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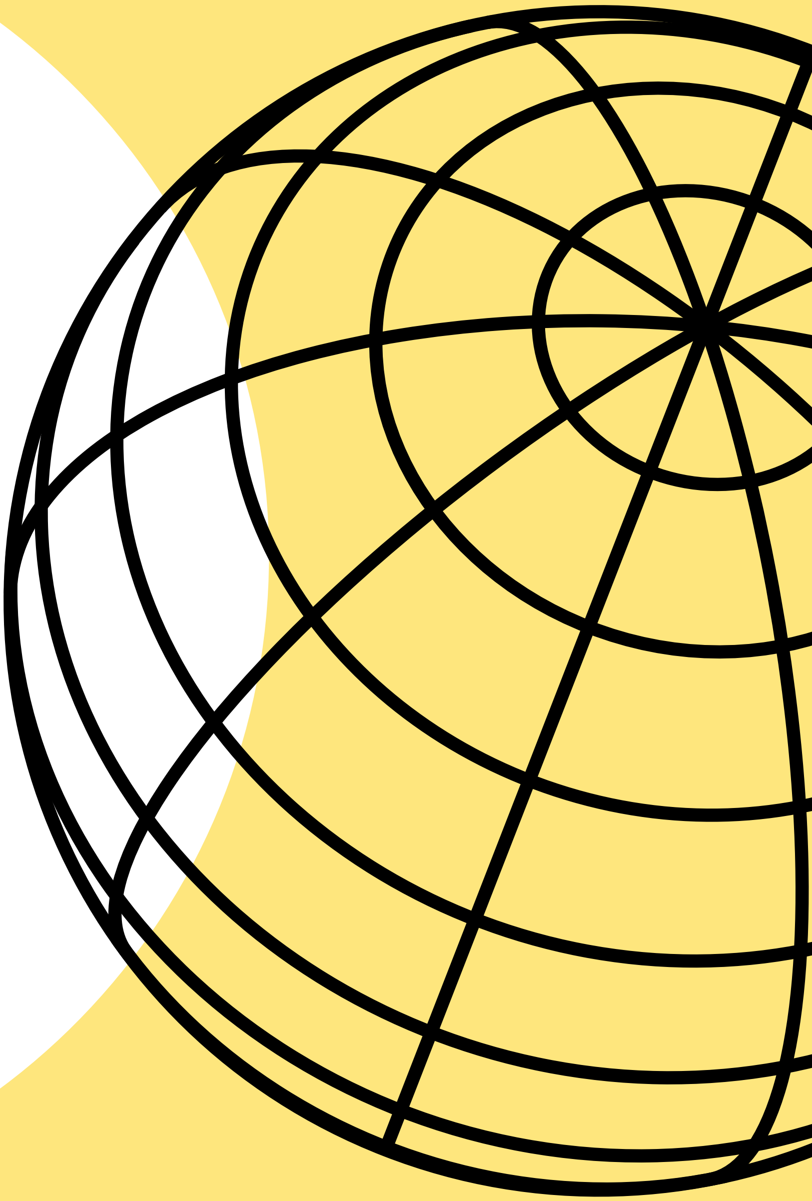


MARKET RESEARCH REPORT

IMPACT ENTREPRENEURSHIP

Table of Contents

List of Figures

Methodology

The purpose of this report is to gain insights into the current market scenario and the future scope for impact start-ups. The analysis was done to understand the performance of these start-ups as well as the key pain points being faced by the investors in this field. This report tries to address these challenges with feasible solutions keeping the start-ups as well as the investor's point of view in mind.

The main reason for choosing this topic for research analysis is the growing need to inculcate sustainable solutions in the corporate world. The need for environmental and social outcomes is very high especially in the post-COVID world, and impact start-ups have a tremendous role to play to build the economy back from its current state.

The analysis was carried out through thorough research with the aid of previous reports and surveys to gain an understanding of the market. The mode of data collection was online with the help of web tools, online communities, and online forums. The geographical scope of this research is global, although some references are made pertaining only to India.

One major limitation that was faced, was the fact that Impact entrepreneurship being a relatively new sector, had limited data available on online platforms to get a clear picture of the market. Nonetheless, all the understandings which were gained in the process, have been carefully cumulated into this report to predict future growth and opportunities in this sector. This paper thus intends to shed some light on Impact entrepreneurship, deliberate upon its need in today's world, and outline some viable solutions to counter the major challenges being faced.

Executive Summary

"Investors around the world are making impact investments to unleash the power of capital for good."

The major findings and observations of this report have been summarized below as follows:

1. Impact start-ups and Impact Investment industry is growing tremendously, with the overall assets of start-ups almost doubling every year.

2. Funding is the major challenge faced by impact start-ups and hence, investors are experimenting with blended finance, modifying the current revenue-sharing model as well as an impact-based incentive structure.

3. Impact investing is broadening into sectors like Energy, Education, Water and Sanitation, etc., beyond the Financial Services.

4. According to a survey, the contribution of banks and other financial institutions in providing funding capital to the impact start-ups has increased significantly.

5. The government can play a major role in supporting impact start-ups through incentives in the form of tax deductions, collaboration with other stakeholders and intervening to prevent the limited flow of funding.

6. Consumers are willing to buy products associated with a good cause, as long as they are being offered at the same price and quality as that of non-impact products.

7. Most of the impact start-ups tend to fail because consumers lack some attached proof to believe the sustainable claims being made by the start-ups.

Introduction

"Often we are impatient about impact – because we want change to happen faster, but social innovation is the way to bring humanity back on track."

The term Impact Entrepreneurship refers to enterprises that are ethical, transparent and make a measurable impact at scale in the social or environmental problems they aim to tackle. Impact start-ups and companies unlike non-profit organizations and philanthropies, look out for profits and simultaneously try to create a social and environmental impact through various market strategies. The impact in this context must be relevant, measurable and scalable.

One thing to keep in mind is that Impact Entrepreneurship is not just an approach. It's rather a management system that covers the whole spectrum of market – customers, employees, business partners, public etc. Thus, impact companies cater not only to the welfare of their consumers and public, but also their employees, business partners and environment at large.

Impact companies thus follow a framework called the Triple Bottom Line (TBL) framework which looks into three perspectives:

1. Economic perspective
2. Social perspective
3. Environment perspective

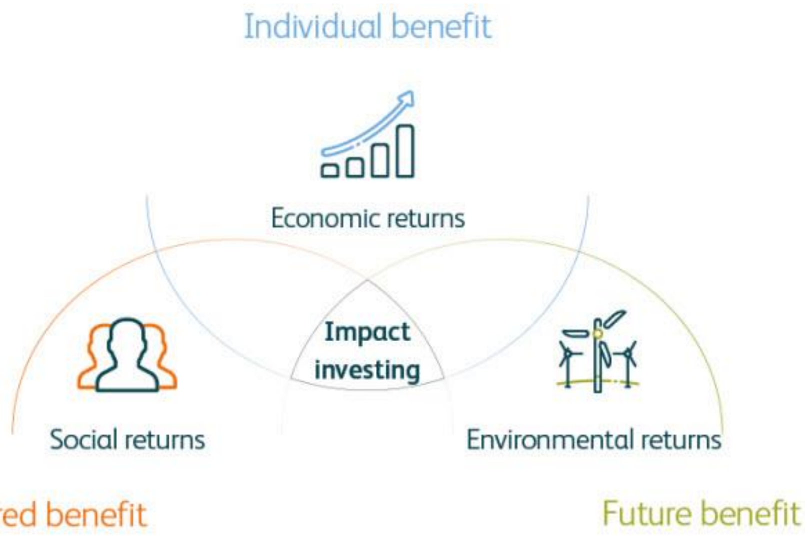


Fig.1 TBL Framework

The goal of this framework is to enhance sustainable practices and thus the traditional financial perspective is extended to include social and environmental practices of the firm. Hence to follow this framework, impact start-ups and companies have two business models – the revenue model and the impact model. Here, the key feature that distinguishes the impact entrepreneurs from others, is the impact aspect. Impact firms have to build an impact model along with the conventional revenue model. And thus, the pairing of profit-focus and impact-focus is what makes these companies impact driven.

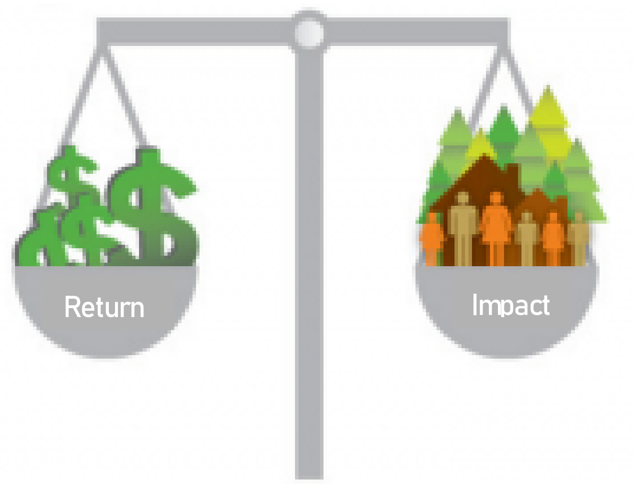


Fig. 2 Business model representation

However, one thing to keep in mind is that measuring a firm's wider societal and environmental impacts is not easy. Standard measures for accounting the impact do not exist and the measures currently in use are still evolving. Greater clarity on measurement and assessment of impacts is still emerging. Meanwhile, organisations like Global Impact Investing Network, Principles for Responsible Investment are trying to develop standards for the industry.

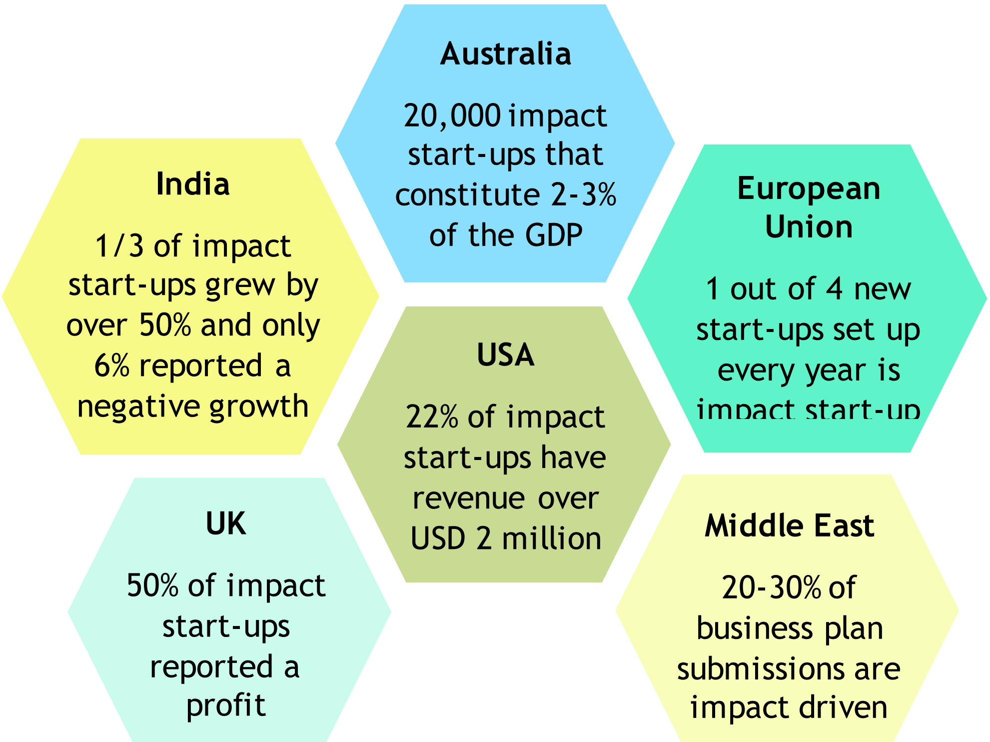
Why Impact Entrepreneurship?

"To change the standards of our society, we can't just offer a product sold to consumers, but a solution that proves our sustainable processes are an environmental, social and financial improvement to the norm."

Apart from the fact that impact investing offers solutions to address global challenges, its growth also serves another important purpose – changing the way we look at investing. Before dwelling deeper into the topic, it is important to note that impact investing is not riskier than traditional investing. Some might believe that the financial returns might be affected due to the expanded focus on creating an impact. But in reality, a tangible commitment to impact is strongly correlated with the overall business growth and development.

Global Scenario

With the ongoing Coronavirus crisis, the global economy is in a dire condition. Impact firms with the help of their sustainable solutions can help build back the economy at a faster rate. Given below are some impact start-ups statistics from around the world.



Growth of Impact start-ups

The assets of impact start-ups have been increasing almost two-fold over the past few years. This growth has been observed due to the increasing awareness of applying sustainable solutions in the corporate world. This increasing awareness has led to more amount of capital being directed towards impact investments.

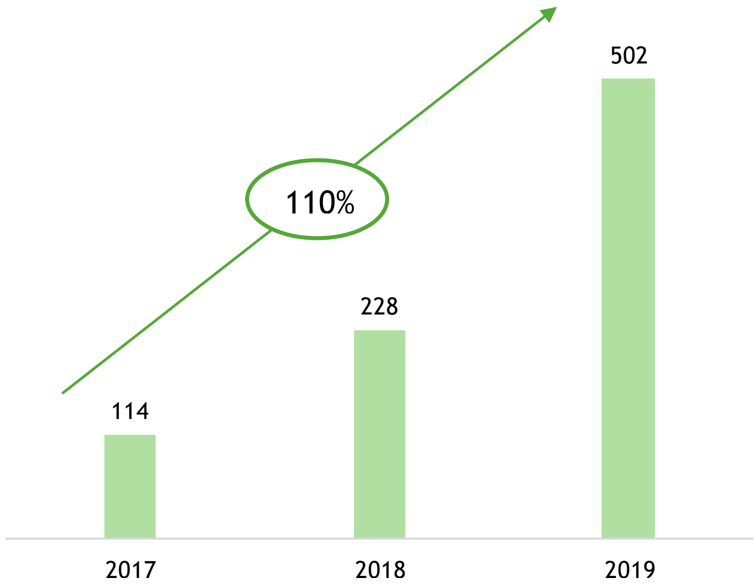


Fig. 3 Growth of assets of impact start-ups (USD billion)

The assets of impact start-ups as of 2019 comprise only 0.67% of the overall global financial asset management industry. This amount is very small compared to the annual capital outlay estimated at USD 1.4 trillion to USD 2.5 trillion which is the amount allocated to achieve the Sustainable Development Goals (SDG) set forth by the United Nations by 2030. Nevertheless, impact start-ups are playing a key role in achieving these SDGs by not only showing potential for societal and environmental impact but also financial returns.

Key Impact Companies

Major Impact Investing Firms

Triodos Investment Management

Asset: USD 5 billion

Cause: Renewable energy, Sustainable food and agriculture, Healthcare, Education

BlueOrchard Finance

Asset: USD 3.5 billion

Cause: Food production, Education programs, Climate change issues, Hunger and poverty

Reinvestment Fund

Asset: USD 1.2 billion

Cause: Housing projects, Healthcare, Education programs

Vital Capital Fund

Asset: USD 350 million

Cause: Renewable energy, Agro-industrial projects, Healthcare, Housing projects

Major Challenges

"Challenges are what make life interesting, overcoming them is what makes life meaningful." – Joshua J. Marine

Since impact entrepreneurs work with two business models, they face some challenges which are specific to this sector. Some of these can be overcome with small amendments while some challenges require drastic changes in the current system and policies. These challenges have been discussed below:

1. **Scalability constraints**: Impact entrepreneurs face difficulties in scaling both their impact and revenue simultaneously due to budget issues. This is when, these start-ups tend to partner with other organisations or scale through franchises.
2. **Labor**: Start-ups face an issue in employing labor as well as retaining them because some part of the job involves working in remote areas which is something people hesitate towards going for.
3. **Funding**: The previous two challenges can be tackled with a few good strategies. However, funding is a challenge which requires some changes in the current reforms. This issue has been explained further below.

Why is funding an issue?

Impact start-ups unlike traditional start-ups grow at a slower pace initially in the budding stage since their focus is distributed in two regions. Adding to this, investments of impact start-ups are more front-loaded i.e. they need an immediate funding of USD 2-3 million, unlike traditional start-ups which take a seeding fund of USD 100,000 and then go for higher amounts. Impact start-ups need this lump sum money owing to the fact that most of their projects are involved in remote areas where necessary transportation and communication systems are needed along with other extra expenditures.

When facing funding issues like these, impact start-ups either tend to go to the impact investors or venture capitalists. Impact investors don't provide funding at the budding stages because they need some positive cash-flow within the start-up to begin with. Venture capitalists have their own limitations too. They don't fund huge amount of money in the first go. Even if they do, they don't support the start-ups at early stages. Grants are an option for funding too, but they are tied up with a lot of policy barriers and hence impact start-ups don't tend to prefer them.

To address these financing gap issues, VCs are experimenting with blended finance or are considering modifying the current revenue-sharing model. They are also trying to explore a concept of impact-based incentive structure, where instead of trying to earn beyond a given internal rate of return, the VCs can earn the excess value addition by achieving and growing their target impact.

Blended Finance

Blended finance is typically a model to finance developmental projects like that of impact firms wherein it combines its initial investment with either a philanthropic organization or the government, which is followed by a subsequent commercial investment.

This first investment, also referred to as a concessional investment takes the form of a first-loss capital and its main purpose is to help the start-up take off. This investment absorbs much of the outsize market risk and accepts the below market rate of returns. Since the concessional investment already takes up most of the risk, the start-up becomes attractive for funding to investors who seek good market rate of returns with lower risk.

Blended finance thus provides a path to correct market failures without the government and other agencies having to finance the entire project through public funds. This tool can help mitigate specific investment risks and draw attention to projects in developing areas, which many investors tend to overlook due to the high risk attached to it. However, the investor must ensure that the start-ups are scalable and can be made commercially viable.

Over the past 10 years, the International Finance Corporation has deployed USD 1.2 billion concessional investments to support more than 200 impact start-ups in over 50 countries, leveraging USD 4.1 billion in financing and more than USD 5.5 billion in the form of private capital.

Modifying revenue-sharing model

The current revenue-sharing model for most of the VCs is an equity-only model. A few VCs are experimenting with a revised model that aligns with the interests of both the equity owners and the company owners. This model is needed because relying on equity alone, narrows and limits the investor’s choices and causes them to miss out on non-conventional, but still high potential companies. The equity-only strategy says that it’s okay if 7 out of 10 companies fail, as long as the remaining ones compensate for it and provide profits. But this approach has led to the loss of many innovative business models which could have gone on a path of sustainable growth and long-term profitability.

For example, if we consider a company that is steady and stable in terms of profitability but not reaching as much as 5x, 10x or 20x annual growth rates. Such a company will be facing a lot of pressure from its investors, if they are unable to attract potential buyers within few years or go public. But, steady, stable companies are actually good for the economy and can prove to be great for the founders who started them, and as well as the investors who backed them.

If start-ups however want to go for an option other than equities, the only option they sadly have is to take a loan. This is because other options have become scarcer for a young company aiming for a steady growth. And debt has become more difficult to secure in the past few years, particularly for early stage ventures that still have a fair amount of risk.

The third option which is currently being explored by VCs, is to pick out high potential companies which are undiscovered and overlooked. They may be too early for debt, but might have growth aspects that can help provide attractive returns when capitalized in the right manner. Such companies can be given a little time initially to build the business and then later allow the investors a 5% share of the revenue as the company grows up to generate a target return multiple on the original investment. If the start-up grows fast, the investors win with them. If the start-up otherwise goes through a rough quarter, the investors share the risk.

This structure thus involves a more integrated understanding between the investors and start-ups, thereby allowing the start-up to grow at its own pace and provide annual returns which deem to be profitable once the start-up gets established.

Market Potential

“Impact investing can be a powerful instrument of change.” – Judith Rodin

Impact entrepreneurship has come a long way and has tremendous potential to grow further. Impact start-ups have immense opportunities to grow in the following four sectors:

1. **Healthcare**: Healthcare facilities are not able to reach the remote communities of the world which is resulting in high mortality and morbidity rates. Impact start-ups are thus trying to bridge the gap between medical practitioners and those who need the facilities. Start-ups have developed a wide array of innovative solutions to improve the affordability, quality and efficiency of healthcare services.

2. **Clean Energy**: Large masses of people do not even have the basic provision of electricity. Impact start-ups are thus providing sustainable electrification solutions to the rural communities. These include using solar energy or biofuels for electrification. Apart from this, start-ups are providing electrical mobility solutions too.

3. **Water Technology**: Groundwater levels are rapidly diminishing in several parts of the world due to climate change and prolonged drought periods. Thus start-ups are working on providing access to clean drinking water to people living in such areas.

4. **Agriculture Technology**: For countries facing agrarian crisis, impact start-ups have innovated solutions to mitigate the challenges being faced by farmers. These include providing marketing solutions to improve productivity, create and deepen market links, as well as provide equipment at affordable prices.

Sector-wise Impact Investment

According to a survey, along with the rise of overall impact investing, the past few years have also seen the broadening of impact investing into sectors like Renewable Energy, Water and Sanitation, Education, etc. beyond the Financial services sector. This growth has been observed because a greater number of investors are seeking impact driven products which provide sustainable solutions.

This is a good sign because tackling these challenges is the need of the hour.

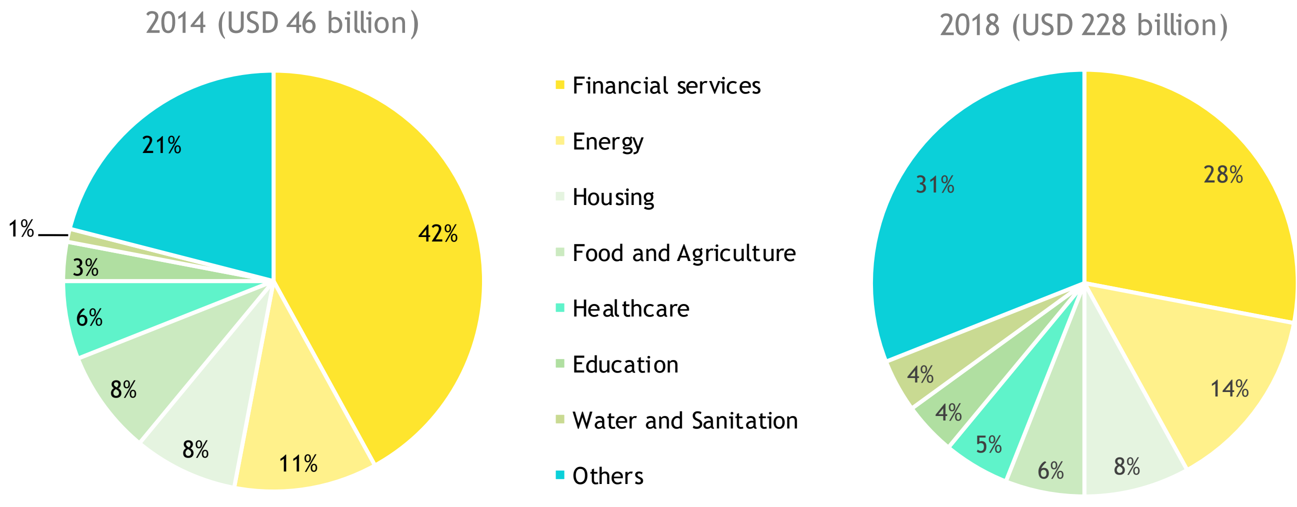


Fig. 4 Sector-wise impact investment

A few questions however still remain unanswered. Firstly, why has there been a decrease in contribution of healthcare sector even when it is filled with immense potential? The reason being a limited number of healthcare experts, leading to a lack of collaboration between them and the start-ups. Thus, start-ups are unable to provide healthcare facilities to people living in remote areas.

Secondly, what is the sector 'Others' in Fig. 3 and why has its contribution increased so significantly? The sector 'Others' majorly comprises of Manufacturing and Communication technologies. With the growing need to stay connected with others over long distances, this sector has grown tremendously to provide better connectivity in remote areas.

Thirdly, why has there been a decrease in the Food and agriculture sector? This is owing to the fact that a majority of the impact start-ups are based in U.S.A. and Europe. These areas are pioneers in in the development of agriculture and start-ups thus have a little role to play leading to a decline in this sector.

Source-wise Impact Investment

According to a survey, the contribution of banks and other financial institutions in providing funding capital to the impact start-ups has increased significantly. This increase shows that more number of mainstream investors are seeking impact driven solutions rather than just financially driven ones. Thus in the future, we can expect asset owners to prioritize financing of solutions towards social and environmental impact, and also observe a major increase in commitment of capital to impact seeking start-ups.

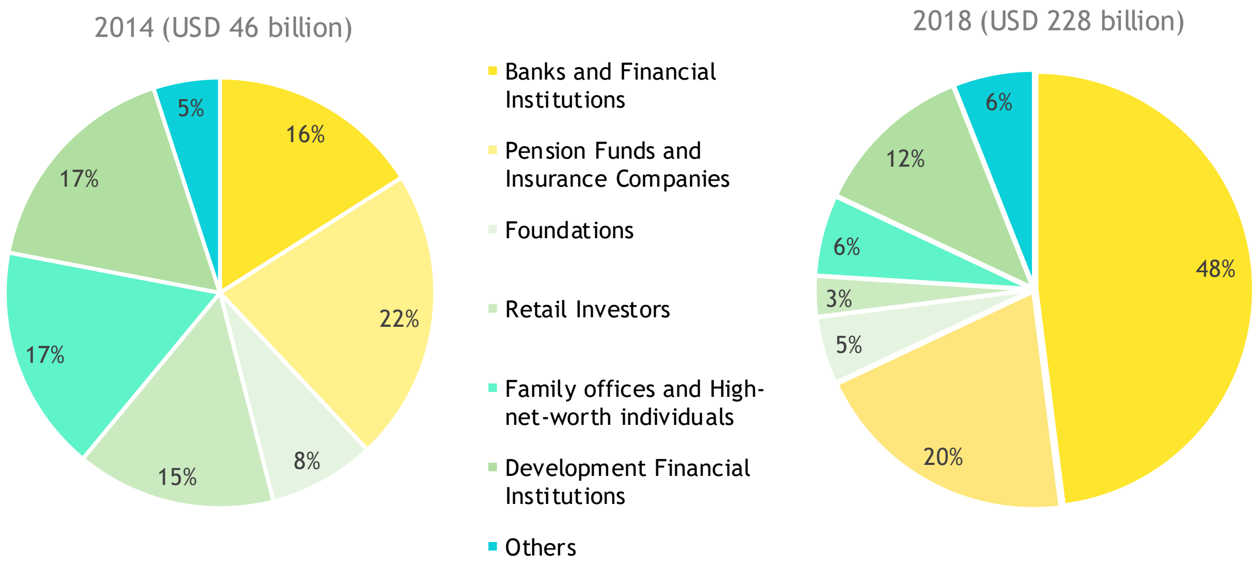


Fig. 5 Source-wise impact investment

Banks, pension funds, insurance companies and financial advisors can provide client investment opportunities for both individuals and institutions with an interest in social or environmental causes. Institutional and family foundations can leverage significantly greater assets to advance their core goals, while maintaining and growing their overall endowment. Government investors and development financial institutions can provide proof of financial viability for private-sector investors while targeting specific social and environmental goals.

Role of Government

Currently, a very few government policies are in favor of impact start-ups. The government can perform a few additional roles mentioned below to support the start-up's growth further:

1. **Incentives:** The government can provide incentives to impact start-ups in the form of tax deduction similar to that of philanthropic organization.

2. **Collaboration**: A lot of times, it so happens that the government alone does not have the capability to deliver and boost the productivity of social outcomes. In that case, it needs to collaborate with other stakeholders to achieve the desired outcome.

3. **Funding issue**: Limited flow of funding often hinders the growth of impact start-ups and the government needs to intervene in such cases. For example, The U.K. Government, along with four other large U.K. banks, provided funding to impact investing companies using dormant bank accounts.

Why do Impact start-ups fail?

"Failure is not the opposite of success, it's part of success." – Arianna Huffington

Transparency is becoming the norm for businesses that are attempting to express their sincerity and gain trust from their customers. According to a survey, almost 82% of the Americans agree that they tend to believe a company is socially responsible when they actively communicate the results of their impact and not just make claims. However, trust is not all that is expected from a company.

Many consumers are actually willing to buy the products produced by impact start-ups but the reason they don't is that, the prices of impact products are much higher than that of non-impact companies. Almost 89% of the Americans are likely to shift brands associated with a good cause, as long as their products offer the same price and quality. This view that sustainable options come along with a higher price and lower quality can be tackled through the same marketing strategies which have led to the success of more mainstream products. This involves paying attention to key attributes other than price and convenience that influence the buying patterns of customers like – quality, need, experience, etc.

When it comes to impact start-ups, a lot of consumers have credibility issues since there are many companies out there claiming to create an impact but there's no attached proof to it. And this is why we need some form of online certification, where a third party can actually verify the claims being made by the start-ups. And if the companies fulfil some sort of criteria, then they get to have a logo on their product which can help consumers make sustainable decisions more conveniently.

Many impact start-ups in the run to create an impact, forget to fulfil these needs of the consumers and thus tend to collapse. Thus, in order to become successful, it is important that these start-ups address these issues.

Conclusion

"Great companies start because the founder wants to change the world, not make a fast buck." - Guy Kawasaki

Impact investing is relatively new to the market and thus it lacks a historical record. But this gap is forcing the investors to think as to how the capital is currently being raised and spent, and make the necessary amendments. While some investors have been practicing impact investing for a long period, there has emerged a new collaborative international effort recently, to accelerate the development of a high-functioning market that helps support and sustain impact investing. While this market is still an upcoming idea, investors are optimistic about its overall development and are expecting an increased scale and efficiency in the future.

The current coronavirus pandemic has endangered the livelihoods of almost half of the world's workforce and risked the fate of many businesses. In these times, many impact start-ups are helping those hit the hardest by this crisis, by providing basic facilities like sanitation, food, education, etc. This crisis has shown the importance of sustainable growth and inclusion, and has prompted many well established companies to come forward and pledge to provide resources to impact start-ups. Many big companies including Ikea and Salesforce have pledged to support impact start-ups spread across different nations of the globe.

Speaking at the 2017 Global Steering Group for Impact Investment Summit, Sir Ronald Cohen, a leading impact investing innovator and advocate, contended that the sector's rapid growth will reach a tipping point and 'spark a chain reaction in impact creation', touching investors, big business, foundations and social organizations, that could hasten the adoption of impact assessment in day-to-day business processes and operations.

In conclusion, impact entrepreneurship is not just some short term social trend but rather a very clear goal and it might just become one of the best strategies for growth, for small and large businesses as well.

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