CHAPTER 1

Financing Innovation: The India Inclusive Innovation Fund

Background

Financial capital – its availability, quality, and accessibility – defines the innovation success of countries. The world's most successfully innovative companies owe their existence to being able to access the right kind of money at the right time. To help create a supporting environment for Indian innovation, the National Innovation Council has focused on finding ways of funding ideas that will impact people at the bottom of the socio-economic pyramid. The objective is to drive ideas that will generate social returns, while simultaneously maintaining commercial viability and profitablity.

The India Inclusive Innovation Fund (IIIF)

Traditional innovation models have often focused more on addressing the *wants of the affluent*, rather than the *needs of the deprived*: a tendency that directs the best human and financial resources *away* from solving more basic developmental needs. A new template is needed: one of ***inclusive innovation***, which will mobilise and deploy India's best creative, human, and financial capital to serve our country's poorer citizens, at the **bottom of the socioeconomic pyramid (BOP)**.

For inclusive innovation to work, India will need to co-opt the dynamism and energy of its vibrant private sector. Enterprise and entrepreneurs bring powerful tools to any attack on poverty and deprivation. They have demonstrated outstanding ability in *innovative problem-solving*: exploring challenges, experimenting with responses, and selecting and delivering novel, workable solutions. Crucially, these solutions are scalable, and *self-sustaining*: by recycling profits into further development, enterprises can expand service delivery with just incremental investments of additional resources.

Indian enterprises could help bridge access gaps in core services for millions of disadvantaged Indians, offering them affordable education, healthcare, energy, and livelihood support. Significantly, some exceptional Indian companies have *already shown the way to doing so*: firms like Aravind EyeCare, Narayana Hrudayalaya, and SELCO use innovatively designed products, business models, and operating processes to bridge service gaps in healthcare and energy – while maintaining their own commercial viability. Enterprises like these can complement the work of government and aid agencies, expanding support for India's inclusive growth agenda.

Inspiring as these examples are, they remain nonetheless *isolated* – too few, in the Council's view.

India's developmental challenges are substantial, diverse, and faced by millions – and need thousands of bottom-of-the-pyramid companies to engage them. We lack, however, a *business ecosystem* that can support wider emulation of such examples. India's business environment does provide finance and talent to conventional commercially-focused companies; however, bottom-of-the-pyramid companies find it much harder to access these same resources – in particular, *risk funding*, with which to seed early-stage ideas and expand successful ones. If innovative, socially-focused ideas are to make it to market (and to citizens who will benefit from them) they will require a funding ecosystem to back them.

The India Inclusive Innovation Fund is a step towards addressing this funding need. The Fund will finance such companies with the capital they need to take their ideas to market. Fund-backed enterprises will target core sectors (such as education, healthcare, and agriculture, among others), and combine social and commercial returns. The outcome of the Fund's work will be a generation of innovative solutions, directing India's most creative thinking towards solving her most significant challenges.

Objectives of IIIF

The India Inclusive Innovation Fund will be guided by *four driving objectives*.

a. ***To Focus on India's Poor.*** The India Inclusive Innovation Fund will back enterprises developing innovative solutions for customers who lie in the 'bottom 500 million' in India's society. These customers will largely reside in under-served rural and semi-urban areas, with limited physical and institutional access to basic services. The 'pain-points' these enterprises address will reflect the realities and needs of these customers: largely involving service, affordability, and access gaps in education, healthcare, agriculture, water, sanitation, and other, similar areas.

b. ***To Combine Social and Commercial Returns.*** The Fund and its investee enterprises will not only address developmental needs, but will do so in a *commercially viable fashion*. The Fund will therefore operate as a for-profit entity with a social investment focus and seek to provide its investors with reasonable financial returns. These returns will be lower than those typically provided by conventional, profit-maximising enterprise financiers like traditional private equity and venture capital funds. However, in providing these returns, the Fund will depart sharply from grant-based development aid and philanthropy models that have traditionally been used to serve deprived citizens.

c. ***To Drive Employment and Livelihood Generation.*** Wherever possible, the Fund will back enterprises that employ India's poorer citizens, or enable them with the capacities they need to build successful livelihoods.

d. ***To Help Establish a Model for Wider Inclusive Innovation Funding.*** It is hoped that the Fund, by investing in BOP-focused enterprise, will establish an example for other Indian funds and financiers to emulate – leading to a new pattern of funding for commercially feasible, socially meaningful innovation.

The Fund's Design

The India Inclusive Innovation Fund will provide funding to BOP-focused companies across the venture development cycle – both in early and in growth stages. Its design will include the following elements:

SIZE

The Fund will be capitalised to an eventual target size of Rs 5000 crores, to be achieved in phases. 80% of its capital will be sourced from private investors, philanthropists, and bilateral and multilateral institutions who share the Fund's objectives. 20% is sought from the Government of India, in seed funding, and to kick-start investment into the Fund, Rs 100 crores is requested from the Government. The Council expects significant interest from bilateral and multilateral agencies, and from socially-focused private investors.

STRUCTURE

The Fund will be structured as an autonomous and professionally-managed entity. The Fund will seek to invest not just in enterprises focused on inclusive innovation, but *also in other funds* that currently back such enterprises. This will allow the Fund to *maximise impact*, expanding the wider funding ecosystem available for BOP-focused companies – by leveraging existing investments made by private and philanthropic investors in bottom-of-the-pyramid enterprises, across a wider base of investees. It will also allow the Fund to draw on the rich expertise and experience in social impact investing developed by existing funds – allowing it to enhance its own operational effectiveness. Preliminary discussions, seeking to explore the feasibility of such a structure with the appropriate government regulatory authorities, have been extremely positive.

TIME-FRAME

The Fund's life has been proposed at 10 years, extendable by up to 3 years. It will be managed, during its life, by a highly professional management team – attracted and selected according to their experience and ability in driving commercial returns, and also according to their social commitment. The team will guide the Fund, and its investee companies, to achieving its target returns.

RETURNS

The Fund will seek to provide its investors with positive *financial* returns; while these returns would be lower than those of traditional venture capital funds, they would be accompanied by demonstrable and measurable *social* returns to its investors. To achieve this objective, the Fund will hold all investee enterprises to *success criteria* that relate both to social impact, and commercial performance. Investee firms will be assessed and monitored according to these criteria. Fund managerial decisions will also be guided by these parameters.

INVESTMENT SOURCING

To maximise its impact, the Fund will seek potential investees from four sources. The Fund will solicit interested enterprise through *open broadcast:* the outreach publicity activity surrounding its launch and initial operations is expected to attract a high level of demand from innovative enterprises. *Angel and venture capital networks* with established investments in early and mid-stage SMEs, and institutionalised social-venture interest communities will prove an important source of potential investees. Given the developmental focus of the Fund, *community organisations* (such as non-profits and NGOs) are expected to prove a rich source of entrepreneurs and enterprises, given appropriate mentoring and incubation support. The Fund will also source investee firms from *other funds* focused on social enterprise, wherever possible and appropriate: either co-investing with these funds in commonly-held social enterprises, or *via* these funds.

INCUBATION AND MENTORING

To de-risk investee enterprises, and help them develop the ability to deliver social impact and financial returns, the Fund will create *a network of mentors* to support and guide innovators and entrepreneurs. The Fund will also establish an incubation programme to train entrepreneurs in domain areas such as finance, marketing, and operations. Capacity for these activities will be taken from existing incubation and mentoring organisations around the country (in academic institutes, and venture support organisations).

EXIT STRATEGY

Traditional venture capital firms realise their commercial returns from investee firms on *exit:* through mechanisms such as initial public offerings (IPOs) on the financial market, and buy-outs by other investment firms. These conventional mechanisms have typically been applied to purely profit-maximising enterprises. In some cases, where Fund-backed enterprises focus on social impact at the (limited) cost of financial performance, a range of other exit mechanisms may be considered.

PROGRESS

Having developed a detailed concept for the Fund, the Council has forwarded a proposal to the Ministry of Finance for its consideration and approval with a view to beginning operations in fiscal year 2012-2013.