

VCs swoop to the bottom of pyramid

DOUBLE ROLE

	Size (\$ m)	Amount (\$ m)	
		Invested	Planned
Commercial-cum-social investing VCs			
VenturEast (across funds)	300	162	25
Nexus Venture Partners	320	10	10
IndoUS Venture Partners**	189.4	5	NA
Dedicated social-investing VCs			
Aavishkaar India	14	7	7
Acumen***	20	20	6
Gray Matters Capital	12	5.6	2
Oasis Fund	48	7	NA
Elevar Equity II	40	3	NA
GGDOEN Cooperatief	35	NA	3
SONG	17	NA	NA
Total		219.6	53

Investments in next 6 months (\$ m) *

* Estimated by respective VC funds, ** India launch in 2007

Source: VC funds

***India launch in 2005, NA: Not available

Plan To Pump In \$53 M Over 6 Mths

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MUMBAI

IN THE 20-company portfolio of Nexus Venture East, a \$320-million venture capital (VC) fund, three businesses stand out. There's Suminter India Organics, which does contract farming for organic produce; D.light Design, which provides solar lighting solutions; and Sohan Lal Commodity Management, which provides grain warehousing facilities in small towns and villages in 12 states. Nexus refers to them as "impact investments" — businesses where the pursuit of

profits is accompanied by the premise of social good.

In the four years it has been in India, Nexus has invested \$10 million in social businesses. However, in the next six months alone, it expects to match that amount. Says Sandeep Singhal, co-founder, Nexus: "Businesses are targeting the bottom of the pyramid because people have a genuine ability to pay. So, we are looking at a few good deals in this space."

It's not just Nexus that is looking at a sharp increase in exposure to social businesses.

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Social investing a difficult space

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EACH of the seven VCs that invest in social businesses that ET spoke to say they expect to increase their investments in such ventures at a faster pace. These seven VCs, which started investing in social businesses at various points between 1997 and 2009, have invested \$220 million in such ventures in India so far. In the next six months, they say, they expect to add a combined \$53 million.

In its five years here, Acumen, a dedicated social-investing fund, has invested \$20 million in 12 social businesses. Rajan Kundra, director of its capital markets and energy portfolio in the US, says interest is growing. Acumen receives several hundred proposals in a year. Currently, it has 8-10 deals in the pipeline and expects to close two by the end of this year in India. Says Mr Kundra: "The flow of capital in such businesses is a poor indication of the dialogue that VCs are having with companies looking to serve the bottom-of-the-pyramid customers."

The big addition, however, is not expected to come from dedicated social-investing VCs like Acumen and Aavishkaar. It is expected to come from VCs which are known for investing in out-and-out commercial ventures and have since diversified into social businesses. For instance, VenturEast, which has invested \$162 million across 30 social businesses, hopes to secure incremental investments of \$25 million in the next six months — the maximum in this space. Nexus follows it, with \$10 million.

Traditional VCs are beginning to see the base of the pyramid as future consumers, with significant collective buying power. Says Sarath Naru, managing partner, VenturEast: "The size of the opportunity is large, as there is a huge need for such businesses. This is attracting a lot more VC interest." The focus of social investing is on sectors like education, clean technologies, electronic waste, microfinance and recycling, among others, as compared to, say, wine-making or TV shows, where there's no direct social benefit.

For instance, VenturEast has invested \$4 million in Kolkata-based Orion Edutech. Orion trains youngsters to work in call centres, and its clients include Wipro, IBM, Genpact and Tech Mahindra. It has about 100 training centres across 17 states; of this, 66 centres are in tier-II and tier-III cities like Bijapur, Siliguri, Trichy and Agartala. "We have invested in Orion as it provides employment to rural and semi-urban



youth," says Mr Naru.

Orion, which began in 2006 with an initial investment of ₹3 lakh, posted revenues of ₹21 crore in 2009-10. "This year, we expect to cross ₹40 crore," says Manish Agarwal, director, Orion. Mr Agarwal and his team have trained about 50,000 students till date. Over the next three years, Orion plans to open about 500 centres, in India and in neighbouring countries with large bottom-of-the-pyramid potential like Vietnam, Malaysia, Philippines, Sri Lanka, Kenya and China.

The growing presence of traditional VCs in the social-investing space is opening up a debate on the 'social impact' of the businesses they are investing in. Aavishkaar Venture Management has been managing a pure social-investing fund since 2002, and has invested \$7 million in 18 businesses. Vijay Rajagopal, its investment manager of services, says: "Some of the mainstream VC investments might have a superficial social relevance, unlike us." In other words, the profitability of a scalable business model is much more attractive to such funds than doing social good, which can be incidental.

Where an Aavishkaar won't invest in a company that is not motivated by social impact, Nexus or Indo US will, if they can see a payback. "One can't build a business to touch a million lives by being purely social," argues Mr Singhal of Nexus. "The idea is to provide a quality product at an affordable price, but do it in a manner that is scalable."

Mr Singhal's argument is that once a business becomes scalable, it has the potential to impact more lives. "So, yes, in that sense, our businesses would not be as cheap as a completely social one," concedes Mr Singhal. Nexus looks for an IRR (internal rate of return) of 25-30% from its investments. Getting that from a pure social business is not easy.

So far, VCs have invested \$220 million in 77 social businesses in India. But there hasn't been a single exit. In conventional commercial ven-

tures, VCs work with a holding period of 3-5 years. In social businesses, the holding period is longer — typically, 6-8 years. Aavishkaar, for instance, is currently working on its first partial stake sale in a company — it refused to give the name — in which it invested eight years ago.

Investors of a conventional VC like Nexus include private investors, institutions, university endowments, foundations and sovereign funds. Some of these investors — called 'limited partners' — might be more demanding for a payback. By comparison, a pure social-investing fund like Acumen is funded entirely through grant money. Its investors are more inclined to philanthropy, and will probably be more patient on the payback.

Social investing is a difficult space, where the challenge is to manage costs and squeeze more out of capital. Commercial funding tends to become available only after a business shows proof of concept. "Most of my companies have raised commercial capital from other funds," says Vinit Rai, founder, Aavishkaar. He says that Vaatsalya (an affordable hospital chain) has received \$6-7 million in the past two years and Vortex (a rural ATM company) has received \$1-1.5 million from new investors.

One way VCs are derisking is by co-investing. Gray Matters Capital (GMC), a \$12-million fund set up in 2006 under the Gray Ghost Ventures banner, invests in social-impact enterprises. It has invested \$5.6 million in India, all co-investment deals with other funds. "Collaborations work well, as we need to share our knowledge with each other," says Arun Gore, managing director and principal of Gray Ghost Ventures, social-venture investments division.

The strategy behind looking for co-investors is they are able to provide additional strategic, regional and sector expertise. Says Mr Gore: "Unless social funds like ours rope in mainstream investors, money will not come into this sector, without which it cannot mature."

The other aspect VCs, dedicated or hybrid, are placing emphasis on is management quality. "When we invest in a company, we invest in people and expand the management teams at all levels," says Kumar Shiralagi, managing director, India, IndoUS Ventures, a hybrid VC. Adds Eric Berkowitz, chief investment officer of Bamboo Finance, which manages the Oasis Fund: "We are active investors and typically seek a board seat with our investees." The objective of a board seat is to help these companies with governance, market development and microfinance linkages.