MONITOR

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FROM Blueprint TO Scale

THE CASE FOR PHILANTHROPY IN IMPACT INVESTING

by Harvey Koh, Ashish Karamchandani and Robert Katz

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HOW WE ARRIVED HERE

This report springs from a point of view shared by Monitor and Acumen Fund — that philanthropy is the essential but often overlooked catalyst that unlocks the impact potential of inclusive business and impact investing. The report has been created with funding from the Bill & Melinda Gates Foundation.

The key themes discussed here are based on the sum of Monitor's extensive research into more than 700 inclusive businesses in Africa and India, and Acumen Fund's decade of experience as a pioneering impact investor. They also draw together the experiences and observations of dozens of impact investors, grant funders, academics and other experts who were generous enough to share their thoughts with us.

In addition, a Monitor team conducted a three-month study of companies in the Acumen Fund portfolio whose development had been significantly affected by grant subsidies, to further develop our insights and provide helpful illustrations. Four company case studies are contained in the main report, and two further case studies can be found as an appendix.

Finally, a thoughtful, diverse and generous group of external expert reviewers helped us to fine-tune the report and its recommendations for clarity and impact.

This report has focused on developing an in-depth, demand-side understanding of the needs and challenges facing inclusive businesses, rather than on studying the drivers and constraints of grantmakers and investors. However, we acknowledge that the latter is a valuable area for further study and action going forward.

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THE CASE FOR PHILANTHROPY IN IMPACT INVESTING

by Harvey Koh, Ashish Karamchandani and Robert Katz
with the assistance of Ravi Swarup, Nidhi Hegde,
Swati Chaudhary and Sahil Shah

"Creativity is not the finding of a thing, but the making something out of it after it is found."

JAMES RUSSELL LOWELL

Introduction

Times of great crisis can be times of great opportunity.

At the beginning of 2012, there is no end in sight for the economic malaise and fiscal crisis that is gripping many parts of the developed world. Global growth is slowing, even in emerging economic powerhouses like India, billions of people remain trapped in poverty. As politicians debate the best way to reform the financial system to prevent future collapses, protestors around the world are questioning the moral foundations of the capitalist system itself.

Despite the crisis, shifting attitudes, new technologies and the promise shown by the microfinance revolution have led to new opportunities for market-based innovations to serve the global poor. These are being pioneered by ambitious entrepreneurs who are taking great risks for little potential financial reward, but for tremendous potential social value. Such ideas have elicited a rush to the new field of 'impact investing'. Hundreds of funds have been set up in just a few years and billions of dollars are to be invested in the next year alone.

But the field is young and doubts are creeping in as many investors report that they are struggling to find good opportunities in which to invest for impact. Why is that? **And can impact investors take the pioneers of 'the next microfinance revolution' all the way from idea to scale?**

These are important questions, not just for these new investors but for the private philanthropists and aid donors who have been working on these issues for decades. If market-based solutions hold real promise for impact, how should funders in development engage to catalyze its full potential? **If impact investing capital is the key to scaling these solutions, what is the role of philanthropy?**

1 The Reality of Inclusive Business

There is tremendous excitement today about 'impact investing' in inclusive businesses that benefit the poor by engaging them as customers and suppliers.

Impact investment is being hailed as an emerging asset class with the exciting prospect of achieving market-rate returns and social good at the same time. In November 2010, a new report[1] by J.P. Morgan, Rockefeller Foundation and the Global Impact Investing Network (GIIN) made waves simultaneously in the worlds of social change and investment. The report estimated that potential profit for impact investors across just five sub-sectors[2] of inclusive business could range from between $183 billion and $667 billion over the next ten years, with invested capital ranging from between $400 billion and $1 trillion.

Potential profit for impact investors could range from between $183 billion and $667 billion over the next ten years.

Attracted by this potential for profit and impact, capital is flowing into this space. The Aspen Network of Development Entrepreneurs (ANDE) recently counted no fewer than 199 impact investing funds.[3] A survey by J.P. Morgan and the GIIN in late 2011 found that the 52 impact investors surveyed intended to deploy $3.8 billion of capital collectively in the next 12 months.[4]

In 2011, the Overseas Private Investment Corporation (OPIC) — the US Government's development finance institution — attracted more than 80 applicants when they issued a call for impact investment proposals.

1 O'Donohoe, N., Leijonhufvud, C., Saltuk, Y., Bugg-Levine, A. and Brandenburg, M. (2010) *Impact Investments, An Emerging Asset Class,* J. P. Morgan Global Research, Rockefeller Foundation and GIIN.
2 The sub-sectors studied were: affordable urban housing; primary education; maternal healthcare; clean water for rural communities; and microfinance.
3 *Impact Report*, (2010) Aspen Network of Development Entrepreneurs.
4 Saltuk, Y., Bouri, A. and Leung, G. (2011) *Insight into the Impact Investment Market*, J. P. Morgan and GIIN.

OPIC committed $285 million to the first six equity funds, with the aim of mobilizing up to $875 million for investment. In November 2011, the Indian Government announced a $1 billion India Inclusive Innovation Fund; more than 80 percent of the capital for this is expected to be raised from the private sector. And in December 2011, the Group of 20 (G20) and International Finance Corporation (IFC) launched the Challenge for Inclusive Business to find innovative, scalable and commercially viable inclusive businesses to be showcased at the G20 summit of world leaders in Mexico City in June 2012.

We believe there are good reasons for this excitement. Inclusive businesses promise effective models for generating social benefits that can become sustainable without relying on donations, and are scalable through the investment of return-seeking capital.

- For **private philanthropists and aid donors**,[5] this offers the hope of drawing vast sums of private capital into their efforts to solve entrenched social problems, and of achieving lasting solutions that do not rely on charitable donations.
- For **investors**, this offers the prospect of targeting a level of social impact alongside private financial return, and of doing this much more actively than the negative screen approach that is already well established for ethical (or socially responsible) investing.
- Meanwhile, **governments** recognize this as an additional way of addressing pressing problems like poverty and inequality in their own countries that harnesses the power of the private sector at a time when economic uncertainty and fiscal pressure are constraining the public sector's scope of action.

Inclusive businesses promise effective models for producing social benefits that are sustainable and scalable.

Last but not least, these models hold the promise of involving **beneficiaries** as willing suppliers and customers, and of recognizing their innate drive and capacity to improve their lives in significant ways, instead of seeing them as mere recipients of charity.

REALITY CHECK

While we believe that this potential is real, we also believe that we are a long way from realizing it fully. The rosy picture of abundant opportunities to make high returns that many have drawn from the hype may be obscuring the challenges faced by investors seeking to deploy capital into inclusive businesses.

In *Investing for Social and Environmental Impact*,[6] Monitor Institute colleagues argued that the newly identified impact investing industry was entering a phase

5 Where we have drawn out implications and recommendations for philanthropy, we intend those to apply to both private philanthropy and aid, unless otherwise stated.

6 Freireich, J. and Fulton, K. (2009) *Investing for Social & Environment Impact*, Monitor Institute.

Of 439 promising inclusive firms studied by Monitor in Africa, only a third were commercially viable and only 13% were actually at scale.

of 'marketplace building' that would likely take five to ten years. They identified three key challenges. The first was the lack of efficient intermediation, with high search and transaction costs caused by fragmented demand and supply, small and complex deals, and a lack of understanding of risk. The second was the lack of enabling infrastructure to help people identify and function as part of an industry since the market was structured around a history of bifurcation between philanthropy and investment.

The third, and most relevant for this report, is the lack of sufficient absorptive capacity for capital. This means there is an imminent lack of impact investing opportunities into which large amounts of capital could be placed at investors' required rates of return. Monitor's conversations with numerous impact investors have confirmed that this remains a major challenge for the industry. This has also been corroborated by a recent survey[7] of more than 50 impact investors conducted by J.P. Morgan. When asked about the most critical challenges to growth of the impact investment industry, respondents ranked "shortage of quality investment opportunities" second, right after "lack of track record of successful investments."

This shortage of opportunities is particularly acute when it comes to inclusive businesses whose activities are clearly socially beneficial to Base of the Pyramid (BoP) households, and whose work is therefore credibly part of a market-based approach to solving some of the problems of poverty.

Acumen Fund's investing experience reflects this reality: it has considered more than 5,000 companies in the past ten years and has invested in just 65 of those. Recent Monitor studies of inclusive businesses on the ground paint a similarly challenging picture. In 2009-10, a team led by Mike Kubzansky conducted an ambitious 16-month study of inclusive businesses across nine countries in sub-Saharan Africa. Their aim was to gain a better understanding of when, where and how market-based approaches in Africa succeed.[8] The team looked at 439 promising inclusive businesses and found that only 32 percent were commercially viable and had potential to achieve significant scale. Only 13 percent were actually operating at scale.

Many of the companies in Monitor's Africa study faced not only all the challenges of small businesses in Africa — such as difficulty in accessing finance, attracting and retaining human capital, achieving economies of scale, creating trusted brands — but also involved further challenges. They would sell to a hard-to-reach customer base with severely limited resources. They would engage suppliers with limited capabilities, high volatility in production and low loyalty due to cash flow needs. The goods and services offered by these companies were often in 'push'

7 Saltuk, Y., Bouri, A. and Leung, G. (2011) *Insight into the Impact Investment Market*, J. P. Morgan and GIIN.

8 Kubzansky, M., Cooper, A. and Barbary V. (2011) *Promise and Progress, Market Based Solutions to Poverty in Africa*, Monitor Group.

DEMONSTRATING EXTENSIVE INNOVATION

Extensive innovation is central to **Husk Power Systems** (HPS), a company based in the Indian state of Bihar that is becoming increasingly well-known as a model of rural biomass energy generation. (For more information on HPS, see the full case study in section 3.)

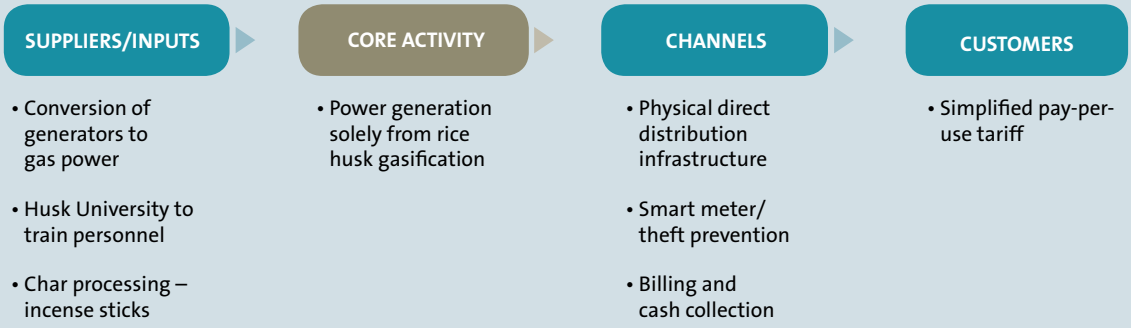
HPS began by pioneering technology that transforms rice husk, a readily available agricultural waste product, into gas that in turn generates electricity. However, HPS is a micro-grid electrification company seeking to bring power to villages and districts without any pre-existing electricity infrastructure. Therefore, innovation had to go far beyond its core technology, reaching further up and down the value chain relative to a conventional developed-economy power producer (see Figure 1).

HPS had to devise ways of distributing power, using low-cost bamboo poles, to the homes of villagers. It implemented sophisticated power theft prevention systems to achieve theft rates below five percent, compared to the Indian average of over 30 percent. It could not find sufficiently low-cost smart meters and so needed to develop its own, which the company says are the lowest cost smart meters in the world. Meanwhile, the company's target customers had never bought electricity before and had few appliances, so the company offered a simple tariff based on the number and type of electrical appliances they possessed, and then built an invoicing and collection system accordingly.

Upstream, HPS encountered difficulty sourcing gas-powered generators, and so it developed the capability to convert diesel-powered ones that were much more readily available. The gasification process itself produced a waste product, rice husk char, that had to be disposed of responsibly and this drove up costs. In response to this, HPS developed a method of turning this waste into incense sticks, which has become a significant side business generating additional revenues and providing employment for hundreds of local women.

Unsurprisingly, recruiting skilled staff to build, operate and maintain this complex web of activities in many small villages has been a challenge, especially since there is no existing electricity industry to speak of in the regions where it works. HPS is therefore in the process of setting up 'Husk University' to train the workers it needs now and in the future as it moves into aggressive growth.

FIGURE 1: Husk Power Systems — Innovation Across the Value Chain



categories like preventative healthcare, which required high levels of awareness building and education, unlike 'pull' categories like mobile phones that consumers already desired and demanded. And these challenges would come on top of the pervasive issues of poor infrastructure, and unfriendly and inefficient regulation.

In response to these myriad challenges, many of these businesses cannot simply follow business models that have been established to serve more developed, non-BoP populations. Instead, they are required to innovate on multiple dimensions simultaneously, often pioneering new business models that are tailored to the particular needs and constraints of the BoP marketplace.

THE PROBLEM AND THE OPPORTUNITY

Modest margins, long times to scale and high risk add up to a tough proposition for investors.

Innovation is risky. Innovation across multiple dimensions in order to pioneer new business models serving the BoP is especially risky. In the emerging field of inclusive business, there are still many more unproven models than there are proven ones, so the vast majority of investment opportunities are at the early stage. And building and scaling new business models takes time: Monitor's research in India suggests that new inclusive firms take more than a decade to achieve a reasonable level of scale.

Meanwhile, the extreme challenges of the BoP environment mean that operating margins are typically low and volatile. Monitor's recent analysis of 50 inclusive businesses in Africa indicated that net operating margins were, at best, between 10 and 15 percent. As an impact-focused investor, Acumen Fund reports that its portfolio companies have an average profit after tax of minus 20 percent. Its eight most profitable investees record an average profit after tax of just six percent. Despite a highly selective approach, and heavy investment in post-transaction support to enhance value and manage risk, Acumen Fund only expects a return of just over 1x invested capital from its current portfolio. This is in line with its stated aims, but is far off the expectations of mainstream financial-first investors.

Returns from microfinance — by far the most established and mainstream of inclusive business sectors — are higher but still modest. Unitus Capital, for example, reports that net internal rates of return for debt-based microfinance investment vehicles (MIVs) averaged 4.9 percent through 2008, while riskier equity-based MIVs achieved 12.5 percent.[9]

But most models of inclusive business are at a much earlier stage of development than microfinance. Their modest margins and long times to scale combine to generate low internal rates of return. When this is set against the high risk of these

9 *MIV Overview*, (2009), Unitus Capital.

situations, it paints a decidedly unattractive proposition for investors, because small gains on a few successes could be far outweighed by heavy losses on many failures; this is particularly true where businesses are pioneering new business models for which commercial viability is unknown. For this reason, the assumption that investor capital will naturally flow to these opportunities and catalyze the full potential of inclusive business is unduly optimistic.

Investor capital may also be unable to support the heavy up-front expenditure that is required to stimulate awareness of (and therefore demand for) new push product categories among customers, or to improve supplier skills to meet the requirements of the business model. This is because of both the quantum of expenditure required and the difficulty for the firm (and its investors) of capturing its exclusive benefit. Unless there are significant barriers to entry (e.g., well-protected technological advantage, exclusive trading rights), a product's commercial success will likely spawn copycat competitors that free-ride on the firm's category marketing investment, thereby diluting the value captured by the firm and returned to investors.

From a philanthropic funder's perspective, however, things look very different. In a world with vast and seemingly intractable problems, and limited philanthropic resources, there is tremendous appetite for innovations to improve effectiveness and sustainability, including those that seek to direct the power of private markets (see sidebar). There is also a growing realization that lofty aspirations for social impact will not be achieved by placing only the safe bets. Moreover, the process of developing and trying out good impact ideas typically produces *some* social good — directly for the beneficiary and sometimes indirectly in the

DONORS AND THE PRIVATE SECTOR

Some funders will already be familiar with the rationale for engaging with the private sector to achieve their program goals, but many will not be. Louis Boorstin, a deputy director at the Bill & Melinda Gates Foundation who has also been an investment manager at the IFC and an investment banker at Lehman Brothers, explains: "Donors can use the power of the private sector to deliver improved health, sanitation and other benefits for the poor. These interventions with the private sector catalyze changes in the way companies, financial institutions and consumers operate rather than simply procuring specific goods or services for beneficiaries. However, funding must always serve as a complement, not a substitute, for market forces."

Louis describes five potential sources of social value from private-sector interventions by funders:[1]

- **SUSTAINABILITY** — Once an activity is shown to be commercially viable, the private sector is likely to sustain it without requiring subsidies.
- **REPLICATION** — A success in the private sector naturally leads to imitation by others who also want to earn a profit, producing replication with diminishing levels of further public support.
- **LEVERAGE** — Private capital can be catalyzed to support social objectives, thereby minimizing the use of scarce donor funds.
- **INNOVATION** — Engagement with the private sector provides direct access to new technologies and business models that can meet social objectives more effectively.
- **EFFICIENCY** — Working directly with the private sector offers access to the latest management techniques and systems, while also benefiting from the focus on efficient operations demanded by the market.

Louis adds a note of caution that engaging with the private sector carries a different set of risks from working with the public or NGO sectors: "You have less control over how a project is implemented, and you need to be aware that market forces can move in unexpected ways."

1 From a discussion draft prepared by Louis Boorstin for the Workshop on Private Investment for Social Goals held in Geneva, Switzerland, in September 2004.

form of learning effects for the field — that is valued by the philanthropist, even when it does not result in a viable business. In contrast, an investor faces the prospect of an unmitigated loss of value if a business idea turns out not to be viable.

Funders are also used to committing sizeable resources to such initiatives as 'social marketing' to change behaviors in BoP communities, or training BoP workers and suppliers in new skills. The existence of a business model that can leverage those initiatives to drive sustainable improvement for BoP households makes spending on those programs all the more worthwhile. And funders have little issue with creating valuable public goods — such as business models, labor skills, infrastructure and customer awareness that can be used by more than one firm — so long as they produce the desired social impact. From this perspective, copycat replication that ends up reaching more of the BoP population while improving value, reducing cost and improving choice, is a *good* thing because it multiplies impact.

The MFI sector received $ 20 billion in subsidies from philanthropists and aid donors to refine its model over two decades.

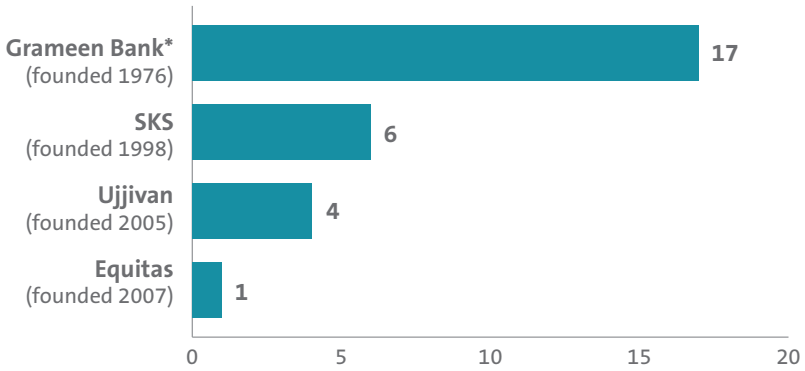
It is precisely in these situations that philanthropic support can play a catalytic role in ways that investor capital cannot. Nowhere can this be seen more clearly than in the development of the microfinance sector. As is now well known, microfinance (or, rather, microcredit) is based on a radically different business model from mainstream bank lending: namely, joint-liability group lending, mobile agents, very small loan sizes. As microfinance is now seen as a commercially attractive sector with billions of dollars of invested capital, it is easy to forget that the microfinance business model was promising but unprofitable for many years, long before it burst into the public consciousness. In those unprofitable years, subsidies in the form of grants, soft loans and guarantees from philanthropists and aid donors allowed the early pioneers to refine the model through "thousands of cycles of trial and error"[10] until it established its commercial viability and became attractive to investors. It is estimated that the microfinance sector received $20 billion in such subsidies in its first two decades of development.[11]

The pioneers who received these subsidies not only became successful in their own right, they also paved the way for other players to replicate their model much more quickly and easily. For instance, Grameen Bank, the pioneer of the microcredit model in South Asia, took 17 years to break even after launching in 1976. However, subsequent replicators achieved the same success over a much shorter time: SKS in India, launched in 1996, broke even six years later. The pace continued to accelerate, with Ujjivan (founded in 2005) achieving break-even after four years of operation, and Equitas (founded in 2007) after just one year (see Figure 2). The early subsidies for a pioneer firm such as Grameen did more than just build its own business operations; it also helped to establish the business model for all players in the sector.

10 As the journey of refining the Grameen Bank model was described in Counts, A., (2008), *Small Loans, Big Dreams: How Nobel Prize Winner Muhammed Yunus and Microfinance are Changing the World.*

11 As referenced in Mapping of Funding Flows, (2005), CGAP, from the working paper by Hudon, M., *On the Efficiency Effects of Subsidies in Microfinance: An Empirical Enquiry.*

FIGURE 2: Time from Start of Operations to Operating Break-even Microfinance Lenders



Note: *Grameen was started in 1976 by Prof. Yunus using the money he received from a Fulbright scholarship as a project, the bank was formed in 1983.

Source: Mix Market data; *Small Loans, Big Dreams* by Alex Counts

Today, with interest growing in the potential to profit from impact investing, buoyed by the commercial success of the microfinance model, we risk overlooking the role of philanthropic support in developing the inclusive business models that are emerging today. Without this, 'the next microfinance model' is unlikely to get very far, and the capital that is seeking to invest in such a model will remain on the sidelines.

If we believe that impact-oriented funders can play a crucial role here, this poses some important questions. What is an appropriate role for such funding to play in a situation where firms are seeking to make profits, albeit modest ones? Where and when in the journey of a pioneer firm could such grants be deployed for the greatest benefit? What specific needs should be met by these grants, and what should a funder be seeking to achieve as a result? We address these questions in the next section.

Buoyed by the commercial success of the microfinance model, we risk overlooking the role of philanthropic support in developing the inclusive business models that are emerging today.

WHAT ABOUT ON-GOING SUBSIDIES?

In the context of commercially viable business, philanthropic funding is a subsidy. The specific focus of this report is on those subsidies that catalyze the development of firms pioneering inclusive business models that are intended to be commercially viable and to grow to scale by tapping into the expanding pool of return-seeking impact capital.

This is not the only role of subsidies in the broader field of market-based solutions to poverty. Notably, on-going subsidies from private or public sources could sustain models that are not fully commercially viable. Examples of this approach are described in Monitor's previously published studies of market-based solutions in India and Africa (see the recommended reading list at the end of this report). These include grant funding for capital expenditure in rural power generation where regulatory price caps prevent such expenditure from being recouped fully from user charges, and the practice of 'buying down' the price of commercially supplied products to enable access by the poorest customers.

The intuitive logic of this approach has been developed into a robust theoretical argument by economists Andreas Nilsson and David T. Robinson. In a forthcoming paper,[1] they explain how on-going subsidies of this kind, essentially hybridizing charitable and profitable investment, can produce optimal solutions that would be excluded by a strict bifurcation of the world into purely charitable and purely profitable models.

1 Nilsson, A. and Robinson, D. T. (2012) *What is the Business of Business?* (unpublished).

2 The Pioneer Gap

"Pioneering don't pay." ANDREW CARNEGIE

Firms that are pioneering new business models shoulder a heavy burden, particularly in the BoP environment. By definition, these firms are blazing new trails rather than following the well-worn paths established by others.

They must develop and refine their models the hard way, by trying them out in an unforgiving, low-margin marketplace. Inevitably they suffer failures and setbacks on the road to viability. Often they also have to invest heavily in educating customers about the possibilities of new 'push' solutions, and in developing unskilled suppliers and fragmented distribution channels to serve their requirements. Although excited by their novelty, investors are often rattled by these firms' risk profiles and are unimpressed by their financial returns, all the while suspecting that they might actually be savvy nonprofits masquerading as commercially viable models.

These are tough challenges that call for strong support. However, knowing how best to support a pioneer firm requires a firm understanding of its needs, which change as the firm evolves over the course of its journey from start-up to eventual scale.

Monitor's research has identified the following **four stages of pioneer firm development** that are distinct both from the firm's experience and the investor's perspective:

Blueprint

First of all, pioneers need to ***blueprint*** their designs for the future business. This is often driven by not much more than a strong sense of 'moral imagination', striving for radically better solutions to meet the needs of the poor. This stage involves connecting the capability for business and often technical innovation to address the needs of customers or suppliers in the BoP. This is no trivial matter, as the requisite capabilities for technology, product and business innovation are not as commonplace in the BoP population as they are in more affluent populations. The gulf in experience, understanding and skills that separates these groups of people is a significant barrier to the origination of high-potential inclusive business ideas.

Even so, an idea or concept on its own is not a blueprint. There needs to be a clear sense of what the business will offer, what it will do and how it will do it. In other words, there needs to be a compelling initial business plan. At the end of this first stage, we would also expect product prototypes and any critical novel technologies to have been demonstrated successfully, resulting in what some might call a product or technical 'proof of concept'.

Validate

However, having a product that works is not enough. In the second stage, pioneers need to ***validate*** the commercial viability and scalability of the business model described in the blueprint. This involves running market trials in which business plan assumptions are tested. Will customers want this product? Will they be willing to pay for it from their small and hard-earned incomes? Will this be enough to cover the costs of the business, not just the direct cost of the product itself? These are crucial questions, and the process for answering them is almost always iterative. Market trials often reveal issues and weaknesses in the blueprint, leading to refinements in the product, technology and business model, and further trials. The greater the degree of model innovation involved, the more time and resources need to be invested in this stage.

Having a product that works is not enough; pioneers need to validate the commercial viability and scalability of the business model.

Models of inclusive business call for particular effort and rigor at this stage because motives are almost always a blend of the social and the financial, which can weaken the focus on commercial viability. Moreover, unlike a mainstream business

pioneer at the same stage, it is important to discern whether a particular social impact model might be able to develop and scale through a non-market-based route, as traditional nonprofit organizations have done.

Prepare

Successful validation sets the stage for pioneer firms to launch their products fully into the marketplace. However, alongside this initial period of commercial activity and growth, pioneer firms need to ***prepare*** the conditions in the market and within the firm in order to support sustainable scaling. This is especially true where the firm is, in effect, attempting to create a new market, by virtue of establishing a new category of product or a new value chain model. On the demand side, the firm may need to pay for customer education and category marketing to drive awareness of and desire for 'push' product categories that BoP customers do not actively demand at present, such as preventative healthcare, low-cost drip irrigation or insurance products. On the supply side, the firm may need to improve the capabilities of suppliers, such as the skills and knowledge of smallholder farmers, or build new distribution networks to reach widely dispersed customer populations in rural villages.

There might also be internal needs that have to be addressed and these often present particular challenges for innovative models in the BoP. Take the need to hire skilled personnel as the firm grows: educated personnel may be in limited supply in the areas where the firm is operating, and the business may require new skills that have not historically been needed in those areas and are therefore not readily available in the labor force.

Pioneer firms may need to stimulate new demand for 'push' products, or cultivate new value chains.

Scale

If the pioneer firm can successfully surmount these challenges, it emerges in a strong position to ***scale*** activities in order to reach many more customers or suppliers in the BoP. During this stage, firms face new challenges as they enter new geographies, control costs, exploit efficiencies, and manage a more diverse and sophisticated group of investors and stakeholders. They will often also be responding to competitors, as new entrants are attracted by the success of the pioneer firm and see a way to benefit from the investment that it has made in preparing the market.

THE PIONEER GAP

The pioneer firm, like any other firm, needs support and funding at each stage of its journey. In the ***blueprint*** stage, there is a need to connect more sophisticated capabilities for business innovation to unmet customer needs in the BoP, when the two are normally separated by a vast gulf, socially, culturally and often geographically.

TABLE 1: Four Stages of the Pioneer Firm's Journey

STAGE	1. Blueprint	2. Validate	3. Prepare	4. Scale
	Developing the blueprint for the future business	*Testing and refining the business model*	*Enhancing the conditions required for scaling*	*Rolling out the model to reach large numbers of customers and/or suppliers*
KEY ACTIVITIES	• Understand customer needs • Develop initial customer proposition • Develop business plan • Develop core technologies and/or product prototypes	• Conduct market trials • Test business model assumptions • Refine business model, technologies and/or product as required	• Stimulate customer awareness and demand • Develop supply chains, upstream and downstream • Build organizational capability to scale: systems, talent, plant, etc.	• Move into new geographies and segments • Invest in assets and talent • Enhance systems and processes • Exploit scale efficiencies • Respond to competitors
KEY NEEDS	• Innovation capability • Strategy development and business planning • Talent networks • Seed funding	• Operationalizing the model • Focus on cost, value and pricing • Learning orientation and flexibility • Innovation capability • Funds to facilitate market trials and refinement	• Marketing strategy and execution • Supply chain design and implementation • Systems and processes • Talent and networks • Funds for marketing, supply chain, fixed assets, inventory	• Competitive strategy • Realizing scale efficiencies • Risk management • Formalization of impact standards and expectations • Stakeholder management • Funds to support expansion
END MILESTONES	• Compelling initial business plan • Demonstrated core technologies and/or product prototype	• Refined business model, technologies, product • Validation of viability and scalability • Indication of customer demand	• Strong customer awareness and demand • Effective supply chains • Organizational systems, talent, assets in place to support scaling	• Sustainably reaching all BoP customers and/or suppliers

Few impact investors are prepared to provide money in the earlier stages, and this is entirely rational.

In the *validate* stage, the firm requires up-front investment to enable multiple rounds of market trials as it tests and refines its core business model, and good counsel to help it stay focused on the key questions it must address. In the *prepare* stage, heavy investment is often required to improve the tough conditions of the BoP business environment and to pave the way for growth.

Unfortunately for the pioneer firm, few impact investors seem prepared to provide money and technical assistance in these earlier stages. Monitor's Africa research found that only six of the 84 funds investing in Africa or across regions offered early-stage capital. This has been reinforced by the interviews we conducted as part of this study: the overwhelming majority of impact investing funds and advisors we spoke to expressed a strong preference for investing in the later stage, certainly after commercial viability had been established and preferably once market conditions were well prepared for sustainable scaling.

This is an entirely rational approach. In the *blueprint* and *validate* stages here, unlike in the case of angel or venture capital investing in mainstream business ventures, there is limited potential for outsized financial returns within a timeframe that is

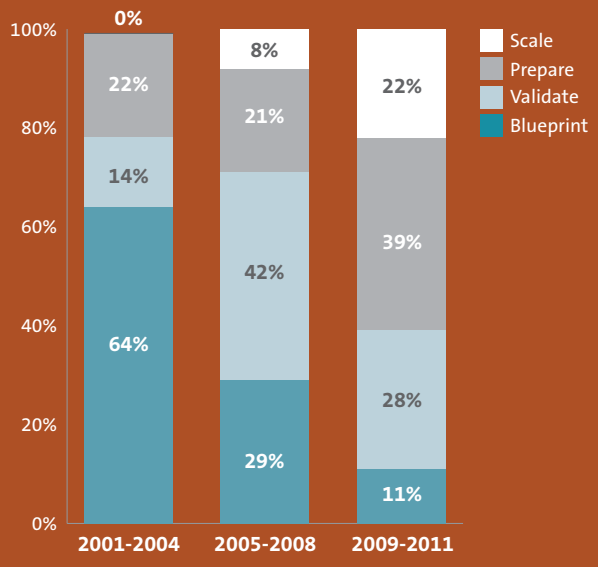
ACUMEN FUND'S DEAL PROFILE EVOLUTION

As an impact-focused funder and then investor, Acumen Fund has seen a gradual shift in its deal profile towards the later stage. In the first three years of its life, Acumen Fund made 78 percent of its capital and funding deployment in the blueprint and validate stages, compared with 39 percent in the last three years (see Figure 3).

Launched in 2001, Acumen Fund initially made a combination of grants and investments mostly in the high-risk early stages: these included grants to the Aravind Eye Hospital, Project Impact and International Development Enterprises India, as well as investments in Kashf Microfinance Bank, A to Z Textile Mills and WaterHealth International. In 2004, Acumen Fund to moved its approach away from grant-making and towards providing exclusively investment capital — debt and equity — to high-potential social ventures, resulting in a dramatic shift in deal activity from the blueprint to the validate stage.

The next step change came in 2009 as Acumen Fund began funding some of its deals out of a return-capital fund (known as Acumen Capital Markets I) in addition to philanthropic funds, specifically targeting second- and third-round investments in early investees as well as other later-stage opportunities. This evolution in investing style and change in financial return requirements contributed to the further shift in capital deployment towards the later stages.

FIGURE 3: Acumen's Investment Over Time



Source: Acumen Fund, Monitor Analysis

acceptable to investors (typically five to seven years) in order to compensate for greater early-stage risk and small deal sizes. In the *prepare* stage, where new product categories or value chain models are being created, there is a high likelihood that initial spending on market preparation may not be recouped by the firm and its investors because much of the benefit accrues to others, such as new entrants, or to the firm's customers or suppliers.

This poses the question: how will promising inclusive business models get to these later stages where they become investable without support earlier on in their journey? We call this critical gap in support the 'Pioneer Gap', and we believe that this is a key factor constraining the availability of investment opportunities for impact investors.

How will promising inclusive business models get to these later stages where they become investable without support earlier on in their journey? We call this critical gap in support the 'Pioneer Gap'.

Unless we address this pioneer gap, much impact capital will continue to sit on the sidelines or be deployed into sub-optimal opportunities for impact, and fail to achieve its potential in driving powerful new market-based solutions to the problems of poverty.

HOW PHILANTHROPY CAN CLOSE THE GAP

We believe that philanthropic funding can play a critical role in closing this pioneer gap. The right grant support can help pioneer firms to develop, validate and establish new business models, and even build entirely new markets to serve the BoP. Grants represent the ultimate 'risk capital' for these businesses because they are not predicated on the likelihood of financial return, and so can tolerate uncertainty around commercial viability. They also lend themselves well to the creation of a public good where heavy investment is required to prepare market conditions, such as building supply chains or stimulating customer awareness. The benefits of this investment accrue not just to the pioneer firm but to the copycat competitors that spring up in its wake. Moreover, the time horizons of private philanthropists in particular can be much longer than that of investors or governments, and so can support the long gestation periods associated with new inclusive business models.

Grants represent the ultimate 'risk capital' because they can tolerate uncertainty around commercial viability and can seek to create public goods.

M-PESA — UK Department for International Development (DFID) and Vodafone

We have already described the role of grants and similar subsidies in the developmental journey of the microfinance sector. Another example is that of M-PESA, a small- value electronic payment system accessed using ordinary mobile phones in Africa. Developed by a team at mobile phone giant Vodafone in London, England, and introduced by its affiliate Safaricom in Kenya in 2007, the service has seen dramatic growth in users and is now used by some nine million customers, repre-

senting 40 percent of Kenya's adult population. BoP customers who previously had to use slow, expensive and unreliable methods of sending money to friends, family, colleagues and business partners can now use the M-PESA service to help meet life needs, do business and save regularly.

As in the case of microfinance, M-PESA has achieved considerable public acclaim as a commercially viable model that delivers significant benefits for the poor. It is also too easy in this case to overlook the role that grants played in getting M-PESA to where it is today. The UK's Department for International Development (DFID) provided critical funding to Vodafone in the *blueprint* and *validate* stages, in order to develop the initial idea into a product and to conduct market trials to establish its viability. DFID also funded organizations such as the Financial Sector Deepening Trust, whose FinAccess survey data helped the central bank of Kenya to realize the opportunity presented by this new product and lend its support as a regulator.

More recently, M-PESA's growth in newer geographies has also been supported by grant funding. In 2010, the Bill & Melinda Gates Foundation committed a $4.8 million grant to Vodacom in Tanzania to help it ***prepare*** the market for broader M-PESA adoption, by raising awareness about the benefits of the service, particularly among unbanked communities in remote parts of the country.

The UK's Department for International Development (DFID) provided critical funding to Vodafone in the blueprint and validate stages to develop M-PESA

Shell Foundation and clean-burning cookstoves

Another example comes from the clean-burning cookstoves sector. Billions of people in the developing world cook using indoor stoves fuelled by wood, coal or biomass such as dung. According to the World Health Organization, the indoor air pollution produced by these fuels kills almost two million people every year. More than half of those are children under the age of five. The scale of this problem has motivated a range of governments and aid donors to develop and promote alternatives over the past four decades, but many of the initiatives failed to be sustained.

Learning from these past failures, Shell Foundation[12] began to work on identifying financially sustainable solutions that could be taken to scale and replicated to achieve global impact. The foundation took a variety of approaches spanning the *blueprint*, *validate* and *prepare* stages. For instance, the foundation partnered with the United States Agency for International Development (USAID) to fund EnterpriseWorks/VITA to train 78 entrepreneurs in Ghana to develop improved cookstoves and to conduct a category campaign to encourage consumers to switch

12 Shell Foundation is an independent UK charity established by the Shell Group in 2000 to promote enterprise-based solutions to the challenges arising from the impact of energy and globalization on poverty and the environment.

to energy-efficient cook stoves. Out of this program came a company called Toyola Energy that went on to secure $270,000 in investment from impact investor E+Co and has now sold more than 100,000 stoves, with lofty ambitions for further growth across West Africa.

Between 2002 and 2007, Shell Foundation also committed more than $10 million in seven countries to fund nine cookstove pilot schemes. The realization that better-performing stoves were required, together with a more commercial approach to sales and distribution, led Shell Foundation to partner with a single company, Envirofit, that has now sold more than 300,000 clean cookstoves benefiting over a million people. With a loan guarantee from Shell Foundation, Envirofit is now seeking to lever in debt finance to enable continued growth and market expansion.

Building on its work with individual enterprises, the Foundation has begun to invest in *preparing* the global market for clean-burning cookstoves. In 2010, Shell Foundation — in partnership with the United Nations — spearheaded the creation of the Global Alliance for Clean Cookstoves with some 270 partner organizations, $130 million of additional funding levered in and strong support from world leaders like US Secretary of State Hillary Clinton. The Alliance aims to strengthen supply, enhance demand and promote an enabling environment to foster the adoption of clean cookstoves and fuels, and hopes to impact 100 million households by 2020.

WHAT ABOUT THE DEVELOPED WORLD?

While this report focuses on the pioneer gap for inclusive businesses serving the poor in the less-developed world, our conversations with funders and impact investors that operate in the developed world suggest that there is a similar need for early-stage philanthropic support for models that may later attract investor capital. For example, the anti-recidivism interventions that now play a central role in the groundbreaking private-sector social financing pilot of the Social Impact Bond (SIB) in Peterborough in the United Kingdom, were developed over many years by charitable organizations using grant funding. Impact-focused investors in the developed world also report similar difficulties in sourcing good investment opportunities, and in achieving sufficient return from successful deals to offset losses on failures in a high-risk environment.

Monitor Inclusive Markets and Low-Income Housing in India

Grant support can also help to catalyze entire *market ecosystems*. This is important because sometimes a wide range of innovation is needed across the value chain, as we described in the previous section, and a single firm or type of firm may not be able to achieve this on its own. One example of this is a grant-funded initiative in low-income ownership housing at Monitor Inclusive Markets (MIM) in India, which has successfully established new models for both housing supply and mortgage lending. This is providing an unprecedented opportunity for those living on less than $3 a day — many of whom live in slums and work in the informal sector with little documented proof of income — to buy and move into high-quality housing,

Grant support can help catalyze entire market ecosystems that generate sustainable and meaningful impact.

financed by 'micromortgages' and delivered on a fully commercial basis. In the past two years, more than 50,000 units have already been sold, and there is growing interest in the model in India and elsewhere.

In the *blueprint* stage of this ecosystem's development, MIM focused on understanding the target customer and developing tailored business models, working closely with the regulator, the National Housing Bank. In the *validate* stage, MIM provided implementation support and, in one case, incubation support, to the first-mover companies in this new industry, the majority of whom were small entrepreneurs with limited resources. In both of these early stages, substantial grant funding from the World Bank, IFC, Michael & Susan Dell Foundation, the Rockefeller Foundation and other donors made it possible for MIM to play a catalytic role in developing solutions for a market segment that mainstream housing players had not historically viewed as being commercially viable.

Enterprise philanthropy aims to establish models for inclusive business into which return-seeking capital can be invested to drive scale.

ENTER ENTERPRISE PHILANTHROPY

What we are describing is not philanthropic funding in a conventional sense. Its immediate beneficiaries are typically businesses with a profit objective — albeit only modest profits in many cases — rather than nonprofit organizations. The focus is still on impact, but instead of paying for specific social goods or services, it aims to establish models for inclusive business enterprise into which return-seeking capital can be invested to drive scale. It supports and develops firms pioneering these new models in the interest of the impact created by those pioneer firms themselves and by those that follow in their wake if they are successful. Because of these characteristics, we have called this emerging practice 'enterprise philanthropy'.

How, then, should enterprise philanthropy be carried out? How can grant funding help pioneer firms to move towards — not away from — being investable? How should existing funders think about approaching this practice of enterprise philanthropy vis-à-vis the established work of giving grants to nonprofits?

In the next two sections, we will use a number of cases taken from the Acumen Fund portfolio to draw out some key learnings from the work of funders and intermediaries in this area, such as the Bill & Melinda Gates Foundation, Shell Foundation and Acumen Fund itself. Our aim is to provide some early answers to these questions, focusing in particular on the *validate* and *prepare* stages of the pioneer firm's journey.[13]

13 The blueprint stage has not been a focus for this report as the challenges in that stage often relate more to the development of impact-creating interventions and their supporting technical innovations, than to the challenges of building an enterprise. Perhaps in accordance with this, the practice of providing charitable funding for this stage is more established than for later stages. That said, we believe that grant funding for the blueprint stage continues to be a priority need given its high early-stage risk and consequent unattractiveness to investors.

While our case study approach will necessarily focus on a small number of companies, the themes reflected in these cases are drawn from Monitor's accumulated research knowledge in this space, Acumen Fund's investing experience, and the reported observations of the investors, funders and other experts interviewed for this study.

Of course, these cases are narratives about firms, their challenges and their opportunities, their successes and their failures, with all the complexity that that implies. It would be unrealistic to suggest that grants were wholly responsible for the business outcomes, good or bad, described in these cases. The many variables relating to leadership, strategy, organizational capability and market conditions are the real factors driving success or failure. It is therefore the potential for grants to affect this complex interplay of people and organizations that is our focus as we delve into the case studies in the following sections.

3 Validating Viability

Every new business model needs to be validated. Nowhere is this more critical than for businesses that are trying to create social benefit and operate in challenging BoP conditions.

In this section, we discuss two case studies drawn from the Acumen Fund portfolio where significant grant support has been applied to the ***validate*** stage: one with a positive trajectory that has been reinforced by grant support, and another with a negative trajectory, where grant support could have played a more effective role. We then summarize four key themes of effective enterprise philanthropy practice that are drawn from our broader field observations and are exemplified by these case studies.

CASE STUDY: LIFTING THE FOG OF DARKNESS

Husk Power Systems has pioneered a new way of providing electricity to rural India through the gasification of rice husk.

In spite of a booming economy in India that recorded growth rates of nearly 10 percent per year in late 2011, more than 400 million Indian

citizens[14] — or a third of the population — still have no access to electricity. In rural areas, 45 percent of poor households currently lack access to an electric power source. The Central Electricity Authority (CEA), the main advisory body to the Government, has said that a massive 100,000 megawatts of additional power generation capacity will be needed between 2012 and 2017 to satisfy India's energy needs, a target that is unlikely to be met due to the acute shortage of coal and growing concern about ecological impact. Even if power generation capacity targets were to be met, the country would still face the considerable challenge of distributing electricity to rural areas.

Husk Power Systems has 75 operational mini-power plants, each achieving break-even within six months.

The third of the population that does not have access to electricity live a very different, literally darker life compared to the rest of the country. Their primary access to light is from unsafe and inefficient kerosene lamps and candles, which are more expensive than the equivalent electric lighting. Their enterprises are less productive because work is limited to daylight hours; their children are unable to study in the evenings; they have very limited access to modern information technology; and they suffer from a significant rate of respiratory illnesses related to indoor air pollution.

It was against this backdrop that, in 2007, Gyanesh Pandey and Ratnesh Yadav made a breakthrough. Working through a nonprofit called Samta Samriddhi Foundation, the ambitious entrepreneurs succeeded in producing gas from rice husk, a readily available agricultural waste product. From this gas, they generated electricity, bringing power and light for the first time to the remote and run-down village of Tamkuha (which means 'Fog of Darkness').

The company that sprang from that breakthrough, Husk Power Systems (HPS), now provides electricity to 25,000 households in 250 hamlets and villages across the rural state of Bihar. The company has 75 operational mini power plants. Each of these achieves operating break-even[15] on average within six months of starting operations. HPS has raised $1.65m of investor capital from Acumen Fund, Draper Fisher Jurvetson, LGT Venture Philanthropy, Bamboo Finance and IFC, and has very recently secured funding to take its model to Africa.

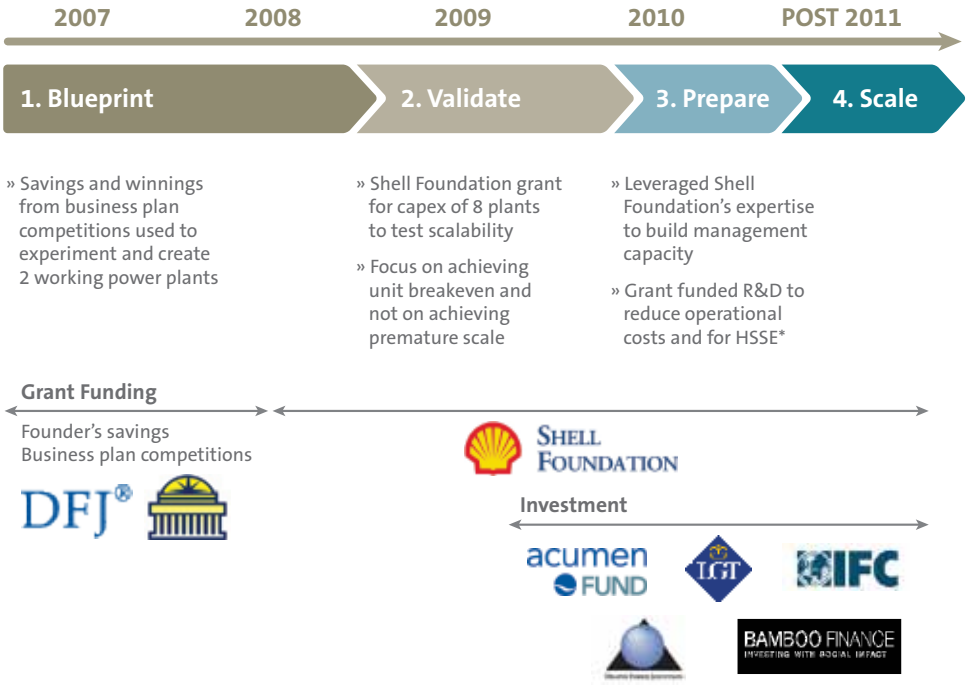
In section 1, we laid out the impressive scale and scope of innovation achieved by HPS in order to serve its target customer. However, back in 2007, very little of this was in place. Personal savings and winnings from business plan competitions allowed HPS to build two working power plants and demonstrate that its core technologies

14 Article published on IEA website, *Energy poverty: The missing Millennium Development Goal?*, (March 1 2011), http://www.iea.org/index_info.asp?id=1847.

15 The Indian Ministry of New and Renewable Energy (MNRE) provides on-going sector subsidies to power-generating projects using biomass and wind sources. This contributes significantly to the break-even economics of the HPS model in India.

worked. However, that was hardly sufficient for either social impact or commercial success in serving the off-grid villagers of Bihar. Relating this back to the four-stage framework we introduced earlier, HPS had made good progress in the *blueprint* stage (see Figure 4). However, it had yet to *validate* the commercial potential for the whole business model, which involved the significant challenge of actually getting power into off-grid village homes and generating revenues from those households.

FIGURE 4: Stages of Development of Husk Power Systems



Note: *HSSE – Health Safety Security and Environment
Source: Acumen Fund, Primary research interviews, Monitor Analysis

Shell Foundation made grants rather than investments in the conventional sense, but took an enterprise-based approach to develop businesses that could then attract investment capital.

In 2008, HPS entered into a funding relationship with Shell Foundation, which had been seeking to back promising ventures delivering energy to low-income communities, especially those based on 'bio-energy' technologies. Shell Foundation made grants rather than investments in the conventional sense, but took an enterprise-based approach and intended to develop businesses that could then attract investment capital in order to achieve significant scale; in other words, it was an *enterprise philanthropist*.

Simon Desjardins, who manages Shell Foundation's Access to Energy Program, explains, *"We started by asking the question: what will investors need to be able to back this business? We then designed our support in order to help the business move towards ultimately receiving commercial investment and scaling. If we had to do this all over again, the one thing I would change is that we would start the conversation with investors right at the beginning, so that their input is taken into account far in advance of them actually investing. In fact, this is a process we have since adopted."*

Table 2: Shell Foundation Grants to Husk Power Systems

PERIOD	SPECIFIED USAGE AND CONDITIONS	KEY OUTCOMES
NOV 2008 – JUN 2009	• Research and development • Build 3 new plants to test scalability	• Demonstrated ability to replicate plants at accelerated pace and with consistent performance outcomes
JUN 2009 – JAN 2010	• Build 5 new plants • Trial new energy payment system • Initiate carbon credit conversion with the assistance of a specialist consultant • Hire senior management • Further R&D to enable tar reduction, assisted by Shell Global Solutions • Further R&D to reduce plant cost • Complete intellectual property legal work • Establish Husk Power University, a centralized training facility for personnel	• 20 percent reduction in tar • 10 percent reduction in cost of engine development • IP formally protected in India and USA • Training facility established
APR 2010 – DEC 2010	• Pre-paid metering system tested and installed at pilot • Further R&D on operational efficiency • Explore options to monetize waste streams • Hire key senior staff, including director of operations, with partial subsidy support • Conduct an external HSSE audit	• $1.3 million capital raised • Pre-paid meter system developed • Key staff hired and on-boarded • Progress on implementation of recommendations under safety audit report
JAN 2011 – JUN 2012	• External consultancy to assist with building Husk Power University • Continued implementation of HSSE audit recommendations • Rolling out of pre-paid meters • Establishment of Husk Power University • HR Subsidy for senior management • Disbursement of final tranche conditional upon successful raising of commercial Series A funding	• Initial training curriculum and scale-up plan for HPS University developed • Existing plants retrofitted to HSSE standards reflecting audit recommendations, and new plants being installed to the new standard • New meters rolled out • Training facility established and in use as the primary training site for new HPS employees • New senior manager (COO) hired • Series A funding secured

"If we had to do this all over again, we would start the conversation with investors right at the beginning."

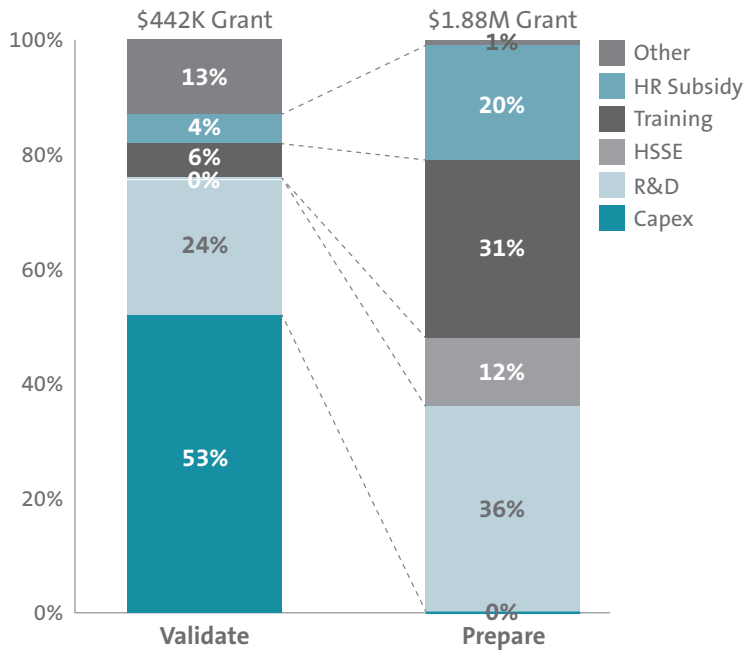
SIMON DESJARDINS, SHELL FOUNDATION

Each tranche of the grant was targeted and designed to help the business maintain its focus as it progressed.

Shell Foundation provided a series of targeted grants aligned with key business step changes, complemented by business and technical expertise drawn from the Shell Group as well as from external consultants where appropriate. All in all, the Foundation has made grants totaling $2.3 million to HPS. It also helped to facilitate the entry of investors that led to the successful close of pre-Series-A investment[16] in 2009. This range of support was provided in the context of a close, collaborative working relationship between HPS management and Simon Desjardins, who spent a third of his time working with HPS on the ground in India. This support proved to be invaluable to HPS as it proceeded to *validate* its business model between 2008 and 2010, and then to *prepare* the business for greater scale through 2010 and 2011.

Each tranche of the grant was targeted and designed to help the business maintain its focus as it progressed towards full investability and scalability. Meanwhile, the specific, time-bound nature of the grants minimized any perception that grant funding might be available to fund any expenditure on a permanent basis within the business. Figure 5 shows how differently the Shell Foundation grants were used in the *validating* and *preparing* stages.

FIGURE 5: Usage of Grants from Shell Foundation



Source: Shell Foundation, Acumen Fund, Monitor Analysis

From the outset, the premise was that HPS would sustain itself from its customer revenues, as any mainstream business would. The typical HPS customer paid Rs.

16 Early-stage investment.

100 ($2) per month, covering the requirements of two light bulbs and a mobile charging point. This focus on charging a 'commercial price' and achieving a cost structure that enabled profitability at that price, was critical to building a business that could scale up commercially. The Shell Foundation grants were carefully designed so as not to compromise this discipline. Furthermore, the Foundation also required HPS to contribute its own funds towards activities that were grant-funded: for example, the Foundation's grant of over half a million dollars for training is being matched by $950,000 from HPS.

The risk with highly targeted and prescriptive grants is that they run counter to the actual needs of the business, and interfere with the competent decision-making of management. HPS and Shell Foundation managed this risk by ensuring joint prioritization of key needs and grant objectives. Gyanesh and his team helped to formulate the objectives, targets and conditions attached to each grant, as they were closest to the business. There were some exceptions to this, notably the Health Safety Security Environment (HSSE) improvement program in 2009. The primary impetus for this came from Shell Foundation, which saw the critical need for robust safety standards and systems, based on the extensive experience of their Shell Group colleagues.

It is critical to charge a commercial price and achieve a cost structure allowing profitability at that price.

Gyanesh, who is CEO of HPS, says of the relationship: *"We have a very open, collaborative working relationship with Shell Foundation. Yes, each of the grants is given for a specific purpose — none of it is just free money for us to spend as we wish — but I have never been asked to do something that I didn't think was important for the business."*

CASE STUDY: PROTECTING THE POOR FROM FINANCIAL SHOCKS

FMiA's doctors conduct awareness camps, screenings and consultations with potential and existing policyholders in Pakistan.

In 2005, AKAM launched an initiative to test new micro-insurance products to help the poor in which Acumen Fund invested $384,000 of equity, with the expectation that the firm would grow rapidly and break-even within 3 years.

The economic development of low-income communities is vulnerable to the financial shock of adverse events such as crop failure, serious illness, death and natural disasters; such shocks can wipe out years of steady progress by a household in a matter of months. These communities also have minimal access to insurance products that could help them to manage these risks more effectively. However, selling insurance in the BoP is difficult as it involves customers sacrificing some cash today (when they have very little as it is) to receive a future benefit that is not only uncertain but also perceived to be unlikely, as most people underestimate their vulnerability to these events.

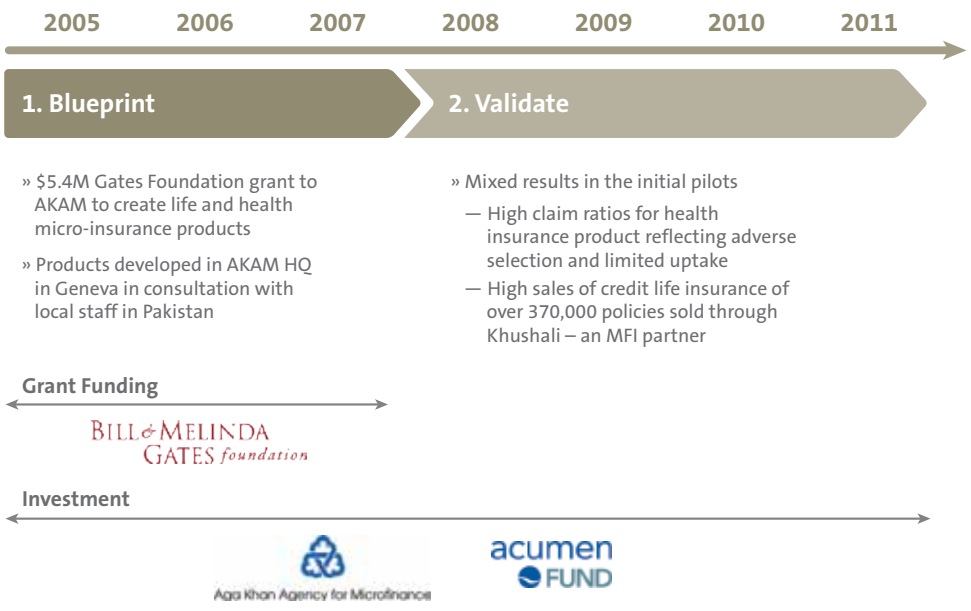
In 2005, the Geneva-based Aga Khan Agency for Microfinance (AKAM)[17] launched an initiative to test new micro-insurance[18] products to help the poor mitigate the risk caused by severe adverse events. This was funded by a $5.5 million grant from the Bill & Melinda Gates Foundation. The initiative focused on mitigating two key risks — death of a family breadwinner and hospitalization due to severe illness or maternity complications — which were 'high-severity, low-frequency' events affecting BoP households. By 2005, credit life micro-insurance was well established internationally, but there were no successful precedents for commercially viable health micro-insurance products and so it fell to a new company created by AKAM, First Microinsurance Agency (FMiA), to pioneer a new model in Pakistan.[19]

17 The Aga Khan Agency for Microfinance (AKAM) was established in 2005 in order to provide a professional dedicated platform for the microfinance activities, programs and banks that had been administered by sister agencies within the Aga Khan Development Network (AKDN) for 25 years.

18 'Micro-insurance' is the term used to describe a range of insurance products aimed at low-income groups not served by mainstream commercial insurance schemes, typically with low premiums and accordingly low caps compared with mainstream products.

19 While the initiative launched in both Pakistan and Tanzania, the Tanzanian company only offered a credit life product, not a health product, and did not develop its business as much as its sister company in Pakistan. Much of the data used in this case study comes from a detailed report prepared by Aga Khan Foundation USA and AKAM, *"The AKAM Microinsurance Initiative: Case Study and Lessons Learnt,"* supplemented by interviews with individuals who had been involved with FMiA. We are grateful to AKAM for sharing their report with us and allowing us to draw on it in preparing our case study.

FIGURE 6: Stages of Business Development of FMiA



Source: Acumen Fund, Primary and secondary research, Monitor Analysis

Following an initial period of research and design — the *blueprint* stage — with work conducted both at AKAM in Geneva and on the ground in Pakistan, FMiA Pakistan was created in January 2008 (see Figure 6). Ten months later, Acumen Fund invested $384,000 of equity in the new business, with the expectation that it would grow rapidly, just as microcredit had done in Pakistan, and achieve break-even within three years. AKAM and Acumen Fund injected a further $1.8 million into a stop loss facility that would bear 90 percent of the company's cumulative underwriting losses (i.e., the shortfall of premium income over claims payments) in order to encourage a mainstream commercial insurer to underwrite FMiA's policies. Because of the low premiums associated with micro-insurance, FMiA decided to focus on group rather than individual sales in order to gain distribution and administration cost efficiencies. Its health insurance products were to be sold to households on a voluntary basis in the rural northern areas of Pakistan, and bundled mandatorily by microfinance institutions (MFIs) with microcredit in cities such as Lahore and Karachi.

In 2008, FMiA Pakistan moved into the *validate* stage with its health insurance product. The city pilot launched in Lahore as a mandatory product for all new borrowers and enrolled some 10,000 persons in 2008. However, by the end of that year the company's MFI distribution partner had run into broader business difficulties and found itself unable to continue. Undeterred, FMiA struck up a partnership with another MFI to run a pilot in Karachi along similar lines. By the end of 2009, close to

21,000 people were insured, but the claims ratio[20] was high at approximately 285 percent. Under pressure from its partner, the company introduced a lower-price 'family package' in October 2009 for a three-month trial, but once launched, these concessionary terms proved difficult to retract and this in turn made it difficult to bring down the claims ratio.

The challenges in the rural northern areas were even greater. To begin with, the population was generally in poorer health than those in the cities. FMiA also very likely experienced the phenomenon of adverse selection: those who were already ill or pregnant were more likely to get insured. The company had tried to prevent this by requiring that sales were made only to pre-existing 'natural groups' such as Village Organizations or Women's Organizations, and that at least half of all households in a group should take up the product. However, it transpired that households could easily join such groups in order to buy the product, and the 50 percent take-up minimum was too low to protect against adverse selection.

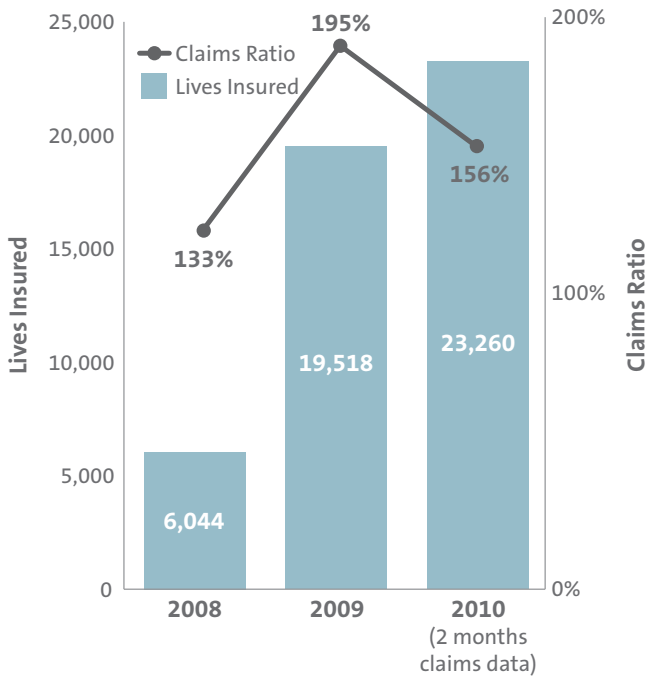
FMiA introduced a lower-price 'family package' for a three-month trial, but once launched these concessionary terms proved difficult to retract.

The other part of the challenge was claims management. FMiA implemented a smart card system for patient authentication, but the lack of computer connectivity in many facilities rendered this unusable. And despite the company's close links to the healthcare provider, Aga Khan Hospital Services, it is likely that treatment protocols were not fully enforced and that hospitals sometimes recommended treatment and hospitalization in cases where FMiA doctors would not.

As a result, the northern areas health product registered a high claims ratio of almost 270 percent in 2008. AKAM and FMiA knew that they had to assess the situation in detail, and make the necessary changes to the product and distribution model. However, because of the armed insurgency in the neighbouring Swat region, the AKAM expert team based in Geneva was unable to visit the northern areas until late 2009. Meanwhile, total enrollment tripled to over 23,000 in 2009 without any reduction in claims ratios, with the district of Gilgit-Baltistan registering a peak of 415 percent in that year. Eventually, the expert team was able to assess the situation and make substantial modifications to the health product, to bring down the claims ratio through 2011.

20 The ratio of claims payments to net premium income in any given period. Insurance models must have claims ratios significantly below 100 percent in order to be sustainable. New insurance schemes often show high claims ratios in the initial period; sometimes these decline automatically through growth and diversification of the risk pool, but at other times these reflect underlying problems with product design or distribution that require rectification.

FIGURE 7: FMiA Northern Areas Health Product — Persons Insured and Claims Ratio



Source: AKAM Microinsurance Initiative Case Study and Lessons Learnt, Annex 3, Monitor Analysis

By the end of 2011, there had been heavy underwriting losses from the health product, borne mostly by the stop loss guarantee facility. Meanwhile, even though the more conventional credit life product had grown to cover 370,000 lives and stabilized at an acceptable claims ratio of 60 percent, it did not generate a sufficient income contribution to cover the high fixed costs of the FMiA business, and the company could not see a clear path to independent financial sustainability.

Heavy underwriting losses from the health product and insufficient income from clients led to FMiA closing down.

AKAM therefore agreed with the Gates Foundation to end the grant, and FMiA was closed down. Acumen Fund wrote off its equity investment in the company and withdrew its share of remaining funds in the stop loss facility. New Jubilee Life Insurance (NJLI), which had been underwriting FMiA's policies and was considering a move into micro-insurance at the time, decided to acquire the failed company's staff and assets, encouraged by AKAM's decision to continue providing the stop loss facility. AKAM is confident that the work of pioneering a viable micro-insurance model will continue developing within NJLI and a new business plan for the former FMiA unit projects financial break-even in 2016.

THE FOUR Ps OF ENTERPRISE PHILANTHROPY

These two case studies underscore the importance of *validating* the viability of innovative business models, and highlight the pivotal role that funders such as Shell Foundation and the Gates Foundation, and intermediaries such as AKAM, can play at that critical juncture. We believe there are four general themes — Four Ps — of effective enterprise philanthropy practice that are exemplified by these case studies:

P Purpose

It is essential that management, funders, intermediaries and investors are well-aligned on their goals and expectations for the business. We see this alignment of purpose clearly in the case of HPS: Shell Foundation shared the management team's vision of achieving scale by way of commercial capital and helped to bring in investors, including Acumen Fund, to reinforce this trajectory.

In the case of FMiA, this alignment was not as strong. While there was a shared interest in both impact and viability across the company and its backers, the Gates Foundation and AKAM were focused on testing and learning from an experimental model of health micro-insurance, while Acumen Fund was more focused on building a successful inclusive business that would reach financial break-even within three years. AKAM was also more interested in developing a product that was targeted at the rural, hard-to-reach population to have maximum impact while Acumen expected that the focus would be more on urban growth through MFI partners.

P Profitable Proposition

When *validating* the business model, the customer proposition that is offered in the marketplace must be one that is profitable for the firm long term, at prices that customers are actually willing to pay. Market trials are unreliable if they are run with short-term concessionary prices and offerings that are significantly different from those that can be sustained over the longer term, as market conditions in the BoP are so stringent. For much the same reason, businesses in the *validate* stage need to have a robust understanding of unit cost and a tight focus on achieving an efficient cost position. Any investor, funder or intermediary involved in the firm's development at that stage should be aware and supportive of that focus.

From the outset, HPS charged the long-term sustainable price for electricity, using a simplified tariff tailored to its target segment of low-income, low-usage households who were new to buying electricity. In line with this,

HPS and Shell Foundation went to great lengths to reduce the unit cost of electricity, including designing proprietary smart meters (as existing ones were too expensive), further R&D to reduce the cost of plants by 25 percent, and the processing of char into incense sticks to avoid the high cost of disposing of this waste product. At no time was the Shell Foundation grant used to enable provision of the product for free or at a short-term concessionary price.

Meanwhile, FMiA struggled to achieve a profitable proposition in health insurance, in part because it launched products with terms that were too generous (both in the northern areas and in Karachi) and were then difficult to scale back. This reflected an understandable concern that customers would not buy the product because it was not sufficiently attractive. Reflecting on the experience, AKAM now believes that it would have been wiser to start with a less generous product that had a high likelihood of profitability, and then assess the scope for adding cost to deliver more benefits. Another contributing factor identified by AKAM was the low burden of risk borne by NJLI — just 10 percent of losses, compared with 90 percent borne by AKAM (supported by the Gates Foundation grant) and Acumen Fund through the stop loss facility — which may have led to them not pressing more strongly for decisive and effective action on profitability.

P Progression

In the ***validate*** stage, investors, funders and intermediaries should help the pioneer firm progress towards greater viability. A key part of this is helping management to maintain discipline at each step-change milestone and honestly assessing progress towards validation.

The specificity and discipline of the Shell Foundation grants to HPS are a good illustration of this. Contrary to the perception of grants as 'free money', grants can be more prescriptive at an operational level than equity or debt, through a combination of restriction, disbursement conditionality and reporting requirements. Shell Foundation used this quality of grants in designing its instruments, thereby helping HPS to stay focused on the key step changes it was seeking to achieve. The key to this working in practice was Shell Foundation's highly engaged approach, allowing aims and milestones to be developed jointly by both parties so that they were appropriate to the business and thus more likely to be achieved. HPS and Shell Foundation also did not rush into bringing in investors before the model had demonstrated its viability.

The story of FMiA shows how difficult this can be in practice, especially when complicated by external events. The insurgency in Swat prevented the rapid-cycle learning and adjustment that was critical to the refinement of the health insurance product in the remote northern areas, in contrast to the quicker and more effective modifications made in the first six months of the Karachi pilot. Lack of adjustment, combined with accelerating enrolment in the northern areas, led to the escalation of underwriting losses. The Gates Foundation could have instituted stronger measures in its grant to support disciplined progression at FMiA through AKAM; for instance, this could have required the company to restrain continuing growth in enrollment where claims ratio data pointed to serious issues with product design, distribution model or gate-keeping. Acumen Fund could also have used its influence as a major investor to help the business maintain discipline. Evelyn Stark from the Gates Foundation, says: *"The grant was made in the early days of the Financial Services for the Poor program when the team was in a more exploratory phase. Our strategic goals and grant-making practices have been significantly tightened since that time."*

P Persistence

Persistence is critical because it is not easy to develop new business models that work. As we have explained, the pioneers of the microcredit model spent decades developing and refining the model before they demonstrated viability and became investable.

Shell Foundation took a realistic view of this when it began working with HPS. Instead of rushing to scale, HPS and Shell Foundation worked over a number of years to test key assumptions and build out the model, thinking about each step in the value chain. HPS and Shell Foundation also took time to build the capabilities required to operate efficiently and safely at scale, before pushing ahead with Series A commercial investment and a concerted effort to scale up.

Whether persistence in validating the FMiA business model, within NJLI, will eventually pay off is not certain — it never is, with any new model. However, given the inherent challenges of micro-insurance and the experimental nature of health micro-insurance in particular, many cycles of trial and error were likely necessary. It was highly unlikely that the model would break even within three years of Acumen Fund's investment. Brian Trelstad, the former Chief Investment Officer of Acumen Fund, says: *"The expectation that FMiA would break even in three years was unrealistic. Even in developed markets a new insurance product can take five to seven years to*

become profitable, and this was a much more uncertain environment where we were trying something no one had managed to do successfully before."

Grant support, particularly where a single funder is providing a large proportion of the total funding needs of the business, can play an influential role in the early-stage development of the firm. It is no surprise then that the themes elucidated above seem as closely related to how an entrepreneur should set about building a viable business as to how funders and intermediaries should deploy their support.

Effective support at this early stage can help pioneer firms to tackle head-on the tough questions that they face and really develop models that can generate financial surpluses, so that ultimately they can benefit from infusions of impact capital with which to drive towards sustainable scale. Alternatively, it may help some pioneers to realize that their ideas are not commercial in nature, and should be reframed and optimized as nonprofit models. Either way, effective support at this stage plays a crucial role in creating more effective solutions that can then harness the right resources to drive impact.

DISCIPLINE AND PROGRESSION

It may seem old-fashioned to suggest using grant features such as restriction, disbursement conditions (based on achieving specific milestones, for instance) and reporting requirements to help an enterprise make disciplined progression. The progressive view in nonprofit funding is towards a lower degree of restriction in funding, whereby funders should reduce the burden of reporting on grantees.

This situation in enterprise philanthropy is fundamentally different from that of funding nonprofits: grants and other charitable donations to traditional nonprofits are typically their main source of revenue (the equivalent of commercial revenue for a business), and less commonly a way of providing growth or development capital (the equivalent of equity or debt invested in a business). Therefore, giving unrestricted grants to a nonprofit frees them up to make their own decisions about how best to deliver (in the case of revenue funding) or invest against (in the case of capital funding) their mission, rather than tying them down to funders' ideas of what they should do.

Using grants to catalyze the early-stage development of a pioneer inclusive business is a fundamentally different activity. These businesses should generate revenues from customers and raise capital from investors, so grants are not intended as a direct substitute for these. Instead, grants are given to support a specific step-change in line with the needs of the business, and should therefore carefully designed to reinforce that focus. This could also prevent the business from inadvertently straying into a nonprofit mindset, defocusing from its customer-facing activities and becoming more focused on raising and servicing grant revenues.

Naturally, where there are multiple funders engaged with one company, it is important to align these design features across all relationships, in the same way that all key investors in a business should be agreed on the firm's business plan and objectives going forward.

4 Preparing Markets

BoP markets are not always ready for the innovations that are introduced by pioneer firms, and this is often a barrier to successful growth of inclusive business models.

Customers in the BoP do not always readily desire and demand the products that could be highly beneficial to them, such as preventative healthcare or insurance. We call these 'push' product categories, in contrast to 'pull' categories, such as housing and mobile phones. Distribution channels in the BoP do not always have the ability to get products to customers, especially in rural areas. And suppliers in the BoP sometimes do not have the ability to deliver the products that they should ideally produce. In these situations, markets need to be ***prepared*** in order to create the right conditions for activity. Enterprise philanthropy can play a vital role here.

In this section, we will discuss two grant-related case studies from the Acumen Fund portfolio, both drawn from the same sector but in two different countries and with different trajectories. We will also revisit and build on the Four Ps that we introduced in the previous section.

CASE STUDY: EASY WATER, BETTER LIVELIHOODS

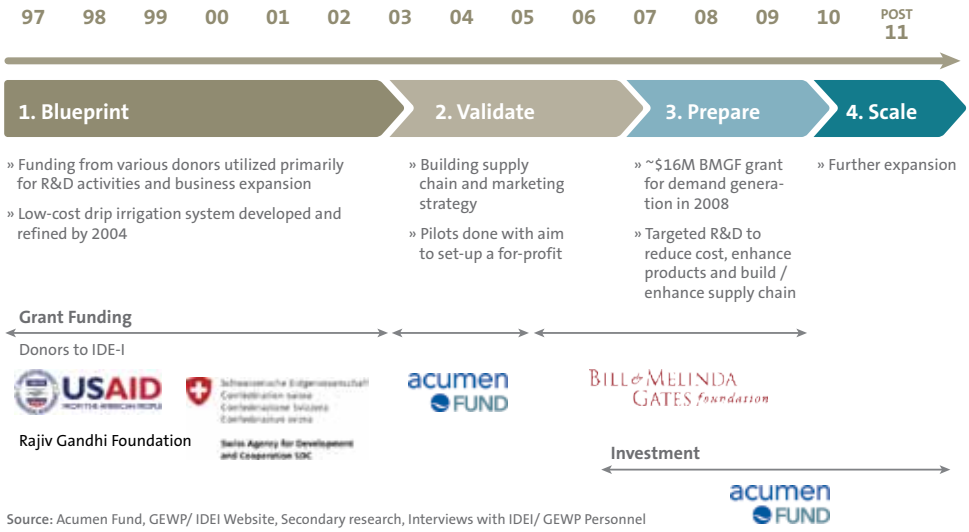
Using low-cost drip irrigation, Ramakrishna Mahajan has cut power use and increased yields from six acres of cotton and vegetables outside Aurangabad, India.

In 2002, International Development Enterprise India (IDEI), a nonprofit organization seeking to improve the productivity of the smallholder farmer, invented a promising product. The product looked unassuming — a thin but strong plastic tape with holes punched in it. However, it promised to bring drip irrigation, a valuable technology that had been previously available only at high cost to large farms, within reach of the smallholder farmer. Amitabha Sadangi, the head of IDEI, knew that this could have a dramatic impact on rural BoP livelihoods. By bringing water directly to the stalks of plants instead of flooding channels, crop yields could be increased by 50 percent and significant reductions could be achieved in water and energy use, leading to both cost savings and environmental benefits.

GEWP's promise was to bring drip irrigation within reach of the smallholder farmer with a dramatic impact on rural BoP livelihoods.

But how would he get the product to the smallholder farmer, and to as many as possible? While IDEI had always relied on grant funding from donors such as Swiss Agency for Development and Cooperation (SDC), Skoll Foundation and Lemelson Foundation for its R&D activities, Amitabha believed that the best route to scale for a strong product was a commercial one. He wished to avoid relying on on-going subsidies, which he viewed as distorting markets and encouraging corruption. He had already tried once before to commercialize a product — a treadle pump for irrigation — and saw no reason to proceed any differently with this new product.

FIGURE 8: Stages of Business Development of GEWP



Source: Acumen Fund, GEWP/ IDEI Website, Secondary research, Interviews with IDEI/ GEWP Personnel

Intrigued by the product's potential, Acumen Fund stepped in as funder, giving IDEI $100,000 and technical assistance from Adrien Couton, an Acumen Fellow. This helped IDEI to further invest in product development, leading to the creation of two new product variants and to develop a business plan for a new company, Global Easy Water Products (GEWP), that would take the new *KB Drip* low-cost drip irrigation solution to scale. GEWP received investment from Acumen Fund and proceeded with *validating* its business model: developing its product offering, beginning contract manufacturing, configuring its distribution model, and, most importantly, proving that it could sell products at a commercial price to smallholder farmers.

The problem was that smallholder farmers in India had no previous experience with drip irrigation and therefore had no appreciation of its benefits.

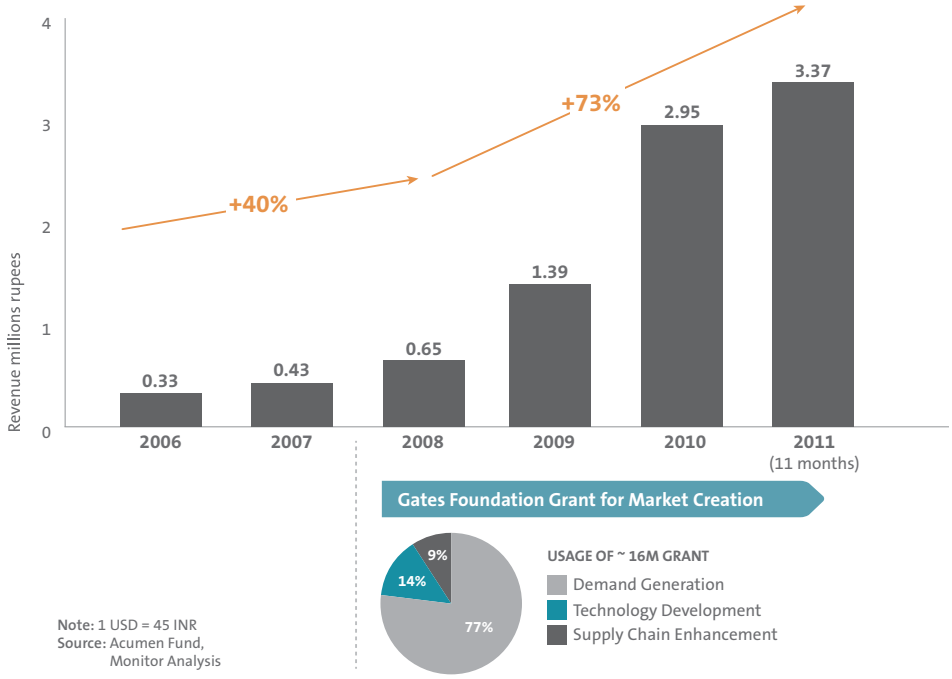
However, it faced a tough problem. Smallholder farmers in India had no previous experience with drip irrigation and therefore had no appreciation of its benefits. IDEI and GEWP faced an uphill struggle trying to convince farmers that they should spend some of their scarce money on this new product that neither they nor anyone they knew had ever used before. The eager early adopters taken for granted in upper-income markets were nowhere to be found in this one. Meanwhile, the small agricultural dealerships that were distributing *KB Drip* were used to responding to customer requests, not to actively promoting specific products.

IDEI had been using donor and commercial funds since 2002 to create this new market, but the breakthrough came in November 2007, when the Bill & Melinda Gates Foundation committed $16 million of funding to IDEI to specifically support the development of the low-cost drip irrigation program with a particular focus on *preparing* the market. Approximately $11.5 million of the grant went towards increased demand stimulation activity, designed to make farmers more aware of the benefits of drip irrigation. Using this money, IDEI showed Bollywood-style films in villages, conducted product demonstrations, and installed demonstration plots in the fields of the most receptive farmers, which then generated word-of-mouth publicity about the

product's benefits. The remainder of the grant funded further research and development to improve the product offering, and development of the supply chain.

The investment in generating customer awareness and demand resulted in acceleration of sales. The annual growth rate in sales increased from 40 percent in the years before the grant to 73 percent in subsequent years (see Figure 9).

FIGURE 9: Grant-Enabled Market Creation



Note: 1 USD = 45 INR
Source: Acumen Fund, Monitor Analysis

GEWP's current trajectory is highly promising. In 2011, some 65,000 farmers purchased *KB Drip* products. With penetration in the 'prepared' districts still relatively low at five percent, there is considerable headroom for further growth and impact. However, despite the fundamental alignment in strategic intent between IDEI and GEWP, there are usual differences between them in day-to-day operations that one would expect between a mission-driven organization and a for-profit company. As such, it is encouraging that GEWP has now achieved full operational independence with the transfer of the remaining drip irrigation units from IDEI. The company has also hired a new managing director, O.P. Singh, who has a commercial background in rural and agricultural financial services, to strengthen the capabilities that the company will need as it pushes forward into *scaling*.

Perhaps the clearest sign of IDEI and GEWP's early success is the emergence of competitors in this market. Most of these are small local copycat producers, but one notable recent entrant is an American startup called Driptech, which has launched operations in India and China. In India, Driptech is headed by Pratyush Pandey, the former managing director of GEWP, and is targeting villages in districts where the Gates Foundation-funded demand stimulation activities have been conducted but penetration of low-cost drip irrigation is still minimal.

The clearest sign of IDEI and GEWP's early success is the emergence of competitors in the market.

"All the players in the market have benefited from the Gates grant, because the market is now aware of the product. But farmers also now have a range of options instead of just one supplier, which has to be a good thing ultimately," says Pratyush. In effect, the Gates Foundation grant has helped to create a public good in the form of greater smallholder farmer awareness and receptiveness to drip irrigation products. Whether this grant achieves greater impact directly through GEWP or indirectly through players such as Driptech makes no difference to a philanthropic funder such as the Gates Foundation, whose interest in this situation is the benefit of the farmer rather than a private return on investment.

CASE STUDY: THE STORY CONTINUES... IN PAKISTAN

Zulfiqar Ali farms four acres in the village of Dabri, Punjab province, irrigated by MicroDrip irrigation kits.

The story of IDEI's invention extends beyond India's borders. In Pakistan, Thardeep Rural Development Program (TRDP) — led by Dr. Sono Khangharani, a passionate and charismatic non-governmental organization (NGO) leader — had been working with farmers in the Tharparkar desert and other arid areas of southern Pakistan. Since 2005, TRDP had been exploring ways to make drip irrigation accessible to the smallholder farmer, including early discussions with Unilever about bringing appropriate technology to Pakistan.

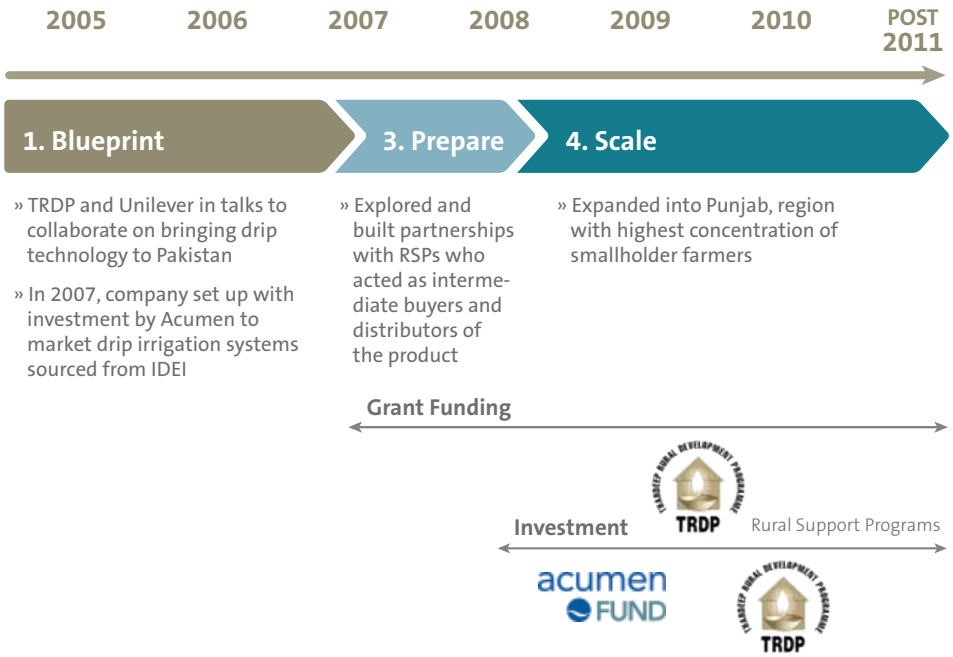
When Dr Sono heard from Acumen Fund about the promising work of IDEI and GEWP in India, he was intrigued by the prospect of replicating their model and their impact in Pakistan. Talks ensued and, in 2007, MicroDrip was incorporated to bring low-cost drip irrigation to Pakistan with TRDP and Acumen Fund as shareholders.[21]

21 While the company was incorporated in 2007, Acumen Fund's investment in MicroDrip was made in 2008.

The opportunity seemed straightforward. MicroDrip would begin its operations in the arid regions of Sindh, an area with a high degree of water scarcity and a large number of smallholder farmers, and therefore a clear need for drip irrigation solutions. The company would import the *KB Drip* tape and accessories from GEWP in India, and would then leverage connections with TRDP and other similar organizations (known as Rural Support Programs, or RSPs) to get those products into the hands of the smallholder farmer. By doing so, it also aimed to tap into the large pool of donor subsidies available to the RSPs and significantly reduce the price of the product to encourage adoption.

MicroDrip aimed to tap donor subsidies to the RSPs to reduce price and encourage adoption.

FIGURE 10: Stages of Business Development of MicroDrip



Source: Acumen Fund, Monitor Analysis, Primary research

Such was the level of confidence following initial product trials in the *blueprint* stage that MicroDrip moved quickly through the *prepare* stage and into the *scale* stage (see Figure 10). Our research indicates that there was minimal work done on market research or testing in the *validate* stage. Neither was there much work done on *preparing* either the market (e.g., stimulating demand) or the supply chain (e.g., training distribution partner personnel).

It soon became apparent that this confidence had been misplaced. Even though Sindh was an area of high need, there was no ready demand for its products. Being an arid region, Sindh had never developed agriculture to the levels of more fertile regions like Punjab. Farmers were highly risk-averse and drip irrigation was even less familiar to them than it was to Indian farmers, which meant that MicroDrip had a real challenge on its hands trying to convince them to buy its new product.

Acumen Fund believed that the new business needed to be separated from TRDP so that it could develop a more independent, commercial culture while leveraging its vast rural network for marketing and distribution. Superficially, this was achieved: many of the MicroDrip team were hired from outside TRDP, and the new company was housed in a separate building. In reality, however, the ties between the parent not-for-profit and new for-profit were close and deep. In the short *prepare* stage of just over a year, TRDP was closely involved in every aspect of MicroDrip operations as the new organization was being assembled. Going forward, the active support of TRDP was essential to help MicroDrip promote and distribute the product to farmers.

Compared to IDEI in India, which had prior experience of selling products such as treadle pumps to farmers, TRDP had a more traditional nonprofit orientation, accustomed to providing free support to rural communities. Unsurprisingly, this shaped its approach to distributing MicroDrip's product. TRDP and the other donor-funded RSPs that distributed the product subsidized the price of the product by up to 80 percent in order to encourage farmers to take the product. They would often accept the farmer's labor in digging trenches and laying the pipes as in-kind payment for the remainder, such that in many cases there was no cash cost to the farmer. An estimated PKR 3.5 million ($39,400) has been provided in price subsidies through TRDP alone.

At first glance, this approach appeared to be bearing fruit. By 2009, MicroDrip sales had grown to nearly PKR 9 million ($100,000). However, the picture on the ground was less positive, as reports came in that farmers were not using the products they had bought. One of the problems was that smallholder farmers in Sindh typically had no access to tubewells or canal water, so they needed to run diesel pumps to draw water for irrigation. The MicroDrip system required pumps to be run daily for short durations rather than once a week for a longer time in order to flood the field, as farmers were used to doing. This required significantly greater effort from the farmer, both in running the pump multiple times a day and in the additional maintenance required of the KB drip system.

Usage of the subsidized product by farmers was limited as they were not used to the increased effort in running and maintaining the product.

Many farmers received the product without sufficient training in how maintain it, and therefore did not see the benefits of the product. There were reports of installations failing after a period because pipes would become clogged up with minerals due to the harder groundwater, exacerbated by poor system maintenance. The former chief operating officer of MicroDrip says, *"I have had first-hand experience of these problems. I had a MicroDrip system that failed to work, and after several attempts to get it fixed, such as manually repairing tears and regularly flushing the laterals, I just gave up and pulled it all out. It now just sits there outside our house, unused. I fear that's what happened with many farmers who see too much effort and too little value of the product, and will probably never buy it again."*

The lack of training of both MicroDrip and RSP personnel has been identified as one cause of these problems. Another was the lack of market-specific customer research

and R&D to develop offerings tailored to the needs and conditions of the Pakistani smallholder farmer. More fundamentally, it now seems likely that MicroDrip and its distribution partners suffered from a misguided focus on selling the hardware (i.e., drip irrigation tape and accessories) into as many smallholder farms as possible through deep price subsidies, instead of on delivering value to the customer through a complete proposition that delivered satisfactory levels of performance and was backed up by strong service elements.[22] The fact that it chose to focus on the tougher, albeit needier, region of Sindh rather than Punjab made matters worse.

MicroDrip focused on selling the hardware through deep price subsidies, instead of delivering value to the customer through a complete proposition.

In 2010, MicroDrip finally accepted the commercial logic of focusing on the more fertile and developed province of Punjab, which also has the highest density of smallholder farmers, moving its base to Lahore, the capital of Punjab. Significant investment has also been made into market research and product R&D, and the company now offers a revised range of products that are more tailored to local preferences and affordability constraints, including product options with motorized accessories to help draw water.

The problem of the firm's reliance on RSP partners and their subsidies has also proven to be a weak point in 2011, as massive floods in Pakistan caused the partners to redirect a significant portion of their funding to relief, rescue and rehabilitation work, rather than to subsidizing MicroDrip's products. This has caused sales for the year to fall significantly below expectations. Sales growth rates in recent years have been in the low single digits, a far cry from the dramatic growth rates posted by GEWP in India.

THE 4Ps REVISITED

These case studies illustrate the critical difference that can be made by appropriate grant support in *preparing* the market for new 'push' product categories. We have identified some key learnings for funders and intermediaries: these recap the Four Ps we introduced in the previous section — Purpose, Profitable Proposition, Progression and Persistence.

P Purpose

Alignment between funder, investor and company is critical to the fundamental aim of creating an investable business that sells products to customers with a specific social benefit, rather than one that gives things away to beneficiaries. The Bill & Melinda Gates Foundation and IDEI not only shared a focus on impact on smallholder farmers in the BoP, they also shared a vision of scale for GEWP that was based on sustainability without

22 Our discussions with GEWP in India suggest that some 40 percent of the product's direct cost relates to the service rather than hardware elements.

on-going subsidy and the potential to attract investor capital in time. Past activity can be a good guide to future expectations: a market-based, rather than charitable, approach had been reflected in IDEI's track record on the treadle pump product that preceded its innovation in drip irrigation.

In contrast, TRDP was a traditional nonprofit that was more accustomed to responding directly to the social need of beneficiaries, rather than to creating a commercial business that could grow without subsidies, as Acumen Fund intended. Despite the steps taken to separate MicroDrip from TRDP and set it on a commercial trajectory, the critical decision to launch in Sindh rather than Punjab indicates a primary concern with social need rather than commercial factors, and one that was ultimately not sustainable in business terms.

P Profitable Proposition

From the outset, GEWP charged a price for its products that it expected to be able to sustain on a commercial basis over the longer term; meanwhile, its parent organization, IDEI, invested heavily in building customer awareness and cultivating demand. This was accompanied by a significant R&D effort to enhance its product offering.

MicroDrip took a different approach, relying on deep price concessions through TRDP and other RSP channels, instead of stimulating genuine customer demand. This was effective in terms of driving hardware sales but resulted in insufficient attention being paid to delivering a proposition that customers really valued. This was reflected in problems across a range of areas including product design, installation, maintenance and customer training. This practice also established price points in the market that would not be possible to maintain without increasing the amount of subsidy proportionally in line with sales.

P Progression

It is clear that GEWP progressed distinctly through the *blueprint, validate* and *prepare* stages, and with each step the firm moved closer towards the eventual goal of sustainable scale. In the *prepare* stage in particular, the substantial investment in the market and the firm enabled by Gates Foundation led to marked improvements in sales and have likely created a strong foundation for further scaling.

On the other hand, MicroDrip relied too heavily on the Indian precedent and failed to ***validate*** the assumptions supporting its business model in Pakistan. MicroDrip then failed to invest in demand stimulation, R&D and

supply chain development in the *prepare* stage, which were precisely the areas that had received investment in India. As a result, MicroDrip faces an even harder challenge going forward than it did when it started, as the company seeks to overcome negative customer perceptions due to poor product performance and lack of perceived value.

The case of MicroDrip also holds a cautionary lesson for those interested in porting products or business models from one country to another: just because it works in one country does not mean it will work in another, or even in a different part of the country. The rigorous testing and refinement of the *validate* stage is skipped at one's peril, as is the investment in the market and the firm at the *prepare* stage if the target customer is not yet familiar with the value of the product one is selling.

P Persistence

The work of educating potential customers and building supply chains in the BoP in the *prepare* stage cannot be accomplished overnight; instead, it requires persistent focus and resources over time. In the case of IDEI-GEWP, each district required targeted and sustained effort over three to six years in order to build genuine customer understanding and demand; only then could GEWP generate a reasonable return on its sales efforts in those areas. Conversely, the story of MicroDrip to date shows that, while direct price subsidies can give businesses a more immediate boost in getting products into the hands of the target customer, such subsidies do not create the conditions for — and might even hinder — longer-term success in both financial and impact terms.

Because the work of ***preparing*** market demand and supply may not produce sufficient private financial return within five to ten years, if ever, a dependence on return-seeking capital alone may come up short. This is particularly true in situations with 'push' categories that are novel in the BoP market and do not enjoy ready effective demand from customers, and where suppliers and distributors are underdeveloped and inadequate for the requirements of the new business model.

In situations like these, where investor capital is unlikely to meet business needs, enterprise philanthropy can have critical and lasting impact. Enterprise philanthropy can take a broad view of impact beyond the individual firm to encompass whole markets, and provide funding to build the right demand- and supply-side conditions in these markets so that pioneer firms — and those that follow them — can truly scale their activities and impact.

5 Closing The Pioneer Gap

Enterprise philanthropy can play an important role in closing the pioneer gap between ***Blueprint*** and ***Scale***, turning the promise of inclusive business impact into reality. We set out six initial recommendations for funders and investors to help develop this nascent practice.

FOR PHILANTHROPIC FUNDERS:

Interested funders can consider a range of approaches, and potentially in tandem with investing strategies.

1. Consider moving into enterprise philanthropy through a range of approaches

More enterprise philanthropy is needed to unlock the potential of inclusive business, and interested funders can consider a spectrum of approaches as described in Table 3. One route is what we have called 'classic' enterprise philanthropy as exemplified by the work of Shell Foundation (described in section 3). Another is to give grants to non-profits that are already engaged in inclusive business development as the Bill & Melinda Gates Foundation does (described in sections 3 and 4). Across the spectrum collaboration with established players or with networks such as Toniic (a global impact angel investing network) could help seek out promising opportunities to fund.

Philanthropic funding does not have to be deployed in isolation from investment capital. In fact, two of the approaches in Table 3 blend or 'layer' grants with capital to create hybrid models that target high-risk situations. Another uses grants to deliver much-needed capacity building (or technical assistance) to overcome the inherent disadvantages

TABLE 3: The Enterprise Philanthropy Spectrum — Potential Approaches for Interested Funders

	APPROACH	DESCRIPTION	OPTIONS FOR NEW FUNDERS	EXAMPLES
1	Grants to firms, including for-profits	'Classic' enterprise philanthropy direct to inclusive businesses in less-developed countries	• Build own capability • Collaborate/ co-fund with established players	Shell Foundation Lemelson Foundation Africa Enterprise Challenge Fund KL Felicitas Foundation
2	Grants to nonprofit hosts or intermediaries	Grantmaking to non-profits incubating or otherwise developing inclusive businesses	• Seek own opportunities • Collaborate/ co-fund with established players	Bill & Melinda Gates Foundation — AKAM, IDEI (see sections 3 and 4)
3	Philanthropic funds deployed as equity or debt	Investing debt or equity into businesses in higher-risk situations, aiming for 1x return	• Build own capability • Fund or co-fund with established players	Acumen Fund
4	Early-stage accelerators	Layering grant funding with investment capital to pursue high-risk, early-stage situations, with significant capacity building support for investees	• Build own capability • Fund established players	First Light Accelerator Village Capital ACCION Venture Lab
5	Technical assistance/ capacity building adjunct	Grant funding to enable investee capacity building, alongside return-capital investment operation	• Build own capability • Fund established players	Grassroots Business Fund
6	Market/ecosystem development	Grant funding to develop a range of complementary business models and promote wider conditions (e.g. standards, regulation) needed for sustainable impact at scale — focused on a given sector	• Build own capability • Fund or co-fund with established players	Shell Foundation — clean burning cookstoves Omidyar Network — microfinance Michael & Susan Dell Foundation — clean water Gatsby Foundation — agriculture

of the BoP business environment, alongside a return-capital investment model. Even where funding ultimately flows through as a grant to the pioneer firm or a nonprofit, funders could deploy complementary mission investing strategies.[23]

Funders should support the creation of new specialist intermediaries for enterprise philanthropy, in much the same way as leading funders helped to create Acumen Fund over ten years ago.

However, moving to enterprise philanthropy will be challenging for most funders. It aims to shape the working of market forces that may be unfamiliar, and in contexts that are not only less-developed but physically and culturally remote. It requires the blending of a resolute focus on impact with the ability to adopt an investor's perspective on business models, management teams and performance. Some funders will be confident in building their own capabilities, but many others will prefer to fund or co-fund with established players who already have such capabilities.

2. Create and back new specialist intermediaries

We believe that more players with specialist enterprise philanthropy capabilities need to emerge. In particular, we see a critical lack of specialist intermediaries to connect mainstream philanthropic resources to the practice of 'classic' enterprise philanthropy, in contrast to the 200 impact investing funds that have emerged. We believe that funders interested in this emerging field should support the creation of new specialist intermediaries for enterprise philanthropy, in much the same way as leading funders interested in impact investing, such as The Rockefeller Foundation, helped to create Acumen Fund over ten years ago. These new intermediaries would accept funding from a wide range of foundations and aid donors, and develop strong in-market capabilities in order to deploy grant funding and capacity building into the pioneer gap.

Of course, these new intermediaries will face tough questions and challenges. Enterprise philanthropy is not a familiar concept, and these new funds will need to clearly distinguish themselves from impact investors and venture philanthropy funds. They will need to develop strong on-the-ground capabilities in less-developed countries — hiring staff, building networks, finding opportunities, delivering technical assistance, managing portfolios and measuring impact — and maintain a strong connection to funders that are predominantly based in more-developed countries. The good news is that they will be entering at a time when groups such as the Aspen Network of Development Entrepreneurs and the Global Impact Investing Network are beginning to invest significantly in building the field infrastructure and skills on which to scale up their operations.

23 Discussion of the practice of 'mission investing' by foundations is beyond the scope of this report. We refer funders based in the United States to Stetson A. and Kramer M. (2008), Risk, Return and Social Impact: Demystifying the Law of Mission Investing by U.S. Foundations, FSG Social Impact Advisors. Funders in Europe could read Bolton M. (2006), Foundations and Social Investment in Europe, European Foundation Centre, and consult the directory of resources prepared by the European Foundation Centre's Social Investment Group http://www.efc.be/Networking/InterestGroupsAndFora/SocialInvestment/Pages/KnowledgeResources.aspx.

3. Embrace risk and acknowledge failures

Working at the frontier of inclusive business in the hope of breakthrough impact is an inherently risky endeavor that will see significant, if not high, rates of setback and failure: we need to acknowledge and accept this. Much of the support that is utilized in these situations will not result in business success, which mirrors the experience of venture capital (VC) investors in developed markets. However — unlike VCs who expect a high rate of failure and sometime even prefer to invest in entrepreneurs only after they have tried and failed — funders may struggle to reconcile this with the traditional concept of accountability and good stewardship in philanthropy. We encourage enterprise philanthropists to take risks with new models and new markets, ***and*** to be open about their experiences of failure as well as of success so that learning can be maximized for the field.

4. Expand perspective to encompass markets and ecosystems

Experienced philanthropic funders may find the entire approach of this report somewhat strange: why are we so focused on the individual firm? History does not suggest that successful individual ventures, either for-profit or non-profit, are sufficient for driving large-scale social impact, because of the complex and systemic nature of entrenched problems. What we ***have*** observed is the powerful change that can result from the aligned activity of many players, on issues such as civil rights in the United States and the immunization of children in poor countries.

Philanthropic funders are uniquely placed to take a broader perspective and work at a range of points across the market and ecosystem.

Meanwhile, we have also observed that vibrant and increasingly global markets in goods and services (and talent and capital) are influencing the way we live, work and relate to others. Markets do this in ways that cannot be attributed entirely to individual companies; even companies like Apple and Facebook, which are exerting significant influence on both popular culture and the evolution of their industries, have relied on — and been shaped by — their suppliers, customers, competitors and precursors.

In the same way, the impact of any market-based solution, at its fullest potential, will be achieved by a multiplicity of actors working in a given market, and not just within the private sector. The microfinance sector illustrates this well: in addition to a competitive array of microfinance institutions lending to end customers, there is a wider ecosystem of funders, investors, investment funds, ratings agencies, research bodies, conveners, regulators and policymakers that is shaping the evolution of the market and, ultimately, its impact on poor households.

Philanthropic funders are uniquely placed to take this perspective and work at a range of points across the market and ecosystem in order to enhance the conditions for eventual impact at scale. Investors, even impact-focused inves-

tors, must keep their eye trained on the performance of their own companies first and foremost, and their interest in the broader issues will be shaped largely by this lens. We believe that this perspective is vital and that is why we have included market and ecosystem approaches in the spectrum of enterprise philanthropy in Table 3. In particular, we believe there is an opportunity to take the emerging lessons of microfinance[24] to shape the market-based solutions of tomorrow for the greatest possible impact.

Investors should engage more with those funders working upstream of or alongside them to establish new models and markets.

FOR IMPACT INVESTORS:

5. Collaborate with funders on new business models

Impact investors, particularly those seeking innovative solutions to the problems of poverty, will continue to face serious challenges with deal flow. It is imperative that investors recognize the crucial role that funders can play in building the pipeline in these situations by cultivating pioneer firms and ecosystems. Investors could engage more with those funders working upstream of or alongside them, and explore the potential for collaboration in order to establish new models and markets. Some investors, particularly those investing in the early stage, may even pursue layered capital approaches as described in Table 3. At the very least, impact investors should clearly and proactively communicate their requirements and criteria for investment so that active enterprise philanthropists are fully aware of them and can guide early-stage pioneer firms towards true investability.

6. Align investment strategies with aims and expectations

More fundamentally, impact investors need to realistically appraise their own investing strategies and ensure that there is alignment with their expectations for risk, return and impact. Pursuing new business models to tackle the toughest social problems affecting the poorest communities will not generate high risk-adjusted returns, and in fact may not even generate 1x return. On the other hand, investing in proven business models (such as microcredit), or in businesses that serve both BoP and non-BoP populations, could potentially allow the achievement of higher risk-adjusted returns. We strongly encourage investors to be consistent in making these choices, and to be honest in the way that these choices are communicated and expectations set with investors and partners.

24 For an excellent summary of this, see Cheng P., Hodgkinson R., and Lord C., Ed. (2011) *The Impact Investor's Handbook: Lessons from Microfinance*, CAF Venturesome: Market Insights Series.

CLOSING THE GAP

Inclusive business has the potential to transform the lives and livelihoods of the poor, but the field is young and many models are as yet unproven. The long road to establishing any new model begins with the audacious efforts of the lonely pioneer firm: without the right funding and support in bridging the pioneer gap, the exciting promise of this field will remain just that. The good news is that there is already a small group of enterprise philanthropists that are leading the way. However, many more need to join them, to create a truly vibrant ecosystem that can offer the full range of capital, funding and support that inclusive business pioneers need. Many pioneers will fail, but some will succeed and establish, in time, effective market-based models into which billions of dollars of impact capital can be directed to improve the health, education, livelihoods and security of our poorest and most vulnerable communities.

In doing this, enterprise philanthropy draws fully on the best of philanthropy as it has already been practised for decades: the bold and persistent support of radical innovations and visionary leaders over long time horizons, often building whole fields not just single organizations, and with the ultimate goal of achieving profound and lasting change for millions of people. **It is this very same combination of philanthropic foresight, ambition and courage that will be the key to truly realizing the 'impact' in impact investing, by helping many more inclusive business pioneers get from blueprint to scale.**

FURTHER STUDY

Our work has pointed to a number of areas that required further study but fell outside the scope of this report.

- An analysis of supply-side barriers and constraints for enterprise philanthropy, and recommendations for interested funders, including detailed consideration of how effective and sustainable intermediaries might be established.
- An in-depth review of whole market and ecosystem approaches to enterprise philanthropy to draw out the emerging lessons from those practices and provide concrete recommendations for interested funders.
- A collaborative, data-driven review of the enterprise grant experience base to date to provide more granular best-practice guidance to interested funders in areas including entrepreneur due diligence/selection, design of grants (and other instruments) and performance management, and as well as benchmarks for funding and time scales by geography and sector.

The Enterprise Philanthropy Playbook

While the design of grantmaking programs is beyond the scope of this report, we have a number of ideas emerging from our research.

FUNDING IDEAS

In the ***validate*** stage, funders could:

- Support testing and refinement of inclusive business models, both in nonprofits and for-profits
- Support nonprofits in hosting and incubating early-stage enterprises with commercial potential
- Provide targeted technical assistance, particularly to new ventures with few resources and enterprises founded by nonprofits, focused on validating business model viability

In the ***prepare*** stage, funders could:

- Support category marketing and education campaigns to drive awareness among BoP customers and create desire for new beneficial products
- Upgrade BoP supplier or labor force capabilities through training programs, information provision, certification and/or fixed asset building
- Upgrade infrastructure for distributing products to the BoP customer
- Strengthen management teams and systems within enterprises

As this shows, funders who are only able to give grants to organizations that are officially recognized as nonprofits or charities, need not feel excluded from participation in this field. As illustrated by the example of the Bill & Melinda Gates Foundation and IDEI in section 4, nonprofit organizations can often be a key player in helping to pioneer inclusive business models.

Important questions should always be asked up-front to ensure that enterprise grants flow to the right opportunities and minimize the risk of merely providing a cheap substitute for impact capital.

BLUEPRINT FOR IMPACT

While not the focus for this report, the ***Blueprint*** stage also provides opportunities for grantmakers to stimulate the creation of promising inclusive business models. Specifically, funders could:

- Support foundational research into customer or supplier needs in the BoP which could then be released into the public domain as a basis for business innovation
- Encourage established corporations to explore inclusive extensions to their current business
- Encourage nonprofit organizations to develop commercializable impact ideas and supporting technologies
- Build stronger innovation capabilities within organizations that have good understanding of BoP needs and potential to generate solutions
- Strengthen the pipeline for entrepreneurial talent with the right perspective, motivation and skills to create and scale inclusive business models

QUESTIONS TO ASK

In the ***validate*** stage, ask:

- Is this an inclusive business model that will help better address the problems of poverty? Does it generate greater social benefit in the BoP than established businesses that also engage the BoP as customers or suppliers?
- Is there a need to validate this new business model because there is high uncertainty as to its viability?
- Does this uncertainty seem to be a barrier to generating sufficient investor interest in the pioneer firm?

In the ***prepare*** stage, ask:

- Is this a push product without sufficient ready demand from BoP customers despite producing clearly superior social benefits while staying within affordability constraints? Is there a requirement for a large one-time investment in stimulating demand?
- Are supplier, labor force, distribution channel or other infrastructure constraints a critical (but addressable) barrier to the firm's sustainable growth? Is there a requirement for a one-time investment in improving these conditions?
- Is any required investment so large, or the benefit from that investment so likely to be diffused across multiple parties, or both, that investor capital is unlikely to adequately meet that need?

Where the answers to these questions are in the affirmative, funders can have greater confidence that their grants are playing an important, value-adding role that is distinct from that played by investor capital.

APPLYING THE FOUR Ps IN PRACTICE

But this is not just about *what* we fund, it's about *how* we fund. In previous sections, we described the Four Ps that characterize effective enterprise philanthropy practice. How should we put them into practice? Here are some suggestions.

1. Purpose: *Ensuring aligned purpose towards building investable businesses that produce specific social impact*

Speak to management and key investors and funders: ask them about how they define as success for the business and what metrics or milestones they would use to track success by their definition.

Look at their past track record: past behavior is a good predictor of future intent.

Discuss 'what-if' scenarios: 'What if the product loses money? What if customers don't buy the product? What if a better product comes along from a competitor?' These discussions can tease out significant differences in aims and expectations between the parties. After all, it is when things go wrong, or serious challenges (or opportunities) arise, that alignment of purpose is really tested.

2. Profitable Proposition: *Driving a focus on profitable propositions for customers and suppliers*

Push for rigorous testing of profitability: because many inclusive business promoters come from non-BoP backgrounds, there is a tendency to 'over-feature' or just 'over-cost' products, in the hope that some combination of customer preference, scale economies and on-going subsidies will make the product viable in the long run.

Invest effort up-front to clearly define the standards for profitability, and help the firm design and run valid market trials. It is not always easy to agree the conditions for viability, and test for them, in the early stages of a new business model. For instance, companies commonly expect significant scale economies which would bring down unit cost as production increases, which could make it difficult to determine the long-term sustainable unit price at which to run market trials, especially because there are no benchmarks from similar companies already operating at scale.

Invest in helping the company track and analyze their unit profitability: many early-stage businesses do not have well-developed capabilities in this respect.

Avoid constraining the set of customers the business is allowed to serve. Monitor's research suggests that many viable models serve a range of customers at various income levels in the BoP or even outside the BoP.

3. Progression: *Encouraging progression through key stage gates towards investability*

Develop a team with the right skills and experience to help the firm navigate its progression, identify the critical step changes ahead, and support management in achieving those. Not all of these people need to be on your staff; in fact, given the range of challenges the firm will face, it is a good idea to develop a strong network of capable, trusted advisors who can be called on to assist as needs arise.

Design features into the grant to help the firm maintain discipline on achieving key step changes in its business. This needs to be done *with* the company, not *to* it, because grants can only be an enhancer of discipline, not a substitute for it. And these design features should allow some flexibility, in terms of timing for instance. Where there are multiple enterprise philanthropists engaged with one company, these design features should be aligned across all relationships, in the same way that all key investors in a business should be aligned on the firm's business plan and objectives going forward.

Be disciplined yourself. The temptation to forgive business model issues when we see clear potential for impact is strong indeed.

Encourage honest and open consideration of the paths forward. Many interesting impact models will not turn out to be great business ideas but they may well have strong potential to develop and grow as nonprofits.

4. Persistence: *Expecting and supporting persistence in overcoming the challenges inherent in pioneering new models and new markets*

Plan for multiple cycles of business model testing, learning and refinement. The world's toughest development challenges are unlikely to be solved on the first attempt. Looking to previous attempts to solve similar problems or meet similar needs can provide some guidance on how much time, money and effort will be required.

Be realistic about time frames. Monitor's research suggests that it is not uncommon for the firm's journey to viability and scale to take five to ten years. Pushing a pioneer firm to scale before the model is worked out or the distribution infrastructure developed is a recipe for disaster.

CASE STUDY: MODEL VISION

Toti and Omprakash's vision had been deteriorating, to the extent that their last crop was lost because they never saw the insects that were ravaging their fields. After receiving vision screenings through VisionSpring, they each bought a pair of glasses. Story time is once again a nightly tradition for their grandchildren and the two have a healthy crop nearly ready for harvest.

VisionSpring is a pioneering inclusive business founded in New York in 2001 by Dr. Jordan Kassalow and Scott Berrie to manufacture and sell affordable eyeglasses to BoP communities in the less-developed world. Jordan, a qualified optometrist, had seen first-hand the widespread lack of access by the rural poor to eyesight correction during his year volunteering at the Aravind Eye Hospital in India. By bringing reading glasses to the rural poor where they lived, he hoped to improve their lives through better eyesight. [1]

Jordan explained: *"The idea was to reach tens of millions of people, using philanthropic capital to kick start the business but ultimately scaling through market forces."* VisionSpring was established using grants from funders such as the Open Society Institute, Draper Richards Kaplan Foundation and Skoll Foundation, but the model had always been intended to be commercially sustainable from sales revenues. It also aimed to deliver dual social impact: through the improved vision of rural low-income customers, and through the improved livelihoods of Vision Entrepreneurs (VE), who are typically women drawn from the same rural poor communities, specially trained to sell VisionSpring glasses.

When Monitor first studied VisionSpring in India in 2007, it was clear that there was a problem with VE channel economics. The approach was door-to-door, raising awareness among customers, conducting spot eye tests and selling reading glasses priced at Rs. 150–200 ($3–4) each. Typically, the first few months of a

1 A study by the University of Michigan showed that the improved vision enabled by VisionSpring products increased customer incomes by 20 percent and their productivity by 35 percent.

VE's career would go well as she sold to family and friends in her home village. As the local pool of customers was tapped out, with little prospect of repeat sales, the VE would have to venture farther afield to make additional sales. This required greater effort and incurred travel costs, and yet sales were unlikely to reach the levels achieved initially; as a result, few VEs made this their primary livelihood. More importantly, it did not seem feasible to scale the VE approach into a model with break-even economics that would be sustainable in the long term, so VisionSpring management knew something needed to change with the product offering or the go-to-market strategy.

In response to these issues, VisionSpring developed new channel models with improved economics. In El Salvador, funded by a grant from the Inter-American Development Bank, the company expanded their pilot hub-and-spoke model, which was centered on a village store carrying a wider range of products including prescription eyewear. This new approach led to an eightfold increase in revenue from 2010 to 2011, with five stores at the end of the period running at over 90 percent of costs covered by sales. Thanks to the catalytic effect of the IDB grant of validating the business model, the company is now looking to scale the model across the country.

In India, VisionSpring created a new channel in which mobile vans visit villages to run communication activities, conduct eye camps, and sell glasses. This has been enabled by grant funding from Mulago Foundation and the Jasmine Charitable Trust, among others. Results from the initial fleet of 20 vans have been positive, with a doubling of sales from 30,000 eyeglasses in 2010 to 65,000 in 2011, and there are plans to grow the mobile van network substantially in 2012.

These examples of what VisionSpring calls 'strategic philanthropy' are now helping the company to validate its business model and move closer towards full commercial viability. It estimates that 55 percent of revenues will be from sales (as opposed to grant subsidies) in 2011, compared to 23 percent two years before.

Over the years, VisionSpring has also sought to consolidate and align the support coming from grant funders towards their long-term goals. Jordan explains: *"The Foundation side of the organization was consumed with fundraising, often in painfully small increments. Given our small team, in the early years, this distracted from the critical business mechanics that needed to be hammered out. To make matters worse, many funders were only interested in funding programs, not in building a robust organization with the capacity to provide those programs in perpetuity."*

In an effort to get some control back, VisionSpring issued an 'investor prospectus' in 2007 to gather a small group of key grant funders who would provide growth capital and have standardized reporting requirements. Within a 12 month period, VisionSpring attracted over $3 million in philanthropic capital from lead investors including the Skoll Foundation, The Lavelle Fund for the Blind and The Peery Foundation. In 2011, the company reported that it had already exceeded all of its 2012 goals.

CASE STUDY:
POST-CONFLICT ORGANIC

After 20 years in internally displaced persons camps in Uganda, Basil is now making a living from cotton and sesame with the support of GADC

Founded in 2009 by South African entrepreneur Bruce Robertson, Gulu Agricultural Development Company (GADC) is a for-profit cotton ginnery operating in the war-torn districts of Gulu and Amuru in Uganda. By the time he started GADC, Bruce was already an experienced cotton entrepreneur, having run similar businesses in Uganda since 1995, as well as in Zimbabwe, Mozambique and Malawi.

GADC is a commercial business that has enjoyed a strong start, achieving positive net income and cashflow in its first year of operations. It has also substantially improved the economic situation of more than 30,000 smallholder farmers in Gulu and Amuru by rebuilding a local cotton industry that had been destroyed by 25 years of armed rebel conflict in the area.

The Danish International Development Agency (DANIDA) quickly saw an opportunity in GADC to further improve farmers' livelihoods. Many of the cotton farmers around Gulu were already farming without chemical inputs and, because the land had been fallow for many years, the soil was free of contami-

nants. However, because they were not part of a certified-organic program linked to a foreign buyer, they were not able to capture the significant premium of up to 30 percent paid for organic cotton. Farmers also lacked some of the required practices: for instance, they were not documenting their usage of inputs nor had they adopted rigorous measures to prevent cross-contamination.

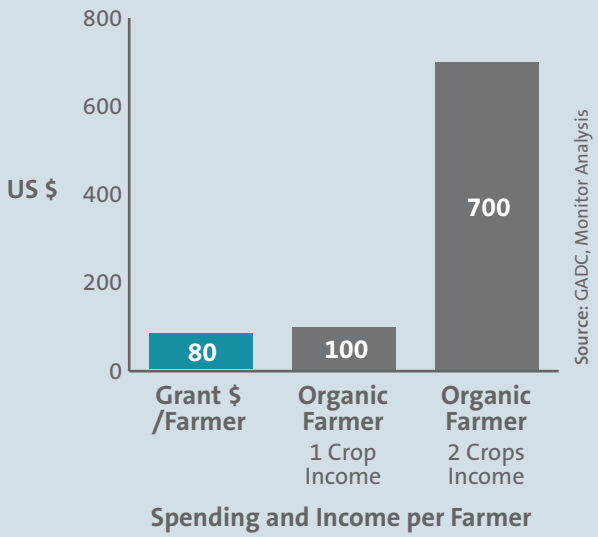
Eager to facilitate a move to certified organic production, DANIDA offered an $800,000 grant to GADC to fund extension services that would provide training to farmers to help them make the switch. DANIDA also offered to link GADC with a Danish business partner, Illuminati Noir. They could assist with organic certification, and also be a ready buyer for the company's organic cotton output.

GADC decided to take up the offer. Bruce says, *"GADC is a commercial company that also produces a social benefit. We need to make money, so that is how we make our decisions. We could see that moving to organic would be good for the farmer, but without the DANIDA grant, we couldn't run the extension services as we wouldn't make enough additional money from the business to justify the up-front investment."*

Since then, the grant-funded extension services have helped more than 7,000 farmers move to certified organic production of cotton, as well as to begin planting an additional organic crop—sesame. This has resulted in average crop yield from a two-acre plot increasing from $500 a year to around $1,200 a year, an improvement of 140 percent. By the end of 2012, GADC expects that the extension services will have helped 10,000 farmers move to certified organic production and consequently enjoy dramatically improved livelihoods.

The support from DANIDA falls in the ***prepare*** stage, as it focuses on improving the capabilities of suppliers in order that GADC can scale up production of a more socially beneficial product line. We saw in the case of IDEI-GEWP that the level of investment required to prepare the market in this stage could be prohibitively high from the firm's perspective, but could be very attractive from the perspective of the aid donor, and so it is in this case: figures show that the overall income uplift for GADC organic farmers due to the DANIDA grant in just one season is $2.4m, four times the value of the grant (see Figure 11).

FIGURE 11: Grant Expenditure vs Additional Income Earned per Participating Farmer



Glossary of Terms

- **BoP:** The term 'Base (or Bottom) of the Pyramid' (BoP) popularized by the late Professor C. K. Prahalad[1] in his book is widely used to refer to low-income communities that have historically been excluded from formal markets. The World Resources Institute reports that there are 4 billion people in the BoP, with incomes below $3,000 in local purchasing power. Their incomes in 2002 PPP dollars are less than $3.35 a day in Brazil, $2.11 in China, $1.89 in Ghana, and $1.56 in India. BoP markets are often rural, poorly served, dominated by the informal economy, and are therefore relatively inefficient and uncompetitive. Despite this, the BoP constitutes a $5 trillion global consumer market in aggregate. [2]
- **INCLUSIVE BUSINESS:** A business that provides a product or service that is clearly socially beneficial to the BoP, based on a business model that is commercially viable and ideally scalable.
- **IMPACT INVESTING:** Actively placing capital in businesses and funds that generate social and/or environmental good and at least return nominal principal to the investor. This report is particularly interested in the placement of capital in inclusive businesses and funds that invest in them.
- **GRANT:** A monetary or in-kind award provided to an organization, typically to achieve a defined social or environmental benefit, with no expectation of financial return.
- **CAPACITY BUILDING/TECHNICAL ASSISTANCE:** An in-kind award to an organization to support the building of organizational capability and capacity, and/or enable project delivery. This might take the form of business advisory services, technical advisory services, research services, organization-building activities or facilitation of linkages with partners, among others.
- **PHILANTHROPIC FUNDER/DONOR:** An organization that provides grants and/or capacity building to achieve social or environmental impact objectives. This would include private or public philanthropic foundations, aid donors (bilateral or multilateral) and development finance institutions.
- **COMMERCIAL VIABILITY:** A commercially viable firm or business model is one that is able to sustain itself and attract investment because earned revenues from sales to customers exceed costs, over time.
- **OPERATING AT SCALE:** Serving a large number of target customers or suppliers within a given geographic context. Previous Monitor reports on inclusive business have considered a firm serving BoP customers to be at scale in Africa if it has reached 100,000 customers per year, and in India, if it has reached 1 million customers per year. Likewise, a firm engaging with BoP suppliers is considered to be at scale in Africa if it is serving 10,000 suppliers per year in Africa, and in India, if it is serving 30,000 suppliers per year.

1 Prahalad C. K. (2004), *The Fortune at the Bottom of the Pyramid,* Wharton School Publishing
2 Hammond, A., Kramer W. J., Tran J., Katz R., Walker C. (2007), *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid,* World Resources Institute/International Finance Corporation

Individuals & Organizations Interviewed for this Study

GENERAL

- Abby Sarmac, *Lemelson Foundation*
- Ajit Kanitkar, *Ford Foundation*
- Amit Bouri, *Global Impact Investing Network*
- Andres Rico, *TechnoServe*
- Andrew Farnum, *Bill & Melinda Gates Foundation*
- Anil Sinha, *International Finance Corporation*
- Antony Bugg-Levine, *Nonprofit Finance Fund*
- Audrey Selian, *Rianta Capital*
- Charly Kleissner, *KL Felicitas Foundation*
- Chris West, *Shell Foundation*
- David Porteous, *Bankable Frontier Associates*
- David Robinson, *Fuqua School of Business, Duke University*
- Durreen Shahnaz, *Impact Investment Exchange Asia*
- Erik Simanis, *Center for Sustainable Global Enterprise, Cornell University*
- Fred Ogana, *TechnoServe*
- Geeta Goel, *Michael and Susan Dell Foundation*
- Guy Stallworthy, *Bill & Melinda Gates Foundation*
- Harold Rosen, *Grassroots Business Fund*
- Homi Kharas, *Brookings Institution*
- Kelly Clark, *Marmanie Consulting Ltd.*
- Lester Coutinho, *Packard Foundation*
- Louis Boorstin, *Bill & Melinda Gates Foundation*
- Matt Bannick, *Omidyar Network*
- Mona Kachhwaha, *Caspian Advisors*
- Neera Nundy, *Dasra*
- Oliver Karius, *LGT Venture Philanthropy*
- Patrick Maloney, *Imprint Capital*
- Puneet Jhaharia, *Grassroots Business Fund*
- Reuben Abraham, *Indian School of Business*
- Robert Kraybill, *Impact Investment Exchange Asia*
- Sandeep Farias, *Elevar Equity Advisors*
- Simon Bishop, *Shell Foundation*
- Varun Sahni, *Impact Investment Partners*
- Vijay Mahajan, *BASIX India*
- Vineet Rai, *Aavishkaar*
- Vishal Mehta, *Lok Capital*
- Wolfgang Hafenmeyer, *LGT Venture Philanthropy*

COMPANY ANALYSIS

- Al Doerksen, *International Development Enterprises*
- Amitabha Sadangi, *IDEI and GEWP*
- Suresh Subramanian, *IDEI and GEWP*
- Om Prakash Singh, *GEWP*
- Pradip Nawale, *GEWP*
- Karthik Janakiraman, *ex-Acumen Fellow at GEWP*
- Kathy Lombardo, *Bill & Melinda Gates Foundation*
- Bruce Robertson, *Gulu Agricultural Development Company*
- Warwick Thomson, *DANIDA*
- Dr. Jordon Kassalow, *VisionSpring*
- Peter Eliassen, *VisionSpring*
- Pritpal Marjara, *VisionSpring*
- Vikram Raman, *ex-Acumen Fund Health Manager*
- Laura Hattendorf, *Mulago Foundation*
- Dr. Sono Khangarani, *MicroDrip*
- Saqib Khan, *ex-COO MicroDrip*
- Joel Montgomery, *ex-Acumen Fellow at MicroDrip*
- Tariq Khan Baluch, *ex-FMiA CEO*
- Michael McCord, *MicroInsurance Centre*
- Marianne Vermeer, *ex-Senior Acumen Fellow at FMiA*
- Evelyn Stark, *Bill & Melinda Gates Foundation*
- John Pott, *Former Project Director at Aga Khan Agency for MicroInsurance*
- Peter Wrede, *International Labour Organization*
- Gyanesh Pandey, *Husk Power Systems*
- Simon Desjardins, *Shell Foundation*
- Mario Ferro, *ex-Acumen Fellow at Husk Power Systems*
- Nat Robinson, *Juhudi Kilimo*
- Rashid Bajwa, *National Rural Support Program (Pakistan)*
- Pratyush Pandey, *DripTech*
- David Kuria, *Ecotact*
- Khurram Hussain, *ex-Acumen Fellow at Ecotact*
- Saleem Ismail, *Western Seed Company*
- Shane Heywood, *ex-Acumen Fellow at Western Seed Company*
- Satyan Mishra, *Drishtee*
- Justin DeKoszmovszky, *SC Johnson*
- Chuck Slaughter, *Living Goods*
- Laurie Thomsen, *KickStart*

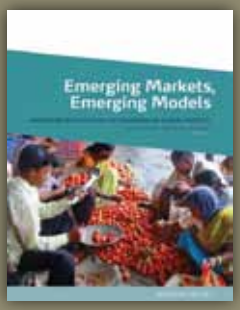
Recommended Reading

MONITOR PUBLICATIONS

Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry

Jessica Freireich, Katherine Fulton (January 2009)

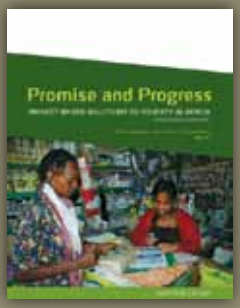
This report examines impact investing and explores how leaders could accelerate the industry's evolution and increase its ultimate impact in the world. It explores how impact investing has emerged and how it might evolve, including profiles on a wide range of impact investors. The report also provides a blueprint of initiatives to catalyze the industry.



Emerging Markets, Emerging Models

Ashish Karamchandani, Mike Kubzansky, Paul Frandano (March 2009)

This report focuses on the actual behaviors, economics, and business models of successful 'market-based solutions' in India. Findings were based on more than 600 in-person interviews with low-income customers and small suppliers, and detailed interviews with and research on over 270 social enterprises.



Promise and Progress: Market-Based Solutions to Poverty in Africa

Mike Kubzansky, Ansulie Cooper, Victoria Barbary (May 2011)

This report provides a comprehensive analysis of financially sustainable enterprises that address challenges of poverty. It is the result of a 16-month research project on the operations of 439 enterprises across 14 sectors, in nine sub-Saharan nations. The focus is on understanding the behaviors, economics, and business models of successful inclusive enterprises.

TO DOWNLOAD THE ABOVE REPORTS, GO TO WWW.MIM.MONITOR.COM

OTHER PUBLICATIONS

The Fortune at the Bottom of the Pyramid
C.K. Prahalad
(Wharton School Publishing, 2004)

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