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Capturing BoP Markets

Corporate Impact Venturing with Inclusive Businesses

OUR NEXT ENDEAVOUR

AUTHORS:
Christina Tewes-Gradl
Sarah Worthing
Aline Menden

endeva

About "Our next Endeavour" 02

"Our next Endeavour" is Endeva's working paper series on current issues in enterprise solutions for development. The papers explore topics we consider relevant and topical for inclusive business. The papers are based on research and analysis. They are targeted at practitioners from companies, development agencies and NGOs. With this, "Our next Endeavour" aims to inspire forward thinking, stimulate dialogue and spark new collaborations.

If you wish to wish to comment on this paper, please write to Dr. Christina Tewes-Gradl (c.gradl@endeva.org)!

We are keen to hear your reactions.

Kuapa Kokoo farmers harvesting ripe cocoa pods in Ghana. In 1998, The Body Shop International provided an equity investment to Divine Chocolate, an fair-trade initiative of the Kuapa Kokoo co-op.

Photo: Divine Chocolate

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Foreword

Inclusive businesses pioneer innovative solutions to meet the demand of the world's most vulnerable people for essential services such as education, health, transportation, or energy. However, they often cannot scale up fast and wide enough to close the gap. Corporates, on the other side, seek to expand their reach into the base of the global economic pyramid (BoP). Corporate Impact Venturing enables inclusive businesses and corporates to partner up and meet their objectives better together.

Corporate Impact Venturing produces tripartite returns of financial, social and strategic significance. Corporates can promote sustainable development through direct investments in inclusive businesses, thereby supporting socially beneficial innovations to scale. Inclusive businesses can leverage the corporate's financial backing, managerial know how, technology and organizational structures to expand their services and replicate it in other countries.

We are therefore delighted to be publishing our research into this emergent field. Our purpose is to explore how Corporate Impact Venturing is applied in practice, and what is needed to enable these productive partnerships. The report thus aims to inform our dialogue with a growing community of professionals, corporate funds, and inclusive ventures engaged in this nascent field. We hope the findings will help shape the emerging space of Corporate Impact Venturing in low-income markets.

Dr. Christina Tewes-Gradl, Sarah Worthing, Dr. Aline Menden

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Defining CIV

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The **base of the global economic pyramid (BoP)** comprises four billion people and a US$5 trillion opportunity. Corporations recognize this market potential. Nevertheless, they often find it difficult to develop business in these markets successfully. Corporate structures—the clockwork that allows corporations to operate routinely and efficiently—restrict companies from innovating radically in emerging markets. Internal bureaucracy, short investment horizons, high return expectations and risk aversion all hamper corporations from building successful inclusive business models.[01]

Meanwhile, many **inclusive businesses** are operating successfully in emerging markets. Their business solutions are enabled through new technologies such as mobile health and off-grid energy solutions, new distribution models such as micro-franchises, or new operating models such as specialized clinics and low-cost schools. However, they often lack the financial and managerial capacity to scale and replicate.[02] Although their products or services have viable markets and address pressing social needs, they stay small.

Box 1

What is Inclusive Business?

Inclusive businesses integrate low-income people into their value chains as consumers, employees, producers or retailers. The organizations behind such business models range from small enterprises to multinational corporations and originate from both industrialized and developing countries.

Corporate venturing into inclusive businesses mainly targets startups and small to medium sized enterprises operating at the BoP.

Corporate Impact Venturing (CIV) combines the strengths of corporations and inclusive businesses, and mitigates their respective weaknesses. CIV is an umbrella term that encompasses all ventures generating financial, strategic and social and/or environmental returns.[03] This report focuses exclusively on inclusive business ventures, or social impact ventures in low-income markets of developing countries.[04] Corporations acquire or partner with inclusive businesses, they achieve social impact, and they gain footholds in new markets. With a portfolio of strategic investments at the BoP, corporations can hedge risks and may eventually absorb inclusive businesses to strengthen their operations and growth potential. For their part, inclusive businesses gain opportunities to scale and replicate their business models, attract additional funding, benefit from corporate business expertise, and advance their social impact objectives.

01. World Business Council for Sustainable Development (2013). *Scaling Up Inclusive Business*

02. Endeva (2014) *Multiplying Impact: Supporting the Replication of Inclusive Business Models*

03. On the broader approach of CIV, see Volans Ventures Ltd (2014). *Investing in Breakthrough: Corporate Venture Capital*

04. It should be noted that many inclusive business models achieve environmental returns in addition to their primary socioeconomic impacts. Examples include renewable energy products, eco-friendly feminine hygiene products and clean cook stoves. Adidas's Hydra Ventures' investment in CRAiLAR Technologies Inc. is an example of a corporate impact venture targeting environmental returns.

Box 2

Internal venturing

Corporations can also develop new inclusive business internally. While internal business development is sometimes also referred to as "venturing", these activities are not considered in this report. Corporations may develop inclusive business through an impact intrapreuer program, or it may set up teams or business units that develop and implement an inclusive business model. Sometimes, these activities are part of a company's CSR program. Well-known cases of internal inclusive business development include CEMEX's Patrimonio Hoy[05] or Allianz's micro-insurance scheme.[06]

However, when it comes to BoP markets, many corporations struggle to "build" successful business from scratch. Reasons include difficulties creating appropriate internal structures, the many unknowns of BoP markets, a lack of people with the right skills and capacities and corporate bureaucracy.[07] CIV overcomes the barriers described above by investing in existing inclusive businesses, thereby outsourcing innovation and BoP market expertise.

05. Patrimonio Hoy is a social enterprise developed by CEMEX that provides BoP consumers with building materials, micro financing, technical advice and logistical support to assist them to build their own homes and transform their living conditions.

06. Allianz tailors insurance schemes to fit the needs of low-income families in Asia, Africa and Latin America. More than 20 million people are covered by microinsurance protection from Allianz.

07. WBCSD (2014). *Scaling up inclusive business - solutions to overcome internal barriers.*

This report seeks to bring greater clarity to the emerging practice of CIV. The next section examines the opportunities CIV presents from the perspective of the inclusive business and the corporate. Section three describes CIV models corporations currently use. Section four describes the CIV cycle from strategy through design to implementation. The final section expands on practical ways to overcome current constraints and build the ecosystem of CIV.

Case Study 1

Pearson and Omega Schools

In 2012, Pearson Affordable Learning Fund acquired a minority interest in the Ghanaian for-profit private school chain Omega Schools. Omega's model expands access to affordable education of a consistent quality in areas lacking sufficient public schools. Students learn better with quality, standardized curricula and high teacher-to-student ratios.

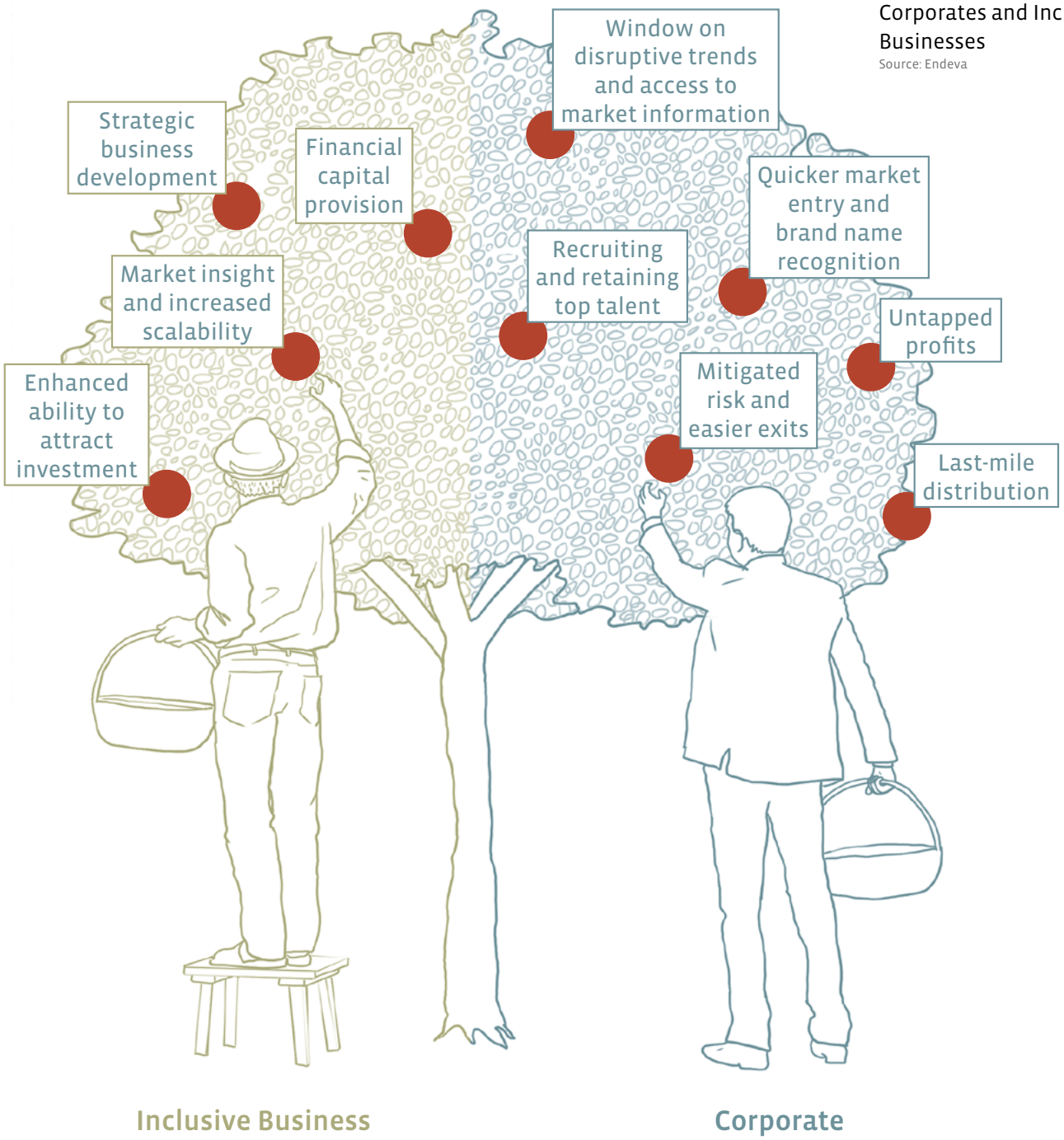
As one of the world's leading education companies, Pearson's equity investment in Omega Schools enabled the low-cost private school chain to rapidly scale tits "pay-as-you learn" daily fee model. With the assistance of Pearson's investment, Omega has grown from 10 schools in 2011 to 38 schools serving more than 20,000 students in 2015.

Through venturing in educational start-ups, Pearson is benefitting from the experience of educational entrepreneurs at the BoP and positioning itself as a leading supporter of transformative and innovative education models in low-income markets.

Opportunities of CIV 06

When corporations invest in or partner with inclusive businesses, mutual benefits and opportunities can be attained. Aside from the opportunity to benefit low-income communities, CIV also offers financial and strategic opportunities and incentives.

Figure 1:
Opportunities for Corporates and Inclusive Businesses
Source: Endeva



Opportunities for the inclusive business

Financial capital provision

Inclusive businesses often struggle to raise funds. Conventional venture capitalists and angel investors are usually hesitant to provide capital due to the lower margins, longer investment duration and higher risks associated with inclusive business investments. CIV therefore fills an important gap in financing for BoP market initiatives. Access to finance enables the inclusive business to further develop a functional and sustainable business model to scale and expand into new markets.

Box 3

Financing Inclusive Businesses

Apart from CIV, other funding sources for inclusive businesses include impact investors (e.g. angel investors, venture philanthropists and foundations) as well as private sector and public sector grants.

Corporate philanthropy or CSR funding may also finance an inclusive business but with no expectation of financial gains by the corporate.

Strategic business development

Corporate investors also provide strategic support to their investees: for example, access to corporate business knowledge or complementary technologies, skills training, corporate employees or advice on regulatory procedures. Under its CIV partnership with Pakistani irrigation company MicroDrip, Unilever Pakistan provided operational and strategic assistance. Unilever's insights and testing facilities allowed the inclusive business to conduct field tests and fast-tracked the drip irrigation product to Pakistani markets. Strategic assistance like this enables the inclusive business to rapidly scale and even replicate in other markets.

Market insight and increased scalability

Local inclusive businesses benefit from corporate investors' insights into global markets. Corporations may share invaluable network contacts and assist inclusive businesses to navigate international markets. Leveraging the experience and know-how of corporations, inclusive businesses may even expand their product or service offerings to target markets outside the BoP. For instance, the Indian education start-up InOpen Technology Inc. expanded its e-learning software line to the United States and Japan under the guidance and support of Benesse Corporation (see Case Study 6).

Enhanced ability to attract investment

Many inclusive businesses have leveraged the financial backing of a corporate to raise additional resources in later funding rounds. The Divine Chocolate Company, a Fairtrade chocolate company whose primary shareholders are Ghanaian cocoa farmers, leveraged The Body Shop's investment in its cocoa production co-op Kuapa Kokoo to secure additional funds from Oikocredit and Comic Relief. Once Coca Cola had provided initial funds for One Degree Solar's BrightBox, the inclusive business also secured funding from Schneider Electric.

Opportunities for the corporate

Window on disruptive trends and access to market information

Investing in an inclusive business provides a corporate with a "window" on emerging market trends, consumer habits, innovations and disruptive technologies. This early access to breakthrough developments gives firms a competitive edge, a foothold in evolving markets. For instance, the One Degree Solar investment offers Schneider Electric experience in BoP cleantech innovations and a foothold in African markets as BoP consumers search for alternatives to kerosene lamps. Field research conducted by Nielsen proved that small kiosk owners using BrightBox reduces kerosene spending by 90 percent, increases the entrepreneurs' revenues by 15 percent, and improves safety, productive hours, security, and customer traffic.[08] Even if corporates have established offices in developing countries, CIV provides market insights that inform new product or service developments.

08. International Association of Investors in the Social Economy (2013). Schneider Electric Energy Access (SEEA) Fund invests in One Degree Solar. Last accessed on November 29, 2015 at: http://www.inaise.org/?q=en/node/2068#sthash.frYudjmh.dpuf

Quicker market entry and brand name recognition

Rather than sinking substantial costs into product development, firms find CIV activities with inclusive businesses a much quicker and cheaper vehicle to drive product development and brand promotion. Corporations also open up avenues for expansion in new areas. CIV can also enhance the public image of both the corporate's core business and its supply chain. Unilever's CIV partnership with Clean Team Ghana enabled it to assess the market viability of portable sanitation systems and provided an outlet for its branded cleaning products.

Untapped markets

With four billion consumers in relatively unsaturated markets, corporations understand the growth potential of BoP markets. Market sectors at the BoP range in size from an estimated US$51 billion in information and communication technology to about US$433 billion in energy.[09] The EKOCENTER developed by Coca Cola and SolarKiosk is expected to produce profits for Coca Cola by 2017: a remarkably quick turnaround even by developed market standards. CIV can also stimulate additional demand in unsaturated markets. Part of Coca Cola's motivation for partnering with One Degree Solar was its recognition that keeping stores well illuminated increases beverage sales.

09. IFC (2007). *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*

Recruiting and retaining top talent

As more professionals seek roles with companies creating social impacts, corporations engaging in CIV can attract and retain top talent by differentiating themselves from similar corporations. This is one of the key drivers of corporate impact investment strategies.[10] Some corporations have also incorporated CIV activities into corporate volunteer schemes. Schneider Electric fosters expertise exchanges by providing Schneider employees with the opportunity to work alongside startups funded through the Schneider Electric Energy Access Fund. Boehringer Ingelheim also provides employee volunteer opportunities with inclusive businesses through its Making More Health initiative.

10. European Venture Philanthropy Association (2015). *Corporate Social Impact Strategies – New Paths for Collaborative Growth*

Mitigated risk and easier exits

If an inclusive business is not producing the required returns, corporate exit from an investment is less expensive and onerous compared to abandoning internal R&D and production. Companies are more reluctant to let go of internal projects. This may be due to path dependencies created by the vested interests of internal staff and the high sunk costs involved in internal R&D. In contrast, the arms-length approach of CIV facilitates more objective decision-making about commercial viability. Furthermore, CIV also presents the opportunity to partner with third party funds or impact investors in order to distribute risk and still benefit from strategic returns. In this case, the level of risk mitigation depends on how the risk is shared.

Last-mile distribution

By investing or partnering with inclusive businesses, corporations may seek to fill gaps in the value chain and overcome the last-mile distribution challenge. Inclusive businesses often possess established local networks and inventive distribution models that corporations can benefit from, such as micro-franchises or mobile sales agents. Coca Cola's strategic partnership with SolarKiosk provided distribution centers for cooled Coca Cola beverages in previously unreached communities. Although using inclusive businesses may not be a comprehensive, long-term solution for value chain gaps, CIV can be a provisional yet practical solution.

Students study at a branch of the low-cost, for-profit Omega Schools. Pearson Affordable Learning Fund provided an equity investment into the Pay As You Learn business model in 2011.

Photo: Pearson Foundation

CIV Models

In this report, we focus on models of CIV that invest in or partner with inclusive businesses. We term these approaches **CIV capital** and **strategic alliances** (see Figure 2).[11] Much like traditional corporate venturing, both categories of CIV activities include the provision of non-financial resources in addition to a financial investment or a strategic partnership. These non-financial resources may be managerial and technical expertise or access to corporate employees and training. Providing non-financial resources is mutually beneficial; the inclusive business profits from accelerated growth, the corporate reduces the risk its investment will fail.

11. The models presented in this paper are built upon Landström and Maso's models in *The Handbook of Research on Venture Capital* (2012)

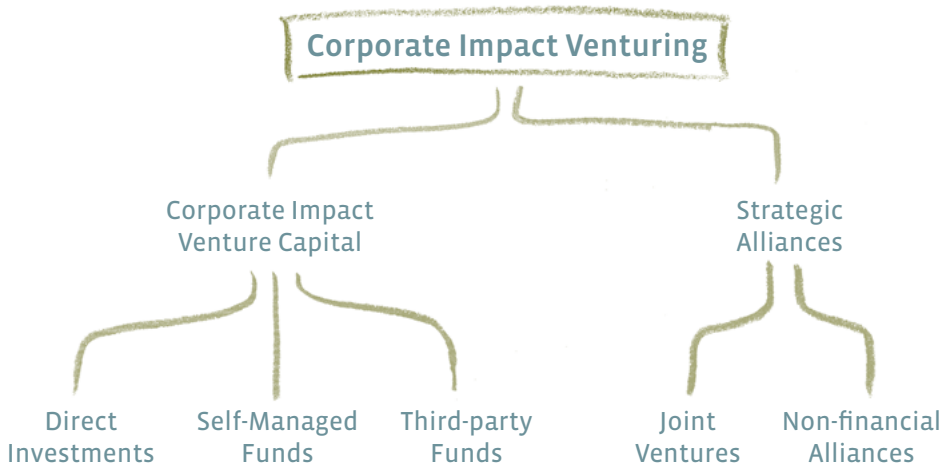


Figure 2: CIV Models
Source: Endeva

CIV Capital

In CIV Capital, corporations invest in inclusive businesses with the expectation of financial, strategic, social and/or environmental returns. Equity investments and loans are the most common forms of corporate impact venture capital and can be initiated at various stages of the inclusive business—sometimes as early as a Series A or Series B funding round. To minimize the risk of investment failure, some corporations wait to invest until an inclusive business reaches maturity as an established business. An example is Schneider Electric's investment in One Degree Solar's BrightBox product line. Affordably targeted to BoP consumers, One Degree Solar's BrightBox is a solar-powered battery kit that powers light bulbs, phones, radios, and other USB devices. Schneider only provided CIV capital to One Degree Solar once the inclusive business had developed an extensive business network in Kenya and had secured Coca Cola as a BrightBox customer.

There are **three main models** of CIV capital: direct investments, self-managed funds and third-party funds. Some corporations choose to directly invest in a particular inclusive business; they then assign relevant business units to manage the venture cycle, extract strategic advantages and investigate value add opportunities. Other corporations take a more hands-off approach; employing intermediaries such as venture philanthropy organizations and impact investment firms.

Direct investments

Direct investments provide funds to inclusive businesses from the corporation's primary accounts with the investment listed on its annual balance sheet. The capital may come from the corporate business unit most closely aligned with the inclusive business. Generally, this is the business unit that will be responsible for extracting strategic returns from the investment. Corporations measure returns through traditional financial metrics as well as by monitoring social impacts. This limitation is due to the long time required to manage the venture and the resource-intensive provision of non-financial support. Corporations often need internal expertise in venture capital to successfully manage direct corporate impact ventures, although they can employ intermediaries for transaction advice.

Case Study 2

The Body Shop and Divine Chocolate Ltd.

In 1998, The Body Shop International provided a direct equity investment to Divine Chocolate Limited, a Fairtrade chocolate company owned by Ghanaian cocoa farmers via the co-op Kuapa Kokoo.

The equity investment was equal to 14 percent of the total shares of the inclusive business. In addition to the equity investment, The Body Shop also supported the Kuapa Kokoo co-op by buying its raw cocoa products.

Self-managed funds

In a self-managed fund, the corporate sets up an investment company or creates a captive fund, i.e. a fund funded entirely by the corporate. The corporate exercises control by holding a position on the fund's board, by appointing the fund's management team, or by doing both. The fund or firm may invest in multiple projects that align with its investment strategy and the corporate's core business. Both internal talent and venture capital expertise may be employed to run the fund. For instance, in 2008, approximately two-thirds of US self-managed corporate venture funds employed senior personnel from outside the parent company.[12] Given the additional human resources needed, self-managed funds require substantial time and resources to establish. The Pearson Affordable Learning Fund is a self-managed fund established by the British multinational publishing and education company in 2012. Initially established with US$15 million of Pearson capital to invest in for-profit educational enterprises, the fund now manages a portfolio of 10 investments in Africa and Asia. Unilever Ventures and Tengelmann Ventures are also examples of self-managed funds.

12. MacMillan, I., Roberts, E., Livada, V., and Wang, A. (2008). *Corporate Venture Capital (CVC): Seeking Innovation and Strategic Growth*

Case Study 3

Tengelmann and Coffee Circle

In 2011, Tengelmann Ventures took a 30% equity stake in the German inclusive business Coffee Circle. Coffee Circle buys coffee directly from Ethiopian farmers and injects a large portion of its profits back into local social projects such as building schools and drilling wells.

Tengelmann Social Ventures has invested in two other early stage businesses in the field of online education and web domain business. Since 2014, Tengelmann's Kaiser supermarket chain sells Coffee Circle products through select stores.

Third-party funds

Corporations can also invest CIV capital through third-party funds such as venture philanthropy funds, syndicates or funds with corporates as limited partners.[13] In most third-party funds, a general partner seeks investment capital with limited partner investors that support the fund's investment strategy. Therefore, the corporate is one of several investors in the limited partnership. General partners in the third-party fund make final investment decisions although the corporate may exert some authority depending on the investment strategy of the fund, the governance structures and whether or not the corporate initiated the fund.

Third-party funds use fund managers to select and manage investments so very little internal expertise is required. For corporations starting out in CIV, using a third-party fund may help them "learn the ropes" before they start a self-managed fund or make direct investments and partnerships. Third-party funds may also be an economical and effective way for smaller firms to engage in CIV. The Energy Access Venture Fund is an example of a third-party fund; Schneider Electric is a limited partner and Aster Capital is the general partner.

13. In traditional corporate venturing, third-party funds are a contested space in the corporate venturing sector. This report includes third-party funds as a functional model as long as the investment is aligned with the core business of the firm with the possibility of acquiring the investee at a later date.

	Structure	Inputs	Strategic Return	Constraints	Examples
Direct investment	• Direct investment funding for each deal, closely related to business divisions and future opportunities	• Capital • Internal corporate talent and resources	• Gain direct business and technological experience in emerging markets. • Get input for R&D projects, business development or as part of CSR strategy	• Corporate is responsible for all stages of the investment cycle	• Unilever • The Body Shop
Self-managed fund	• Corporate acts as a general partner in the fund • Captive fund	• Capital • Internal corporate talent and resources	• Gain insight into emerging businesses and technologies	• Requires internal corporate venturing capabilities	• Tengelmann Ventures • Benesse Social Investment Facility
Third-party fund	• External fund • Corporate may act as limited partner in the fund	• Capital	• Gain market awareness and understanding while hedging risk	• Diminished strategic returns	• Energy Access Venture Fund

Table 1:
Models of Corporate Impact Venture Capital
Source: Endeva

Strategic alliances

Strategic alliances include both strategic non-financial partnerships and joint ventures with inclusive businesses. These alliances can generate income, lower production and/or distribution costs, assist with product development and create innovative market-based social benefits. Some alliances may involve extending firms' supply chains; others may provide corporations with BoP market insights.[14] Through a resource-sharing alliance, Unilever Pakistan supplied management expertise and marketing personnel to MicroDrip to assist the irrigation enterprise. In return, Unilever received insights into micro-irrigation technology and potential growth markets.[15]

14. For more examples of skill and supply chain partnerships between corporations and inclusive businesses, see Acumen and Business Fights Poverty's report (2015) *Social Enterprises and Global Corporations: Collaborating for growth with impact*

15. Solomon, L.D. (2014) *Alleviating Global Poverty*, pg. 196

Case Study 4

Coca Cola and SolarKiosk

In 2014, The Coca-Cola Company began a partnership with SOLARKIOSK to help further develop its EKOCENTER project, which was created to bring sustainable development to underserved communities. EKOCENTERs can provide solar power, safe drinking water, mobile connectivity, consumer goods and a variety of services to communities. Designed to do good and do good business, they act as a catalyst for community growth.

This strategic venturing partnership enhances Coca-Cola's market presence by building strong community ties and last-mile distribution, while Solarkiosk benefits from the rapid scale of its business model. To date, there are nearly 100 EKOCENTERs located throughout Africa and Asia.

SolarKiosk and The Coca-Cola Company CIV partnership on EKOCENTER provides underserved communities with basic goods and services in an economically self-sustaining model.

Source: The Coca-Cola Company

Strategic alliances can be broadly divided into two categories: joint ventures and non-financial alliances.

Joint ventures

These are agreements between corporations and inclusive businesses to embark on specific projects to realize financial, strategic, and social returns. A CIV joint venture is aligned with the corporate's core business and has the potential to produce innovations that can be absorbed into the firm's operations. The parties share expenses, revenues and assets with the joint venture lasting for

a pre-determined period. Joint ventures can also include the establishment of a wholly separate inclusive business model. For instance, Danish biotech company Novozymes and CleanStar, a social and environmental venture firm working in BoP markets, established their joint venture CleanStar Mozambique. CleanStar Mozambique is an inclusive business that replaces thousands of charcoal-burning cook stoves with cleaner ethanol cook stoves.

Checklist for joint venture agreements between corporations and inclusive businesses:

- ✓ Social, financial and strategic objectives of the joint venture, including metrics for measuring impact
- ✓ Responsibilities of the corporate and the inclusive business, including the day-to-day management of operations and finances
- ✓ Financial contributions, assets and employees transferred to the joint venture
- ✓ Clear guidelines on the products, services and intellectual property developed by the joint venture
- ✓ Confidentiality agreement
- ✓ Resolution processes on disputes between parties
- ✓ Exit strategy and termination procedures

Non-financial alliances

Non-financial alliances are mutually beneficial partnerships between corporations and inclusive businesses that fulfill the following criteria:

- **Strategic alignment:** The inclusive business's products or services align with the corporate's core business, thereby facilitating sharing of strategic insights that empower both the inclusive business and the corporate.
- **Financial benefits:** The alliance provides financial returns for the corporate and the inclusive business, either by reducing existing operating costs or by increasing revenues. Examples of measures providing enhanced returns include more last-mile distribution points, strategic additions to the supply chain and expanded product or service portfolios.
- **Social value creation:** Low-income communities benefit from affordable, market-based poverty solutions generated by the alliance. Renewable energy products, sanitation solutions, financial inclusion, accessible health care and communication solutions are a few examples of social impact created by CIV non-financial alliances.[16]

Non-financial alliances include a written agreement such as a MOU or contract and are generally administered by the business unit that aligns most closely to the inclusive business's core business. Coca Cola and SolarKiosk's strategic partnership on the EKOCENTER kiosk is an example of a non-financial alliance (see case study 4).

16. Acumen and Business Fights Poverty (2015). *Social Enterprises and Global Corporations: Collaborating for growth with impact*; Volans Ventures Ltd (2014). *Investing in Breakthrough: Corporate Venture Capital*; World Business Council for Sustainable Development (2013). *Scaling Up Inclusive Business*

Case Study 5

Clean Team Ghana

Clean Team Ghana provides affordable, hygienic toilets to rural communities in Ghana. The social enterprise is the result of a joint venture between Unilever and Water and Sanitation for the Urban Poor (WSUP), which they formed after Unilever conducted feasibility studies on portable toilets in India and discovered an untapped market opportunity at the BoP.

Unilever found an expert partner in WSUP and together they developed a viable business model. Although Unilever has since sold its share of Clean Team Ghana, the corporate still benefits financially from selling its branded toilet cleaner with the portable toilets. As of 2015, Clean Team Ghana had sold 2,500 toilets, employed more than 40 staff and benefited 17,500 people.

A Clean Team Ghana employee on his rounds servicing portable toilets in Ghana

Source: TheGround_Up Project

CIV Cycle

The investment life cycle for CIV closely mirrors the four-stage cycle for traditional corporate venturing: establish strategy, identify investees, implement the investment or partnership and realize returns. One key difference with CIV is that social impact analysis is integrated into the full investment cycle, from the selection of inclusive business investees to the final exit strategy.

Box 4

Measuring Social Impact

Measuring social impact is not within the scope of this report but there is extensive literature available that can assist in assessing the social impact of CIV activities. Resources include:

- *Measuring socio-economic impact – A WBCSD guide for business (2013) WBCSD.*
- *Proving and improving the impact of development partnerships - 12 good practices for results measurement (2013) Endeva*
- *Policy Brief on Social Impact Measurement (2015). OECD*
- *Measuring and Improving Social Impact: A guide for nonprofits, companies, and impact investors (2014). Marc J. Epstein and Kristi Yuthas*
- *IRIS (https://iris.thegiin.org/). IRIS is an online catalogue of industry-accepted impact metrics for investments and is managed by the Global Impact Investing Network*

Establish strategy

Before engaging in CIV, it is important to define the corporate's objectives and desired outcomes. This will help establish a clear strategy and identify the right model. Corporations should consider the geographic focus of investment, the business stage of the inclusive business, the range of the investment amount, the use of intermediaries and whether to seek other strategic partners to co-fund investments. The strategy should not only detail how the venture will generate a social impact but also how that impact will be measured. The Pearson Affordable Learning Fund, for instance, has a strategy to invest in inclusive businesses associated with the education sector in Africa and South Asia. Pearson usually invests between US$2–3 million in Series A rounds and takes equity stakes of between 20 percent and 45 percent. Although CIV can take place at any stage of the inclusive business's development, the risk tolerance of the corporate determines at what stage it is prepared to invest. This also depends on the investee's capital needs as well as its ability to absorb the investment. When establishing strategy, the appropriate model of corporate impact venturing is selected and intermediaries, if needed, are sourced. The various models of CIV strategic alliances and CIV capital are discussed in greater detail in section three. Based on the results of its strategy development, a corporate can start identifying potential investees.

Identification

Corporations identify potential inclusive businesses through incubators, accelerators, NGOs, calls for applications, online platforms and intermediaries. After the initial identification period, corporations or their intermediaries short-list the most viable inclusive businesses and conduct due diligence along with an in-depth market analysis. Ultimately, the needs and objectives of both the corporate and the inclusive business must match, as must the assets they bring to the partnership. Close alignment will not only maximize the corporate's strategic returns; it will also attract high-caliber inclusive businesses keen to tap into the corporate's expertise.

Case Study 6

Benesse Corporation and InOpen Technologies

When seeking Series A funding, InOpen Technologies, an India-based provider of computer science education solutions for K-12 schools, appointed Unitus Capital to assist in the search. Unitus Capital is an investment advisor focusing on the base of the pyramid. InOpen Technologies was an ideal match for the Japanese education company. Benesse Corporation who was searching for a partner to develop products for the global education market.

Benesse made the equity investment from the Benesse Social Investment Facility, a fund established in 2013 with US$15 million initial Benesse capital to invest in companies focused on solving social issues in education, child care and other related fields in emerging Asian countries and Japan. With the assistance of Benesse's CIV capital investment, InOpen Technologies has expanded and provides content in eight Indian languages and two international languages to more than 500,000 students in 200 private schools across India.

Implementation

Once an inclusive business is deemed suitable, negotiations start. Depending on the structure of the venture, the corporate, oversight committee or the general partners of the fund make the final investment decision. If applicable to the venture, the inclusive business's payment to the corporate or the fund is negotiated for when the project comes to fruition. For the majority of corporate impact venture capital examples examined in this report, the investment was an equity investment with a minority stake. The partners draft a term sheet with the conditions for financing, share price, anti-dilution provisions, liquidation preference, debt ceiling and voting rights. Some corporations include a seat on the inclusive business's board of directors as a condition of their investment or partnership. This stage also involves continuous sharing of non-financial resources such as skilled staff and continuous training and mentorship. By closely monitoring and evaluating the investee, the corporate extrapolates key strategic learnings and incorporates them into its core business. For example, after its initial partnership with SolarKiosk, Coca Cola saw the opportunity to build on the business model by using EKOCENTERs for its "Ripple Campaign", a marketing campaign that provided a small percentage of beverage sales' revenues to communities that had an EKOCENTER.

Realize Returns

As inclusive business models often take up to ten years to realize financial returns, there are very few examples of corporate impact venture exits. The strategic and social return dimensions of CIV may also incentivize investors to hold on to shares far longer than is customary in traditional corporate venture capital. Corporations may also chose to absorb and scale a successful inclusive business model internally, rather than exiting the venture. If a corporate decides to exit its inclusive business investment, it can adopt one of a variety of exit strategies drawn from venture capital models:

Mergers and acquisitions: For corporations that have realized significant strategic returns, acquisition may be a logical and profitable exit strategy. For many corporations, the ultimate goal of CIV is to integrate innovative and profitable inclusive business models into the corporation. Mergers and acquisitions by other corporations are the most common exit strategies among venture firms.[17]

Redemption: This option allows the inclusive business investee to purchase back the corporate's stock at a pre-appointed premium.

Initial public offering (IPO): As most inclusive businesses operate in countries without stock markets, IPO exits are expected to be rare in the field of CIV. However, the emergence of social stock exchanges such as the UK's Social Stock Exchange, and the Toronto-based Social Venture Connexion offer innovative platforms for IPO exits.

For both the M&A and the IPO exit solution, both partners have to take care that the mission of the inclusive business can remain intact.

17. In conventional venture capital, mergers and acquisitions represent a greater number of liquidity events in comparison to IPOs. In 2006, mergers and acquisitions accounted for $16.7 billion USD exits while IPOs only accounted for $5.1 billion USD in the venture capital sector.

Spotlight

The roles of intermediaries

Intermediaries can be important partners for corporations throughout the CIV cycle, particularly for firms new to the field. Intermediaries include venture philanthropists, impact investment firms and impact investment advisers.

Venture Philanthropists: Venture philanthropy has grown considerably throughout Europe in the past decade; there are over 180 venture philanthropy organizations in 25 countries registered with the European Venture Philanthropy Association. Venture philanthropy is the provision of financial instruments and organizational capacity building to both non-profits and for-profit startups. Venture philanthropists fund and help trial and scale up social innovations by providing entrepreneurial and management assistance. As many venture philanthropy organizations include former private sector players, venture philanthropists leverage extensive networks of outside expertise. Venture philanthropists also assist inclusive businesses to identify corporate partners. In 2013, the Indian inclusive business InOpen Technologies partnered with Unitus Capital to identify a suitable corporate investor. Unitus Capital liaised with various potential investors until finally obtaining Series A funding from the Japanese education giant Benesse Corporation. Empowered by Benesse expertise and funding, InOpen Technologies is now scaling its computer science learning platform across India and into foreign markets.

Impact Investment Firms: Impact investment firms operate similarly to conventional investment firms apart from their additional expectations of social or environmental returns. Shareholders in impact investment firms recognize the long-term nature of inclusive business returns. Although rare, impact investing may also use either company or shareholder expertise to foster greater growth in investees. There are already several examples of corporations employing impact investment firms to assist with due diligence and structuring the investment terms for corporate impact venture initiatives.

Impact Investment Advisers: Impact investment advisers conventionally provide three streams of services: strategy consulting, incubation models and investment mechanisms. These organizations may be for-profit or non-profit entities that can help assemble a potential investee portfolio for corporations. Although there are only a few examples of firms engaging impact investment consultants for CIV, this dearth of examples could be partly attributable to the small number of impact investment advisers. However, these intermediaries will continue to play a vital role building the field's ecosystem.

Building and enabling environment

As CIV is an emerging field, critical structures to facilitate these collaborations are not yet in place.

Challenges for corporates

These challenges can be broadly grouped into three general categories: lack of know-how, difficulty identifying viable investees and a scarcity of supporting structures.

Lack of know-how

CIV with inclusive businesses is a rather new phenomenon, and early experiences still need to be analyzed to draw out learnings. Moreover, the relevant literature is divided across impact investing, inclusive business and venture capital, which slows the accumulation of insights. With few examples of exits or contending literature to draw from, corporations may struggle to attain executive buy-in when faced with the long-time horizons and the "unknowns" of CIV.

Difficulty identifying viable investees

Identifying scalable and commercially viable inclusive businesses is one of the key difficulties corporates encounter when considering CIV. Inclusive businesses at the BoP may lack the visibility to be noticed by multinational firms. For inclusive businesses, securing initial seed funding and growing to a stage where it can further scale and absorb additional capital are major challenges. Consequently, there are a limited number of inclusive businesses currently in a position to receive corporate impact venture capital. In 2014, the J.P. Morgan impact investor survey identified the "lack of appropriate capital across the risk/return spectrum" and the "shortage of high-quality investment opportunities with track record" as the most limiting characteristics of the impact investing market.[18]

18. J.P. Morgan & Global Impact Investing Network (2014). *Eyes on the Horizon: The Impact Investor Survey*

Lack of supporting structures

Internal and external support structures must be adapted to meet the unique demands of CIV with inclusive businesses in BoP markets. Internal structures include investment capabilities through either direct funds or third-party funds such as Schneider Electric's Energy Access Ventures Fund. Corporations must also have strategic business teams capable of integrating innovation gains from inclusive business ventures, in the same way as technology companies effectively extract innovations from their investee startups. The lack of accessible and salient external support structures (such as intermediaries and investment tools) is also a key barrier. Without external actors and appropriate means, corporations with little experience in venture capital often struggle to implement successful investments.

Facilitating CIV

In order to address the key challenges facing CIV with inclusive businesses, an enabling environment should be fostered through increased research, greater support structures and encouraging development of viable—and visible—inclusive businesses.

Establish accessible information

Once there is an established history of CIV cases and successful exit examples, think tanks and corporate research entities will be able to provide accessible know-how to interested corporations. Key research areas include, but are not limited to: efficient investment models to maximize returns with minimal inputs; benefits and drawbacks of using intermediaries; internal support structure models; well-defined and agreed ways to conduct due diligence; and evaluation frameworks that reflect the three-fold objectives of financial, social and strategic returns. In addition, further research is needed to improve models in order to maximize strategic and social returns and to develop ways to measure those returns. Such assessment tools would help companies decide when to engage in CIV rather than establishing their own inclusive business. An industry standard on what "impact" constitutes also needs to be developed so investors can commit to reporting against consistent social deliverables in addition to standard financial reporting. Peer-learning could be accomplished through collaborative workshops where companies share and acquire insights.

Build intermediary capacities

Only a small handful of intermediaries that cater to CIV with inclusive businesses provide external support structures. However, intermediaries can adapt their models and service offerings in order to interface between corporations and inclusive business investees. For corporations with limited internal capacity or resources, intermediaries are ideally positioned to conduct research, manage due diligence, evaluate the commercial potential of an inclusive business start up and deliver investment-ready innovations. Intermediaries need to develop the capacity to provide a strategic fit both for corporations and for inclusive businesses.

Design adequate investment instruments

CIV also requires alternative investment instruments for corporations unable to set up internal or external funds. Risk-sharing instruments should be explored to incentivize firms with low risk tolerance. These instruments would diffuse risk as banks or impact investors co-invest with the corporate. Impact investors and CIV capitalists could also partner in an external fund model in order to disperse risk, maximize social impact but not detract from the firm's strategic returns. Corporations could benefit from impact investors' ability to identify investees with a social impact potential as well as matrices to measure and quantify impact. Impact investors will profit from the non-financial resources the corporate will offer the inclusive business, potentially increasing financial returns.

Improve match-making facilities

CIV partnerships could be facilitated through databases such as the Inclusive Business Accelerator or India's Artha Platform, both online platform that connects impact investors, donors and social enterprises. Incorporating CIV into existing online investment platforms would (a) help identify investment-ready inclusive businesses and (b) enable syndication between different parties, allowing them to pool resources, share risks and maximize impact at the BoP.

Inclusive businesses that are scalable, socially beneficial and financially profitable do exist – and often need partners to grow and multiply their impacts. At the same time, corporations need to innovate and establish footholds in emerging markets. CIV presents an exciting vehicle for empowering both these actors to achieve their financial, social and strategic objectives. By building knowhow and supporting institutions, intermediaries, impact investors, impact investment advisors and corporates themselves can nurture and expand this promising approach.

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