiPower choose dual head offices to highlight differences in corporate and operational locations. Frontier Markets' corporate head quarter is in Delhi with another head office in Jaipur, Rajasthan. Similarly, DesiPower has headquarters in Bangalore and Araria, Bihar. However, these tend to be exceptions and as mentioned previously, most enterprises prefer to set up their corporate headquarters in tier 1 cities that have a more robust financial ecosystem.

Figure 21 **Geographic distribution of social enterprises interviewed**

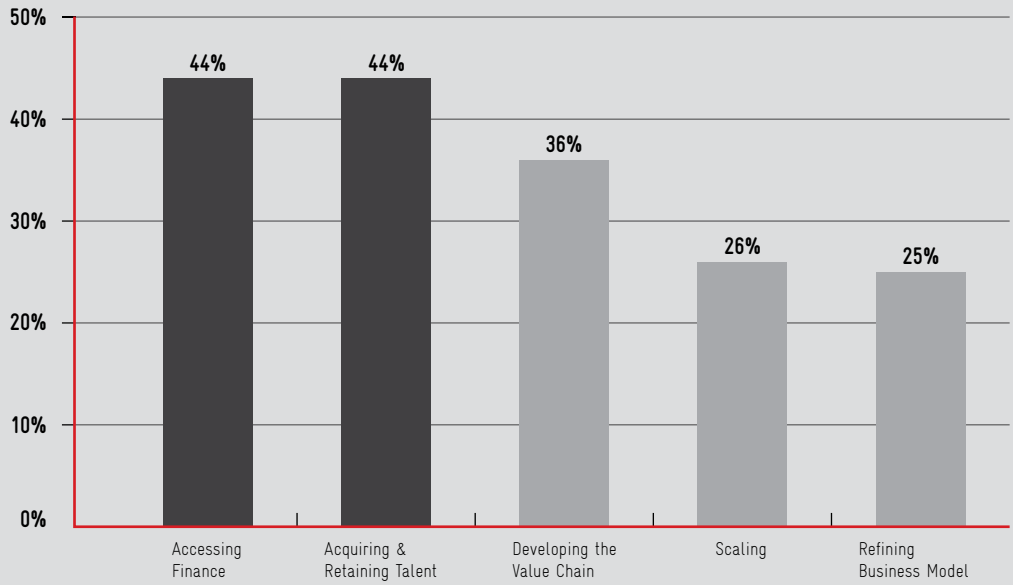


Source: Primary Interviews

3.5 Non Financing Challenges

This study also aims to understand the top non-financing challenges that social enterprises face in India. After finance the next most challenging aspect for social enterprises is finding and retaining employees. Over 90% of the enterprises that we interviewed stated talent acquisition and retention as their biggest challenge. The findings also resonate with the findings from a social enterprise survey conducted by Intellecap in 2012:

Figure 22 Top 3 challenges that social enterprises face



Source: Intellecap, Social enterprise survey, 2012

Social enterprises find it especially challenging to acquire top management and retain their field staff. Finding qualified trained employees in some niche sectors is another challenge that social enterprises face, especially while operating in remote parts of the country.

Other than talent acquisition, a number of social enterprises also mentioned that they faced challenges in legal structuring, market building, product development and business development. To address these challenges, social enterprises seek external support from institutions such as incubators, academia and sector forums and also seek support internally through advisors and board of directors. Some of the social enterprises that had access to external support from institutions such as incubators found the programs to be very helpful. There were very few social enterprises that had the opportunity to attend a formal incubation program and prima facie, there is an opportunity for setting up more incubation facilities in the country.

Footnotes

9 Sankalp Forum is India's leading social enterprise forum

10 We assumed that Sankalp Forum's database has a coverage of 5%, 20% and 50% for agriculture sector, coverage of 20%, 50% and 70% for education sector and 10%,30% and 70% for all the other sectors across early-seed, growth and mature stages respectively

11 We used the world bank definition here because the data on initial investments on plant and machinery was not available for social enterprises

12 Earnings Before Interest, Taxes, Depreciation, and Amortization

13 Sankalp Forum Database of social enterprises

14 Credit Guarantee Fund Trust for Micro and Small Enterprises

15 Economic Times Article published Sept. 12, 2012

16 Economic Survey of India 2012-13

17 K-12, a term used in education and educational technology, is a short form for the publicly-supported school grades prior to college. These grades are kindergarten (K) and the 1st through the 12th grade (1-12).

18 The Economic Times, 2011

19 The Hindu, June 14, 2012

20 The Economic Impacts of Inadequate Sanitation in India

21 The average debt requirement per enterprise in water and sanitation sector was derived with a smaller sample size of enterprises and hence might not be accurate

22 Energy Access in India. 2012

23 Securing tomorrow's energy today: Policy & Regulations Energy Access for the Poor, Deloitte, February 2013

24 Emerging Trends in Healthcare. ASSOCHAM and KPMG. February17, 2011

25 Emerging Trends in Healthcare. ASSOCHAM and KPMG. February17, 2011

26 The average debt requirement per enterprise in technology for development sector was derived with a smaller sample size of enterprises and hence might not be accurate

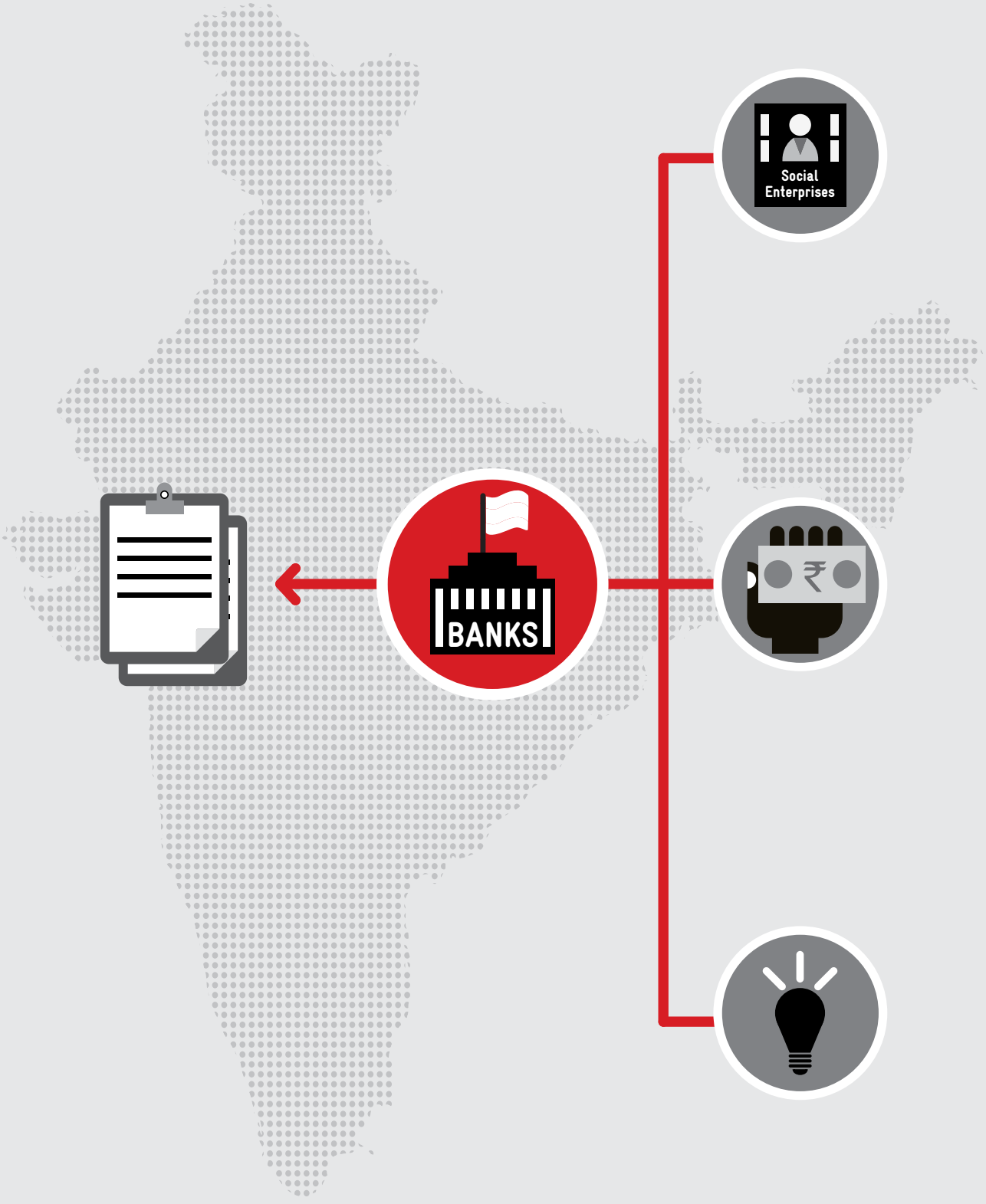
27 Source: VCCircle investment data

28 Lok Capital report on MFIs, 2009-2010

29 MHUPA – Working Group on Urban Housing, 2007-2012.

30 Economically Weaker Section: INR 3,300 monthly income, Low Income Group: INR 3,300-7,500 and Middle Income Group: INR 7,500-14,000

31 States Covered: Assam, Andhra Pradesh, Bihar, Chhattisgarh, Delhi, Goa, Gujarat, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, R


Social Enterprises
BANKS

4 Social Enterprises and Access to Finance 'Beyond Equity': A Supply-side Perspective

This section of the report highlights takeaways from discussions with various actors in the social enterprise financing ecosystem. It collates findings from interviews with bank managers in both public sector and private sector banks, fund managers at venture capital firms and heads of Non-banking financial companies (NBFCs) that provide customized lending to social enterprises. The broad areas of enquiry included recognition of social enterprises as a separate entity by the various institutions, process or product customizations for providing capital to social enterprises and potential innovation for ease of debt access to social enterprises.

4.1 Banking sector: Follows a risk averse, collateral-based lending methodology

Most lending practices in the banking sector (public sectors and private sector) are guided by the directives of the central banking institution – Reserve Bank of India (RBI). Thus most decisions with regard to debt provision to enterprises are governed by RBI regulations and most banks do not innovate significantly in their lending practices.

- *Non-Recognition of Social Enterprises:* Interviews with various bankers highlighted that there is no special recognition of social enterprises in the banking system. Customized lending to the sectors under the social enterprise definition vary either by the Priority Sector Lending (PSL) guidelines (elaborated in Chapter 5) defined by the RBI or due to the bank's inherent focus on certain sectors, e.g. dedicated agri-lending verticals at certain banks. As mentioned in the previous chapter, most social enterprises under the definition of this study would be considered under the MSME lending verticals of banks.
- *Financial Illiteracy of Entrepreneurs:* Most bankers consider entrepreneurs in the Small and Medium Enterprise (SME) segment, especially first generation entrepreneurs, to be ignorant of basics of fundamentals such as financial statements, business plans etc. The view is that first-generation entrepreneurs do not follow the standard book-keeping practices thereby revealing the true financial status of their businesses and hence the risk perception with such enterprises gets exaggerated. However most social entrepreneurs, despite being first generation entrepreneurs, are well aware of the standard best practices in financial management and tend to keep a good record of their finances. Hence, there is a mismatch between bankers' perception about the financial literacy of social entrepreneurs and their actual skills, possibly leading to a misperception about the bankability of social entrepreneurs.
- *Emphasis on Collateralized Lending:* Most banks prefer loans even within the SME segment to be backed by collateral. This emphasis on collateral is used as a financial disciplining mechanism for part of the entrepreneur. Collateralized lending is not limited to social enterprises, but most asset-light/ service sector enterprises in the larger MSME space as well.

The SIDBI backed Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGTMSE) is promoted by the banks as a means of non-collateralized debt for SMEs. However experience shows that most social enterprises have not been able to access the scheme due to a variety of reasons elaborated in the next section.

- *Non-viability of Product Innovation in Social Enterprise lending:* Structuring innovative products by use of warranties, convertible options etc. are common in high ticket loans (INR 50 Million and above); however, in case of smaller ticket loans (up to INR 20-30 Million) bankers tend to prefer traditional secured/ unsecured term loans. The smaller loan size does not merit the cost incurred in customizing the product offerings. The table below (Ref Table 2) lists all the existing MSME financing products by the banking system, most of which are security backed traditional fixed-repayment products.
- *Regulatory Constraints:* Many bankers counted the complex Non-Performing Asset (NPA) and liquidation norms as one of the biggest factors for withholding lending to new and emerging sectors that encompass the social enterprise space. The preference for traditional sectors grows mainly from the fact that they are considered to be less risky. On the other hand enterprises in the social enterprise space have a perception of being more risky with higher default rate. Thus, the operational challenges in NPA recognition and liquidation norms deter banks from taking more risks in their lending processes.

Table 2 MSME Financing Products by Banks

Product	Tenure	Collateral	Credit Size Limit
Overdraft	1 year; revolving credit, renewed annually	*Primary Security* – Hypothecation of stocks in trade and receivables *Collateral Security* – A minimum value of the loan amount in the form of mortgage of immovable property and/ or other liquid security	50% – 60% of the amount of receivables
Cash Credit	3 months – 1 year; revolving credit, renewed annually	*Primary Security* – Hypothecation of stocks in trade and receivables *Collateral Security* – A minimum value of the loan amount in the form of mortgage of immovable property and/ or other liquid security	50% – 60% of the amount of receivables
Short-term Loan	3 months – 1 year; revolving credit, renewed annually	Mortgage of fixed assets such as land, building, factory	-
Long-term Loan	1-5 years	Mortgage of fixed assets such as land, building, factory	60-80% of the cost of the collateral
Asset-Based Financing	3-7 years	Secured by an asset (e.g., a purchase order, contract, accounts receivable, invoice, letter of credit, inventory, machinery, equipment	80-90% of the cost of asset
Letter of Credit		Letters of credit are available against 25%-35% cash margin and mostly on a 100% collateral security in the form of residential property, corporate guarantees or liquid securities	Credit is available for procuring raw material, manufacturing the goods, processing and packaging and shipping the goods
Credit Card	1-3 years	No collateral required, only a third-party guarantee for a lower limit on the card, and hypothecation of stock in trade, receivables, machinery, office equipment etc. for an upper limit (beyond INR 0.5 Million)	Maximum limit of INR 1 million

Source: Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)

4.1.1 Existing Innovations in the Banking Sector - Innovation Branch promoted by SIDBI:

Since October 2012, SIDBI has been partnering with now 10 banks to set up special 'Innovation Branches' to aid SMEs in capital. These branches are intended for enterprises that have just commenced generating revenues and have received a round of funding from angel groups. The enterprises can receive non-collateralized loans up to INR 10 million under the CGTMSE scheme. The USP of the branch is that it aims at providing debt to enterprises that would otherwise not be considered by banks. The loan tenure is for 5-7 years and aimed at total project financing and enterprise scale-up for. Focus is not on increasing valuation but on increasing bank's portfolio and increase loan size to the enterprise over time. No bank relies on due diligence /business plan validation done by Venture Capital (VC) firms/ angel investors in the loan evaluation process. The simplified evaluation process and non-collateralized lending can be a boost in debt flow to the social enterprises. However, the branches are too recent and it is difficult to evaluate their performance at this stage.

4.1.2 Existing Innovations in the Banking Sector - NABARD's financing to non-agricultural Social Enterprises:

NABARD is a development bank that facilitates credit flow to the agriculture/farming sector. However, it is also mandated to support all other allied non-farm activities in rural areas. Under its support for non-farm activities, NABARD runs a number of programs that provide soft loans (loans at easier terms than traditional banks) to enterprises. E.g. NABARD's Umbrella Programme on Natural Resources Management (UPNRM) provides for loans to enterprises that support Natural Resource Management projects at interest rate range of 9-12% per annum. Social enterprises in Water and Sanitation along with those in the Agriculture and Rural Development sector are known to have availed non-collateralized working capital loans under this scheme.

4.1.3 Existing Innovations in the Banking Sector - CGTMSE:

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was set up by Government of India and SIDBI in the year of 2000-01. The CGTMSE provided guarantees to banks and financial institutions to facilitate collateral free loans to MSME sector. Currently loans up to INR 10 million are covered under this scheme.

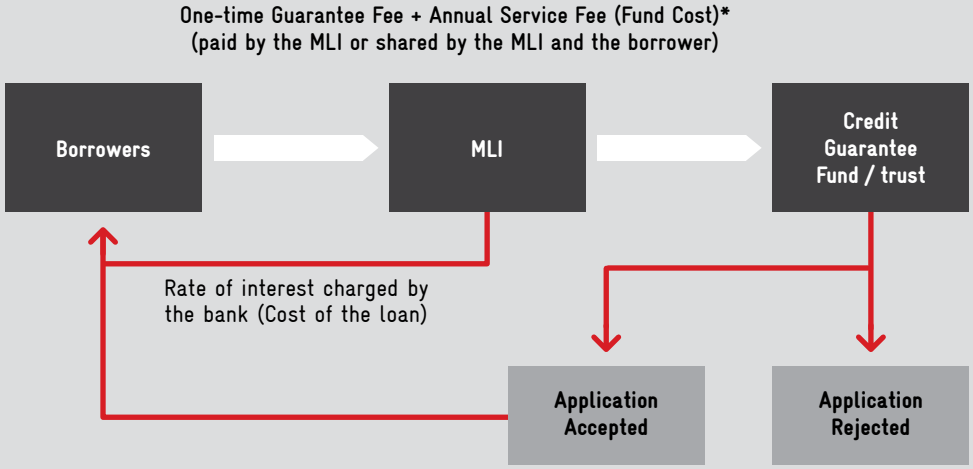
Table 3 Overview of the outstanding amount covered on default by the CGTMSE

	Maximum of INR 0.5 Million	INR 0.5 –5 Million	INR 5 –10 Million
Micro Enterprise Segment	85% of amount in default with maximum limit of INR 0.45 Million	75% of amount in default with maximum limit of INR 3.75 Million	INR 3.75 Million with 50% of amount in default above INR 5 Million with a maximum limit of INR 6.25 Million
Women entrepreneurs and Enterprises in North East	80% of amount in default with maximum limit of INR 4 Million		INR 4 Million with 50% of amount in default above INR 5 Million with a maximum limit of INR 6.5 Million
Other Category	75% of amount in default with maximum limit of INR 3.75 Million		INR 3.75 Million with 50% of amount in default above INR 5 Million with a maximum limit

Source: Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)

Guarantee cover is given to collateral free loans disbursement by Member Lending Institutions (MLI) such as banks. The operation and risk-sharing mechanism via the guarantee fee and annual service fee is depicted in Figure 23 below.

Figure 23 Graphical Representation Of CGTMSE's Operations

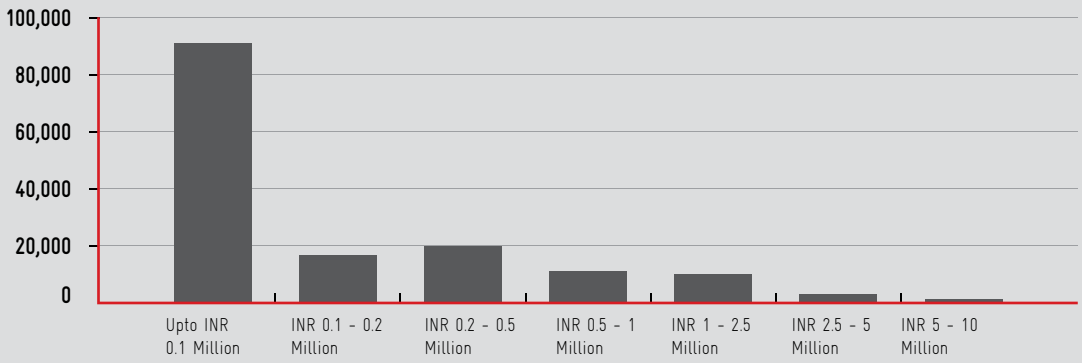


Source: Effectiveness of Credit Guarantee Scheme, ISB (April 2012)

Some interesting **trends in the performance of the scheme** could highlight the reasons for difficulty in credit access by social enterprises in India. The trends include:

- **Loan Approval Amount:** Figure 24 below shows the slab wise loan disbursements. The maximum number of disbursements, that is, 90,997 of them constitute about 60% of the total number of disbursements have been in the sub-0.1Million category. This shows a clear bias towards small ticket loans as opposed to the larger size loans required by Social Enterprises. It can also be construed to reflect the "risk averse" nature of banks wherein they gain comfort in providing collateral free loans for small-ticket products.

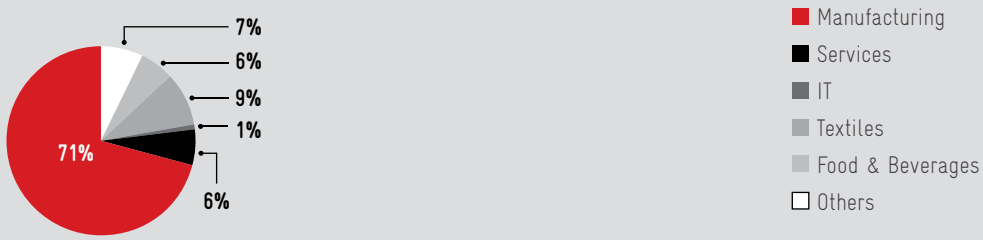
Figure 24 Graphical Representation Of CGTMSE's Operations



Source: Credit Guarantee Fund for SME: Review and next steps (Browne & Mohan, 2010)

- Sectoral Distribution: Manufacturing industries enjoy the major chunk of coverage while loan disbursement to the service sectors is sector is fairly low. Given that social enterprises are predominantly asset-light, service sector businesses; this bias towards manufacturing sector could stymie flow of debt under CGTMSE to them.

Figure 25 Sectoral distribution of CGTMSE approvals



Source: Credit Guarantee Fund for SME: Review and next steps (Browne & Mohan, 2010)

- **Stage of Enterprise:** Only 5% of the loans were disbursed to start-ups (less than 2 years) and the majority of the disbursements were for primarily existing clients whose risk profiles were very well known. The CGTMSE does not ask banks to use a different scoring model for start-ups and established firms or even across various industrial sectors. As a result many entrepreneurs cannot access the credit as on several parameters business plans fall short of the traditional lending norms

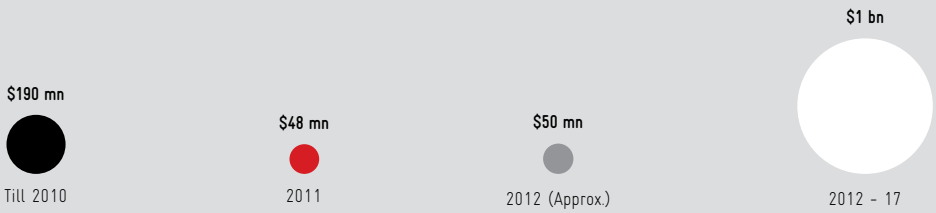
- **Operating Model:** The CGTMSE involves individual approval of loan applications by the MLI. However, globally successful credit guarantee schemes adopt a portfolio model or a closed model to enhance the performance of the scheme. In a "portfolio model", the guarantor does not approve single loans, but different criterion is set for different target groups for guaranteeing loans. E.g. the criterion for capital intensive sector will be different from a sector which has high working capital requirement. In a "closed model", a specific target group is identified for guarantee cover. Following such model can ensure lesser operational challenges in loan disbursement by the banks by ensuring efficiencies of scale.

  Thus the reach of credit through the CGTMSE scheme is hindered due to the inherent biases in the lending process by the banks.

4.2 Venture Capital Funds: Limited in innovation due to regulations

Venture Capital funds especially those in the 'Impact Investment' space are the prominent source of funds for social enterprises in India. Impact investments or mission driven investments or social venture investments are a fast growing space in India. As of 2011 total social venture investments totaled USD 48 million, which is expected to grow to USD 1 billion over the next 5 years (Refer Figure 26). However, these are limited to equity investments with little or no innovation in 'beyond equity' investments.

Figure 26 Social venture investments in india



Source: VC Edge; Investor Interviews

- *Recognition of Social Enterprises:* Most impact investors have an understanding of social enterprises and the various business models therein. These investors lay emphasis on the financial returns of their investee enterprises as well as their social missions. Most of these funds tend to have a sector focus that overlaps with the broad social enterprise definition for this project.

Table 4 Sector Focus of Impact Investment Funds

Fund	Sector Focus
Aavishkaar	Technology for Development, Handicrafts, Renewable Energy, Agriculture, Rural Innovations, Health, Education, Microfinance
Acumen Fund	Agriculture, Education, Energy, Health, Housing, Water
Impact Investment Partners	Affordable healthcare
Lok Capital	Microfinance, Business models that have strong deterrents against consumption oriented lending (i.e. complimentary crop or health insurance or livelihood training) and promote access to other basic services like education and healthcare
Omidyar Network	Consumer Internet & Mobile, Entrepreneurship, Financial Inclusion, Government Transparency, Property Rights
SEAF	33 identified sub- sectors of India's agribusiness value chain

Source: Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)

- *Investment Options:* According to the investors, theoretically, there are possibilities of structuring mezzanine deals/ making investments with quasi-equity instruments in India. Most quasi-equity instruments are used in the case of disagreement on valuation between the investor and the investee and there is mismatch on the exact equity stake infusion. Funds also have the option of providing debt to their investees. However most VC funds invest either via pure equity infusion or optionally convertible debt that would eventually convert to equity.

  Despite the options, investors prefer making pure equity investments due to regulatory and operational challenges in using alternate options.

Box 8 Debate on the use of convertible debt in the US

The US market is very advanced in the use of convertible products for structuring investments (elaborated in latter chapters). However, there is a recent debate on the value of using of convertible debt by angel groups. The primary concern of some angel investors in the use of convertible debt is that, if and when the debt eventually converts into equity, it will do so at a valuation that is too high. Investing in convertible debt which eventually converts to equity at a high valuation reduces the return on that deal and does not compensate adequately the risk taken by the fund at a very early stage.

- *Provision of Debt:* SEBI[32] guidelines state that both domestic and foreign VC funds can provide debt to their investees. While there are no restrictions on the amount of debt domestic VCs can provide, according to SEBI regulations not more than 33.33% of investible funds by foreign VCs may be invested by way of debt or debt instrument of an existing investee.

Conversations with fund managers highlight that operational challenges and lack of clarity in regulations lead to the preference of use of equity as an investment option. There are very few pure domestic Indian funds (SIDBI Venture Capital, IFCI) that can provide debt to investees without the above mentioned SEBI regulations. However, combination of factors such as lack of clarity on legal and operational requirements for providing debt; mandate by the funds LPs to make equity investments; and lack of clarity on the risk-return profile of in the investment structure withhold these domestic VC funds from providing debt to their investees.

4.3 NBFCs: Pioneering debt access innovations for Social Enterprises in India

NBFCs in India are championing debt access to social enterprises through both product and process innovations. New models such as non-collateralized lending and customized repayments are being explored, as are process innovations such as customised risk assessment, channels of sourcing etc.

Table 5 Range of product offerings by NBFCs in India

NBFC	Products / Services Offered
IFMR Capital	• Loan securitization for high quality originators impacting low-income households, such as, Microfinance Institutions, Affordable Housing Finance companies, institutions lending to Small & Medium Enterprises • Loan products for small farmers using agricultural produce as collateral
Intellegrow	Customized debt financing for enterprises in their first 12-48 months of operations • Short-term working capital loan for purchase of raw materials against a delivery order from a reputable buyer • Term loan for purchases of cash-generating equipment • Receivables loan with collection via escrowing future receivables • Line of credit in the form of invoice discounting, bill discounting or letter of credit
Kinara Capital	Loans in the range of INR 0.1-1 Million to enterprises with turnover of less than INR 20 Million. These include term loans, short-term working capital loans and bill discounting
NABFINS	Loans that support production/aggregation/marketing in sectors like agriculture, sericulture, handlooms, and handicrafts. Loans are forwarded to the following: • Farmers, artisans & individuals • Self Help Groups • Small and marginal producers groups • Micro and small enterprises • Producers' Companies (particularly those of the small and marginal segment) • Mutually Aided, Souharda & other Cooperative Societies, • Companies / corporate bodies / partnerships engaged in agriculture, non-farm activities mainly with focus on poor / disadvantaged sections of the population, remote geographies etc.
Silicon Valley Bank	• Venture Debt for startups and early-stage enterprises VC / angel backed companies • Growth/ Mezzanine Debt for growth-stage VC backed companies
Vistaar	Loan products for small business • *Small Business Mortgage Loan:* For small businesses, self-employed segment like traders, manufacturers & services requiring larger amounts of capital up to INR 2 Million • *Small Business Hypothecation Loan:* For small business across all sectors of economy for capital needs of up to INR 60,000

Source: : Interviews, Company Websites

- *Product Innovations:* NBFCs in India have been pioneering the use of venture debt as a means of debt provision to enterprises. This includes companies such as Silicon Valley Bank (SVB), IntelleGrow etc. In chapter 7 of this report, the concept of venture debt as a fund raising tool is elaborated in detail; however the case study below gives a brief highlight of the current use of venture debt in India by SVB.

Box 9 **Silicon valley bank: India's first venture debt enterprise**

Silicon Valley Bank (SVB) is an NBFC fully funded by its parent SVB USA and operational in India since 2007. It lends to pre-revenue/ pre-profit companies and sometimes lends right on the back of an angel round. Prefers to lend to Series A venture backed companies in the USD 2.5 million range.

Product Type: Structured debt that provides 8-15 months of cash flow runway to the enterprise; aimed at aiding enterprises in meeting their working capital/ capital expenditure / asset financing / acquisition financing needs. Repayment could be in the form of monthly EMIs or bullet payments with a small equity kicker.

USP: It is a bridge financing tool that can help address companies cash needs between two rounds of funding. Loan tenure of average 2-3 years helps enterprises address the time lag and cash crunch between raising next round of capital.

NBFCs are also experimenting with various forms of **securitizations.** The Institute for Financial Management and Research (IFMR) has been carrying securitization of microfinance loan pools since 2009. In 2012, it also carried out the first securitization of SME loans in India. The details of this securitization are mentioned in chapter 7.

Most of the innovative NBFCs are also focusing on **non-collateralized** lending. This helps address one of the biggest causes of bank loan rejection by social enterprises.

- *Process Innovations:* NBFCs are experimenting with various innovations to customize the lending process either by means of **customized credit appraisal process** or targeted outreach to enterprises. Some NBFCs target enterprises in a particular supply chain in order to ease sourcing and maintain standardized operations. Other NBFCs are building geographic focus to build competence in a region. Since most small enterprises lack proper documentation, NBFCs have customized the loan appraisal process to undertake new processes such as peer evaluation, reference checks, in-person due diligence, using **non-traditional documents** for determining credit history and willingness to pay of the entrepreneur. Innovative **risk mitigation tools** are also being used such as use of insurance products (life insurance credit shield/ term loan insurance); High Mark Check of borrowers; securitization etc.

Box 10 **Intellegrow: process and product innovator in social enterprise lending**

IntelleGrow Finance Company (IGF) provides customized debt financing to emerging and growing businesses in India. Adopting a "viability-based" lending approach, the facility is designed to provide debt and skills support to enterprises in sectors such affordable basic services, healthcare, water and sanitation, energy, education, agricultural supply chain and financial inclusion etc.

Process Innovations:
IGF loans are tied to specific anticipated cash inflows such as secured orders or seasonal sales spikes. Assessment of business viability of an enterprise is based on factors such as:

- Industry of operation
- Company's business and financial operation

- Business plan implementation: Entrepreneurial credentials, order-book, basis of projections
- Cash flow assessment

- *Regulatory Challenges:*

  PSL Guidelines: Existing PSL guidelines do not consider on-lending by NBFCs to priority sectors identified (details in Chapter 5) under the PSL channel. This is a bottleneck in scaling up of NBFCs, despite the innovations and reach that these NBFCs have had in lending to the priority sectors; banks resort to direct lending in the priority sectors to meet their PSL targets.

  Minimum Capitalization Norms: Due to lack of clarity, provision of debt by venture capital funds (especially foreign funds) is not common. For foreign funds to lend to enterprises in India, routing through NBFCs is a more efficient channel. This is because foreign investments are allowed under the automatic route (where the borrower can enter into a loan agreement without prior approval from Reserve Bank of India), only for a specific set of activities such as Venture Capital, Micro Credit, and Rural Credit etc. In other cases they need to be routed through an NBFC subject government approval to the following minimum capitalization norms:

  - USD 0.5 million for foreign capital up to 51%
  - USD 5 million for foreign capital more than 51% and up to 75%
  - USD 50 million for foreign capital more than 75% out of which USD 7.5 million to be brought up front and the balance in 24 month
  - 100% foreign owned NBFCs with a minimum capitalization of USD 50 million can set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital.
  - Joint Venture operating NBFCs that have 75% or less than 75% foreign investment can also set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capitalization norms

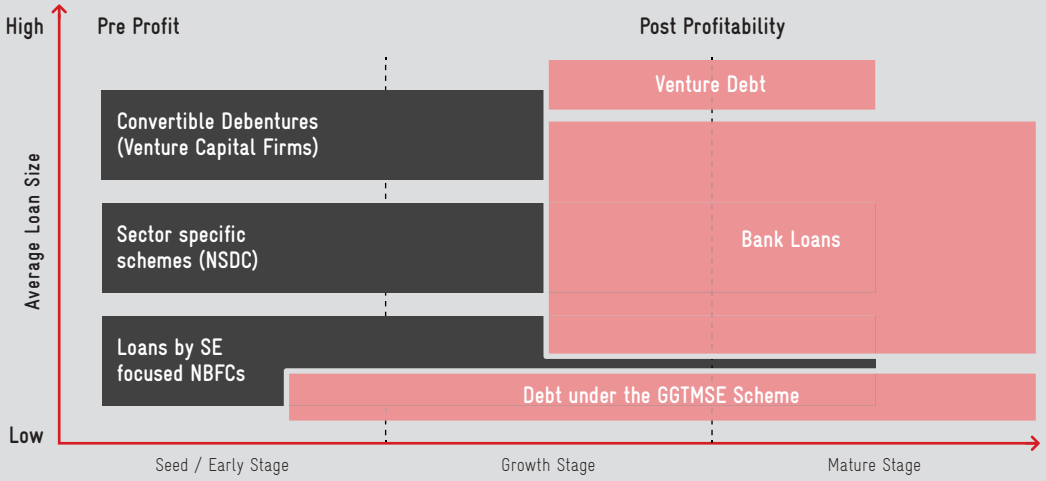
These criterions limit the flow of foreign capital via NBFCs

4.4 Conclusion

The previous section reviewed the status of financing options "beyond equity" to social enterprises. Figure 27 visually depicts the spectrum of finance available to social enterprises in India and compares the ease of accessing capital through these sources across their stage of growth. It becomes clear that bank loans are only available to enterprises in the growth and mature stage; while early stage social enterprises mainly rely on sector specific schemes, loan products by NFBCs or convertible debt by VC firms. As case studies suggest, it is specialized institutions that have become the innovators in financing social enterprises.

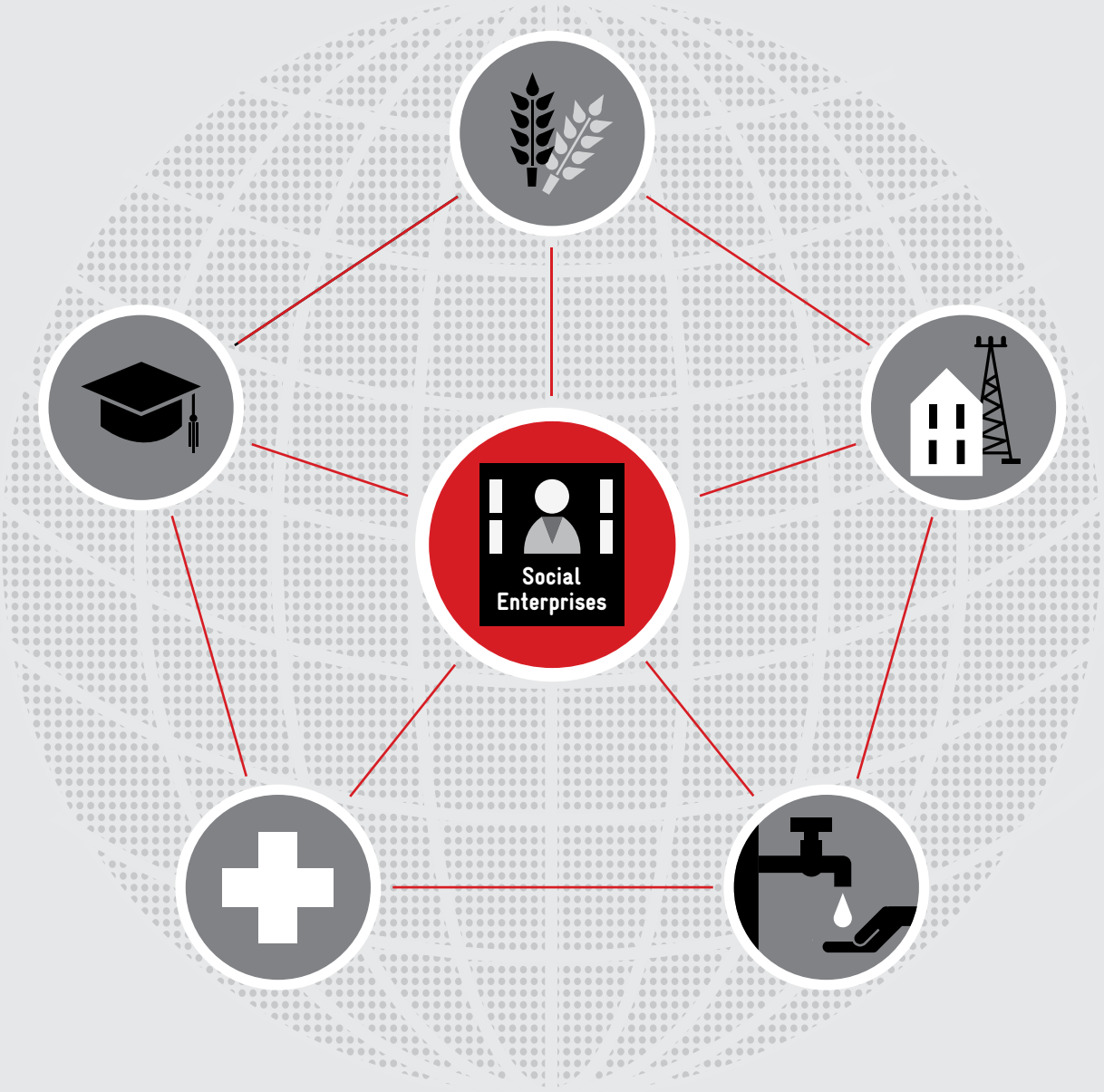
The following sections look beyond India's borders to explore what lessons can be learnt from international financial institutions. Chapter 5 examines best practices from other emerging economies, while Chapter 6 reviews international experiences with innovative financial products and their applicability in India. Chapter 7 specifically explores whether specialized institutions can be an avenue for social enterprise lending.

Figure 27 **Spectrum of products for social enterprises in India**



Footnotes

32 Securities and Exchange Board of India


Social
Enterprises

5 Social enterprise financing in 'Emerging Economies'

5.1 Summary

To explore international trends and possible learnings for India from beyond its borders, this section compares the social enterprise space across emerging economies. The social enterprise[33] sector remains in nascent stages in most of the countries researched. Brazil and India have the most developed social enterprise sector with strong ecosystem support, and sufficient activity. However, there are no specific government policies to support the growth of the sector in any of the countries. While some developed countries like the US have recognized social enterprises through a separate legal form like the L3C, developing countries are yet to recognize social enterprise as a unique type of company and cater to its specific needs. The Philippines are closest to having a national policy for social enterprise – the Social Enterprise Bill of the Philippines has been filed in the House of Representatives. If passed, the bill will "call on the state to play a major role in providing the necessary support to make Social Enterprise sector," according to the Manila bulletin, and will recognize them as a "legal brand." Most countries in the study have some sector specific policies to encourage enterprise activity in that sector. Agriculture is the most popular sector for government policy support for access to finance. Subsidized loans products for farmers are available in most countries, and are often backed by government policies. Similarly, some countries also have policies that support lending to clean energy enterprises. Most countries have policy support mechanisms for access to finance for SMEs. The level of support varies between countries. Policy support typically involves government funded programs for capacity building, loan guarantee programs, bank linkages, and minimum SME lending requirements for banks[34]. Table 6 sketches access to finance scenario for social enterprises across the ten countries.

Table 6 Heat map of social enterprise support across emerging economies

Country	Direct Policy Support to SE	SME Policy	Ecosystem Support for SE	Entrepreneurship	Ease of Access to Finance
Brazil	No Policy	Supportive	Several Stakeholders	High Levels	Easy
China	No Policy	Supportive	Some Stakeholders	High Levels	Difficult
Indonesia	No Policy	Supportive	Some Stakeholders	Medium Levels	Some Difficulties
Malaysia	No Policy	Supportive	Some Stakeholders	Medium Levels	Some Difficulties
Philippines	SE Bill Proposed	Supportive	Some Stakeholders	Medium Levels	Some Difficulties

Russia	No Policy	No Clear Policy	Few Stakeholders	Low Levels	Difficult
South Africa	No Policy	Supportive	Some Stakeholders	Low Levels	Difficult
Taiwan	No Policy	Supportive	Some Stakeholders	High Levels	Easy
Thailand	Favorable Government Policy	Supportive	Several Stakeholders	High Levels	Some Difficulties
Vietnam	No Policy	Supportive	Some Stakeholders	Medium Levels	Difficult

Source: Intellecap Analysis

5.2 Lessons for India

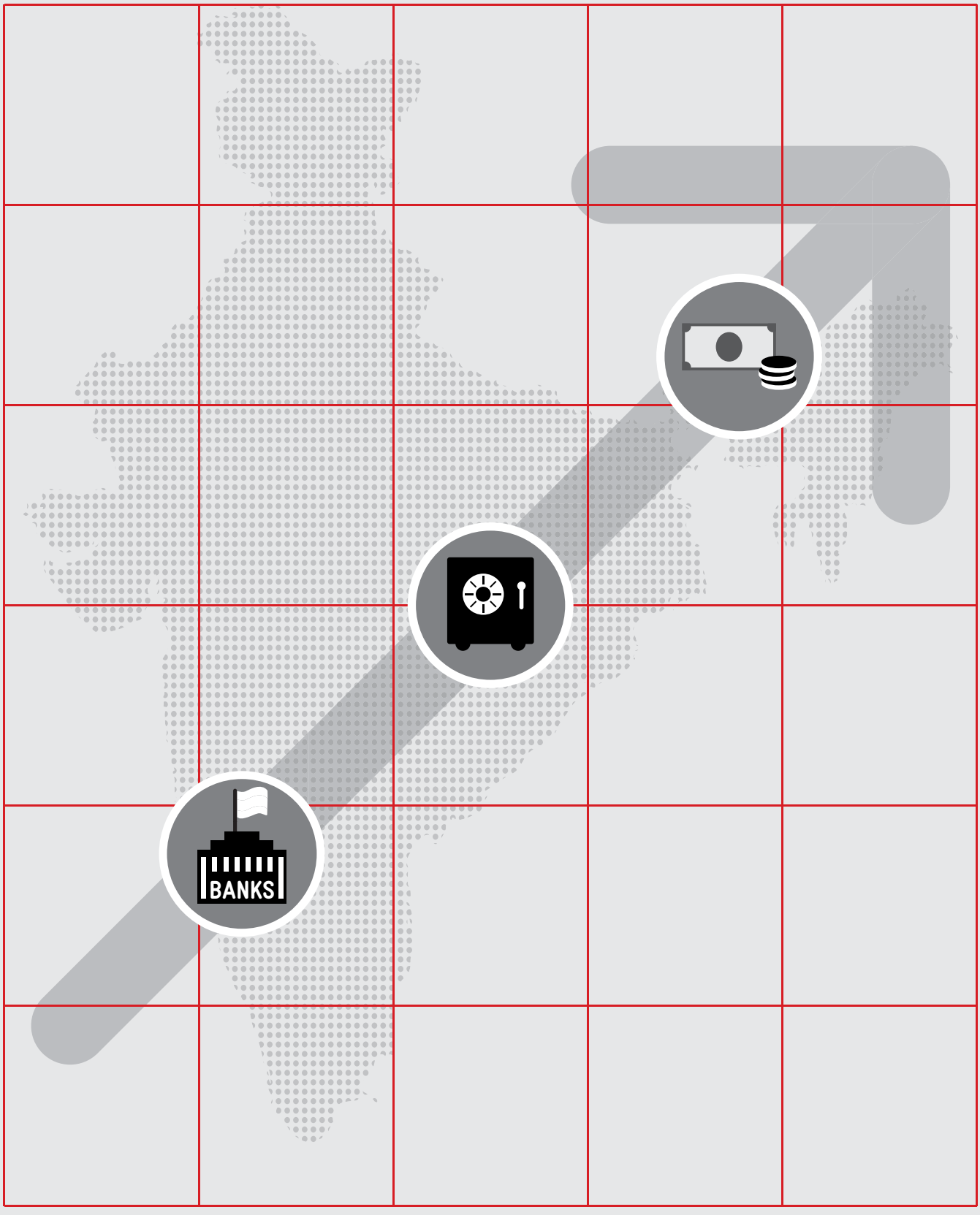
The following could serve as learning models to inspire India's policy to promote non-equity financing for social enterprises. Details of each of this features and programs are included in the country summaries (Refer APPENDIX 4: EMERGING MARKET COUNTRY SUMMARIES)

- **China:** Banking services for social enterprises that offer features to cater to their unique needs. E.g. no minimum deposit limits.
- **Brazil:** Strong ecosystem of funding agencies, investors, incubators, accelerators and entrepreneurs. The broader economy impacts the growth of social enterprise (E.g. through high borrowing rates) – cheaper international funds may help mitigate this issue
- **South Africa:** Availability of financing for businesses may not be enough to encourage growth of social enterprises. Providing the right ecosystem support through capacity development, training, incubators, and accelerators, and developing positive attitudes towards entrepreneurship through education are essential.
- **Taiwan:** With cooperation from the government and financial institutions, the **Taiwan SMEG fund** helps several SMEs get access to finance by reducing the burden for both FIs and enterprises.
- **Vietnam:** Exemplifies using Development Finance Institutions (DFI) and donor funds for SME lending.
- **Thailand:** Widespread awareness and government and financial sector support for social enterprises. Development of a clear national and local agenda for SME development, including development of institutions to support banks and SMEs has proven successful for growth in SME sector.
- **Malaysia:** iGuarantee portal a one stop shop for SMEs seeking financing. Ensures financial literacy, and provides bank linkages.
- **Indonesia:** Government guaranteed loans and working capital finance for SMEs.
- **Philippines:** Cluster approach to SME support. The government identifies cluster of products and services for funding support, and offers them comprehensive support and loans at subsidized rates.
- **Russia:** Corporate support of social enterprises. Corporation partnering with a microfinance institution to provide loans to social enterprises.

Footnotes

33 The countries do not share a common definition for social enterprise. In some of the countries profiled in the study, social enterprise is a term used for NGOs or hybrid business model organizations. However, in other countries the term is used to refer to businesses that serve a social agenda through their products or services.

34 The government of India has identified certain sectors as "priority" sectors for banks to service on the basis of their importance to national growth, and the gap in demand and supply for credit in those sectors. This practice is commonly used by several developing and developed countries as a support mechanism for ailing or needy sectors. The government of India studies priority sector lending (PSL) practices in Brazil, China, Indonesia, Nepal, Pakistan, and the Philippines, as a part of a research paper to inform its own policy. These schemes have largely focused on the agriculture and microfinance. Policy design varies between countries from banks being required to lend a certain hage to priority sectors, to providing lower interest rates to these sectors.

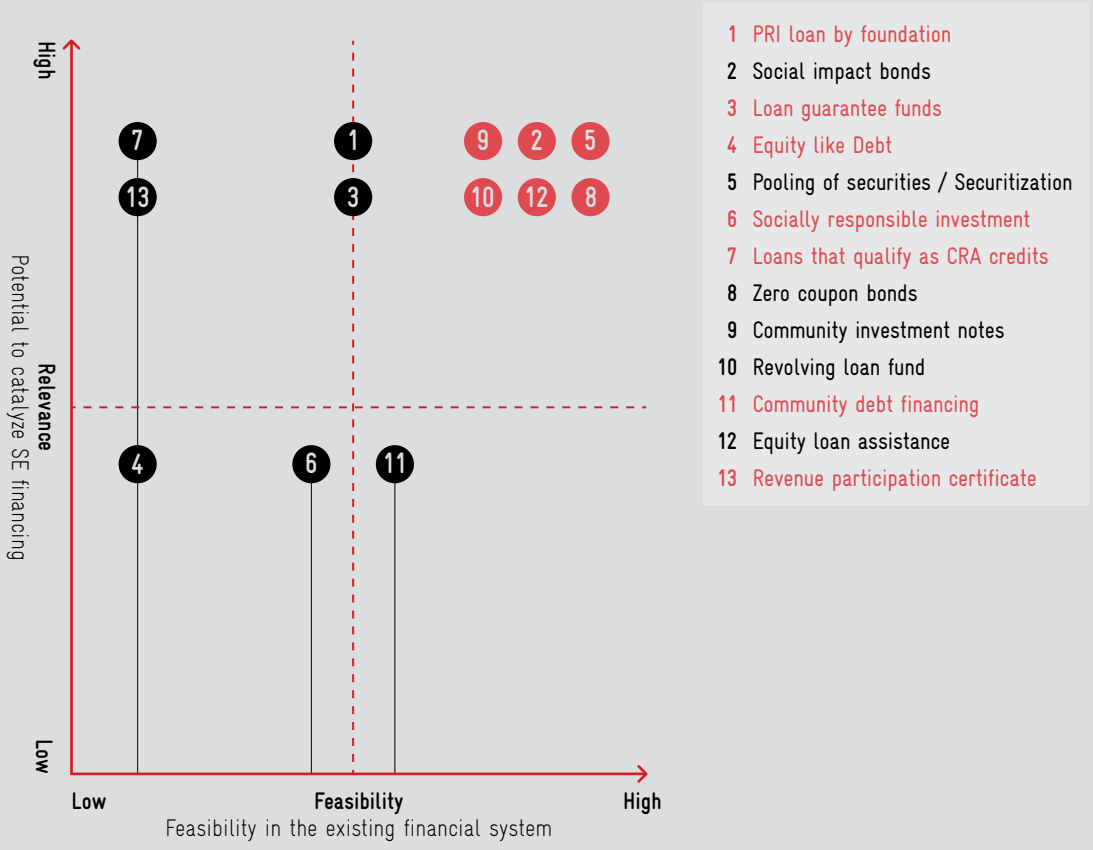

BANKS

6 Innovative Instruments for Financing Social Enterprises

6.1 Innovative Financial Instruments and their Applicability in India

Internationally, there is a trend towards product innovations in financing social enterprises 'beyond equity'. These products can be of two kinds: Fund Raising products and Risk Mitigation products. Fund raising products as the name suggests aids in raising capital 'beyond equity' for social enterprises. Risk mitigation products helps reduce the risks involved in capital raising by social enterprises. In India, banks tend to use insurance products (KeyMan Insurance for entrepreneurs and general insurance for equipment and collateral) as a tool for risk mitigation. Diversification of loan portfolio across industries is another such risk mitigation tool. This section discusses some innovative products and analyzes the feasibility of replicating them in India. Figure 29 below broadly summarizes the findings from the analysis.

Figure 28 Implementation assessment of innovative financial products in india



Source: Intellecap Analysis

6.1.1 Program Related Investment (PRI)

Product details:

One commonly used financing mechanism for social initiatives are PRIs, investments often made by foundations to support charitable activities that involve the potential return of capital within an established time frame. Unlike grants, PRIs take the form of low cost loans, loan guarantees and linked deposits and at times, even equity investments in non-profit and for-profit social enterprises. Rates of return on PRIs by definition must be below market on a risk-adjusted basis, and most often are set at very low interest rates (1-4%). There are no set requirements for PRI loan structures, which vary considerably, based both on the needs of the borrower or project and the expectations of the foundation lenders. Terms can range from periods of a few months to more than 15 years. Typically, PRIs are made as a supplement to existing grants. PRIs have largely been used to support programs like affordable housing and community development.

PRIs were created by changes in the US federal tax code in 1969. Till 2009, more than 5,400 PRIs (of USD 10k or more) valued at nearly USD 3.8 billion have been made in the United States alone. However, only a few hundred from thousands of foundations routinely make PRIs and even when they do, PRIs usually represent less than 10% of their annual distributions. Foundations from the US such as the Ford Foundation, the MacArthur Foundation, the Bill & Melinda Gates Foundation and the David & Lucile Packard Foundation have been most active in the PRI space.

Product benefits:

- Foundations can redistribute the funds or replenish their endowments once PRI loans and investments are repaid.
- The repayment requirements of program-related investments allow recipients to establish their creditworthiness to other, more traditional investors.
- The requirements also heighten financial discipline and accountability, which helps strengthen business practices of the recipients.
- The recipients of the PRI can leverage the below-market interest rate of PRI by combining with a market-rate loan and 'blending' the interest rate which would still be below the market rate and more affordable.

Performance:

The financial and program-specific progress of the recipients of the PRIs is tracked by majority of the foundations by using expert consultants and resources such as CDFI Assessment Rating Service, Calvert Social Investment Foundation and PolicyMap.

Intellecap Assessment:

Relevance **(HIGH)** – Highly relevant to SEs given that capital is available at a lower rate and repayments are flexible

Feasibility **(MEDIUM)** – Mechanism could be interesting for Indian CSR-departments against the background of Companies Bill and mandatory 2% spending in Corporate Social Responsibility. Structuring and monitoring PRIs requires financial and program skills on part of foundations

6.1.2 Social Impact Bonds (SIBs)

Product details:

A SIB is a multi-stakeholder partnership in which a government contract for social services is structured as a pay-for-performance contract. This is a new approach to scale social programs where the impact investors & philanthropic funders take on the financial risk of expanding preventive programs that help un(der)served people. Typically, the government would take on this risk but here, the government pays only if the program succeeds. The program is delivered by non-profit service providers with support from intermediaries who also bring in an

evaluation advisor and an independent assessor to set performance targets and objectively review the program.

The first SIB came into being in September 2010 in UK. After raising GBP 5 million from philanthropic funders, Social Finance UK—an NGO that develops financing structures and raises capital to help fund social service organizations—launched a SIB to help rehabilitate 3,000 short-term prisoners at Peterborough Prison expected to be released over a six-year window. Under the SIB contract, four UK nonprofits are implementing programs to help inmates increase their education levels, vocational skills, and confidence both during and after confinement. The reoffending rate of the Peterborough prisoners will be measured against a control group of 30,000 short-term prisoners from other jails who are not receiving these preventive support services. If reoffending rates among the Peterborough prisoners drop by 7.5 %, investors get a minimum payout of 7.5 %; if reoffending rates are even lower the payout could increase up to 13.5 %.

Currently, there are about 14 SIBs in UK alone with growing global interest in US and Australia.

Product benefits:

- SIBs, by shifting the financial risk away from government and aligning incentives among a broad set of stakeholders, could fill a critical void in offering a structured and replicable model for scaling proven solutions
- SIBs support government's goal of performance transformation and help it move from paying for activities to paying for results, making successful implementation more likely
- By helping scale successful programs, SIBs reward service providers who have invested their time and efforts in creating these effective programs

Challenges:

- SIBs, even in the UK are currently in the pilot stage and hence there is little information on its actual performance or benefits
- Due to the delayed nature of observed impact, elected government officials may not be completely interested in SIBs
- SIBs will require coordination across multiple stakeholders and agencies and flexibility in existing mechanisms which may make it difficult to succeed
- Repaying investors based on program performance and realized savings will be difficult as capturing and aggregating benefits across multiple stakeholders and programs as well as different levels of the government

Intellecap Assessment

Relevance **(MEDIUM)** – SIB seems to be focused on nonprofit enterprises delivering the program and intermediaries managing the program. There is the need to explore models that include SEs.
Feasibility **(LOW)** – Currently, this is in a pilot stage; more experiences on success is required. Getting government involved would require advocacy.

6.1.3 Loan Guarantee Funds

Product details:

Popular financial instrument are loan guarantees, a promise by a guarantor to assume the debt obligation of a borrower in case of a default. A guarantee can be in part or full. Institutions like USAID and European Investment Fund (EIF) guarantee loans and other deft finance granted by local institutions or partners known as 'intermediaries' to small and medium enterprises. The guarantees also encourage private lenders to extend financing to un-served/ under-served borrowers in new sectors and regions. Besides the sharing of risk, the intermediaries also enjoy improvement for their solvency ratio and provision of immediate cash by guarantee fund in case of default. Loan guarantees have 3-fold benefits:

- Sharing of risks makes it easier for intermediaries to fund new sectors
- Allows lenders to take additional risk by creating a new product or offering improved loan terms
- After the guarantee expires, banks continue to lend to these borrowers as intermediaries now have experience of dealing with these category of borrowers

The key products are:
Direct guarantee – to intermediaries that provide finance directly to borrowers partially covering a portfolio of loans
Counter guarantee – to intermediaries that issue guarantees

Product features:
Guarantee rate – for each guarantee in the portfolio, it ranges from 50%-100% and can be structured on the needs of the borrowers and intermediaries
Fees – Commitment fees are charged to encourage full use of available budget

Development finance institutions like IFC, USAID, ADB and EIF are some of the key players who offer loan guarantee and partial credit guarantees.

Good Practices in Risk Sharing via Guarantee Funds[35]:

- Size of Loan Cover - The optimum percentage of risk covered by a guarantee fund should vary between 50-80%. Lenders are unlikely to find a cover of less than 50% risk coverage for individual guarantees attractive, as it would not compensate for the loan appraisal and recovery process. However, a cover of more than 80% could create a moral hazard for itself as lenders might lose their incentive to expedite the recovery process
- Line of Risk - It is important to establish a clear line of risk as defined by the order in which the lender claims collateral/guarantee from the different parties involved in the loan i.e. first the borrower, then the guarantor and finally the guarantee fund. This is important because if the lender is forced to pursue the borrower first, the lender will be required to institute legal proceeding which saves the guarantee fund from having to review these issues itself. It also removes problems related to the validity of the loan contract or any of its clauses
- Size of the Guarantee - Size is most commonly defined as a fixed percentage of the unpaid part of the principal, plus interest payable at the moment the guarantee is called by the lender

Intellecap Assessment:
Relevance **(HIGH)** – Can be a new source of funding for funders of SEs
Feasibility **(MEDIUM)** – Is being done internationally however instances of Indian experience are still limited

Box 12 | **IFC-SEWA loan gauarantee program**

In May 2012, the IFC decided to provide a partial credit guarantee for a USD 5 million loan via ICICI Bank to Self-Employed Women's Association (SEWA) sponsored Grassroots Trading Network for Women. The loan will be further utilized for on-lending to SEWA members to purchase the clean energy lanterns and cook stoves.

Under the IFC-SEWA arrangement, women members will be provided a loan of INR 4,800 - 6,000, depending upon the products selected, repayable with 15% interest in 16 installments, for buying solar equipment from the designated suppliers.

USP: Unique financial model where unsecured loans are being offered at as low as 15% interest to rural households. There is no unsecured finance/subsidy for clean energy products available at such low rates either from a bank or an MFI. IFC's guarantee helps bankers to stay confident about the borrower

6.1.4 Equity like debt

Subordinated debt:
It is also known as subordinated loan or junior debt as the debt providers have a subordinate status in relationship to the normal debt. It has a lower credit rating and therefore, a higher yield. However, it has a lower priority than other debt in case of liquidation during bankruptcy. This is usually structured as a term loan for a fixed period with flexibility in repayment (interest-free period, etc.)

Convertible loan:
It is essentially a loan where borrowed money has to be repaid back with interest. The conversion feature gives the lender an option to convert all or a portion of the outstanding principal of the loan into some form of an equity position in the borrower's company. Simply, the lender has reserved the right to exchange the creditor position with the company to become an owner in the company. The borrower is willing to provide the lender with this option in exchange for securing more favorable terms on the loan such as no prepayment penalties, lower interest rate, payment vacations, etc.

Quasi-Equity debt:
This is usually structured as a debt where the financial returns are calculated as a percentage of the future revenue streams of the investee company. This is very beneficial to social enterprises or charities where share capital may not be possible due to the investee's legal structure. If the future expected financial performance is not achieved, a lower or possibly zero return is paid to the investor. Conversely, if performance is better than expected, then a higher financial return is payable. The instrument can be structured so that the return is capped or be limited in duration. The returns too can be linked either to the gross revenue or the incremental revenue. This offers the borrowers better alignment of cost of capital with business performance, less time-consuming proposition than raising equity finance and no dilution of ownership and control.

Convertible debt:
This is a loan that can be turned into equity, generally upon occurrence of future financing.

Warrant:
It is a security that entitles the holder to buy the underlying stock of the issuing company at a fixed exercise price until an expiry date. In essence, it is similar to options. This is also similar to an equity kicker.

Royalty financing:
This is when the investor takes an ownership in the product and has to be paid a percentage of the profit in return of the investment.

Intellecap Assessment:
Relevance **(HIGH)** – Equity as debt, with all its variants is essential for SE to grow
Feasibility **(HIGH)** – No legal or feasibility issues

Box 13 | **Social loan**

A recently experimented model, a 'Social Loan' will provide social enterprises with a flexible financing tool while linking investors' returns to growth in turnover and social impact.

Community transport organization HCT Group in the UK teamed up with Bridges Ventures to design this product. In 2010, the HCT Group raised GBP 3 million out of a total GBP 5 million fundraising, aimed at

meeting HCT's capital requirements. The total fundraising is expected to comprise GBP 2 million in Social Loan and GBP 3 million in a traditional fixed rate loan.

Bridges Ventures, lead investor on the Social Loan, invested GBP 1 million in the Social Loan. The Futurebuilders Fund, which the Social Investment Business manages on behalf of the Office of the Third Sector, has invested GBP 1 million in the fixed rate loan and GBP 0.5 million in the Social Loan. Rathbone Greenbank Investments, a Bristol based fund manager, is expected to invest in the second round.

USP: The creation of the 'social loan' concept aims to level the playing field for social enterprises which have to compete with private sector companies who, by the nature of their business model, have better access to credit. The social loan aligns returns to investors with growth or falls in the enterprise's turnover and social outcomes.

6.1.5 Pooling of securities

Product details:

Structured microfinance transactions can be broadly classified as direct and indirect securitizations. In direct securitization, microloans originated by single or multiple MFIs can be pooled into a Special Purpose Vehicle (SPV) that is typically a trust. The trust issues securities backed by the cash flows from the pool. The buyers of these securities now own a portfolio of microloans and the consideration received for the issuance pays off any original financier. Typically, these securities are sold in tranches. In this form of securitization, investors have an exposure to the underlying borrower and the performance of these transactions depends on the credit worthiness of the microloan borrower and the MFI's ability to collect repayments in a timely manner.

Figure 29 Graphical depiction of securitization process

Source: Introduction to Securitisation for MFIs, IMFR Capital

In indirect securitization, loans made to MFIs get pooled into an SPV. The most commonly used form of indirect securitizations is collateralized debt obligations (CDOs).

The advantages of securitization for the originator of the microfinance assets include relief in regulatory and economic capital, diversification of investor base, access to new and potentially cheaper sources of funding based on asset risk rather than corporate risk and portfolio management.

IFMR Capital, based in Chennai, has completed 3 securitization transactions in last one year including one with Vistaar Finance which is in the SME finance segment.

Intellecap Assessment:

Relevance **(HIGH)** – Learnings from structured microfinance financing can be applied for SE funding where pooling of loans made SEs can be securitized

Feasibility **(HIGH)** – This is already being done in India

Box 14 | **IFMR SME Securitization**

In July 2012, India's IFMR Capital closed an INR 77.2 million rated PTC securitization transaction (called Abeona SBL IFMR Capital 2012) with its partner; the Bangalore based NBFC, Vistaar Financial Services Private Limited. The transaction was IFMR Capital's first securitization of an exclusive SME loan pool and one among very few similar transactions in the past.

The pool was broken up into two tranches. IFMR Capital invested in the junior tranche while a large NBFC invested in the senior tranche.

Vistaar's product offering to has both a lower sized loan (up to INR 70 thousand) backed by hypothecation of stock as well as a higher ticket size product backed by mortgage of property (up to INR 1.5 Million). Vistaar's credit appraisal process depends heavily on estimation of real cash flows in the small business which is often not reflected in financial statements or paper documentation.

USP: First transaction with a new and small originator (Vistaar) in a space that is dominated by larger NBFCs having significant vintage.

6.1.6 Socially Responsible Investment Product (SRI)

Product details:

This is also known as Sustainable and Responsible Investing. SRI is about making investment decisions to achieve long-term competitive financial returns together with positive societal impact. As a result of its investing strategies, SRI works to enhance the bottom lines of the companies in question delivering long-term growth for shareholders. In addition, investors seek to build wealth in underserved communities. SRI investors include individuals, and institutions such as corporates, foundations, insurance companies, pension funds, religious institutions among others.

The typical approaches applied by investors in SRI are:

- **Screening** – This is a practice of evaluating investment portfolios or mutual funds based on social, environmental and good corporate governance criteria. 'Buy' lists include enterprises having strong environmental practices, good employee-employer relations, making positive contributions to the society. There is also a 'negative' screen which includes companies whose business practices and products are harmful to individuals, communities or the environment. SRI investors avoid making an investment in these companies.
- **Shareholder advocacy** – This involves SRI investors taking an active role in talking or dialoguing with companies on issues of social, environmental and governance concerns. This is done to create a positive pressure on the companies and their managements at improving company policies and practices, encouraging good corporate citizenship and promoting long-term shareholder growth.
- **Community investing** – This directs capital from investors to communities that are underserved by traditional financial services institutions and providing access to basic banking products along with credit, capital and equity that these communities would otherwise lack. Community investing makes it possible for local organizations to provide financial services to low-income individuals and to supply capital for small businesses and community services such as affordable housing, healthcare, etc. This is the fastest growing area of SRI. There are a wide range of products and services available for investors interested in SRI such as mutual funds (including hedge funds and exchange traded funds), term deposits (cashable or fixed term – money invested in community projects) and savings accounts. As of 2012, there are more than 300 mutual fund products in the US alone following the SRI approach with assets of over USD 640 billion.

Intellecap Assessment:
Relevance **(MEDIUM)** – This is not a new concept but would have an impact on SE funding
Feasibility **(MEDIUM)** – This is legally feasible but companies need to provide data regarding their practices and impact of their products to investors to take SRI based decisions

6.1.7 Loans that qualify for Community Reinvestment Act (CRA) credits

Product details:
The CRA is a US federal law, passed in 1977, designed to encourage banks and financial institutions to meet the financial credits and service needs of low and moderate income (LMI) neighborhoods. However, the CRA is not about spending public money for this or applying for grants formally with the government. The law simply requires that lenders use their private-sector resources to meet the financing needs of all communities in which lenders conduct business, consistent with safe and sound banking practices.

CRA requires periodic evaluations of each institution's lending, investment and service activities in LMI neighborhoods. Regulators take performance on these evaluations into account when considering lenders' applications for expansion of services, mergers and acquisitions. Also, a positive or a negative CRA rating can have a powerful impact on the lender's image and its relationships with communities and neighborhoods and consequently, its long-term business performance.

Under current CRA regulations, community development encompasses:
- Affordable housing, including multi-family renting
- Community services targeted at LMI individuals
- Activities that promote economic development by financing small businesses
- Activities that revitalize or stabilize LMI geographies

The most obvious type of CRA resource available is loans. They can take many forms and maybe market-rate or below market-rate and have unconventional terms or underwriting criteria, for e.g., lengthened amortization periods, no-interest periods, low down-payment requirements, reduced fees or points, or special collateral provisions. Lenders can distribute the loans directly or through intermediaries. Many lenders also provide non-profit organizations bridge loans or working capital loans as part of their CRA activities.

Intellecap Assessment:
Relevance **(MEDIUM)** – This is similar to Priority Sector Lending that is applicable on Indian banks. If the social enterprises are also included as part of it then there are chance of it making a higher impact.
Feasibility **(HIGH)** – This is legally and technically feasible as long as usage of funds and their impact is tracked effectively

6.1.8 Zero Coupon Bond (also known as Discount Bond)

Product details:
A zero coupon bond is a bond that makes no periodic interest payments and is sold at a deep discount from face value. The buyer of the bond receives a return by the gradual appreciation of the security, which is redeemed at face value on a specified maturity date. They are very common and most even trade on major exchanges.

Zero coupon bonds are usually long term investments maturing in ten or more years. Although lack of regular payments (or coupons) can discourage some investors, others find the securities ideal for meeting long term financial goals. The deep discount helps the investor grow a small amount of money into a sizeable sum over the years. Zero coupon bonds issued by the government are very safe and hence risk of default is nil. Zero coupon bonds were introduced in

1960s but did not become popular until 1980s. Corporates, governments and treasuries of countries issue zero coupon bonds. Pension funds and insurance companies like to own long maturity zero-coupon bonds because of the bonds' high duration. This high duration means that these bonds' prices are particularly sensitive to changes in the interest rate, and therefore offset, or immunize the interest rate risk of these firms' long-term liabilities.

The reason it is not very popular amongst investors is that in the US, the bond owner has to pay taxes on a yearly basis on interest which has not been paid out as yet. However, in India, the bonds are taxed based on formula for long term capital gains. The other reason for not preferring zero coupon bonds is that the money collected at the end of the term may have lost some of its value due to inflation.

Intellecap Assessment:
Relevance **(HIGH)** – They remove the burden of periodic interest payments for SEs that are not immediately cash flow positive. Can also be customized with the option to make early re-payments
Feasibility **(HIGH)** – Zero coupon bonds have been introduced in India.

6.1.9 Community Investment Notes

Product details:
The Community Investment Note (CIN) is a high impact investment with a fixed rate of return. On purchase of a CIN, the full value of the principle is lent out to help underserved communities. As loans are repaid, the capital is lent out again, multiplying the social impact of the capital. At maturity, the capital is returned with interest. This product has been pioneered and offered by Calvert Foundation since 1995.

CIN is an instrument in which individuals and institutions can invest in increments of USD 1000 purchasing directly from Calvert Foundation or through brokers approved by Calvert. The term of CIN varies from 1 to 5 years with fixed rate of return increasing from 0.5 to 2.0%. Since 2004, 1 year and 5 years notes are electronically exchangeable. Also, from 2007, in partnership with MicroPlace, CINs can be purchased for as little as USD 20. Initially, funds like ACCION and FINCA were the principal borrowers, but from 2007, Calvert's has been investing directly in MFIs operating across the world. The Note portfolio is professionally managed by a team that uses industry-leading due diligence to carefully vet the borrower. Some of the areas where investments have been made are:

- Promoting healthier communities
- Supporting affordable housing
- Investing in women
- Creating jobs
- Expanding access to financial services
- Educating the next generation
- Promoting environmental responsibility
- Promoting sustainable trade and agriculture

Each year, investors are provided with a detailed report on the real-life impact of their investment. As of December 2011, CIN had more than 7,200 investors investing close to USD 215 million, sourced by more than 400 brokerage firms across the USA. Out of the total investments, USD 184 million has been lent out to 208 borrowers in 80 countries with a rate of repayment of 100% to investors.

Intellecap Assessment
Relevance **(HIGH)** – This is another form of a loan with low rate of interest
Feasibility **(HIGH)** - This is an easily replicable model and can be implemented in India

6.1.10 Revolving Loan Funds (RLF)

Product details:

RLF is a gap financing measure primarily used for development and expansion of small businesses. It is a self-replenishing pool of money, utilizing interest and principal payments on old loans to issue new ones. While the majority of RLFs support local businesses, some target specific areas such as healthcare, minority business development, and environmental cleanup. Often the RLF is a bridge between the amount the borrower can obtain on the private market and the amount needed to start or sustain a business. With competitive rates and flexible terms, an RLF provides access to new financing sources for the borrower, while lowering overall risk for participating institutional lenders. Typically, RLF loans include:

- Operating capital
- Acquisition of land and buildings
- New construction
- Facade and building renovation
- Landscape and property improvements, and
- Machinery and equipment

Product characteristics:

Durations vary according to the use of funds. A loan used for working capital, for instance, may range from 3 to 5 years, while loans for equipment are up to 10 years and real estate loans may last 15 to 20 years. Loan amounts range from small (USD 1,000 -10,000) to mid-sized (USD 25,000 - 75,000), with larger (USD 100,000 - 250,000 and up) amounts available when the borrower has secured a substantial sum from private lenders.

Borrowers undergo a standard financial review having to submit their business plan, financial statements, cash flow projections, etc. They must also adhere to performance metrics set by the loan administrator. Review committees must be careful while giving loans as making too many long-term loans could result in fewer new loans, slowing the revolving mechanism and defeating the purpose of the product.

There are numerous examples of local community and state-level RLFs in the US. For example, Cascadia Loan Fund provides loans to small businesses and nonprofit organizations in Washington and Oregon. The Cascadia RLF is capitalized primarily through individual donations and investments. Loan interest and fees cover the operating expenses. In addition, donations and grants are used to administer technical assistance and special programs. Loans are available for businesses owned by low-income people, women, minorities, and immigrants, child care businesses, businesses that create family-wage jobs in low-income communities, businesses in rural communities, nonprofit community building organizations, cooperatives, and businesses that work to preserve or restore the environment. Till 2003, 434 loans amounting to USD 29 million had been provided for. Cascadia loans are used to finance equipment and inventory, working capital, building improvements, debt refinancing, and other qualifying expenses. The default rate for Cascadia loans is extremely low (1%) in part because borrowers are given customized technical assistance and closely monitored to ensure success. This is similar to Community Investment Note by Calvert in revolving of capital mechanism

Intellecap Assessment:

Relevance **(HIGH)** – While a revolving loan fund cannot finance projects on its own, borrowers benefit from flexible and favorable terms, and financial institutions enjoy lower overall risk in supporting tsmall businesses

Feasibility **(HIGH)** – No legal or feasibility issues

6.1.11 Equity Loan Assistance

Product details:
This is primarily an interest free loan for SMEs with a moratorium on the repayment of the loan.

State Bank of India (SBI) has a product called Small and Micro Interest-free Loan as Equity (SMILE) launched in 2010. This is to assist professional and technically qualified entrepreneurs setting up Micro and Small Enterprises (MSEs) get margin funding for projects worth more than INR 1 million. Equity assistance is capped at INR 1 million for MSEs and INR 0.5 million for professionals. The entrepreneur has to contribute to 50% of the margin. The procedure for appraisal and sanction of the loan is similar to normal cases. The repayment is over a period of 3 years after an initial moratorium of 5-7 years during which, the other term loads can be repaid.

There was no record of how the product has performed in the market and calls to SME branches of SBI in Hyderabad did not yield any info. Also, internationally, there are no examples of this. Maybe it is termed as something different.

Intellecap Assessment:
Relevance **(HIGH)** – Significant impact to SE lending but amount cap needs to be looked at
Feasibility **(HIGH)** – No legal or feasibility issues as SBI is already having such a product in India

6.1.12 Community Debt Financing

Product details:
Community Debt Financing Institutions (CDFIs) use investor capital to finance or guarantee loans to individuals and organizations that have been historically denied access to capital by traditional financial institutions. These are generally high-risk ventures in rural areas. The loans made by CDFIs, that are fully repayable at competitive interest rates, reflect local knowledge of the needs of the community.

Intellecap Assessment:
Relevance **(MEDIUM)** – Not innovative but can be helpful for SE funding
Feasibility **(MEDIUM)** – Implementation of the product should not be a challenge given its focus on local knowledge and needs of the community; however the high risk perception attached with the products can reduce its attractiveness

6.1.13 Revenue participation certificate (RPC)

Product details:
Revenue Participation Certificate gives the investor rights to the revenues of the company. The return for the investor is based on a percentage of the revenue of the start-up. Revenue Certificates are a desirable form of security structure for the entrepreneurial company because issuing one involves no equity ownership. Through Revenue Certificates, investors earn current cash returns (monthly or quarterly) over the life of the investment.

Intellecap Assessment:
Relevance **(HIGH)** – Both enterprises and investors can benefit. By selling "Revenue Certificates" to raise capital, social enterprises can successfully fill the capital gap between personal equity financing and capital from the traditional capital markets
Feasibility **(LOW)** – The financial ecosystem in India needs to evolve significantly before RPCs can be introduced

6.2 Innovative instruments for raising development assistance

In addition to the instruments mentioned in the previous section, innovative instruments/ channels can be used to raise fund for development assistance. These can be broadly classified into 3 main groups:

1. Instruments to mobilize government funds
2. Instruments to mobilize private funds
3. Instruments that increase efficiency or debt conversion in order to free up additional funds

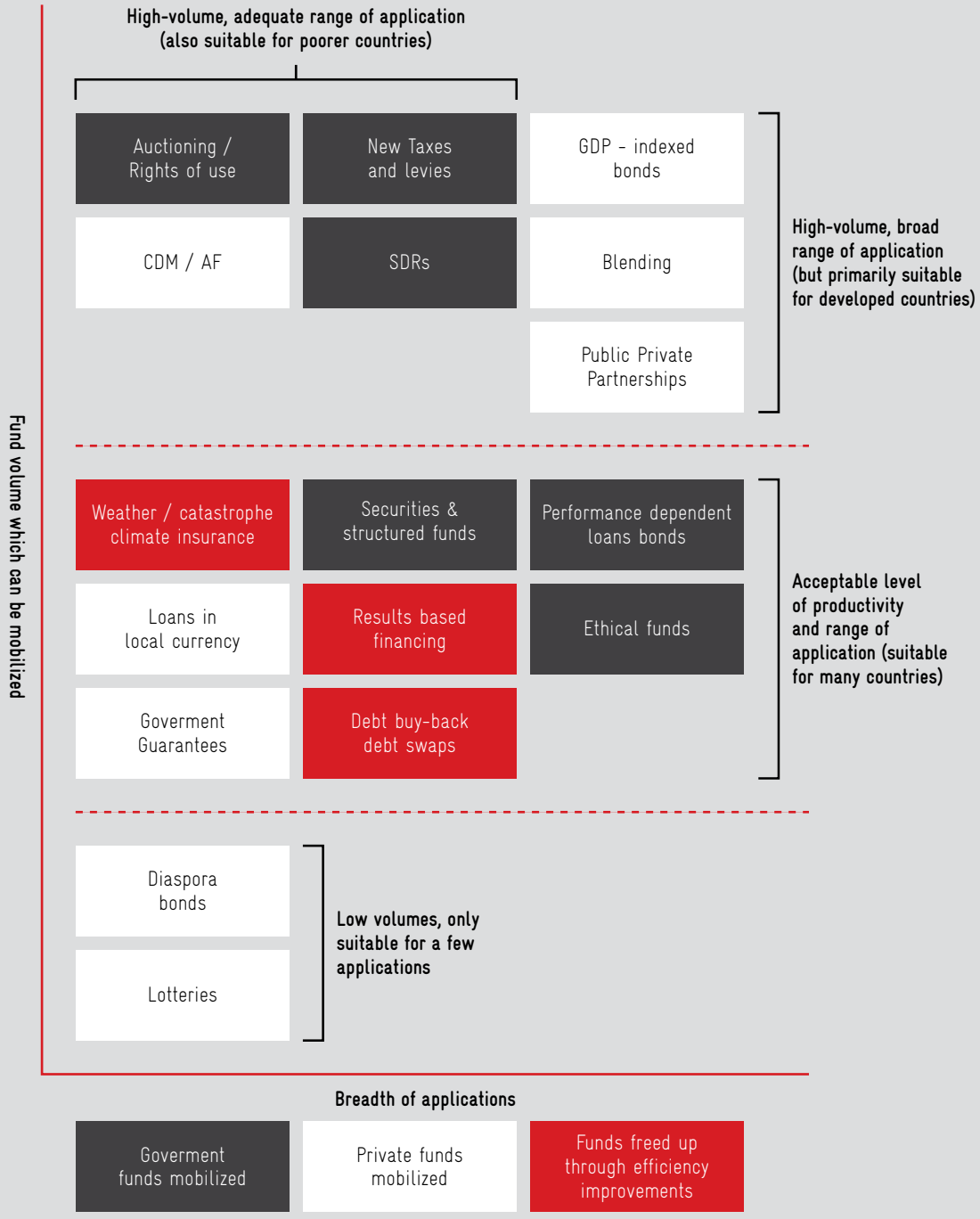
The various instruments are captured in Figure 31 below. Detailed descriptions of these products are captured in APPENDIX 6: INNOVATIVE PRODUCTS FOR RAISING DEVELOPMENT ASSISTANCE

For a foreign entity to participate in increasing the flow of debt capital to social enterprises in India, some of the relevant products from this innovative product spectrum would include:

1. Instruments to mobilize private funds
   - **a.** Government Guarantees
   - **b.** Ethical funds
   - **c.** Blending
   - **d.** Securities & Structured Funds

2. Instruments that increase efficiency or debt conversion in order to free up additional funds
   - **a.** Results based financing
   - **b.** Debt buy-backs/ debt swaps

Figure 30 **Spectrum of instruments based on their breadth of application and their potential for mobilizing large sums**



Source: An overview of innovative financial instruments used to raise funds for international development, KfW, August 2012

6.3 Venture Debt: A tool with potential?

As mentioned in Chapter 4, NBFCs in India have been pioneering the use of venture debt as a means of debt provision to enterprises. While the instrument is a relatively new in India, it has immense potential in enterprise financing as seen from international experience. This section analyzes the use and popularity of venture debt internationally.

Definition:

Venture debt, also known as venture lending, is a term that broadly covers loans to early stage VC-backed companies. In return for the loan, the venture lenders receive principal and interest payments together with warrants and sometimes, depending upon the contract, the right to invest in a future round. Lending to early stage companies can broadly take two forms, venture leasing and venture debt

- *Venture Leasing:* Resembles leasing in the traditional sense, where specific assets are leased and the title of these assets belongs to the lessor
- *Venture Debt:* A venture loan is where a loan is provided and backed by a senior lien on substantially all assets of the company including intellectual property. Venture debt is generally any form of debt financing (including overdraft facilities and/or invoice discounting) provided to a company that is still dependent on VC financing to fund its operations

1 **Venture Debt Products available internationally:**

- *Equipment loan:* Equipment loans enable a company to finance specific assets in a cost-effective manner. These loans generally have 36-month terms with the principal amortized monthly. The loans are secured by the equipment itself
- *Growth capital loan / term loan / working capital loan:* Growth capital loans are used to fund general corporate and operation's needs. These covenant friendly, nonrestrictive loans provide start-ups with runway and flexibility and are structured to fit the specific needs of a company. (Covenant friendly meaning they have flexible covenant structures suitable or adjusted for growth stage and VC backed companies). They are usually much more flexible than a bank equivalent
- *Line of credit:* A line of credit is a loan facility which is also referred to as an accounts receivable line, a formula line or a receivables line. It can be drawn down as the need arises or not touched at all and saved for emergencies
- *Bridge loan:* A bridge loan is a short-term secured loan that is used until a company can arrange a more comprehensive longer-term financing. The need for a bridge loan arises when a company wants additional flexibility whilst arranging a longer-term equity or debt facility
- *Pre-IPO loan:* A pre-IPO loan would be similar to mezzanine, would be slightly larger than other deals, and would reach maturity after one or two years
- *Account receivable facilities:* Accounts receivable facilities are tailored for companies that have reached a threshold of sales volume and therefore could be financed with additional capital. This product is not offered widely amongst European venture lenders
- *Subordinated debt:* In some cases, a start-up wants to further delay its next round of financing even though the company already had some debt on its balance sheet. These loans are generally secured by a second lien on the assets of the company and are free of covenants, providing runway or cushion to the start-ups next equity financing. This product is not offered widely amongst European venture lenders
- *Convertible debt:* Convertible debt allows a company to convert all or a portion of its outstanding loan into equity at a certain point in the future, usually structured at the outset. This hybrid instrument allows a company to get the benefits of a loan while also enabling it to convert into equity. This product is not offered widely amongst European venture lenders
- *M&A Financing:* There are various financing products that can be tailored to the needs of companies that are contemplating mergers, acquisitions, or specialized financial transactions. These products are generally structured to provide maximum flexibility with respect to size, timing, and option value. Structure options enable a company to match its financing needs with its business objectives

2 **Venture Debt in the USA:** Venture debt providers are typically classified into two categories:

- *Commercial banks with venture-lending arm:* These banks typically accept deposit from the startup companies, and offer venture debt to complement their overall service offerings. Some players in this category are: Bridge Bank, Comerica, East West Bank, Silicon Valley Bank, Square 1 Bank, Wells Fargo
- *Specialty finance firms ("venture debt shops"):* Typically can provide higher dollar size and more flexible

loan terms. Some prominent ones are: Hercules Technology Growth Capital, Horizon Technology Finance, Lighthouse Capital, NXT Venture Finance (backed by Stone Point Capital/Trident Funds), ORIX Venture Finance (venture debt arm of the Japanese financial services firm), Oxford Finance, Pinnacle Ventures (this is a crossover equity and debt firm), TriplePoint Capital (backed by Wafra), Western Technology Investment. Silicon Valley Bank is by far the largest; with perhaps 70% market share in this space. Two of the other major banks, Comerica and Bridge Bank, also have significant operations in the Silicon Valley/Bay Area.

- *Market Size:*
  - According to statistics compiled by VentureOne, venture loans totaled nearly USD 2 billion in 2006. Conservative estimate is that a venture debt market equal to 10% of VC dollars invested, while the aggressive estimate was 10–20% of VC dollars invested
  - Typical venture loan is anywhere from USD 2–10 million, banks. Within the segment banks provide loans of up to USD 2 million, while non-banks provide average loans of USD 3 million and up
  - The term of a typical venture loan is between twenty-four and thirty-six months, sometimes with an interest-only period of three to nine months before the term begins, and sometimes with an option to draw down the loan for up to one year
  - In addition to the debt security, there is also an equity piece comprised of warrants in the start-up. Warrant coverage typically ranges from 5–15% of the loan amount. For the banks, which are prohibited by law from holding equity interests, the warrants are held either at a holding company level or in a separate legal entity
- *Some key trends in Venture Debt in the US*
  - VC backing increases the probability that a startup will obtain venture debt, for both early-stage and late-stage backing. Having VC backing reduces the impact that cash flows have on the lending decision
  - Holding key patents increases the probability of receiving venture debt, the likelihood that a firm receives the loan significantly increases if the patent portfolio is offered as collateral,
  - The probability that a startup will obtain venture debt financing increases with the amount of warrants being offered
  - High-growth startups with positive cash flow have the highest probability of obtaining a venture debt
  - Interestingly, offering key patents as collateral is more important to the lender than offering tangible assets
  - Qualitative research proposed that venture debt is the most prevalent in IT

3 **Venture Debt in Europe:**

- *Market Size:* The amount of venture debt investment peaked in 2007 at GBP 309m invested in 123 deals. Venture debt as a percentage of venture capital was 10.2% in the UK and 5.8% in Europe in the same year, its highest on record.

Table 7 Typical venture debt transaction

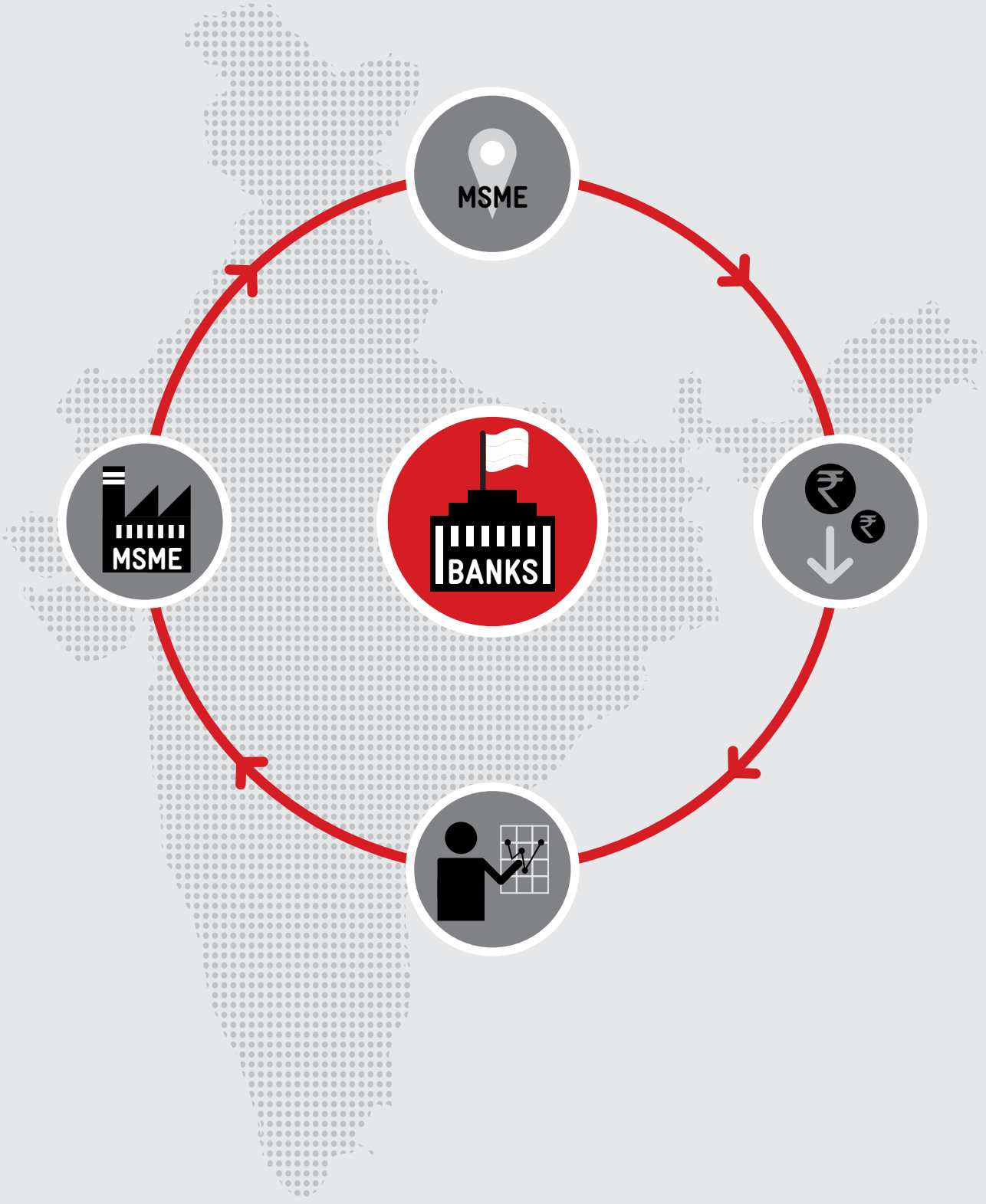
Typical Term	3 Years
Average annual interest rate	10-15%
Typical Size of Loan	GBP 1-5 million
Warrant Size (% of the size of a loan)	10-20%

Source: The Rise of Venture Debt in Europe, May 2010

- *Trends in Venture lending in Europe*
  - As of 2010, Close to 400 companies have received venture debt from UK venture lenders with GBP 425 million invested into UK companies, GBP 362 million into European companies and GBP 199 million into the rest of the world (mostly in Israel)
  - The average size of a venture loan is GBP 2.1 million with a range of GBP 1-5 million. Companies in the internet, biotech and semiconductor sectors had the highest average loan size
  - Companies raising their second round of equity were the number one recipient of venture debt. Only 18 investments have been in a first round
  - 33% of companies in one venture lenders portfolio had a turnover of less than EUR 1 million at the time of receiving a loan whereas another 41% had a turnover greater than EUR 5 million

Footnotes

35 KFW-Development Research, Focus on Development, No-5, 2012, An overview of innovative financial instruments used to raise funds for international development, Author: Dr. Helke Walde (Note: Please note above is a summary of this seminal research paper)
"Mapping of some important innovative Finance of Development mechanisms", - OECD conference 2011, Paris Innovative Finance for Development Solutions, The World Bank Group, *http://siteresources.worldbank.org/CFPEXT/Resources/IF-for-Development-Solutions.pdf*
'World Economic and Social Survey 2012: In search of New Development Finance". United Nations, 2012, New York


MSME
MSME
BANKS

7 Specialized Institutions: An Avenue for Social Enterprise Lending?

The previous chapters highlighted that there is no special recognition for Social Enterprises in the Indian banking system, as is the case across other emerging economies. Social Enterprises are viewed under the larger MSME umbrella and all loan evaluation processes for Social Enterprises follow the norms for MSME loan evaluations. Thus, in order to effectively extend credit to Social Enterprises it is useful to understand best practices in providing bank credit to MSMEs in general. We would like to specifically explore what potential the establishment of specialized institutions has for lending to the social enterprise segment. We are looking at a group of banks that are committed to address social challenges and that have given themselves a label "Sustainable Banks".

7.1 Best Practices in Bank Lending to MSMEs

A recent McKinsey report[36] lists a number of key activities (Refer Table 7) that banks in emerging markets should follow in order to effectively capture the MSME segment. These activities are:

- **Develop a granular understanding of the markets:** MSMEs tend to be dispersed geographically thus banks must identify clear geographic concentrations of MSME businesses. Also it is important to understand the size of the potential banking revenue pool in the sectors in which MSMEs operate and the exact needs and business models of enterprises in each of the sectors.
- **Radically lower operating costs:** Given the low level of bank revenue per MSME client, banks should find innovative mechanisms of lowering operating costs to achieve higher profitability. This could include innovation distribution (low cost branches, correspondent banking, technology-led innovations), product design and staff deployment
- **Manage risk innovatively:** Data availability on credit history of SME borrowers tends to be low. Thus banks should develop new and creative ways to assess credit, such as psychometric testing, cash flow estimates, or qualitative credit assessment (QCA). All associated credit processes (e.g., loan origination, monitoring and collections) must be streamlined.
- **Empower MSME clients:** Financial and business illiteracy in emerging markets leads to poorly presented business cases, the single most important reason why banks decline credit applications. Banks should take the initiative to address this problem, by organizing seminars for existing MSMEs or providing start-up packages for new ones.
- **Engage with government:** Poor business environment and culture in emerging markets necessitates that banks must work with regulatory authorities to establish risk-sharing facilities and credit bureaus, or seek out information that identifies under-served and unserved clients.

Table 8 Best practices that address challenges in MSME lending

CHALLENGES	BEST PRACTICES
DISPERSED CLIENTS: Urbanization lower than in advanced markets – e.g., 30% in India, 40% in Africa, 45% in China versus 80% in Europe	Develop a granular understanding of the markets
LOW BANK REVENUE PER CLIENT: Bank revenue per client averages USD $2,100, so traditional distribution is unprofitable	Radically lower operating costs
POOR DATA AVAILABILITY: Only 5–30% of emerging market SME borrowers are covered by credit bureaus	Manage risk innovatively
BUSINESS / FINANCIALLY ILLITERATE CLIENTS: Financial literacy in BRICS countries (most developed emerging markets) of ~50 to 60% compared to G7 countries of above 60%	Empower MSME clients
POOR BUSINESS ENVIRONMENT: Emerging market nations rank in lower half of World Bank Doing Business indicators	Engage with government

Source: Micro, small and medium-sized enterprises in emerging markets: how banks can grasp a $350 billion opportunity (McKinsey & Co, 2012)

The above best practices highlight that banks should set up **specialized institutions** with customized processes in order to effectively extend debt for their intended target segment. This is a view that is also supported by India's central banking institution – RBI. The next section outlines some of RBI's perspectives on specialized institutions and directed credit programs.

7.2 Institutions and Channels: RBI's Perspective

- *Directed Credit Programs and Specialized Institutions:* The RBI views directed credit programs involving loans on preferential terms and conditions to priority sectors as a major tool of development policy. In 2005, RBI conducted an international review[37] of these programs to understand the merits and demerits of these schemes. The review involved comparative analysis based on key aspects of credit policies such as the scope and size of the programs, the level of subsidies, the sources of funding, the types of implementing institutions, the quality of monitoring and supervision, the rate of loan recovery and loan losses, and the underlying strategy and focus of credit policies across geographies. One of the key findings of this study was that *"Directed credit program is more effective when channelized through specialized financial institutions other than banks, viz., Reconstruction Finance Bank (RFB) and (DBJ) in Japan and Land Bank of the Philippines, Development Bank of the Philippines."*

Thus RBI recognizes the importance of specialized institutions in effective disbursal of directed credit.

Box 15 Specialized institutions for directed credit in the Philippines

Land Bank of the Philippines: A bank in the Philippines owned by the Philippine government with a special focus on serving the needs of farmers and fishermen. Has an extensive rural branch network servicing many rural sector clients in areas where banking is either limited to rural banks or is non-existent.

Development Bank of the Philippines: Second-largest government-owned bank, next only to Landbank. It focuses on financing the various businesses and economic sectors that are vital for the growth of the Philippine economy. E.g. SME segment

- *Dedicated SME Verticals at Banks:* In Feb 2012, the RBI asked banks to set up dedicated verticals for SMEs. While banks which have long-term association with such SMEs as lending partners, the dedicated vertical was aimed at extending this relationship by providing consultancy on finance, cash-flow management, taxation and other related things for a fee. Referring to the previous section, these verticals will help aid many of the best practices such as 'Empowering the target segment' and 'Gain granular understanding of the target segment.

- RBI's bullish view on specialized channels/ institutions for lending highlights the fact that **effective credit flow to social enterprises that meet their unique needs merits a specialized/ dedicated channel.** The next section reviews how globally have developed specialized institutions succeed in extending credit to social enterprises in the relevant geographies.

7.3 Banking for Impact – Integrating Social Concerns in Banks' Core Business

7.3.1 Sustainable Banking – Specialized institutions with a focus on social impacts

Internationally, more and more banks gain market share by focusing on extra-financial concerns and focusing on new customer segments that care about the creation of environmental and social impacts. There are multiple definitions of sustainable banking that is sometimes also termed as social and ethical banking. However, one widely used definition refers to sustainable banking as banking that aims to have a positive impact on people and the environment. Sustainable banking or for that matter, sustainable banks are not a new concept: Originally established in the 1980s in Europe, these banks focused on clients who did not have access to basic banking services such as credit or saving facilities or supporting the local community and economy. The three common core features across the sustainable banks are:

- **Triple bottom line –** Unlike traditional banks that judge lending and investment opportunities with a single bottom line, i.e. profit, sustainable banks are defined by applying three different but complimentary standards that take into account three different criteria, all of them equally considered: social, environmental and economic performance criteria.
- **Total transparency –** Sustainable banks let the customer know in every detail where her money goes, what it produces and to whom the money is being lent. Detailed reports are published at regular frequency to let the customer have a full insight into how her money is helping the world besides earning an interest.
- **Human development –** Sustainable banks focus on helping communities and growing individual capacities rather than simple profit. They believe that human development towards a more green and sustainable lifestyle is more important and beneficial for all than profit made by a few at the expense of others.

In 2009, the leading sustainable banks around the world joined together and established the Global Alliance for Banking on Values (GABV), an alliance of now 21 banks. As of 2012, the combined assets of these banks are USD 60 billion. They have a plan to touch a billion lives by 2020 from a 10 million currently by using sustainable banking.

The principles of Sustainable Banking articulated by the GABV are summarized as:

- *Triple bottom line approach at the heart of the business model* – By focusing simultaneously on planet, people and prosperity, sustainable banks design and develop products and services to meet the needs of the people and safeguard the environment while generating reasonable profit. The approach is

intentional in not just avoiding doing harm but actively using finance for good.

- *Grounded in communities, serving the real economy and enabling new business models to meet the needs of both* – Sustainable banks serve the financial needs of the communities in which they work by financing sustainable enterprise in productive economies.
- *Long-term relationships with clients and a direct understanding of their economic activities and the risks involved* – Sustainable banks establish strong relationships with their clients and help them become sustainable by understanding and analyzing their economic activities. Proper risk analysis is used at the product origination stage itself so that indirect risk management tools are not adopted as a substitute for fundamental analysis.
- *Long-term, self-sustaining and resilient to outside disruptions* – Sustainable banks adopt a long-term perspective to make sure they can maintain their operations and be resilient in the face of external disruptions.
- *Transparent and inclusive governance* – Sustainable banks maintain a high degree of transparency and inclusiveness in governance and reporting not only with its management and shareholders but also with the bank's extended stakeholder community.
- *All of these principles are embedded in the culture of the bank* – Sustainable banks seek to embed these principles in the culture of their institutions so that they are routinely used in decision-making at all levels. They develop human resource policies and stakeholder-oriented practices that reflect and encourage this value-based approach.

7.3.2 Business Model of Sustainable Banks

Most sustainable banks have similar business models. They offer traditional banking products to their clients, who in one way or another are under served by the mainstream banking sector. Since the goals and missions of these banks are not driven only by profit maximization, they work with clients in sectors like renewable energy or social projects that are labeled as too risky by mainstream banks. These banks have been visionary and have supported activities, sectors and individuals that chose a sustainable approach long before sustainability became a buzz word. These banks have also found a way to serve clients that have been neglected due to their poverty, lack of income or collateral. While on one hand, these specialized banks are niche banks that serve a specific sector or population, they are able to provide tailor-made products to their clients and thereby slowly gaining market share. They can choose to recycle gathered deposits in investments in the real economy.

1. **Financing of Sustainable Banks:** Table 9 clearly shows that sustainable banks are heavily financed by their client deposits. Except for XAC Bank and Banca Etica, deposits account for 90% or more of the bank's finances in 2011. This fits perfectly well with their mission to be a savings and loans bank. This also makes them independent from the interbank market. For banks working in poor economies, collecting deposits from clients would be a difficult task and hence they would be dependent on borrowed funds from interbank market, international institutions and microfinance investment funds.

Table 9 Sector focus of impact investment funds

Bank Name	Financing by Equity (2011)	Financing by Deposits (2011)
ABS	5.8%	92.9%
Affinity	7.8%	90.7%
Assiniboine	5.2%	93.9%
Banca Etica	4.5%	67.0%
Bankmecu	11.0%	85.0%

BRAC Bank	7.2%	77.9%
Centenary Bank	17.0%	74.0%
Cultura Bank	10.8%	87.8%
First Green Bank	12.8%	86.8%
GLS Bank	5.2%	86.3%
Merkur Coop Bank	9.4%	84.6%
New Resource Bank	11.4%	87.5%
OnePacificCoast Bank	11.7%	78.4%
Sunrise Community Banks	4.4%	86.2%
Triodos Bank	10.5%	87.0%
Vancity	5.2%	81.6%
XAC Bank	10.1%	43.9%

Source: Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)

2. **Products, Services and Processes:** These specialized banks offer a wide array of products and services to their depositors and borrowers – from traditional deposit and savings accounts to private banking and loans for projects that contribute to a more social and environment-friendly society and credits for poverty alleviation. Banks also have investment funds focusing on certain social, ecological, cultural and development issues. For example, customers of Banca Etica are able to invest their money directly in the bank and its loan portfolio in Social Responsible Investment (SRI) funds.

   At the same time, as these specialized banks are inspired by values of sustainability and human development, they adopt very different lending criteria compared to mainstream banks. In addition to traditional economic evaluation procedures, the companies undergo an evaluation aimed at analyzing and assessing the consequences of their activity on common welfare and the natural environment. To be able to do this, these banks have developed their own models which are applied to both the loan book and the ethical investment funds they are managing. An example is the VARI model (Values Requisites Indicators) of Banca Etica which employs both negative criteria for exclusion and positive criteria for encouragement. BRAC's Microfinance program applies a 'credit-plus' approach where loans are accompanied by various forms of assistance for the borrowers such as skills-training, provision of higher quality inputs and technical assistance as well as marketing for finished goods.

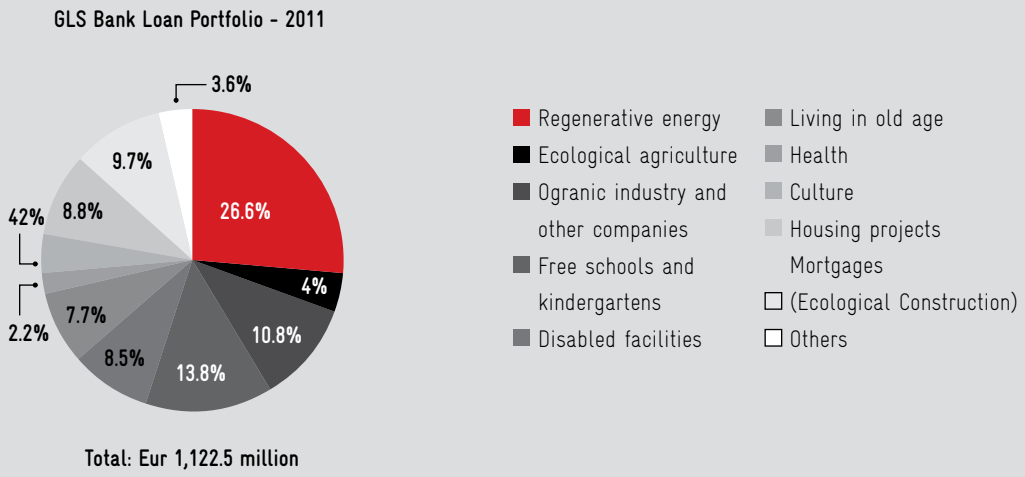
   Thus these specialized banks use core banking products and services to intermediate between those who want to invest their funds so that they can achieve a positive impact on the society, community or the environment and those who need funds to realize projects with such positive impact. Some examples of products that are considered characteristic of these specialized banks are listed in the table (Ref Table 10) below.

Table 10 Product portfolio of sustainable banks

Product type	Bank	Example
Sustainability loans & mortgages	GLS	Loans for wind and solar energy projects
Impact investment	Triodos	Venture capital investments in climate warming projects, organic fruit and vegetable trading and socially responsible fashion production
Sustainability savings accounts and certificates of deposit	ABS (Switzerland)	Certificates of deposits that are connected with loans to sustainable sectors like renewable energy
Microfinance	BRAC	Microcredits

An example of one of the bank's loan portfolio is listed below:

Figure 31 GLS bank loan portfolio



3. **Customer relationship:** In order to improve their relationship with customers, these specialized banks have defined two tools or pre-requisites – transparency on all banking activities and active involvement of the depositors in the bank's investment choices. For example, Triodos Bank customers know how their money is being used through a newsletter that they receive four times a year. The newsletter highlights the people and organizations benefiting from the bank's work. Triodos UK also offers 'Charity Savings Account' where the customer may choose between 10 different charities which receive a yearly fee of 0.25% on the balances of the savings account. Banks like Banca Etica and GLS Bank allow their customers to manage their savings through a certificate of deposit by selecting one of the many investment areas of the bank. Also, the customer may choose the interest rate that will be applied to his savings, ranging from zero to a maximum value. This shows that banks want to enhance the awareness with their depositors about their savings' destination. And by bringing the financed projects closer to the depositor, these banks believe it will shorten the distance between the bank and the depositor

4. **Cooperation across the network**

   A striking factor for sustainable banks in the GABV is that there is a high degree of cooperation amongst their members. Triodos Bank, being a large bank, cooperates with Merkur Bank on lending activities for larger Danish projects while Triodos Bank's international investment funds are sold in Denmark by Merkur Bank. With their target to touch a billion lives by 2020, GABV is encouraging more and more such collaborations between its members.

7.3.4 Sustainable Banking – A financial perspective

While assessing the financial impact for these specialized banks, it is imperative to do so for a group of peer banks over a period of time. The key question to answer is what long term value such a bank would provide to stakeholders including society, clients and investors. This would also help in gaining insights on which types of banks are best suited for the future. For this purpose, a research was undertaken by Global Alliance for Banking on Values (GABV) and published in November 2012 in a report titled, 'Strong and Straightforward: The Business Case for Sustainable Banking'. The research tried to answer the following questions:

1. What support does a bank provide to the real economy?
2. How resilient is a bank in the face of economic challenges?
3. What returns does a bank provide to society, clients and investors?
4. What growth does a bank achieve to expand its impact?

Three peer groups were used for the analysis: Sustainable banks, Global Systemically Important Financial Institutions (GSIFIs) and US Commercial and Retail Banks (USCRBs) with assets between USD100 million and USD 10 billion. The financial profiles for each of the peer groups were determined relative to four components:

- Commitment to real economy
- Capital strength and quality
- Financial returns and volatility
- Growth

Given the financial crisis in the last decade, the data was averaged over three time periods:

- Over the cycle – 2002 to 2011
- Pre-Crisis – 2002 to 2006
- Crisis / Post-Crisis – 2007 to 2011

1. **What support does a bank provide to the real economy?** The relative support to the real economy is illustrated by the proportion of its total balance sheet devoted to client lending and funded by client deposits.

Table 11 Real economy contribution comparison across banks

Loans and Deposits to Total Assets		Sustainable Banks	GSIFIs	USCRBs
Over the cycle	Loans / Total Assets	72.4%	40.7%	65.1%
	Deposits / Total Assets	72.5%	42.0%	76.8%
Pre-Crisis	Loans / Total Assets	73.2%	41.6%	65.1%
	Deposits / Total Assets	71.9%	42.8%	75.1%
Post-Crisis	Loans / Total Assets	71.7%	39.8%	65.7%
	Deposits / Total Assets	73.1%	41.1%	78.5%

Both sustainable banks and USCRBs show consistent commitment to lending and at the same time, a higher reliance on client deposits to fund the bank's assets. For GSIFIs, exposure to lending is significantly lower and reliance on non-client funding highlights their dependence on more volatile funding sources leading to liquidity risk.

2. **How resilient is a bank in the face of economic challenge?** There are striking differences in both the level and quality of capital strength across the reference peer groups. For both sustainable banks and USCRBs, capital ratios have been substantially higher than those of GSIFIs, especially the equity / assets ratio that provides a simple and straightforward measure of capital strength.

Table 12 Capital ratio comparison across banks

Capital Ratios		Sustainable Banks	GSIFIs	USCRBs
Over the cycle	Equity / Assets	7.5%	5.3%	10.5%
	Tier 1 Ratio	12.2%	10.0%	12.7%
Pre-Crisis	Equity / Assets	6.7%	5.0%	10.4%
	Tier 1 Ratio	11.2%	8.6%	12.5%
Post-Crisis	Equity / Assets	8.3%	5.5%	10.7%
	Tier 1 Ratio	13.1%	10.9%	12.9%

3. **What returns does a bank provide to society, clients and investors?** In assessing financial returns of a bank, it is important to focus both on the financial return ratios as well as their volatility. For banks, return on assets is a key measure of the quality of earnings and the management and business structure to deliver them. Return on equity is another measure that is significantly impacted for banks by their capital strategy and capital management process. It is also helpful to look at the volatility of financial returns over time as an investment with lower volatility should require a lower return from an investor.

Table 13 Volatility of returns comparison across banks

Capital Ratios		Sustainable Banks	GSIFIs	USCRBs
Over the cycle	Return on Assets	0.72%	0.55%	0.85%
	Standard Deviation	0.38%	0.38%	NA
Pre-Crisis	Return on Assets	0.71%	0.71%	1.33%
	Standard Deviation	0.31%	0.22%	NA
Post-Crisis	Return on Assets	0.74%	0.38%	0.36%
	Standard Deviation	0.34%	0.35%	NA
Over the cycle	Return on Equity	9.7%	10.8%	7.9%
	Standard Deviation	3.9%	11.6%	NA
Pre-Crisis	Return on Equity	10.4%	15.1%	12.5%

Capital Ratios		Sustainable Banks	GSIFIs	USCRBs
Post-Crisis	Standard Deviation	2.6%	9.4%	NA
	Return on Equity	9.0%	6.6%	3.3%
	Standard Deviation	3.7%	8.8%	NA

There has been a general perception that sustainable banks deliver lower financial returns. However, the tables above clearly refute these opinions. Relative to return on assets, sustainable banks deliver better returns with comparable volatility over the cycle than GSIFIs. The strength of sustainable banks is evident in the returns on assets post-crisis with substantially higher numbers than both GSIFIs and USCRBs. For return on equity, sustainable banks have lower returns over the cycle than GSIFIs but with significantly lower levels of volatility. Here again, in the post-crisis period, the strength and stability of financial returns of sustainable banks over the other groups is clearly demonstrated.

4. **What growth does a bank achieve to expand its impact?**
The growth of loans and deposits showcases growth of both, the market share of the bank and the economy it serves.

Table 14 Growth rates of banks across time

Compounded Annual Growth Rates (CAGRs)		Sustainable Banks	GSIFIs
Over the cycle	Loans	19.7%	7.8%
	Deposits	19.6%	10.0%
	Assets	19.0%	10.4%
	Equity	20.1%	11.5%
	Total Income	16.6%	6.9%
Post-Crisis	Loans	15.6%	4.3%
	Deposits	16.3%	7.8%
	Assets	15.2%	5.1%
	Equity	15.1%	10.5%
	Total Income	11.9%	4.4%

The data clearly shows that specialized banks who refer to themselves as sustainable banks have delivered significant growth over the cycle and more importantly, in the post-crisis period. Sustainable bank growth is amplified by their relatively smaller size. However, these growth rates suggest that the future of sustainable banks will be positively impacted by solid growth prospects.

It can be concluded thus, that these specialized banks over the last 10 years, have demonstrated a stable and positive performance while meeting the needs of the real economy and providing returns to a variety of stakeholders including the investors. This performance gets highlighted even more favorably in the post-crisis period compared with the other peer groups. This evidence from a group of sustainable banks demonstrates that banking based on sustainable principles offers a compelling

proposition for clients, investors and society. It is these specialized institutions that with a strong commitment can provide finance to social enterprises beyond equity. Further details on some of the banks are captured in Appendix 5.

7.4 Specialized Institutions for Sustainable Banking in India: Performance and Challenges

Studying the various international examples of banks focused on sustainable banking, one finds various successful institutions from which we can learn for the Indian context. Some existing initiatives attempt to mirror the international best practices. This section critically evaluates the performance of these existing initiatives in India: We specifically look at cooperative banks as a channel as well as at priority sector lending as an opportunity for social enterprises.

7.4.1 Cooperative Banks

Cooperative banks such as Rabobank and GLS are champions for providing finance to socially oriented entreprises globally. The Regional Rural Banks (RRBs), Urban Co-operative Banks (UCBs), State Financial Corporation (SFC), State Industrial Development Corporation (SIDC) operate in a similar vein having better information on the local context and operations of the enterprises they serve.
However these institutions account for only 8% of the formal debt supply to the MSME sector despite an extensive branch network (approx. more than 20,000 branches across India), due to inherent strategic and operational challenges . These include:

- RRBs operate in smaller, resource-poor markets but tend to have organization structures and operating costs similar to that of full-service bank branches
- RRBs face the perception of being a poor man's bank, resulting in lower deposit mobilization and increased dependence on sponsor banks
- With borrowers wielding considerable influence over the management, resulting in a conflict of interest and weaker decision making, UCBs suffer from challenges of poor governance
- High non-performing assets, poor credit appraisal and inadequate under-writing policies have stifled the growth of State Finance Corporations. In fact, very few of these corporations are active

7.4.2 Directed Credit via Priority Sector Lending

The RBI has identified Priority Sector Lending (PSL) guidelines to ensure greater flow of credit to certain sectors where credit would "normally" not flow to the desired extent. The credit is required for these sectors in terms of employment generation potential of these sectors and also social objective of reaching out to large masses of economically vulnerable sections of population. The existing PSL norms are provided in the table (Ref Table 15) below.

Table 15 Existing PSL guidelines defined by RBI

	Domestic Banks	Foreign Banks
Total Priority Sector advances	40% of Adjusted Net Bank Credit (ANBC)	32% of ANBC
Total agricultural advances Small Enterprise advances	18% of ANBC. However, advances under indirect lending to agriculture in excess of 4.5% of ANBC would not be reckoned in computing performance under the sub-target of 18%	No target 10% of ANBC
Micro enterprises within Small Enterprises sector	i. 40% of total advances to small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery	Same as for domestic banks.

	up to INR 0.5 Million and micro (service) enterprises having investment in equipment up to INR 0.2 Million ii. 20% of total advances to small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above INR 0.5 Million and up to INR 2.5 Million, and micro (service) enterprises with investment in equipment above INR. 0.2 Million and up to INR 1Million. (**Thus, 60 per cent of small enterprises advances should go to the micro enterprises).**	
Export credit	Export credit is not a part of priority sector for domestic commercial banks	12% of ANBC
Advances to weaker sections	10% of ANBC	No target
Differential Rate of Interest Scheme	1% 1 per cent of previous year's total advances	No target

Source: RBI Website

However there have been criticisms to the existing PSL norms. These include:

- *Lack of clarity on allocation of sectors under PSL:* There is no clear policy articulation of why certain sectors and activities are included and others not. For example, the share of agriculture and allied activities as a percentage of GDP in India has come down from 32% in 1990-91 to 15% in 2011-12, whereas the target of 18% of NBC to agriculture under PSL has remained unchanged over the decades
- *Uniformity of Application:* PSL policy for all of India ignores important regional differences. E.g. States like Tamil Nadu and Gujarat require more credit for promoting capital intensive businesses while states like Bihar and Orissa would require more advances for the weaker sections
- *Issues in Implementation:* PSL compliance of each bank is tracked at the end of the financial year i.e. in last week of March. This tends to create the 'March phenomenon' where plenty of credit becomes available in March while remaining in short supply for the rest of the year thus not ensuring smooth liquidity flow through the year.
- *High PSL NPAs:* A Financial Stability Report commissioned by the RBI in December 2011 highlights that the contribution of priority sector to aggregate NPAs of the banking system was 48% as at September 2011, which was higher than contribution to total advances of the banking system of 31% . This was especially pronounced in case of the agriculture sector.
- *Limitations on Channels of Disbursal:* There is a disproportionate emphasis on direct lending rather than lending through specialized intermediaries whose cost structures and underwriting techniques may be better suited to these sectors

A committee constituted by the RBI (Nair Committee) in 2012 suggested changes to the existing PSL guidelines.

- *Agriculture and Allied Services:* Removal of differential targets on direct and indirect lending to the sector
- *Sub-Target of 9% for Small and Marginal Farmers:* 9% of ANBC target for the small and marginal farmers. Additionally in order to mitigate the stress involved in this sector, the setting up of Credit Risk Guarantee Fund for Agriculture has also been recommended
- *Sub-Target of 7% for Micro credit*
- *Education Loans:* PSL limit increased to INR 1.5 Million in India and INR 2.5 Million in case of studies abroad
- *Foreign Banks:* PSL targets raised from 32% to 40%

- *Loans to NBFCs:* Loans for on-lending, buy-outs and securitization to a maximum of 5% of ANBC can be considered as priority sector lending

These recommendations address some of the challenges mentioned above, though they are yet to be fructified in policy changes.

7.5 Sustainable Banking in India via Specialized Channels

The Nair Committee referred in the previous section recommendations identifies 'Lending to non-bank financial intermediaries for on-lending' as a key area for Priority Sector Lending. The committee states:

"Keeping in view the role of non-bank financial intermediaries like Primary Agricultural Cooperative Societies (PACS), Cooperative Banks, NBFCs, Housing Finance Companies and MFIs in extending the financial services to the last mile, bank loan sanctioned to non-bank financial intermediaries for on-lending to specified segments may be reckoned for classification under priority sector, up to a maximum of 5% of ANBC. Portfolio buy-out, securitization and loans to intermediaries for on-lending would be classified as priority sector provided the underlying asset (asset to be financed, in case of on-lending) are eligible for classification under priority sector advances."

Thus there is increasing recognition of utilizing specialized institution for directed credit/ sustainable banking, a view that has already been reviewed in Section 4.2. The following case studies highlight existing NBFCs in India that pioneer directed credit to social enterprises in India highlighting the importance of such channels for increasing credit flow to the segment in India.

Box 16 **Kinara capital**

Objective: Provides loans in the range of INR 0.1-1 Million to micro and small enterprises filling the gap between microfinance and commercial capital with the goal of generating new jobs, improving incomes and creating sustainable businesses.

Products: Term loans, purchase order backed short-term loans and a bill discounting facility to producers and providers across the value chain for asset purchase or working capital needs

Customer Target Groups: Sole proprietor firms, Artisan groups, Partnership firms, Village level Entrepreneur

USP:
- Custom risk assessment methodology
- Flexible product terms
- Supply chain integration: Partnership with Villgro Village Level Entrepreneur (VLE)
- No defaults: Has disbursed 100 loans total loans till now with zero defaults

Customized Services for Client Segment:
- Free financial management training for entrepreneurs to decipher the financial underpinnings of their businesses and give them practical tools for ongoing cash management
- Business diagnostic tool geared for small business owners in India. It is a set of unique questionnaires to evaluate the current business setup spanning operations, management, financial control, supply chain/logistics, and human resources
- Non-collateralized lending

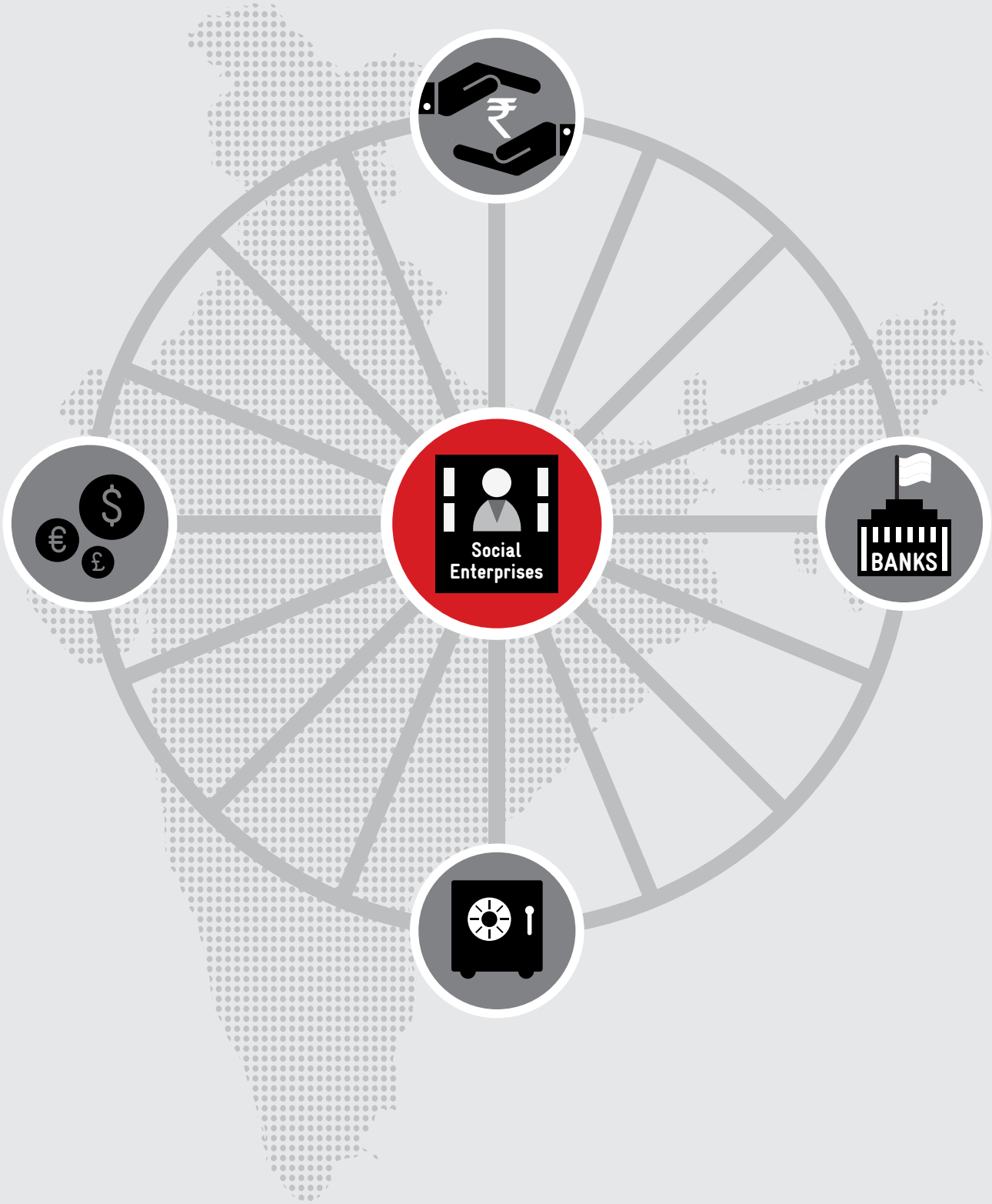
Footnotes

36 Micro -, small and medium-sized enterprises in emerging markets: how banks can grasp a $350 billion opportunity

37 The Draft Technical Paper on Review of Priority Sector Lending, 2005

38 Micro, Small and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward (IFC, November, 2012)

39 ANBC denotes Net Banking Credit plus investments made by banks in non-Statutory Liquidity Ratio (SLR) bonds


Social
Enterprises
BANKS

8 Conclusion

As discussed through this report, social enterprises deliver significant value to the economy not just financially but also through the impact that they create for their customers and suppliers. However, for many enterprises it is difficult to access finance 'beyond equity'. This report identified products, channels, and processes financial institutions can adopt to address social enterprises as a new customer segment.

8.1 Widening the supplier base

The paucity of suppliers of debt to social enterprises is the biggest bottleneck in their financial access. Thus, there is a need to expand the number and variety of suppliers. There can be various channels of supplier base extension including:

- Expand network of innovative early stage focused NBFCs/ aggregators
- Encourage the establishment of more venture debt firms
- Consider setting up specialized banks or social funds that would specifically cater to social enterprises
- Promote **specialized branches** such as the innovation branch supported by SIDBI in partnerships with other established banks. These branches should have dedicated teams catering to understanding the various business models that exist in each of the social enterprise sectors. Also should have a strong recovery setup in case of defaults

8.2 Introduction of innovate products and instruments

Currently there is minimal innovation in terms of the products that social enterprises can use to access debt. As seen in chapter 6, there is a variety of products available internationally for social enterprises. A feasibility assessment should be conducted for each of these products to identify 1-2 key products that can aid social enterprises in debt access most efficiently. Existing products such as venture debt and optionally convertible debt are being used sporadically. There should greater encouragement to promote these products.

8.3 Identify stronger risk mitigation tool

The common argument against lending to social enterprises tends to be the perception that they take higher risks than traditional enterprises. Thus, there is a need to identify stronger risk mitigation tools on part of lenders.

- Promotion of credit guarantee agencies and schemes that provide cover at a portfolio level thus giving banks the flexibility to structure the loans within a portfolio
- Develop innovative risk appraisal models based on behavioral assessment of entrepreneurs, use of non-traditional documents etc.
- Strengthen the existing collateral registry system and expand its scope to include receivables etc. This

can aid social enterprises that do not have access to physical collateral to put forth their receivables as collateral and access debt

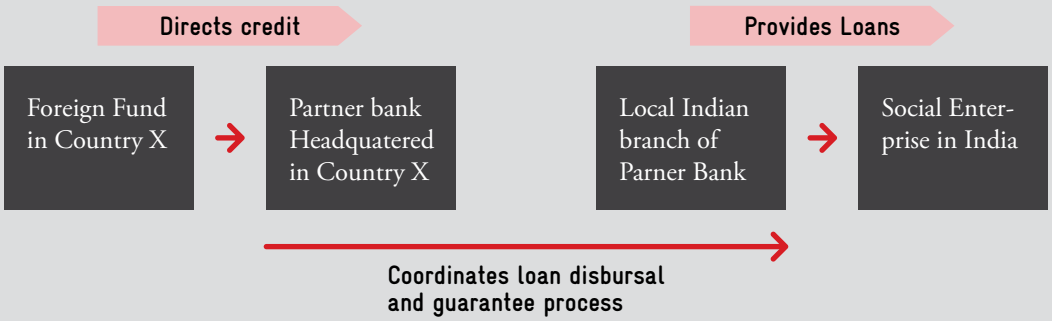
- Develop a uniform format for reporting data to a credit bureau such as CIBIL. This will ensure consistency and accuracy of the data collated, thereby increasing faith of lenders

8.4 Encourage entry of foreign capital through different routes

There are various constraints on provision of foreign capital as debt instruments or setting up debt funds in India. However, foreign funds can consider 3 potential routes of innovatively enhancing debt access to enterprises in India.

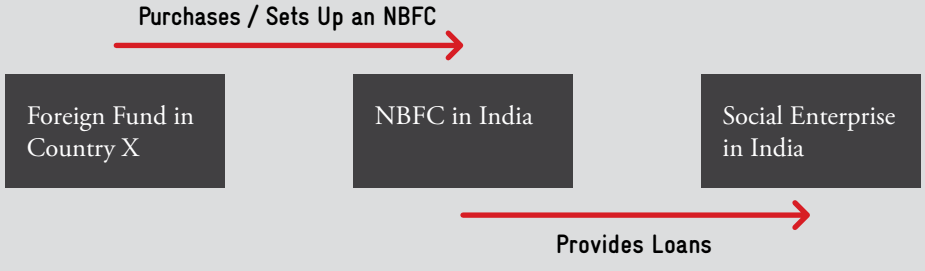
- **Loan Guarantee:** Foreign funds can consider lending to social enterprises by establishing a loan guarantee fund. However, the caveat in the process is that current regulations stipulate, the guarantee fund can be only be operated be in partnership with a bank that has operations in India but is headquartered in the same geography as the foreign entity that intends to set up the guarantee fund

Figure 32 Foreign loan guarantee fund operations in India



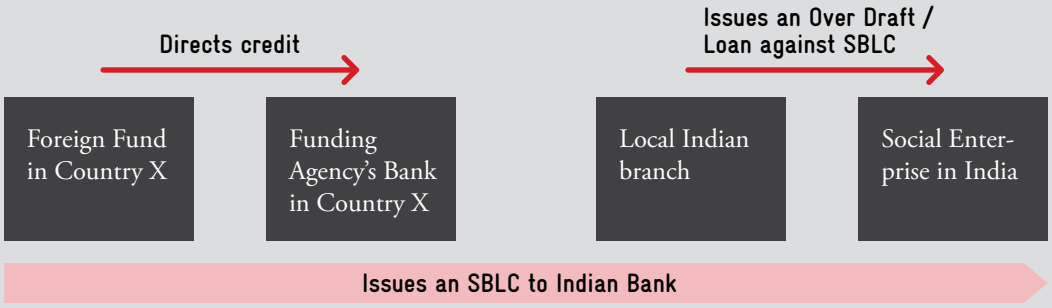
- **Direct Lending via an NBFC:** The foreign fund can consider direct lending either by setting up a wholly-owned NBFC subsidiary (subject to the minimum capitalization norms mentioned in Chapter 4) or purchasing secondary shares of an existing NBFC. Both these processes are subject to RBI approval

Figure 33 Direct lending via NBFC



- **Stand by Letter of Credit (SBLC):** The foreign funds can also direct loans via issuing SBLC- a guarantee of payment issued by a bank on behalf of a client that is used as "payment of last resort" should the client fail to fulfill a contractual commitment with a third party and the social enterprise default on its loan repayment. The operational process is similar to that of setting up a loan guarantee fund, where the foreign fund's bank issues an SBLC to their local Indian banking partner.

Figure 34 Directed lending using SBLC



8.5 Regulatory Changes

Interviews with players across the financial ecosystem pointed to various regulatory hurdles that stymie the flow of debt to social enterprises. The biggest common takeaway was that that the regulator (RBI) needs to be aligned to the agenda of directing credit to social enterprises.

- Change in NPA and liquidation norms to minimize the operational challenges in NPA recognition enabling banks to undertake more risky lending
- Clarity on regulations with respect to debt provision by Indian and foreign venture capital funds
- Including on-lending by NBFCs to priority sector under RBI's PSL targets. However appropriate risk-assessment frameworks should be developed for these NBFCs to ensure that they banks can safely rely on them to meet their PSL targets
- Easing minimum capitalization norms for foreign investments in for NBFCs
- Agreeing on a common definition of social enterprises that is recognized by all the authorities in order to ease the flow of credit to the relevant enterprises

8.6 Recommendations for Banks that want to take progressive steps in Social Enterprise Lending

8.6.1 Product Innovations:

The single biggest limiting factor for social enterprises in accessing debt is that they tend to be asset-light, service oriented enterprises and hence do not have any collateral to present. NBFCs such as Silicon Valley Bank and Intellegrow are bridging this gap by successfully offering products such as venture debt to early stage Venture Capital backed enterprises. These NBFCs do not lay emphasis on collateral and customize principal and interest payments together with warrants and sometimes, depending upon the contract, the right to invest in a future round. Yes Bank can explore similar product innovations within the framework of - RBI's NPA guidelines - that reduce the dependence on collateral for lending to social enterprises.

8.6.3 Risk Sharing/ Mitigation Innovations

- **Risk sharing via Loan Guarantee Funds:** The perception of risk attached with social enterprises is high (due to their new and unproven business models), making bankers wary of lending to these enterprises. Yes Bank can address this gap by setting up risk-sharing mechanisms such as *Loan Guarantee Funds*. These funds would guarantee the loans disbursed to social enterprises fully or partially in case of a default. Banks can partner with multilateral agencies/ private foundations in setting up such loan guarantee funds. There are existing examples of such loan guarantee funds such as those set up by IFC and ICICI bank for loans to purchase clean energy lanterns and cook stoves by members of Self-Employed Women's Association (SEWA) sponsored Grassroots Trading Network for Women. Similarly ADB and Ratnakar Bank partnered for a partial loan guarantee fund for loans to micro-finance institutions.
- **Risk mitigation by reducing information asymmetry:** Social enterprises are enterprises that have new and evolving business models. The nascent nature of social enterprises and the constant evolution of their business models imply that there is very limited information available about them publically. This lack of information and proof of concept hinders bankers from providing debt to social enterprises. Yes Bank can address this information asymmetry by:

  - **Collaborating with sector aggregators** such as Ennovent, Sankalp Forum, Villgro that bring together and work with a number of social enterprises and thus capture information on their operations and expansion.
  - **Adopting SIDBI's Loan Syndication Program** under which SIDBI collaborates with external Accredited Consultant (AC) i.e. individuals who provide advisory on credit sourcing by validating and checking loan applications. SIDBI plans to leverage on the local knowledge of these ACs to verify the credentials of the loan applicants and will provide ratings to the ACs based on their performance. Yes Bank can partner with SIDBI or adopt a similar AC model to reduce the information asymmetry risk of social enterprises.

8.6.2 Process Innovations

- **Customizations:** Customizing the loan evaluation process of social enterprises keeping in mind their unique business models can aid debt-flow to these enterprises. Banks can incorporate practices followed by globally successful sustainable banks such as GLS or Triodos that focus on specific sectors. The banks have devised special risk measurement mechanisms for each of their focus sectors. This risk measurement mechanism ensures the disbursal of loans to enterprises that might not be considered by other commercial banks. Banks could also consider adopting such methods in their social enterprise lending practices.
- **Non-financial support:** Access to finance is the biggest challenge faced by social enterprises. However, non-financial challenges such as talent acquisition and retention and developing a value chain are equally formidable constraints for them. Banks can set up an Incubation program that can help ease these challenges by involving academia and sector forums to increase the exposure of this enterprise. Banks can also help connect the enterprises with expert advisors who the enterprises can align with thereby improving their brand image - especially important in talent retention. Providing non-financial support will in turn improve the financial viability of the enterprises themselves thus aiding them in easier credit access.

8

Appendix

Appendix 1: Abbreviations

AF	Adaptation Fund
ANBC	Adjusted Net Bank Credit
ANDE	Aspen Network of Development Entrepreneurs
BoP	Bottom of the Pyramid
BPO	Business process outsourcing
CBRC	China Banking Regulatory Commission
CCF	Co-operative & Community Finance
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CDFI	Community Development Financial Institutions
CDM	Clean Development Mechanism
CDO	Collateralized Debt Obligation
CGC	Credit Guarantee Corporation
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CIN	Community Investment Note
COMSEC	Community Self-Employment Centre
CRA	Community Reinvestment Act
CSI	Community Shares ICOF
CWS	Co-operative Wholesale Society
DBJ	Development Bank of Japan
DFI	Development Finance Institutions
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EIF	European Investment Fund
ERIA	Economic Research Institute for ASEAN and East Asia
FYSE	Foundation for Young Social Entrepreneurs
GABV	Global Alliance for Banking on Values
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GSIFI	Global Systemically Important Financial Institutions
HIF	Health Impact Fund

IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFMR	The Institute for Financial Management and Research
IMF	International Monetary Fund
JNNSM	Jawaharlal Nehru National Solar Mission
KUR	Kredit Usaha Rakyat
LGU	Local Government Unit
LIF	Local Investment Fund
LMI	Low and Moderate Income
M&A	Merger and Acquisition
MFI	Microfinance Institutions
MLI	Member Lending Institution
MSME	Micro, Small and Medium Enterprises
MSMED	Micro, Small and Medium Enterprises Development
NABARD	National Bank for Agriculture and Rural Development
NASSCOM	The National Association of Software and Services Companies
NBFC	Non-banking financial company
NGO	Non-governmental organization
NPA	Non-Performing Asset
NSDC	National Skills Development Corporation
OSMEP	The Office of Small and Medium Enterprises Promotion
OTOP	One Town One Product Program
PACS	Primary Agricultural Cooperative Societies
PFMA	Public Finance Management Act
PLC	Private Limited Company
PPP	Public Private Partnership
PRESENT	Poverty Reduction through Social Entrepreneurship Coalition
PRI	Program Related Investment
PSL	Priority Sector Lending
QCA	Qualitative Credit Assessment
RBI	Reserve Bank of India
RFB	Reconstruction Finance Bank
RLF	Revolving Loan Fund
RMC	Russian Microfinance Center
RPC	Revenue Participation Certificate

RRB	Regional Rural Bank
RTE	Right to Education Act
SAAT	Foundation for the Administration of Triodos Bank Shares
SBI	State Bank of India
SBLC	Stand by Letter of Credit
SDR	Special Drawing Rights
SE	Social Enterprise
SEA	Social Enterprise Alliance
SEBI	Securities and Exchange Board of India
SEDA	Small Business Development Agency
SEWA	Self-Employed Women's Association
SFC	State Financial Corporation
SIB	Social Impact Bond
SIDBI	Small Industries Development Bank of India
SIDC	State Industrial Development Corporation
SME	Small and medium enterprises
SMILE	Small and Micro Interest-free Loan as Equity
SRI	Social Responsible Investment
SPV	Special Purpose Vehicle
Taiwan SMEG	The Small and Medium Enterprise Credit Guarantee Fund of Taiwan
TSEO	Thai Social Enterprise Office
UCB	Urban Co-operative Bank
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
USCRB	US Commercial and Retail Banks
VARI	Values Requisites Indicators
VC	Venture Capital
VLE	Village Level Entrepreneur

Appendix 2: list of social enterprises interviewed

S.No.	Social Enterprise	Interviewee	Contact Details	Stage
Water and Sanitation				
1	Waterlife India	Mr. Prashanth V Regy, Chief Strategy Officer	prasanthvr@waterlifeindia.com	Mature
2	Banka Bioloo	Mr. Sanjay Banka, Partner	enterprises.banka@gmail.com	Growth
3	Tanclean	Mr. Sunil Uplap, Founder	sunil@tanclean.com	Growth
4	Daily Dump	Ms. Poonam Bir Kasturi, Founder	dailydumpcompost@gmail.com	Early
5	Samagra Sanitation	Mr. Swapnil Chaturvedi, Chief Executive Officer	swapnil@samagra.com	Seed
6	Waterwalla	Mr. Soaib Grewal, Co-Founder	soaib@waterwalla.org	Seed
Clean Energy				
7	Selco India	Ms. Revathi, Chief Financial Officer	revathi@selco-india.com	Mature
8	Claro Energy	Mr. Kartik Wahi, Chief Executive Officer	kartik@claroventures.com	Growth
9	Desi Power	Dr. Hari Sharan, Chairman	desipower@desipower.com	Early
10	Green India Building Systems and Services (GIBBS)	Mr. Arun Shenoy, Executive Director - Business Operations	arun_shenoy@gibss.in	Growth
11	Frontier Markets	Ms. Ajaita Shah, Chief Executive Officer	ajaita.shah@frontiermkts.com	Early
12	Gram Power	Mr. Yashraj Khaitan, Chief Executive Officer	yashraj@grampower.com	Early
13	Green Power Systems	Julien Goupit, Director	julien@greenpowersystems.co.in	Early
Affordable Healthcare				
14	ERC Eyecare	Dr. Parvez Ubed, Founder	parveez.ubed@erceyecare.com	Growth
15	Forus Health	Mr. K Chandrasekhar, Chief Executive Officer	kc@forushealth.com	Growth
16	Jeevanti Healthcare	Mr. Arun Diaz, Director	arundiaz@jeevanti.co.in	Early
17	Swasth India	Mr. Ankur Pegu, Director	ankur@swasthindia.in	Early

S.No.	Social Enterprise	Interviewee	Contact Details	Stage
Financial Inclusion and Technology				
19	Electronic Payment and Services	Mr. Mani, Chief Executive Officer	mani@eps.org.in	Mature
20	Babajobs	Mr. Vir Kashyap, Chief Operating Officer	vir@babajob.com	Growth
21	B2R Technologies	Mr. Dhiraj Dolwani, Chief Executive Officer	dhiraj.dolwani@b2r.in	Growth
22	Vindhya eInfomedia	Mr. Ashok Giri, Chief Executive Officer	ashok@vindhyainfo.com	Growth
23	Kinara Capital	Hardika Shah, Chief Executive Officer	hardika@kinaracapital.com	Early
24	Rain Concert Technologies	Mr. R Abhilash, Chief Operating Officer	abhilash@rainconcert.in	Early
25	Transverse Technologies	Mr. Amarsh Chaturvedi, Director	amarsh@transervetechnologies.com	Early
Education and Vocational training				
26	Pipal Tree Ventures	Mr Santosh Parulekar, Chief Operating Officer	sparulekar@pipaltreeventures.com	Mature
27	Butterfly Fields	Mr. Sharat Chandra, Co-Founder	sharat@butterflyfields.com	Growth
28	Hippocampus Learning Center	Mr. Umesh Malhotra, Founder	umesh@hippocampus.in	Early
29	Sudiksha Knowledge Services	Mr P Naveen Kumar, Chief Executive Officer	naveen.kumar@sudiksha.in	Early
Agriculture and Rural Development				
30	Aarohana Diary	Mr. Deviprasad Rao, Chief Executive Officer	dpr@arohana.in	Growth
31	Eco Tasar Silk	Mr. Kshitij Pandya, Chief Executive Officer	weaveahope@gmail.com	Growth
32	Fabric Plus	Mr. Dilip Barooah, Founder	dbfabricplus@gmail.com	Growth
33	Janani Agriserve	Mr Sundara Rajan, Chief Executive Officer	ceo@jananigroup.com	Early
34	Masuta (Producer Company)	Mr. Madhabananda Ray, Co-Founder	madhab@masuta.org	Early
35	Kisan First	n/a	n/a	Seed

Appendix 3: list of financial institutions interviewed

S.No.	Institution	Interviewee	Contact Details
Public Sector Banks			
1	Dena Bank	Mr. Raj Kapoor, Chief Manager	rajkapoor@denabank.co.in
2	State Bank of India	Mr. Rohan Singh, Credit Officer SME Lending, Moradabad Branch	n/a
		Ms. Lakshmi Nair, Credit manager, Ahmedabad Branch	lakshmi.nair@sbi.co.in
		Mr. S. Ashok Vardhan, Vice President, SME Business Unit, Hyderabad Branch	ashok.vardhan@sbi.co.in
Private Sector Indian Bank			
3	Federal Bank	Mr. Ajith Kumar, SME Head	ajithkumarkk@federalbank.co.in
4	Kotak Mahindra Bank	Mr. BS Sivakumar,* Executive Vice President - Agri corporate loans & agriculture finance	bs.sivakumar@kotak.com
5	Ratnakar Bank	Mr. Aseem Gandhi, * Head - Development Banking & Financial Inclusion.	aseemgandhi@ratnakarbank.in
6	Yes Bank	Mr. Sanjeev Kumar, EVP & Regional Head - Branch Banking Mumbai Metropolitan Region	sanjeev.kumar6@yesbank.in
		Ms. Shilpi Srivastava, Manager, Responsible Banking	shilpi.srivastava@yesbank.in
Private Sector Foreign Bank			
7	HSBC	Mr. Jayesh Modi, Head, Inclusive Business Unit	jayeshmodi@hsbc.co.in
Private Sector Foreign Bank			
9	IFMR Capital	Ms. Nandita Prabhu, * Head - Capital Markets (Non-bank), Investor Relations	n/a
10	Intellegrow	Mr. Sanjib Jha, * Chief Executive Officer	sanjib.jha@intellegrow.com
		Mr. Sidharth Mani, Credit and Implementation Manager	siddharth@intellegrow.com

S.No.	Institution	Interviewee	Contact Details
11	Kinaara Capital	Ms. Hardika Shah, Chief Executive Officer	hardika@kinaracapital.com
12	NABARD Financial Services (NABFINS)	Mr. Ashutosh Kumar, Chief Operating Officer	ashutosh.kumar@nabfins.org
13	Silicon Valley Bank	Mr. V Murali, Director	vmurali@svb.com
14	Vistaar	Mr. Brahmanand Hegde, Managing Director	brahmanand.hegde@vistaarlfi.com
Venture Capital Fund			
15	Aavishkaar	Mr. Ajay Maniar, Principal	ajay_maniar@aavishkaar.org
16	Acumen Fund	Mr. Ankur Shah, Head of Sector Strategies	ashah@acumenfund.org
17	Impact Investment Partner	Ms. Nadia Sood, Founding Partner	nadia.sood@impactinvestmentpartners.com
18	Lok Capital	Mr. Arun Asok, Associate	aasok@lokcapital.com
19	Omidyar Network	Mr. Ameya Upadhyay, Associate	aupadhyay@omidyar.com
20	SEAF	Mr. Hemendra Mathur, Managing Director	hmathur@seafweb.org
21	SIDBI Venture Capital	Mr. R.V. Dileep Kumar, Senior Vice President	rvdilip@sidbiventure.co.in
Independent Financial Institution			
22	Small Industries Development Bank of India (SIDBI)	Mr. Soumya Shankar Panda, Executive	soumya@sidbiventure.co.in
		Mr. M.K.Raveesha, General Manager, Risk Capital	raveesha@hotmail.in
		Mr. P.V.S. Lakshminarayana, Assistant General Manager, Risk Capital	lnarayan@sidbi.in
		Mr. C.S.Rajan, Deputy General Manager, Service Sector Vertical	csrajan@sidbi.in
		Mr. Satish Karambelkar, General Manager, Service Sector and Credit Coordination Generation (CCG) Vertical	satishk@sidbi.in
		Mr. R.K.Agrawal, General Manager, Loan Facilitation Services	rkagrawal@sidbi.in

S.No.	Institution	Interviewee	Contact Details
Stock Exchange			
23	National Stock Exchange of India (NSE)	Mr. Ravi Tyagi,* Head, SME Project	rtyagi@nse.co.in
Joint Venture between SIDBI and Government of India			
24	Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE	Mr. CVKD Prabhu, Manager	cvkdprabhu@cgtmse.in
International Development Organization			
25	Kreditanstalt für Wiederaufbau (KfW)	Ms. Rukmini Parthasarthy, Project Manager (Financial Sector)	rukmini.parthasarathy@kfw.de
26	Department for International Development (DFID)	Mr. Sharad Venugopal, Project Investment Advisor	s-venugopal@dfid.gov.uk

** Participants of panel discussion titled '"Beyond Equity"- Innovation in financing social enterprise' organized at the Sankalp Forum on the 17 April 2013*

Appendix 4: Emerging Market Country Summaries

BRAZIL

Background

Brazil has one of the most advanced social enterprise ecosystems in the world after India. The country boasts a community of funding agencies, investors, incubators, accelerators and entrepreneurs that have supported and led several social enterprises to growth and success[40]. Brazil is considered to be one of the most entrepreneurial countries in the world, with more than 60 million people employed by SMEs[41]. Moreover, the country also nurtures positive attitude towards entrepreneurship as a socially responsible career path, and views failure of entrepreneurs as learning opportunity[42]. Of the 50 enterprises surveyed by Aspen Network of Development Entrepreneurs (ANDE) Brazil, 22% had revenues less than USD125,000, 32% had revenues between USD125,000 and USD625,000, and 20% had revenues more than USD625,000. About 78% of the social entrepreneurs had prior experience starting a business, and 54% have external capital.

Key Challenges

While the social enterprise sector has done relatively well in Brazil, challenges remain. Investor and capacity development community identify potential mission drift as the business models evolve for growth, and concentration in certain geographies among key challenges[43]. Awareness about the concept of social enterprises may also be limited to certain large cities – entrepreneurs from smaller towns and rural geographies do not identify themselves as social businesses.

Current Access to Financing Scenario and Impact of Policy

Over 40% of the businesses interviewed for the ANDE Brazil report mentioned that they expect their growth capital to come partially from loans. This is indicative of the fact that access to loans may be relatively less challenging in Brazil. The country has developed a resilient and flourishing banking sector through effective regulatory and policy controls. Its 579 financial institutions and 1,994[44] "credit cooperatives" and "micro-entrepreneur credit companies" provide access to finance to a large range of financial consumers.

Box 1 **Sitawi: finance for good**

Brazil's first social fund; has made loans totaling USD 1 million to 11 social enterprises. Sitawi defines social loans as low cost capital coupled with strategic advice. The fund is currently capitalized with donor money from institutional and individual donors.

While credit is easily available in Brazil, it is not cheap – according to an E&Y report, average annual interest rates on corporate loans exceeded 31% in May 2011. For this reason, small entrepreneurs largely rely on various sources of equity, which comes cheaper. High lending rates are characteristic of the Brazilian banking sector as a whole, due to low savings rates, institutional weakness, history of inflation, and monetary policies such as minimum remuneration rate on savings, and inflation targets. Monetary policy to curb interest rates in the future, or private bank programs to extend subsidized credit (e.g. Banco Sofisa-IDB) to SMEs could make debt finance more accessible to social entrepreneurs.

Box 2 **Banco Sofisa gets USD 140 million syndicated loan from the IDB**

The Inter-American Development Bank gave a syndicated loan of USD 140 million to fund small enterprises in Brazil. The bank is also working on a program to identify clusters of SMEs in the state of Parana and improve their competitiveness.

CHINA

Background

The social enterprise sector in China is in a nascent stage. It is estimated that the concept gained momentum in the country in 2006. According to the latest Foundation for Young Social Entrepreneurs (FYSE) report[45] 71% of the social entrepreneurs generate less than RMB 500,000(USD 80,000) in revenues and only two that generate more than RMB 10 million(USD 1.6 million) in revenues; only 66% are registered as commercial companies. With a median of employee count 7 people, these enterprises remain fairly small.

Key Challenges

The sector faces a range of challenges from lack of basic public understanding and acceptance of social enterprises, to lack of access to funding at various stages. However, access to financing at mezzanine stages is among the most severe challenges in the FYSE survey. There is no existing government policy or legislation for social enterprises. Enterprises are free to choose their legal form based on their business model. However, entrepreneurs foresee lack of government policies specific to this sector as severe challenges.

Current Access to Financing Scenario and Impact of Policy

Social enterprises, like other SMEs are unable to access capital markets, particularly debt, due to reluctance of banks to lend to private enterprises. Early stage entrepreneurs tend to rely on either grants or impact investors for funding. Mature social enterprises, like other SMEs may be forced to rely on the informal channel for loans[46]. Despite revisions in banking regulations that led to banks offering credit to SMEs, interest rates tend to be between 20 to 30 %[47]. Some of the key policy challenges affecting access to financing for social enterprises and SMEs are, lack of competition in banking, capacity building for banks and SMEs, guarantee schemes, credit bureaus, legal infrastructure, and bankruptcy laws. This may change in the near future with positively changing government attitude and favorable policies for SMEs. In October, 2011, Premier Wen Jiabao held an executive meeting of the State Council to discuss policies supporting SMEs. The China Banking Regulatory Commission (CBRC) issued a notice stating that loans below RMB 5 million given to SMEs may be excluded from the scope of assessment when calculating loan-to-deposit ratio. The effect of these new policies on access to financing for social enterprises and SMEs in general remains to be seen.

Box 3 **Standard Chartered China SME confidence Index**

Launched in Oct 2011, an index of 1000 SMEs tracks business confidence among SMEs. Current levels indicate low confidence in the sector due to weak international economy and slowing domestic growth.

INDONESIA

Background

A growing number of companies and individuals are choosing to be social entrepreneurs in Indonesia according to The Jakarta Post[48]. The country has historically seen social enterprise activity through organizations like cooperatives, Islamic schools, and trade associations that have been known to exist since the 19th century[49]. These organizations have been traditionally associated with nationalism and social consciousness, and are often referred to as "community enterprises". However, modern forms of social enterprises have only grown in the country over the last decade, and over 80% operate on a small scale.

Key Challenges

The ability to scale and achieve large scale impact is one of the key challenges for Indonesia's social enterprises. Social enterprises in Indonesia tend to remain small and work at local or town/ community level. The success of these enterprises largely depends on commitment and buy-in from the communities in which they work[50]. Access to credit is also a key concern for these enterprises and they often rely on micro-credit due to their scale of operations51. Lack of business and financial literacy among entrepreneurs, who tend have low levels of general education, is also a deterrent to the growth and scale of social enterprises.

Current Access to Financing Scenario and Impact of Policy

A significant number of social enterprises in Indonesia rely on the local micro-finance cooperatives for credit financing. Larger social enterprises rely on the community of local and international impact investors for equity. As in the other countries, there is no specific policy for social enterprise that affects access to finance in Indonesia. However, the government has formulated policies to both strengthen SMEs and increase their access to finance. Despite that, about 46% of start-up SMEs rely solely on internal sources of capital and 34% have some access to formal external financing[51]. Start-ups may be reluctant to access external finance due to the perception of high transaction and financing cost, or because they have insufficient collaterals, or because they may not have sound business plans. On the

other hands, banks may be reluctant to lend to SMEs due to lack of credit history, poor business plans, or insufficient cash flow and revenue. An Economic Research Institute for ASEAN and East Asia (ERIA) study recommends capacity building support to SMEs, relaxed banking regulations and incentives for SME lending, and participation of non-banking financial institutions (such as cooperatives) in SME lending, to improve access to finance for SMEs in Indonesia.

Box 4 **KUR-Kredit Usaha Rakyat**

Government-guaranteed loans directed to micro, small, and medium enterprises and cooperatives. KUR provides working capital and investment credit of up to Rp500 million. The credit providers are commercial banks assigned by the government.

MALAYSIA

Background

The social enterprise sector is in fairly early stages of development. Malaysians have only recent understanding of the concept of social entrepreneurship, and the term is most associated with programs that change economic status of poor communities[52]. However, there have been recent entries of ecosystem constituents like the Social Enterprise Alliance (SEA), an industry association and capacity building organization, and Tandem Fund, an impact investor and incubator for social enterprise in Malaysia. These institutions could be critical in shaping and growing the social enterprise sector in Malaysia.

Key Challenges

Activity in the social enterprise sector is fairly limited. A Global Entrepreneurship Monitor (GEM) survey on social entrepreneurship reports Malaysia to show some of the lowest prevalence of social enterprise among the countries surveyed. The challenges of the social enterprise sector range from basic – raising awareness about the opportunity and impact potential the sector offers – to complex issues such as government policy and approach to the sector. The social enterprise sector, when it does become more developed, is likely to face similar challenges as the SMEs in Malaysia. An SME Magazine article[54] lists access to finance, human capital, technology, and markets as key challenges.

Box 5 **iGuarantee**

iGuarantee is the "one stop financial portal" for SMEs in Malaysia, launched by the Credit Guarantee Corporation (CGC) established by the government to assist SMEs without adequate collateral. The online portal helps businesses compare schemes and select the right one. The portal also promotes financial literacy and awareness about loan repayments, and created linkages between financial institutions and SMEs.

Current Access to Financing Scenario and Impact of Policy

Social enterprises in Malaysia were largely Non-governmental Organizations (NGO) or hybrid companies according to the GEM report. They largely rely on grants and equity investments for funding. There are no specific government departments or policies focused on social enterprise. However, as in other countries, the SME support policies in Malaysia could help social enterprises gain access to finance as the sector moves towards traditional, for-profit models. The SME Corp Malaysia

is the apex body responsible for promotion and support of SMEs in Malaysia. The organization has several programs and services aimed at capacity development, incubation, soft loans, emergency loans, and credit rating support that enable access to finance for SMEs. The organization has also designed special programs focused on certain sectors such as LED light manufacturers. However, in the past few years, it has been difficult for SMEs to access loans as banks tighten controls and implement stringent requirements following the global financial crisis.

PHILIPPINES

Background

Social enterprise is a growing sector in the Philippines. The types of enterprises in this sector have traditionally been limited to microfinance, and livelihood creation enterprises such as rural BPOs, and artisan cooperatives[55]. Of the estimated 30,000 social enterprises in the Philippines, over 28,000 are cooperatives that work to provide financial access and livelihood solutions in the 7,000 islands that form the Philippines. However the sector has recently seen activity in clean energy and technology sectors. The social enterprise community has been proactively working to encourage growth in the sector through conferences, organization, and policy advocacy.

Key Challenges

The challenges faced by the sector in the Philippines are similar to those in other countries where the social enterprise sector is emerging. There is lack of coordination in the sector, and need for capacity and ecosystem building could enable entrepreneurs to grow and succeed. In addition to this, lack of government support through policy or incentives, and access to capital make it challenging for existing enterprises to grow. Recent developments indicate that this may soon change – a bill seeking to improve legal and policy environment for social enterprises in the Philippines has been filed at the House of Representatives[56]. The Poverty Reduction through Social Entrepreneurship (PRESENT) Coalition, an alliance of farmers, workers, community enterprises, business associations and fair trade groups is pushing for its approval.

Box 6 | **One town one product (OTOP) program**

Under this program USD 18,200 is allocated for lending to an SME in every locality, through identified funding sources. The Department for Trade and Industry, in coordination with local government units identifies a product or service cluster for funding support. SMEs that offer such product or service are eligible to apply for a loan with a maximum effective interest rate of 10% per annum. The OTOP Program offers a comprehensive assistance package through local government units (LGUs), national government agencies and the private sector.

Current Access to Financing Scenario and Impact of Policy

Access to finance scenario may change for social enterprises once the Social Enterprise bill is passed and policy is conducive to serving their unique financing needs. Currently, a majority of them tend to rely on grants and loans (for cooperatives). As more enterprises develop in sectors their need for financing with grow significantly. The government has created a policy environment conducive to the development of SMEs in the Philippines. However, access to finance remains challenging because financial institutions are not actively involved in lending to SMEs due to perceived high risks and costs[57]. The country has a large unmet demand for SME financing by IFC estimates. According a survey by Philippine Institute for Development Studies, 42% of SMEs have never sought external financing. Although Philippines banks are required to meet minimum SME lending requirements, most banks only lend to larger companies that understate assets, or exclude smaller companies by setting minimum lending amount. SMEs can also access debt through government sources like the Department of Trade and Industry. However, these funds are mostly available to the companies in focus sectors selected by the government.

RUSSIA

Background

Russian social enterprise sector is a decades behind its peers – mostly because of lack of entrepreneurship culture in the socialist country. Businesses face the threat of corporate raid or re-division[58]. There is limited ecosystem activity in the sector. The Russian Microfinance Center (RMC) has a nationwide presence, and promotes social enterprise activity.

Key Challenges

The main challenge in Russia is to encourage people to take up entrepreneurship as a career. The legal environment and law enforcement is not in favor of entrepreneurs, who risk losing their investment if they become targets of criminal organizations. The government attitude towards small businesses could be hostile if they consider the business to be working against its own agenda[59]. In addition to this, there is need for ecosystem building, which includes training and capacity building, information exchange, and policy advocacy.

Box 7 | **Loans for social enterprises in mono cities**

Mono-cities in Russia are cities near large factories that employed a majority of the population. The Novosibirsk Electrode Plant (NovEZ) and the RMC have developed a program for the village of Linevo, where their plant is located. The plant offers up to 30 thousand dollars for starting social enterprises in Linevo.

Current Access to Financing Scenario and Impact of Policy

Currently, access to finance for social enterprises is largely through grant-making organizations, such as the "Green House", the microfinance channel or funds like Nashe buduwee (Fund "One Future"), that have successfully funded 59 social enterprises. There are no specific government policies for social enterprises. This could be due to lack of activity and advocacy in the sector. SME activity is also fairly low in Russia with only 13% of its population employed by SMEs, despite the favorable definition of SME comprising companies with up to 250 employees and/or EUR 26 million in revenues[60].

Some successful loan programs, like the partnership between The Novosibirsk Electrode Plant and the RMC are operating small pockets such as the mono-city of Linevo. However, these are independent of any government policy or legal support. The government-funded Vnesheconombank's SME Bank makes loans of USD 300,000 to 1.5 million at interest rates 2-3% lower than the market rate. However, this may be too large for the fledgling social enterprises.

SOUTH AFRICA

Background

Despite encouraging attitude from the government and policy makers[61], the social enterprise sector in South Africa remains underdeveloped. There is limited presence of local ecosystem players in South Africa, and the sector is dominated by international institutions such as ANDE, TechnoServe, Endeavour, and Ashoka[62]. Several state initiatives such as SEDA (Small Business Development Agency), and COMSEC (Community Self-Employment Centre), provide business development and access to finance to SMEs, but none of them have a social enterprise focus.

Key Challenges

Social enterprises in South Africa face the same challenges that all companies face – access to funding, lack of ecosystem players like incubators, accelerators, and capacity building organizations. A Global

Entrepreneurship Monitor 2011 report sites, among other reasons, lack of entrepreneurship education in schools, lack of cultural support of entrepreneurship, internal market dynamics, government programs and physical infrastructure. While the government has several programs and bodies setup to support small enterprises, they prove to be ineffective largely due to the lack of relevant skills.

Box 8 **South African micro-finance apex fund**

A wholesale funding institution formally established in April 2006. It is a trading entity and is governed by the Public Finance Management Act (PFMA) of 1999. Samaf is tasked to facilitate the provision of affordable access to finance by micro small and survivalist business for the purpose of growing their income and asset base.

Current Access to Financing Scenario and Impact of Policy

Access to finance seems to be one the most formidable challenges for entrepreneurs - 75 % of applications for credit by new businesses are rejected and only 2 % of new SMEs are able to access loans . Various government departments have committed ample capital for financing SMEs through funds like Samaf and Khula Enterprise Finance Ltd. However, very few enterprises qualify for financing. This may be because of lack of appropriate knowledge and skills to sustain and grow a business.

According to a FinScope survey[64] less than 8% entrepreneurs in South Africa have any university degree, only 24% have matriculated, and 66% only have some high-school education. About 82% of claimed they were either self-taught, or learned from family or on the job. Only about 7% received any formal training through university or other courses. Less than one in two enterprises reported keep any financial records for their business. Financial sophistications and literacy could be the reason why businesses are unable to qualify for available financing.

Box 9 **Khula enterprise finance Ltd.**

A wholesale finance institution that supplies funding to small business. Khula`s channels include commercial banks, retail financial institutions, specialist funds and joint ventures. Khula was established in 1996 and is operating as an independent agency under the Department of Trade and Industry. The institution offers loans and credit guarantees through partnerships with several national and regional banks.

TAIWAN

Background

The social enterprise sector in Taiwan is largely dominated by not-for-profit organizations such as charities, and associations[65]. There are some cooperatives and for-profit companies engaged in the sectors such as agriculture, rural business, and information and publishing services that have come up in the last two decades. However most of the social enterprises in Taiwan rely on grants and endowments. Taiwan does, however, have a vibrant SME sector with 1.2 million SMEs accounting for USD 49 million in exports. While some of these may be classified as social enterprises according to different definitions of used around the world – they are not classified so in Taiwan.

Key Challenges

Since the for-profit social enterprise sector is a fairly new phenomenon in Taiwan, the sector needs to

build awareness about its unique benefits and potential for social and economic impact in Taiwan. In addition to this, policies designed for the specific needs of the sector could help encourage new activity and growth in the sector. Despite recent criticism Taiwan has historically been a beacon of exemplary policies for SME development in the world[66]. The Small and Medium Enterprise Association plays a key role in strengthening the ecosystem for SMEs and providing the necessary capacity development, training, financing and investment assistance. Extending a similar nurturing policy environment focused on social entrepreneurs could spur growth in the sector in Taiwan.

Current Access to Financing Scenario and Impact of Policy

The sector in its current stage is largely funded by grants and endowments. When the sector does mature to the stage where there are a larger number of for-profit enterprises, access to financing is unlikely to be a challenge. Government support through the Taiwan SMEG, the credit guarantee mechanism that makes financing cheaper and more accessible to SMEs is an example of a successful government led intervention for resolving financing challenges for SMEs. A similar program focused on social enterprises could achieve similar success.

Box 10 | **Taiwan SMEG – a case study**

The Small and Medium Enterprise Credit Guarantee Fund of Taiwan (Taiwan SMEG), supervised by the Ministry of Economic Affairs, was created in 1974 with the objective of easing access to finance for SMEs. Serving as an intermediary between the banks and the enterprises SMEG reduces the burden of due diligence on banks, and the burden of collateral for SMEs. The fund is supported by donated funds from the government and financial institutions. Key offerings include:

- Indirect guarantee: Enterprises approach banks for loans. Banks reach out to Taiwan SMEG for providing the guarantee for a fee.
- Direct guarantee: Enterprises first apply to SMEG to obtain a Letter of Commitment which they can use to borrow from banks. SMEG uses key non-financial factors such as business management, R&D, industry outlook, etc. to appraise the company
- Package credit guarantee: Application process through banks – offering aimed at larger enterprises with large borrowing needs. Provides guarantee for a smaller percentage fee.
- Package credit guarantee: Application process through banks – offering aimed at larger enterprises with large borrowing needs. Provides guarantee for a smaller percentage fee.

THAILAND

Background

There are approximately 116,000 social enterprises in Thailand[67]. Thailand is one of the only few countries in Asia that enjoys strong government support for social enterprises. The government formed the Thai Social Enterprise Office (TSEO) in 2010, with funding of USD 3.2 million. The growth in the sector can be attributed the youth, who have been enthusiastic towards the sector. Due to high social media presence of these entrepreneurs, Thailand is also one of the few countries with high general awareness about the concept of social enterprise. However, the orientation of social enterprises in Thailand is towards community development, and they tend to work with hybrid legal structures rather than as for-profit companies.

Key Challenges

Social enterprises in Thailand are poised for rapid growth with support from ecosystem players like Ashoka, Change Fusion, and TSEO, government policy encouraging social enterprise, and financial regulatory agencies like the Securities and Exchange Commission lending support to the sector[68]. The developments in this sector have been fairly recent, and the effect of these policies on developing the social enterprise sector remains to be seen. Access to financing is currently a challenge for social

enterprises. However, positive policy environment could encourage enough growth in the sector to make it viable for impact investors to fill the gap between grants and main stream capital[69].

Current Access to Financing Scenario and Impact of Policy

Utilization of external capital currently remains fairly low for social enterprises in Thailand, as it is in other countries. In a survey conducted by Change Fusion, 54% of the enterprises were self-funded, while only 17% had used bank loans. This could be attributed, among other things, to the non-profit and hybrid structures that prevail among social enterprises - only 37% have reportedly broken even as of 2012[71].

The Thai government has ensured a robust national and local agenda for SME development – a model that could greatly benefit for-profit social enterprises. The agenda is supported by institutions such as SME banks, Small Industry Credit Guarantee Corporation, SME Venture Capital Fund, Central Credit Information Service Company Limited and Thai Credit Bureau Company Limited. Together, these institutions facilitate access to finance through information and transparency, and cater specifically to the needs of SMEs. The Office of Small and Medium Enterprises Promotion (OSMEP), acts as the apex body for the sector, and chaired by the Prime Minister.

Despite the Thai government's proactive approach towards SMEs, challenges remain for both banks and SMEs. High transactional costs and cost of capital, lack of business planning/financial literacy among SMEs, and lack of collateral are among a few challenges identified by an ERIA study[71].

VIETNAM

Background

The social enterprise sector in Vietnam remains in a developing stage. The country only saw economic activity flourish after the 1994 end of the US embargo – following which several forms of foreign aid and investment led to development of different types of enterprises. A 2011 research reported[72] 167 social enterprises in the country. Only about 40% of these reported operating as companies or cooperatives. There are no unique legal structures for social enterprises in Vietnam, or dedicated government department to address its specific needs. However, recent initiatives like the SNV Netherlands Development Organization supported Center for Social Entrepreneurship Development[73], in partnership with Center for Social Initiatives Promotion and Root Change could help strengthen the ecosystem and encourage growth in the sector.

Key Challenges

Vietnamese social enterprises listed access to capital, macro-economic factors, and labor availability among their biggest challenges[73]. A 2012 Central Institute for Economic Management report[74] highlights lack of awareness, legal frameworks, and access to finance, management capability, ecosystem support, and human resources as some of the key challenges for social enterprises. These are identifiable as key challenges that social entrepreneurs' face in most countries where the sector is currently nascent or developing. These are also resonant of the challenges most SMEs face in Vietnam[75].

Box 11 | **SMEs Credit Guarantee Fund**

Administered by Provincial People Committee and provides cover up to 80 per cent of the Loan-Collateral Gap (stipulations are that the collateral should at least be 30 per cent of loan and the loan is not "bad debt").

Current Access to Financing Scenario and Impact of Policy

Access to finance is one of the most limiting challenges in Vietnam for both social enterprises and SMEs in general. About 77% of the businesses are under-capitalized, roughly half of which believe that access to capital is a significant barrier to growth[76]. Access to finance is particularly challenging in Vietnam because the banking sector currently not as developed as some of the other countries, and have recently signaled instability. The country has been unable to mobilize saving through commercial banking, and banks may not have the skills and frameworks for risk assessment. This may change with the government's new roadmap for reforms proposed by policymakers in the country[77].

Foreign aid and funds have set up funds from donor money to support SMEs in Vietnam. However, these funds tend to favor export oriented industries and may not be the best resort for social enterprises. Funds focused on the needs of this sector will be best equipped to spur growth in social enterprises in Vietnam.

Box 11 | **Development Assistance Fund**

It provides medium and long term loans at preferential interest rates, post-investment interest subsidies, and credit guarantee to enterprises.

Appendix 5: International Sustainable Banks Case Studies

TRIODOS BANK

History

The Triodos Foundation was established in 1971 with the objective of initiating social change through entrepreneurial activity. The idea was to provide consulting services to help businesses serve the dual purpose of profitability and social impact. But the founders soon realized that these entities lacked access to capital and what was needed was a new type of bank. In 1980, the Triodos Bank was founded with the equivalent of EUR 540,000 in start-up share capital and a full banking license from the Dutch central bank.

Location: HQ in the Netherlands with branches in Belgium, Germany, Spain and the UK

Size: In 2011, its total revenue was over EUR 128 million and it had more than EUR 6.7 billion worth of assets under management

Performance: In 2011, the bank recorded a net profit of EUR 17.3 million. Triodos has maintained a net profit margin between 10-15% and also grown by 15-25% p.a. in the last five years

Ownership

Shares are held by SAAT, the Foundation for the Administration of Triodos Bank shares. SAAT issues depository receipts for these shares to the public. The receipts represent the economic aspects of the shares while SAAT exercises the voting rights of the same.

Products, Clients and Lending Criteria

The different products offered by Triodos include term loans, working capital loans, overdrafts, commercial mortgages, bank guarantees and cash flow lending. Triodos generally lends between EUR

25,000 and EUR 15 million per project and the interest chargeable on such loans is either fixed or base-rate linked. There is a one-time fee of 1-1.5% of the loan amount to cover for the cost of arranging the same. All loans are generally fully secured and occasionally the bank can also consider guarantors as security.

Triodos only finances companies, institutions and projects that operate in their three focus areas of nature and environment, culture and welfare, and social business. Potential clients working in these areas must meet the absolute positive criteria set forth by the bank and also fulfill the absolute negative criteria in order to be eligible for financing.

Box 11 | **Lessons for India**

As shown by Triodos, sustainable banks can generate economic returns and contribute to social development at the same time. Such a concept has not yet been tested in India but has the potential to be replicated successfully. It is possible to set up the legal structure in India, although there are several regulations with regard to Depository Receipts which would have to be taken care of for the same.

CHARITY BANK

History

Charity Bank was incorporated in November 2001 but registered in 2002, both as a charity and as a bank by the Charity Commission and the Financial Services Authority respectively. The bank was born out of research started in 1992 by the Charities Aid Foundation into the concept of a bank which would provide financial services to charities. It was launched in October 2002 with an opening balance sheet of GBP 6.4 million.

Location: HQ in Tonbridge, UK with branches in London, Cardiff and York

Size: In 2011, its annual net interest income amounted to over GBP 2.6 million and it had a total asset value greater than GBP 80 million

Performance: Charity Bank recorded a net surplus of GBP 372,000 in 2011 after almost a decade of operating with a deficit.

Ownership

The bank's primary shareholder is the Charities Aid Foundation, but its nineteen shareholders include well known foundations and trusts such as the Baring Foundation, the Vodafone Foundation and Esmée Fairbairn Foundation.

Products, Clients and Lending Criteria

Charity bank provides charity loan funding from GBP 50,000 to GBP 1 million with an interest rate that varies between 6.5-7.5%. The loans are provided only to "organizations that can demonstrate that they are constituted with social objectives and are non-profit distributing to private individuals". The bank does not usually provide finance to for-profit entities unless it is exclusively for charitable purposes. Loans can be both unsecured and secured, where the former is given for a period of up to five years and the latter can be given for a period of up to twenty five years. The lending criteria used by Charity Bank are a set of minimum requirements which can be both positive and negative. Although this leads to business areas becoming vaguely defined, it gives the bank an opportunity to evaluate a larger number of possibilities.

Box 12 | **Lessons for India**

There are no charitable banks in India as only co-operative banks in India run on a non-profit basis. While institutions based on the model of Charity Bank may be introduced to help boost support for non-profit organizations they still do not fulfill the purpose of financing the increasing number of for-profit social enterprises in the country.

THE CO-OPERATIVE BANK

History

The bank's origins can be traced back to the formation of the Co-operative Wholesale Society (CWS) in 1872 which later became the CWS bank. In its initial years the bank only lent money to retail co-operative societies but it soon began to lend to personal customers as well. In 1972, it became the first bank in over 40 years to join the Committee of London Clearing Banks.

Now known as the Co-operative Bank, it is part of the Co-operative Banking Group along with the Co-operative Insurance Society and the Britannia Building Society, with which it merged in the year 2009.

Location: HQ in Manchester, UK with more than 140 outlets in the country

Size: In 2011, the Co-operative bank had an annual turnover of over GBP 635 million with more than 4 million customer accounts. This is apart from serving businesses, local authorities and retail co-operatives.

Performance: In 2011, the bank recorded an operating profit of GBP 212 million and a net profit of over GBP 155 million after tax and before dividend distribution

Ownership

The bank is not a true co-operative in the sense that it is not directly owned by members. It is a wholly owned subsidiary of the Co-operative Banking Group, whose sole shareholder in the member-owned Co-operative Group. However, an ownership interest in the bank can be acquired by becoming a member of the Co-operative Group.

Products, Clients and Lending Criteria

The Co-operative bank lends to both commercial and social enterprises. However, the bank follows an ethical policy that consists of both negative (activities it will not support) and positive (activities it encourages and supports) criteria. The bank has a separate Social Banking Unit that is dedicated to helping organizations that are committed to making an impact by creating social, economic and environmental change. Its clients include charities, co-operatives, microfinance institutions and other social enterprises. Apart from offering services in financial planning the bank offers products such as overdrafts, term loans and deposits to its customers. Products are customized according to the customer segment (co-operatives, businesses, personal) and interest rates on loan products vary from 6-9%.

Box 13 | **Lessons for India**

Co-operative banks are already present in India but they mostly lend only to its members (as in the case of State Co-operative Banks). While they offer lower interest rates for lending, the functioning of co-operative banks in India is also prone to being influenced by political interests.

RABOBANK

History

The origins of Rabobank can be traced back to 1898, when the first local agricultural cooperative banks formed two centralized, umbrella organizations: the Coöperatieve Centrale Raiffeisen-Bank in Utrecht and the Coöperatieve Centrale Boerenleenbank in Eindhoven. In 1972, the two organizations merged to form Rabobank Nederland, a co-operative of which all the Local Member rabobanks became members and shareholders.

The Rabobank Group consists of Rabobank Nederland, the local rabobanks and several daughter organizations such as Rabobank International, which handles the group international banking business. Rabobank Nederland facilitates local rabobanks and other divisions through market support activities.

Location: HQ in Utrecht, Netherlands with more than 900 branch offices in the Netherlands and 766 branch offices in 46 other countries

Size: In 2011, the Group recorded a total income of EUR 13 billion and had more than EUR 263 billion worth of assets under management and custody. It also employed more than 47,000 full time employees around the world.

Performance: In 2011, the Group's net profit amounted to EUR 2.6 billion, nearly 20% of its total income.

Ownership

The local rabobanks are shareholders and members of the central organization, Rabobank Nederland. The local rabobanks are owned by their members, who act as representatives of the customers in the General Meeting and the Members' Council.

Products, Clients and Lending Criteria

Rabobank offers its products and services to both individual and business clients, with their primary focus being the food and agribusiness sector. Apart from offering various personal and corporate banking solutions, they specialize in providing farm financing to their food and agribusiness clients. This includes products such as working capital loans, seasonal loans, term loans, equipment financing and services such as risk management (commodity risk and foreign exchange risk management), wealth management and succession planning.

Although the bank does not have an explicit set of criteria that is common for all business dealings, its sustainable banking policy has been formed to promote the sustainable development of society in an economic, social and ecological sense. The bank's dealings are firmly based on its co-operative principles and intended to serve the interests of its members and clients.

Box 14 | **Lessons for India**

Co-operative banks in India can follow the Rabobank model to scale and consolidate their position in the banking sector. Such a model would allow banks to serve their members as well as improve their financial viability.

CO-OPERATIVE AND COMMUNITY FINANCE (ICOF LTD.)

History:

Co-operative & Community Finance (CCF) is the trading name of ICOF Ltd. ICOF Ltd. was founded in 1973 with the idea of establishing a revolving loan fund for new co-operative ventures. Donations, deposits and loans were their sources of capital at this early stage. In 1987 ICOF PLC was formed as a subsidiary of ICOF Ltd to enable raising capital by public share issue. This was a pioneering approach to ethical investment by CCF and innovative in the sense that it spread the risk of investors over a wide portfolio of loans. They also established two investment funds – ICOF Community Capital and Community Shares ICOF (CSI). While ICOF Ltd directly manages the business of its two subsidiaries, it is contracted to manage Community Capital and CSI.

Location: HQ in Bristol, UK with offices in Wales and Southampton

Size: In 2011, group lending rose by 82% over the previous year to GBP 619,000 and the total revenue for the year was GBP 267,638

Performance: The group recorded an operational surplus of GBP 35,859 but a trading loss of GBP 33,182 after taking into account provisions for loan losses

Ownership:

CCF is a democratic organization, owned and controlled by its members - which include investors, borrowers and supporters. Memberships of Community Capital and CSI are open to organizations who have bought shares in the society and all borrowers automatically become members. Membership of ICOF Ltd is open to any individual or organization that pays a one-time membership fee.

Clients, Products and Lending Criteria:

CCF lends to employee or community owned social enterprises, including co-operatives, community businesses, development trusts and businesses developed from the charitable and voluntary sector. All should have an appropriate form of employee or community ownership. CCF normally lends loans in the range of GBP 10,000 to GBP 75,000 at interest rates ranging from 6-10% (reducing balance basis), based upon the individual circumstances of the application. A one-time fee between 1% and 2% of the sum advanced is also charged.

The various products offered by CCF include business loans, loans for employee buyouts or company successions, loans for property or business purchase, loans for capital equipment and working capital, loans to replace inappropriate existing finance and loans to broker deals on larger financial packages.

Although CCF does not take personal guarantees, it looks to secure lending against the assets of the borrowing organization where possible. The group has an Ethical Policy with both positive and negative criteria and the same is applied before lending, making investments or entering into any other business dealing.

Box 15 | **Lessons for India**

There is no legal provision for Community Development Financial Institutions (CDFI) such as CCF in India. The concept of social/ethical investments too has not been established in the country and hence it would be difficult for such an institution to set-up and operate successfully.

GLS BANK

History:

The GLS Bank was the first social and ecological bank in Germany. GLS stands for "Gemeinschaftsbank für Leihen und Schenken", which translates as "community bank for loans and gifts". The bank was founded in 1974 and it currently finances around 20,000 projects and businesses.

The Bank focuses on cultural, social and ecological projects which try to tackle challenges in society by developing creative solutions. Loans are offered to projects like independent schools and kindergartens, organic farms, institutions using therapeutic pedagogy, nursing homes, projects for the unemployed, health-food stores and communal living projects, as well as sustainable businesses. Transparency is one of the key aims of the GLS; details of all initiatives that receive loans are published in its magazine "Bankspiegel", together with information on the development of the bank

Location: HQ in Bochum, Germany with 6 branches, all in Germany

Size: In 2011, the GLS Bank recorded a total income of EUR 65 million and had more than EUR 2.9 billion worth of assets under management and custody with a growth of 26% in loans disbursed and 23% growth in deposits compared to 2010.

Performance: In 2011, the bank's net income amounted to EUR 11.3 million, a growth of 35% compared to 2010.

Clients, Products and Lending Criteria:

GLS provides all the products and services of a commercial bank. What distinguishes the GLS Bank is not only the fact that the it invests its savers' money responsibly, but also that savers with the GLS can choose the area in which their money will be invested when they open an account or make a deposit. The users can track which projects and companies have received help in the bank magazine published 3 times a year and also participate in field visits.

Moreover, when customers choose reduced interest payments for their savings, the GLS Bank is able to grant loans to charitable projects with an interest rate that only covers the basic loan administration costs of the bank (in 2012: 2.9 % p.a., 2011: 3.0 % p.a.).

GLS employs specialists from its different focus sectors such as Clean Tech, Agriculture, and Healthcare etc. These specialists take care in evaluating each loan application to ensure that they fall within GLS bank's lending criterion. In addition, the bank has devised a special risk measurement mechanism for its various sectors of operation. This risk measurement mechanism ensures the disbursal of loans to enterprises that might not be considered by other commercial banks.

Box 16 | **Lessons for India**

Cooperative banks exist in India. However, none of them are as transparent as GLS Bank. A model like GLS could exist in India where customers can decide the interest rate at which they earn and which sector they would like to give out loans to if proper processes were setup by the bank.

GABV

History:

The Global Alliance for Banking on Values (GABV) is a membership organization, made up of twenty one of the world's leading sustainable banks, from Asia, Africa, Latin America to North America and Europe. Members include microfinance banks in emerging markets, credit unions, community banks and sustainable banks financing social, environmental and cultural enterprise.

Profitable and growing, the banks in the GABV are independent, licensed institutions with assets that exceed USD 60 billion. Together they touch the lives of more than 10 million people in 25 countries. The network's members have to meet three criteria:

- Independent and licensed banks with a focus on retail customers
- Minimum balance sheet of USD 50 million
- Committed to social banking and the triple bottom line of people, planet and profit

Activities:

Meetings – The second meeting of GABV was held in 2010 in Bangladesh with the theme of 'From Intention to Action'. This is where the announcement of the goal to use sustainable banking to touch a billion lives by 2020 was made.

Research – GABV is working with academicians to understand impact of sustainable banking and identify new and innovative methods. For e.g., MIT Green Hub is working with them to better understand how socially responsible and green banks operate and to learn how they can have an impact on society from their work.

Projects – 3 members of GABV – BRAC, ShoreBank International and Triodos collaborated on structuring, advising and raising the BRAC African Loan Fund, a USD 62.6 million facility that will provide debt capital allowing BRAC to reach over 500,000 microfinance borrowers in Uganda, Tanzania and South Sudan.

Box 17 | **Lessons for India**

Currently, there is no such network existing in India where sustainability or impact oriented banks exchange experiences.

LOCAL INVESTMENT FUND (LIF)

History

The Local Investment Fund (LIF) is a package of flexible financial support to assist new and existing businesses by offering capital grants of 40% of eligible capital expenditure within an approved project, subject to a minimum of GBP 1000 and a maximum of GBP 10000 grant. The remaining amount has to be arranged for from public and private sources.

The scheme is targeted at small and medium sized enterprises (employing less than 250 people) with either a turnover not exceeding EUR 50 million or a balance sheet not exceeding EUR 43 million. The Fund is designed to develop the local economy by stimulating business activity.

Products, Clients and Lending Criteria

The grant is part funded through the European Regional Development Fund (Convergence) businesses and needs to be eligible for funding under this scheme. The project must meet one or more of these objectives:

- Creating jobs & sustaining jobs
- Increasing turnover
- Aiding business growth
- Increasing competitiveness & making efficiency gains
- Increasing sustainability
- Stimulating further investment/growth
- Introducing new products, services or markets
- Supporting a key sector such as clean / renewable energy, creative industries, leisure, tourism
- Creating/developing a Social Enterprise

The fund is made up of 3 regional funds – North West Wales, South East Wales and South West Wales

Box 18 | **Lessons for India**

Such local investment funds focusing on development of a particular region has a lot of potential in India.

Appendix 6: Innovative Products For Raising Development Assistance

Instruments to mobilize government funds

a. *New Taxes and levies:* Introduce new taxes (or raising the level of existing taxes) and then use the additional income primarily to expand development aid.

b. *Government sale/ auction of rights of use:* Sell or auction certain rights of use which can be exploited economically and whose proceeds can be utilized for development cooperation E.g. Auctioning of emission allowances, proceeds from which can be channeled towards climate-related projects.

c. *Allocating IMF Special Drawing Rights (SDRs) specifically to developing countries:* SDRs are claims to currency on International Monetary Fund's member countries that are only used in trading between central banks and cannot be used as real currency for trading in goods. Once SDRs have been allocated to a member country they can exchange them as needed into convertible currency at the central banks of member countries, and use them to finance their development processes.

Instruments to mobilize private funds

a. *Public Private Partnerships (PPP):* A model of cooperation where the private partner generally takes over – either partially or completely – the pre-financing, planning, construction and sometimes even the operation of public infrastructure (e.g. power stations, roads, railways, buildings, forests) and receives in return a predetermined (sometimes performance-dependent) payment from the state.

b. *Government guarantees/ assumption of risk:* These financial instruments can be used by the state in sharing the risks and costs of developmentally worthwhile economic activities, thereby fostering a willingness among private institutions to bring funding to these initiatives.

c. *Blending/ Concessionary loans combining public and private funding:* Combine low-cost budget/ government funds with funds from the international capital market in such a way as to avoid both project underfunding and project overfunding. E.g. Interest rate reduction.

d. *Loans/ bonds with performance-dependent repayment terms:* Make bond and loan repayment terms dependent upon the debtor country's economic performance, so that more funds are repaid in good years and less in bad. This approach can help to avoid debt spirals and thereby reduce the risk of credit default. E.g. GDP-indexed bonds where debt servicing is directly dependent on the rate of

growth in Gross Domestic Product; Counter-cyclical loans where certain pre-defined trigger events will determine whether the debt servicing term is automatically extended.

e. *Securities / structured funds:* Securities are essentially loan repayments are secured against the assignment of future cash flows. Structured funds in addition to providing security against future revenues (like securities) structure the risk as well. The overall risk is divided into tranches, each with different degrees of risk, and these are passed on to investors with varying risk appetites. This means that, ultimately, private capital is mobilized to finance development processes.

f. *Ethical funds/ ethical bonds/ diaspora bonds:* Ethical funds/ bonds are private investment funds or bonds which, as well as targeting a positive return, also consider ethical aspects in their investment decisions, and are therefore prepared to accept some reduction in the level of return achieved. Diaspora bonds are meant for citizens of developing and emerging countries who are living abroad often have a particular interest in supporting the development of their homeland. As a result, they are often prepared to forego their "returns". Unlike purely commercial investors, if economic difficulties arise, they do not immediately withdraw their funds.

g. *Loans issued in local currency:* Most development aid is traditionally issued in internationally convertible currencies. This means, however, that the debtor is burdened with the entire foreign exchange risk. Small and medium-sized enterprises are particularly affected by this, since they usually only have their local currency revenues available. Making it possible for these companies to repay loans in local currency reduces their risk of default and improves their access to credit.

h. *The Clean Development Mechanism (CDM) and the Adaptation Fund (AF):* In addition to the initial auction of emission allowances which mobilizes funds for development finance, the subsequent sale of emission allowances under the "Clean Development Mechanism" (CDM) can also mobilize private funds. E.g. When a developing country builds a wind farm, it can obtain allowances commensurate with the emissions saved compared to thermal power stations, and sell them to a company in an industrialized country which has reduction requirements. This means that the funds flow directly to the project in the developing country. 2% of sale proceeds from CDM go into the Adaptation Fund (AF) which enables even those developing countries which have not sold any allowances to obtain funding to finance special projects for climate change adaptation.

i. *Lotteries:* E.g. The "Belgian Technical Cooperation", together with Belgian NGOs and UN organizations, organizes a national lottery, from which 20% of sales goes into the "Belgian Fund for Food Security", which finances food security projects in developing countries affected by famine.

Instruments that increase efficiency or debt conversion in order to free up additional funds

a. *Results-based financing / Output-based Aid / Health Impact Fund (HIF):* payment is made not for the input required to complete a developmentally relevant initiative (e.g. building a school) but for achieving an effect (e.g. an increased number of successful school-leavers). Output-based aid and voucher systems are variations on this model. E.g. As per HIF pharmaceutical companies would no longer receive a fixed price for medication sold, but be rewarded instead with a set amount (out of an international fund for medicine) for achieving a particular verified effect (e.g. a decline in the incidence of tuberculosis following the introduction of a new medicine into a developing country).

b. *Weather insurance and catastrophe insurance:* The average initial risk of a claim (which must form the basis on which the premium is calculated) can be reduced by spreading the risk very widely.

c. *Blending/ Concessionary loans combining public and private funding:* Combine low-cost budget/ government funds with funds from the international capital market in such a way as to avoid both project underfunding and project overfunding. E.g. Interest rate reduction. E.g. Caribbean Catastrophe Risk Insurance Facility" (CCRIF), shares the risk of the 16 member states thus enabling premiums to be reduced by around 40%, compared to the amount which would have had to be raised for an individual country

d. *Conditional debt forgiveness, debt buy-back and debt-for-development swaps:* Conditional debt forgiveness relieves a developing country from repaying a loan (or a part thereof) if it satisfies certain stipulated, developmentally relevant conditions. In Debt buy-back a third-party donor repays the creditor on behalf of the developing country, subject to certain conditions being satisfied.
Under debt-for-development swaps, the developing country agrees to deploy a sum equivalent to all

or part of the value of the debt written off in return for specific developmentally relevant measures, such as nature conservation (debt-for-nature swaps) or health initiatives (debt-for-health swaps) What all these instruments have in common is that, they do not mobilize any additional external funds rather, they reduce repayment obligations.

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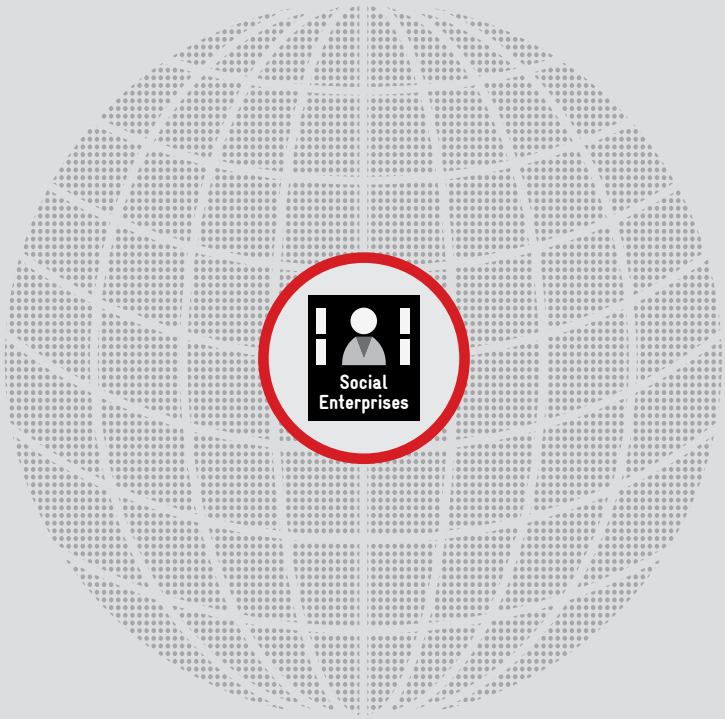
- Energy- Renewable energy and energy efficiency
- Sustainable Urban and Industrial Development
- Natural Resource Management
- Private Sector Development
- Social Protection
- Financial Systems Development
- HIV/AIDS-Blood Safety



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