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Innovative initiatives supporting inclusive innovation in India: Social business incubation and micro venture capital

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ABSTRACT

In India inclusive innovation through social entrepreneurs is currently booming. However, these entrepreneurs suffer from a lack of finance since the bank system as well as the microfinance sector are unwilling or unable to finance them. However, pioneering finance initiatives have been emerging recently to bridge this gap. This paper discusses these emerging alternative financing initiatives which are forming an innovation eco-system of support for inclusive innovation and social entrepreneurship. It highlights two instruments in particular that are used in conventional innovation support: business incubation and venture capital. Two case studies are undertaken in order to provide evidence on how such instruments can operate with a 'dual bottom line' in supporting inclusive innovation and social entrepreneurship.

1. Introduction

In India, inclusive innovation through social entrepreneurship is booming. However finance, though vital for entrepreneurship [6] is often very limited, especially from the formal financial institutions such as India's vast bank system. Refs [1] (Basu 2006) and [2] (Demirguc-Kunt 2008) that finance poses a real problem for Indian entrepreneurs is confirmed by the 2006 World Bank Enterprise survey which found that finance was most likely to be a constraint among Indian enterprises employing 10 staff or less and/or operating in traditional sectors [7].

However, some limited financial support is emerging. Within the bank system, banks such as ICICI Bank are looking for ways to provide innovative financial support for small entrepreneurs. Furthermore, in 2010 financial inclusion was yet again becoming a hot topic and some banks are working with MFI's through bank-linkage models, or starting new initiatives such as the State Bank of India (SBI) which is launching bank kiosks together with retailer Oxigen and MFI Sahyog Microfinance Foundation, using existing Oxigen retailers as customer service points. However, these financial inclusion initiatives are likely to provide amounts too small to have an impact on the financial access for innovative entrepreneurs. Another initiative is the International Finance Corporation's (IFC) investment of USD 25 million in the scheduled commercial bank Federal Bank to provide SME loans in India. However, the emphasis of the investment is on increasing international trade, so investments are likely to be made primarily in urban areas with easier access to international markets. Further initiatives that highlight the importance that finance plays, includes the G20 Finance Challenge, NABARD's Rural Innovation Initiative. In the private sphere, India has seen plenty of recent movement in microfinance, with many focusing on maximising investor returns (Nair, 2010), SKS going public, raising funds on the stock market and thus moving closer to the mainstream financial system, and microfinance organisations like Uvijjan providing integrated financial and non-financial support; and a call by RBI for more inclusive finance.

Nevertheless, in general, inclusive innovation and social entrepreneurship are still struggling to access appropriate finance. Whilst the banks are still not keen on financing inclusive innovation, microfinance, which is often considered the major solution to

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inclusive finance, does not generally provide large enough amounts of finance to support a growing social venture. However, there are now a number of interesting initiatives emerging that are starting to bridge this financing gap, outside of the banking sector. These emerging socially minded support-organisations are in fact creating an innovation-support eco-system. They are tapping into the large gap that exists because of a failure of banks and other formal sector financial institutions on the one hand and microfinance on the other, to provide finance for inclusive innovation and social entrepreneurship. In a sense, an alternative financial sector is taking shape in India [5].

Two of the pioneering instruments that have recently emerged are business incubation and venture capital. They are interesting because they mimic investment forms for venture and innovation finance that exist in the mainstream, urban financial system, but at a smaller scale.

The paper starts by providing an overview of the kinds of innovation support that exist outside the banking system. Particular focus is put on two types of innovation support that exist within the formal financial system too: business incubation and venture capital. That is followed by two cases of Villgro, an inclusive business incubator, and Aavishkaar, a micro venture capital organisation. Finally, there is a discussion of alternative innovation support in light of the case studies.

2. An emerging alternative financial sector?[1]

A logical response to the lack of finance is to suggest that the government should be involved, and outside of the bank system, the Government does provide some rural and innovation finance through schemes. Furthermore, microfinance has become the popular tool for increasing financial inclusion and more recently organisations have been emerging that are shifting the focus from micro entrepreneurs to more productive entrepreneurial investments. Beyond these two larger types of initiatives, a small-scale version of venture capital has emerged. Finally, there are rural incubators. Despite its current small size, this alternative financial sector is of interest because of the way in which the organisations appear to overcome information asymmetries and perceived risks to invest in innovative entrepreneurs, and by extension innovation, that banks and traditional MFI's appear unwilling or unable to invest in.

There are several schemes especially focussed on agriculture such as the Ministry of Rural Development's Council for Advancement of People's Actions and Rural technology (CAPART) which runs an 'Advancement of Rural Technologies' (ARTS) scheme, or rural poor women such as the 'Women in Science and Technology' scheme by the Department for Science and Technology that in general provide subsidised credit (without additional input or assistance) for e.g. machinery, fertilizers or seeds. However, the schemes rarely support entrepreneurs outside of the micro credit remit which, as has already been noted, is not conducive to enterprise growth or innovation. In fact, in recent years, micro-credit and in particular microfinance based SHG-bank-linkage models have become immensely popular with government as well as financial apex institutions such as NABARD and SIDBI. The result being that most discussions surrounding rural and pro-poor entrepreneurship and innovation never move beyond microfinance. At the other end of the spectrum, there are Government schemes that provide finance and support for innovation and entrepreneurship. However, generally the focus is high-technology innovation and larger scale projects than the entrepreneur-based innovative activities that take place in rural areas. Examples of these schemes are the Department of Scientific and Industrial Research's Technopreneur Promotion Programme (TePP). However, within TePP there is a Micro Technopreneurship Support programme (TS) which invests up to Rs 75,000. The related Council of Scientific and Industrial Research (CSIR) also focuses mainly on R&D but offers a Technologies for Rural Sector Fund. Nevertheless, the programme most relevant to rural innovation is the Department for Science and Technology's Science and Society programme focussed on technologies for rural livelihood. In addition DST set up the National Innovation Fund (NIF) in 2000. NIF has on the one hand been involved in setting up the Honeybee Network and the grassroots incubator GIAN together with SRISTI and IIM Ahmedabad. On the other it has worked with the apex institutions SIDBI to set up a Micro Venture Innovation Fund (MVIF) in 2004 though its outreach has been limited so far. More recently, NABARD has sent up a rural innovation fund (RIF) together with the Swiss Agency for Development and Reconstruction (SDC) which seeks to promote livelihoods in rural areas by supporting innovative rural projects, and the new National Innovation Council is setting up a large National Innovation Fund.

An alternative to Government and bank finance is microfinance. Although microfinance is the best known type of non-bank finance that increases financial inclusion[2] and is to a large extent flowing to rural areas, it does not necessarily support innovative entrepreneurship. As noted earlier, a reason for this is the small amounts of the loans, often not amounting to more than Rs 10,000. Additionally, microfinance, and especially micro credit does not provide much other add-on services that make them different to banks, and generally prefer proven business models to new kinds of investments that innovation finance would support.

2.1. Inclusive business incubators

Business incubators are common within mainstream innovation finance, often attached to universities, where they commercialise new ideas and small ventures. The incubator improves business management skills, tests and builds a prototype, researches the market and assists in formulating a competitive business plan with which the venture will attempt to attract

[1] This section is partially based on data that was gathered during a field study in India 2007–2008, in preparation for a PhD on financing pro-poor entrepreneur-based innovation in rural India, at UNU-MERIT, the Netherlands. The field work was financed and supported by the Learning INnovation Knowledge (LINK) network, Hyderabad, India.

[2] Sa-Dhan estimated that the total outstanding credit of microfinance within its network was worth around Rs 21,961 crore in 2007, and Rs 34,413 crore in 2009. according to Sa-Dhan (including NABARD sponsored initiatives). Nair (2010) highlight figures from RBI showing the cumulative bank loans to SHG's to be worth Rs 22,000 crore in 2008/2009, and figures from CRISIL suggesting that the top 50 MFI's portfolio outstanding was worth Rs 7650 crore in September 2008.