

**ILE COMPETITION
AND COMPANY LAW
JOURNAL**

VOLUME 1 AND ISSUE 1 OF 2023

INSTITUTE OF LEGAL EDUCATION



ILE Competition and Company Law Journal
(Free Publication and Open Access Journal)

Journal's Home Page – <https://cclj.iledu.in/>

Journal's Editorial Page – <https://cclj.iledu.in/editorial-board/>

Volume 1 and Issue 1 (Access Full Issue on – <https://cclj.iledu.in/category/volume-1-and-issue-1-of-2023/>)

Publisher

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Chairman of Institute of Legal Education (Established by I.L.E. Educational Trust)

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REVOLUTIONIZING SOCIAL SECTOR FINANCING IN INDIA: A COMPREHENSIVE ANALYSIS OF THE FRAMEWORK FOR SOCIAL STOCK EXCHANGE IN INDIA

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Best Citation – Prakash Chandra Dhundhwal,
REVOLUTIONIZING SOCIAL SECTOR FINANCING IN
INDIA: A COMPREHENSIVE ANALYSIS OF THE
FRAMEWORK FOR SOCIAL STOCK EXCHANGE IN
INDIA, *ILE Competition and Company Law
Journal*, 1 (1) of 2023, Pg. 01-09, ISBN - 978-81-
961120-6-6.

ABSTRACT

The social sector in India plays a vital role in serving the underprivileged sections of society. India is home to millions of social organisations working across various sectors to create positive impact at the grassroots level. India's rapid economic growth coupled with the growing global trend for socially and environmentally responsible business practices has brought about a significant transformation in the social sector funding in the country, through philanthropic grants as well as new-age instruments such as impact investing. However, despite the exponential growth in social financing, the social sector still faces various hurdles and challenges relating to access to finance. Thus, the Ministry of Finance has proposed to set up Social Stock Exchange (SSE), a funding platform for social enterprises and non-profit organisations, under the regulatory ambit of the Securities and Exchange Board of India. In this article, the author attempts to comprehensively discuss and evaluate the framework notified by SEBI for setting up the SSE in the backdrop of India's social sector landscape. The author explores the evolution of the concept of SSE and its need in the Indian scenario, followed by a detailed analysis of the framework and funding instruments notified by the SEBI. Further, the

article, in addition to examining shortcomings of the Indian model of the SSE, analyses the features that set it apart from its global counterparts. Finally, the author concludes the article by suggesting that whether the SSE will prove as a moonshot for the social sector or not is a question of time, but it is certainly a landmark step.

Keywords: Social Stock Exchange, SEBI, Alternative Investment Fund, SSE, Social Sector

INTRODUCTION

On July 25, 2022, SEBI set the stage for the transformation of India's social sector by notifying the framework for establishing a Social Stock Exchange (hereinafter referred to as "SSE") in India. The idea of an electronic fundraising platform to help social organisations raise capital through debt, equity, and mutual funds was proposed by Finance Minister Nirmala Sitharaman in her 2019-2020 budget speech.¹ Prompted by the budget speech, the Securities and Exchange Board of India ("SEBI") constituted a working group to make recommendations on a possible mechanism for the SSE,² and subsequently, a technical group, which submitted its report providing the framework for enlisting social organisations on the SSE, necessary reporting and disclosure requirements and recommendations on other aspects such as social audits, information repositories, etc.³ The framework recommended by the working and the technical groups to set up the SSE and create an enabling environment for accelerated progress in the social impact sector was notified by SEBI on July 25, 2022, amending three

¹ Minister of Finance Nirmala Sitharaman, "Budget 2019-2020, Speech of Nirmala Sitharaman" (Budget 2019-2020, July 2019) <https://www.indiabudget.gov.in/budget2019-20/doc/Budget_Speech.pdf> accessed 18 October 2022.

² Securities Board of India ["SEBI"], "SEBI constitutes working group on 'Social Stock Exchanges' (SSE)" (19 September 2019) <https://www.sebi.gov.in/media/press-releases/sep-2019/sebi-constitutes-working-group-on-social-stock-exchanges-sse_44311.html> accessed 28 October 2022.

³ SEBI, "SEBI seeks public comments on the Report Submitted by the Technical Group on Social Stock Exchange" (6 May 2021) <https://www.sebi.gov.in/media/press-releases/may-2021/sebi-seeks-public-comments-on-the-report-submitted-by-the-technical-group-on-social-stock-exchange_50072.html> accessed 12 November 2022.



different regulations- Securities And Exchange Board Of India (Alternative Investment Funds) Regulations, 2012, Securities And Exchange Board Of India (Issue Of Capital And Disclosure Requirements) Regulations, 2018 and Securities And Exchange Board Of India (Listing Obligations And Disclosure Requirements) Regulations, 2015.⁴

Before exploring the concept of SSE, it becomes imperative to understand the broader concepts of the social economy, such as social enterprises, social financing and impact investments. Social Enterprises and Social Financing are hybrid concepts as they involve the intersection of historically conflicting notions of business and social welfare. Unlike conventional businesses, where profit-making is the primary objective⁵, a social enterprise is a business where the main goal is social welfare rather than maximising profits.⁶ There is no single legal form for SEs; they operate in diverse legal forms, ranging from private limited companies, partnership firms, and limited liability partnerships to trusts and societies.⁷ With the increasing trend of socially, economically and environmentally responsible business practices, new hybrid corporate forms such as L3C, flexible purpose, social purpose and benefit corporations have evolved in the US, UK and other countries.⁸ Therefore, to not hinder the evolution of such hybrid forms in India, the Working Group of the SEBI has abstained from

prescribing a legal definition and recommended that any enterprise, irrespective of its legal form, can be classified as a social enterprise if it commits to the minimum reporting standard.⁹ The report broadly categorises Social Enterprises into two categories- for-profit enterprises ("FPE"), which can raise equity, and non-profit organisations ("NPO"), which cannot raise equity.¹⁰ FPEs include sole proprietorships, partnerships, limited liability partnerships, private firms and co-operatives, whereas NPOs include trusts, societies and charitable organisations registered under Section 8 of the Companies Act (2013).¹¹

EVOLUTION OF SOCIAL STOCK EXCHANGES IN THE GLOBAL SCENARIO

While there has been tremendous growth in the sphere of impact investing in the last two decades, its accessibility has largely remained limited to high net-worth individuals, families and foundations and beyond the reach of small/retail & non-accredited investors.¹²

Due to the rising interest in democratising impact investing and bringing it within reach of a broader set of investors, the creation of Social Stock Exchanges, regulated funding platforms that operate just like conventional stock exchanges and where shares, bonds, and other financial instruments are issued by or for social enterprises are listed and traded,¹³ is proposed.

Thus, a number of initiatives to launch SSEs have been taken up in various parts of the world, such as the Socio-Environmental

⁴ SEBI (Issue Of Capital And Disclosure Requirements) (Third Amendment) Regulations, 2022, SEBI (Listing Obligations And Disclosure Requirements) (Fifth Amendment) Regulations, 2022, and SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022.

⁵ Ronald F. Duska, *Contemporary Reflections on Business Ethics* (Springer Netherlands 2007) 41.

⁶ Briana Cummings, 'Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest' (2012) 112(3) *Columbia Law Review* 578 <<https://www.jstor.org/stable/23238440>> accessed 17 November 2022; Department of Trade and Industry, Great Britain, *Social Enterprise: A Strategy for Success* (2002) 13 <<https://webarchive.nationalarchives.gov.uk/20050301215355/http://www.sbs.gov.uk/content/socialenterprise/documenta.pdf>> accessed 28 October 2022.

⁷ British Council, 'The State of Social Enterprise in India' (2016) 13 <https://www.britishcouncil.org/sites/default/files/bc-report-ch4-india-digital_0.pdf> accessed 27 July 2022.

⁸ Robert T. Esposito, 'The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation' (2013) 4(2) *Wm. & Mary Bus. L. Rev.* 639 <<https://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=1060&context=wmbllr>> accessed 30 October 2022.

⁹ SEBI, 'Working Group Report on Social Stock Exchange' (1 June 2020) 20 <https://www.sebi.gov.in/reports-and-statistics/reports/jun-2020/report-of-the-working-group-on-social-stock-exchange_46751.html> accessed 5 November 2022.

¹⁰ *ibid* 16.

¹¹ Mir Shahid Satar, 'A Policy Framework for Social Entrepreneurship in India' (2016) 18(9) *IOSR-JBM* 30 <<http://www.iosrjournals.org/iosr-jbm/papers/Vol18-issue9/Version-1/E1809013043.pdf>> accessed 17 November 2022.

¹² C Kleissner and J. Kleissner, 'Introduction: Investment Ideas and Examples for Changing the Financial System (A Personal Approach to Systemic Change)' in K. Wendt (ed), *Positive Impact Investing* (Springer 2018) xi.

¹³ D Shahnaz, R Kraybill and LM Salamon, 'Social and Environmental Exchanges' in LM Salamon (ed), *New Frontiers of Philanthropy: A Guide to New Tools and Actors Reshaping Global Philanthropy and Social Investing* (OUP 2014) 157.



Investment Exchange (BVSA) in Brazil, the Social Stock Exchange (SSX) in the UK, and the Impact Exchange (IX) in Singapore, each having different features and characteristics. Although structural and regulatory challenges excruciated the early attempts of launching SSEs, more so owing to their social-financial hybridity, the world has realised the potential and the importance of SSEs for social sector funding by connecting social enterprises with social investors.

STATE OF THE SOCIAL SECTOR IN INDIA AND THE NEED FOR SSE

India's social sector is growing very fast. Domestic philanthropy has quadrupled in eight years, from Rs. 12,500 crores in 2010 to Rs. 55,000 crores in 2018.¹⁴ Apart from philanthropic grants, newer forms of social financing, such as impact investments, have also embarked. The Global Impact Investing Network ("GIIN") defines impact investment as "*investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return*".¹⁵ The advent of impact investment marks a monumental shift from existing socially conscious investing frameworks as it shifts the focus of decision-making from limiting harms to creating positive impacts.

However, despite the promising prospects in the social sector, India alone constitutes more than 20% of the global performance gap in 10 out of 17 Sustainable Development Goals (SDGs) and more than 10% in 6 of the remaining 7 SDGs.¹⁶ As per the India Philanthropy Report 2020, the progress and philanthropic spending in social development in India has been inequitable, both sector-wise and geographically. For

example, despite India's good score in education, it gets one-third of the domestic philanthropy and CSR funds. In contrast, the gender equality sector, where its performance is adjudged as very poor, receives just 1% of the funds.¹⁷ Similarly, there is a massive difference of 20% between the SDG ratings of the best and the worst performing States.¹⁸

Further, according to a report of the British Council, access to finance is the major constraint for around 86% of social enterprises. In contrast, only 10% of the mainstream businesses face such difficulties.¹⁹ Social enterprises identify access to finance as the most significant barrier to their growth plans, such as expanding to new geographical areas and developing new products and services.²⁰

The lack of data on social sector expenditure in India acts as another major hindrance to better decision-making by philanthropic funders, which adversely affects the growth of the social sector. Due to the lack of precise and up-to-date information on funding and outcomes, it becomes challenging for funders to target their resources and partner with other players working in the same area.²¹ Owing to the vast number of non-profit organisations working across the country²² and the variety of activities they are involved in, it becomes even more challenging to collect data on these organisations. The 2019 OECD report also suggests coordinated and simultaneous measuring of data in the social sector to assess the transformation of philanthropic spending into development outcomes, enable funders to

¹⁴ Dasra and Bain & Company, 'India Philanthropy Report 2020' (2020) 2 <https://www.dasra.org/assets/uploads/resources/India_Philanthropy_Report.pdf> accessed 3 November 2022.

¹⁵ Global Impact Investing Network, 'Annual Impact Investor Survey 2020' (2020) 42 <<https://thegiin.org/assets/GIIN%20Annual%20Impact%20Investor%20Survey%202020.pdf>> accessed 14 November 2022.

¹⁶ Dasra and Bain & Company, 'India Philanthropy Report 2019' (2019) 8 <https://www.bain.com/contentassets/069bf9cf144e4b8bbdda8a85386a5611/bain_brief_india_philanthropy_report_2019.pdf> accessed 7 November 2022.

¹⁷ Dasra and Bain & Company, 'India Philanthropy Report 2020' (n 14).

¹⁸ *ibid.*

¹⁹ British Council, 'The State of Social Enterprise in India' (2016) 19 <https://www.britishcouncil.org/sites/default/files/bc-report-ch4-india-digital_0.pdf> accessed 27 November 2022.

²⁰ *ibid.*

²¹ OECD, 'India's Private Giving: Unpacking Domestic Philanthropy and Corporate Social Responsibility' (2019) 12 <https://www.sdphilanthropy.org/system/files/2019-10/OECD_India_Private_Giving_2019.pdf> accessed 7 November 2022.

²² Utkarsh Anand, 'India has 31 lakh NGOs, more than double the number of schools' *The Indian Express* (Delhi, 1 August 2015) <<https://indianexpress.com/article/india/india-others/india-has-31-lakh-ngos-twice-the-number-of-schools-almost-twice-number-of-policemen/>> accessed 30 November 2022.



target their resources in specific areas and allow cooperation amongst them.²³

The current state of the working of the social sector warrants immediate correction of the flaws entrenched in this sector. Thus, bringing together various traditional and hybrid funding channels on a single platform, enabling new funding mechanisms, developing associated infrastructure such as information repositories and social auditors, and fine-tuning regulatory frameworks and tax policy is the need of the hour for overall progress in the social sector.

FRAMEWORK OF THE INDIA'S SOCIAL STOCK EXCHANGE

The framework approved by SEBI envisions creating an SSE as a separate segment to be housed within the existing stock exchange(s), the Bombay Stock Exchange (BSE), the National Stock Exchange (NSE) or both, to deploy fundraising instruments for social enterprises.²⁴

Funding Instruments for NPOs

Zero Coupon Zero Principal Bonds: Zero Coupon Zero Principal Bonds, which will be listed on the SSE, would help NPOs raise funds for specific social projects.²⁵ These bonds will have a tenure equal to the project's duration, and after the tenure is over, the funds will not be returned to the investor but will be written off the investee's books.

Social Impact Funds (SIF): SIF are Category I Alternative Investment Fund (AIF) wherein investment is made into securities, units or partnership interest of social ventures and securities of NPOs as well as social enterprises which follow the social performance norms set out by the fund.²⁶ NPOs can use them as 'grants-in, grants-out vehicles' to raise funds using "social units" issued by a social impact fund or through schemes run by a social impact fund for investors who have committed to

receive only social returns or benefits and no financial returns against their investment.²⁷

Mutual Funds: This model is similar to conventional closed-ended Mutual Funds with the difference that the returns on the investments are to be used to fund NPOs and would be considered as donations from the investors.²⁸ Existing Asset Management Companies (AMCs) can act as fund managers/intermediaries under this model.

Funding Instruments for FPEs

As discussed earlier, unlike NPOs, FPEs can raise equity. Thus, in addition to the structures recommended for NPOs, FPEs would be eligible to list equity on the main board, SME platform or innovators growth platform, subject to fulfilling the listing criteria-as applicable to conventional entities- and social impact reporting requirements.²⁹ Thus, the additional condition of impact reporting will make FPE eligible to be listed on the SSE, where conventional for-profit entities cannot be listed.

Recommendations for Overall Sector Development

Apart from lack of funds, the other significant challenges faced by Social Enterprises in India are access to skilled workforce and government regulations.³⁰ Therefore, the Working Group also recommended providing financial incentives to donors and organisations, fine-tuning CSR & other government regulations and encouraging the development of infrastructural institutions like Information Repositories (IRs) and Social Auditors for the overall development of the social sector in the country.³¹

The Working Group observed that while CSR expenditure on some sectors like rural development and skill development qualifies for

²³ OECD, 'India's Private Giving' (n 21) 24.

²⁴ SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 [ICDR Regulations 2018], Regulation 292A(i).

²⁵ ICDR Regulations 2018, Regulation 292J.

²⁶ SEBI (Alternative Investment Funds) Regulations 2012 [AIF Regulations 2012], Regulation 2(tb).

²⁷ AIF Regulations 2012, Regulation 2(td).

²⁸ ICDR Regulations 2018, Regulation 292(G)(a)(ii).

²⁹ ICDR Regulations 2018, Regulation 292(G)(b).

³⁰ Usha Ganesh and others, 'The Indian Social Enterprise Landscape: Innovation for an Inclusive Future' (2018, Bertelsmann Stiftung) 13 <https://www.bertelsmann-stiftung.de/fileadmin/files/user_upload/201810_The_Indian_Social_Enterprise_Landscape_Study_EN.pdf> accessed 26 November 2022.

³¹ SEBI, 'Working Group Report on Social Stock Exchange' (n 9) 33.



tax exemption under the IT Act, 1961³², CSR spending on other sectors is barred from being deducted from taxable income. It creates a disparity in funding between different sectors. Therefore, the Working Group recommended that Corporations be allowed to deduct all CSR expenditures from their taxable income to reduce the sector-level disproportionality in funding. Other recommendations on CSR include allowing companies to use CSR funds to fund NPOs via the SSE and developing a platform for companies to trade their CSR funds with other companies. These recommendations are under the consideration of the Ministry of Corporate Affairs.³³

SEBI has also recommended a 100% tax exemption for all investments made in SSE instruments and donations made to NPOs with 80G Certificates. Currently, contributions made to NPOs under 80G are eligible for only a 50% tax exemption, whereas donations to government entities qualify for a 100% exemption. Further, with respect to various certifications like 12A, 12AA and 80G, SEBI believes that they should be replaced by the minimum reporting standard under the SSE, which will evolve into a more rigorous standard in the long run. The tax related recommendations are under the consideration of the Department of Revenue.³⁴

Following the Working and Technical Group Reports, SEBI has also taken up the matter of establishing an INR100 Crore Capacity Building Fund with NABARD and SIDBI for overall sector development for organising Information Repositories, implementing reporting standards for Social Enterprises, raising awareness and getting Social Enterprises on board the SSE.³⁵

LEARNINGS FROM GLOBAL EXPERIENCES

SSE is a new concept in social funding, with its origin dating back to 2003, when Brazil

established its Socio-Environmental Impact Exchange, called Bolsa de Valores Sociais (BVSA).³⁶ Since then, many countries have developed different models of SSEs, either as a matchmaking platform or as alternative investment instruments on existing stock exchanges.³⁷ However, out of the seven key SSEs, only three - Canada, Jamaica and Singapore - are active. The remaining four, i.e., Brazil, Portugal, South Africa, and the UK, could not sustain themselves for various reasons such as failure to generate income, inability to cover operational costs and lack of scale and sustainability.³⁸ Thus, it becomes imperative for India to analyse limitations in different models of SSEs and learn from their experience before devising its model.

A. Comprehensive Solution for both NPOs and FPEs

Most developing countries, such as Brazil and South Africa, do not allow investors to earn financial returns on investments made in SSE.³⁹ Whereas developed countries, on the other hand, intend to preserve the ability of a traditional stock exchange to trade in securities and earn financial returns in their SSEs too.⁴⁰ Thus, their emphasis is on FPEs, which can provide both economic and social returns. For example, the UK Social Stock Exchange allows listing only after the Enterprise has been listed on the London Stock Exchange.⁴¹

³⁶ SVR Galina, PCPW Rebehy, LMC Carvalho, 'Determinants of Attractiveness in Social Stock Exchange' (2013) 3 J. Mgmt. & Sustainability 157

<<https://heinonline.org/HOL/LandingPage?handle=hein.journals/jms3&div=66&tid=&page=>> accessed 12 November 2022.

³⁷ Bandini Chhichhia, 'Social Stock Exchanges - Innovative Financing for International Development' (2014) 7 Social Justice 4 <https://ecommons.luc.edu/cgi/viewcontent.cgi?article=1006&context=social_justice> accessed 18 November 2022.

³⁸ International Centre for Not-For-Profit Law (ICNL) and Samhita Social Ventures, 'Creating a Truly "Social" Stock Exchange' (2021) 3 <<https://www.samhita.org/wp-content/uploads/2021/03/India-SSE-report-final.pdf>> accessed 4 December 2022.

³⁹ Principles for Responsible Investment, 'Mobilizing Capital for Impact' (2018) <<https://www.unpri.org/sustainable-financial-system/innovating-stock-exchanges-to-mobilize-capital-for-impact/3600.article>> accessed 17 November 2022.

⁴⁰ ICNL and Samhita, 'Creating a Truly "Social" Stock Exchange' (n 31) 14. ⁴¹ Nicole Motter, 'Stock Exchanges for Social Enterprises? Here's Where You Can Find Them' *Forbes* (27 March 2014)

<<https://www.forbes.com/sites/ashoka/2014/03/27/stock-exchanges-for-social-enterprises-heres-where-you-can-find-them/?sh=421a5e214e5a>> accessed 9 December 2022.

³² Income Tax Act 1961, s 35AC, 35CCA and 35CCD.

³³ SEBI, 'Regulatory Framework for Social Stock Exchange' (24 February 2022) 3 <https://www.sebi.gov.in/sebi_data/meetingfiles/feb-2022/1645691296343_1.pdf> accessed 23 November 2022.

³⁴ *ibid.*

³⁵ *ibid.*



Given the large number of NPOs and their pivotal role in providing basic necessities to the underprivileged sections of the society, introducing an SSE that does not take NPOs on board would be futile. On the contrary, impact investing, which focuses on both social and financial returns simultaneously, is also thriving in India, with a Compound Annual Growth Rate (CAGR) of 26% in the past decade.⁴² Thus, the decision to house both NPOs and FPEs in the Indian SSE is a step in the right direction.

SSE 2.0: Beyond a Matchmaking Platform

SSEs around the world differ from each other in several ways. While the UK SSE serves as an information provider only, the South African and Brazilian SSEs function as mere online matchmaking platforms.⁴³ The SVX in Canada, on the other hand, operates only for institutional investors.⁴⁴ On the contrary, the Indian model not only provides comprehensive solutions, including alternate funding instruments for both NPOs and FPEs but goes beyond a simple matchmaking platform in many ways.

Given the problems that run deep into the Indian social sector, a matchmaking platform would not serve its intended purpose unless other multi-dimensional measures support it.

The Indian SSE focuses on creating a positive investment ecosystem in the social sector through multi-dimensional policy and regulation interventions, developing and promoting infrastructural institutions like information repositories & social auditors. A capacity-building fund of INR 100 Crores is also proposed to be set up to assist organisations in meeting reporting requirements and promote

and raise awareness about the SSE and the funding instruments available therein.⁴⁵ Thus, the Indian model goes beyond matchmaking to create a positive social investment environment by addressing the deep-seated predicaments present in the social sector.

CHALLENGES & SHORTCOMINGS IN THE INDIAN FRAMEWORK

A. Stringent Listing Requirements

Stringent listing requirements are necessary to ensure that only bonafide NPOs and FPEs that create measurable social impact can access the SSE. A significant proportion of NGOs operating in India are fake or misleading and have little to no impact on the ground. For instance, according to the Women and Child Development Ministry, 90% of the NGOs applying for grants under its skill development training scheme for women were found to be fake.⁴⁶ Additionally, the Government has identified around 19 thousand organisations between 2011 to 2019 which were found to be misusing foreign funding.⁴⁷

Globally, there is no uniformity in eligibility criteria set for listing on the SSEs. A social business must have a primarily social purpose in order to qualify for listing on the South African and Singaporean impact exchanges.⁴⁸ In the case of the UK, social or environmental impact need not be the primary purpose, but it must be a core aim of the company.⁴⁹ Canada's SVX requires social businesses to have revenue between \$50,000 to \$25 million and a

⁴² Impact Investors Council and Asha Impact, 'The India Impact Investing Story JUNE 2020 Assessing a Decade of Capital plus Innovation for Impact (2010-2019)' (2020) 11

<https://ashaimpact.com/Admin/CMS/PDF/IIC%20Asha%20Impact%20Report_The%20India%20Impact%20Investing%20Story_June%202020.pdf> accessed 15 November 2022.

⁴³ Dr R Balasubramaniam and Others, 'Roadmap of Social Enterprise Ecosystem as a Precursor for a Viable Social Stock Exchange in India' (Grassroots Research and Advocacy Movement, 2020) 49 <<https://www.nabard.org/auth/writereaddata/tender/0409202831Social%20Enterprise%20and%20Social%20Stock%20Exchange.pdf>> accessed 8 December 2022.

⁴⁴ *ibid* 51.

⁴⁵ SEBI, 'Working Group Report on Social Stock Exchange' (n 7) 33.

⁴⁶ Press Trust of India, 'WCD Ministry detects fake NGOs applying for funds under 'STEP'' *Business Standard* (New Delhi, 2 April 2022)

<https://www.business-standard.com/article/pti-stories/wcd-ministry-detects-fake-ngos-applying-for-funds-under-step-115040200814_1.html> accessed 24 November 2022.

⁴⁷ Dr. Satyapal Singh, 'Discussion on the motion for consideration of the Foreign Contribution (Regulation) Amendment Bill, 2020'(Seventeenth Lok Sabha Debate)

<<http://164.100.47.194/Loksabha/Debates/Result17.aspx?dbsl=4735>> accessed 30 November 2022.

⁴⁸ Bandini Chhichhia, 'The Rise of Social Stock Exchanges' (*Stanford Social Innovation Review*, 2015) <<https://doi.org/10.48558/1BJN-2679>> accessed 28 November 2022.

⁴⁹ Sarah Dadush, 'Regulating Social Finance: Can Social Stock Exchanges Meet the Challenge?' (2015) 37(1) *University of Pennsylvania Journal of International Law* 194

<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2574921> accessed 22 November 2022.

satisfactory company rating through GIIRS, a third-party private standard setter.⁵⁰

In the Indian context, the Technical Group had made detailed recommendations regarding onboarding of Social Enterprises to the SSE.⁵¹ Both FPEs and NPOs are required to establish 'social intent and impact' as their primary goal through a three-layered filter-

- (i) a Social Enterprise must be engaged in 15 broad areas recognised by the Technical Group,
- (ii) the eligible activities shall target underserved demographic segments or geographical areas, and
- (iii) of all its activities in the past three years, at least 67% shall qualify as eligible activities benefitting the target population, to be ascertained through revenue, expenditure or beneficiaries.⁵²

If an FPE conforms with SEBI requirements for the issuing and listing of equity/debt securities and has established social impact as its primary aim, it can move straight to the SSE for listing. NPOs, on the other hand, also need to show registration certificates and details regarding ownership and control to register on the SSE. Further, as per the minimum fund flow requirements set out by SEBI Circular, an NPO must have annual spending of a minimum of INR 50 lakhs and funding of at least INR 10 lakhs in the past financial year to be eligible for registration on the SSE.⁵³

Although SSEs across the world claim to make access to capital more equitable, analysis of

the size of organisations listed on them indicates something contrary regarding the inclusion of small and less mature organisations. The median revenue of organisations listed on UK, Canadian and South African SSEs is 8.2, 4.7 and 0.7 million USD, respectively.⁵⁴ In the Indian context, although there is no comprehensive study, various surveys suggest that a large proportion of the social organisations operating in the country fall under the small category (having annual revenue of less than INR 1 crore).⁵⁵ Thus, the funding & spending requirements for registration have caused apprehensions that the SSE would only cater to the market-oriented large organisations and will leave behind the small grassroots level stakeholders, broadening the existing disparity in access to capital.⁵⁶ The other side of the coin is that such requirements are necessary to ensure that only legitimate organisations register with the SSE and promote competition amongst the registered organisations.⁵⁷ However, the SSE needs to assess with time whether these requirements are serving their intended purpose and not causing indomitable hurdles and should make appropriate amendments if required.

No Provision on Business Model of the SSE

Decrypting global lessons on the business model of different SSEs around the world is essential to ensure sustainability of the Indian initiative. However, the SEBI has shied away from proposing a revenue model for the SSE. According to a study conducted by Impact Finance Network on Impact Investment Platforms including SSEs, 75% of these platforms did not generate enough revenue to cover their operating costs, whereas 53% could not even

⁵⁰ *ibid* 202.

⁵¹ SEBI, 'Technical Group Report on Social Stock Exchange' (6 May 2021) 10 <https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/technical-group-report-on-social-stock-exchange_50071.html> accessed 13 November 2022.

⁵² ICDR Regulations 2018, Regulation 292(E).

⁵³ SEBI, 'Framework on Social Stock Exchange (SSE)', Circular SEBI/HO/CFD/PoD-1/P/CIR/2022/120 (19 September 2022) 2 <https://www.sebi.gov.in/legal/circulars/sep-2022/framework-on-social-stock-exchange_63053.html> accessed on 25 November 2022.

⁵⁴ ICNL and Samhita, 'Creating a Truly "Social" Stock Exchange' (n 31) 16.

⁵⁵ See Asian Development Bank, 'Overview of Civil Society Organizations: India' (2009) 2

<<https://www.adb.org/sites/default/files/publication/28966/csb-ind.pdf>> accessed 2 December 2022; A Parekh, P Dhingra and R Menon, 'What do nonprofits think of CSR?' *India Development Review* (2022)

<<https://idronline.org/what-do-nonprofits-think-of-csr/#1>> accessed 28 November 2022.

⁵⁶ Amitabh Behar, 'Social Stock Exchange is Yet to Take Off in Any Country' *The Indian Express* (24 September 2022)

<<https://indianexpress.com/article/opinion/columns/importing-a-failed-experiment-6608192/>> accessed 26 November 2022.

⁵⁷ Dadush, 'Regulating Social Finance' (n 42) 189.



finance the costs.⁵⁸ Most of the SSEs established worldwide became inactive after a short period.⁵⁹ Brazil's BVSA, which had been operating for the longest period of 15 years, was dissolved in 2018.⁶⁰ Similarly, the Portuguese SSE was disbanded in 2015 and South African and UK SSEs were dissolved in 2017.⁶¹ The consistent pattern that can be observed amongst failed or underperforming platforms is that most of them are based on either a transaction-fee revenue or a limited-membership model. Both of these models fail to garner a sufficient volume of trading.⁶²

For the Indian SSE, SEBI should have proposed a hybrid revenue model comprising philanthropic and CSR grants, listing charges, and government funding to ensure the initiative's sustainability.

Commercialisation and Mission Drift

Social businesses are considerably different from conventional businesses as well as social organisations, as rather than focusing solely on either profit maximisation or social welfare, a social enterprise employs business principles for achieving social objectives.⁶³ However, this social-financial hybridity can become the reason for mission drift of these enterprises if profit-making takes the front seat in such businesses. Besides, social organisations may also be tempted to give prominence to financial motives such as revenue generation, meeting investors' expectations, and administrative or overhead spendings.⁶⁴ India has already witnessed catastrophic consequences of mission drift induced by under-regulated hybridity in a series of suicides by defaulters of

micro-finance institutions in Andhra Pradesh.⁶⁵ However, SEBI has not proposed any provision to prevent the recurrence of such a crisis, which may be caused due to mission drift of the organisations to be listed on the SSE.

While the SSE encompasses listing requirements to ensure that only credible organisations seeking to make a real impact get listed on the platform, there is no screening mechanism to ensure that only the investors who are committed to social outcomes should have access to the platform. In Canada, the Investor Manual of the SVX regulates investors' conduct to ensure that they remain committed to the social mission. According to the Investors' Manual, only accredited investors who are focused on achieving positive social outcomes can access the SVX.⁶⁶ Further, the SVX is also empowered under its Investor Agreement to suspend or terminate an investor's access to the platform either temporarily or permanently.⁶⁷ On the other hand, the Indian model lack such provision regarding suspension and blocklisting of investors.

The SEBI's rationale behind the decision not to implement such a screening mechanism could be the possibility of such a mechanism acting as a barrier and thereby keeping off a significant portion of potential investors from the platform. However, the SEBI could have also opted for regular progress reports in case of large projects and investor education & sensitisation as an extra safeguard against the risk of mission drift. Thus, social audits remain the only guard against mission drift.

CONCLUSION

The twenty-first century has seen rapid growth in impact investments. The rise of social and green entrepreneurship coupled with the global

⁵⁸ A Scholz, A Selian and B Mohn, 'Impact Platforms: Towards an Interoperable Impact Finance Ecosystem' (2018) 5 and 32 <https://85897-621360-raikfcquaxqncqofqfm_stackpathdns.com/wp-content/uploads/2018/10/Impact-Platforms-Report_Final.pdf> accessed 5 December 2022.

⁵⁹ ICNL and Samhita, 'Creating a Truly "Social" Stock Exchange' (n 31) 20.

⁶⁰ *ibid.*

⁶¹ *ibid.*

⁶² Scholz, Selian and Mohn, 'Impact Platforms' (n 49) 34.

⁶³ K Hockerts, 'Entrepreneurial Opportunity in Social Purpose Business Ventures' in J Mair, J Robinson and K Hockerts (eds), *Social Entrepreneurship* (Palgrave Macmillan, 2006).

⁶⁴ Dadush, 'Regulating Social Finance' (n 42) 179.

⁶⁵ Tara S Nair, 'Microfinance: Lessons from a Crisis' (2011) 46(6) *Economic and Political Weekly* 23-26 <<https://www.jstor.org/stable/27918113>> accessed 19 November 2022.

⁶⁶ SVX, 'Investor Manual' 13

<http://s3.amazonaws.com/svx.production/cms/files/files/000/000/002/SVX_Investor_Manual-original.pdf> accessed 25 November 2022.

⁶⁷ *ibid.* 19.



commitment toward sustainable development calls for a more accessible and transparent impact investment platform. The impact of COVID-19 on the global economy in general and the social sector in particular has further pushed the need for comprehensive reforms to ensure unhampered capital flow in the sector.

While most of the SSEs in operation in different jurisdictions are still struggling to attract capital, SEBI has come up with a unique framework after considering the challenges faced by these SSEs, instead of proposing a direct replica of any existing model. The striking features which set apart the SEBI's model from other SSEs in that it accommodates both FPEs and NPOs, goes beyond a simple matchmaking platform to creating a favourable investment ecosystem through multi-dimensional policy and regulation interventions, and developing infrastructural institutions such as information repositories & social auditors. The flexible funding instruments and innovative frameworks such as the pay-for-success model, simplified regulations, and tax incentives further prepare the ground for greater private sector engagement with the social sector.

SSEs have the potential to resolve the most complicated problem of social enterprises by ensuring accessibility of capital by connecting such enterprises with social investors. However, such a platform must be preserved against market malpractices such as mission drift induced by market pressure, scandalous accounting practices, short-termism, etc. Thus, a well-defined regulatory framework is crucial to ensure the efficacy and sanctity of such platforms.

While vigorous listing requirements and reporting standards are required to forestall the risk of mission drift, it is also essential to ensure that such conditions do not become strenuous for small social enterprises and keep them at bay from the SSE. Thus, there is a need for flexibility in the approach to ensure that regulatory compliances do not create an

onerous burden on social enterprises. SEBI needs to maintain a regular dialogue with the concerned stakeholders and, based on their inputs and suggestions, should tweak the requirements as and when required.

However, there have been apprehensions that we are being over-optimistic of the performance of the SSE, keeping in view the global precedents as well as SEBI's own past experiments, such as the SME platform and the Innovators Growth Platform, both of which failed to garner adequate participation. Ensuring a steady flow of funds and working hand in hand with various agencies and authorities will be an arduous task for the SSE. Formulating comprehensive regulations and policy framework, attracting investors and social enterprises and building their confidence are the principal factors that will determine the platform's success.

Thus, while it would be an exaggeration to say that the SSE can be a panacea for all the challenges the social sector is currently facing, it would be equally wrong to dismiss its importance in its entirety, as instead, the reality is more nuanced than these perceived appearances. The SSE is definitely an important step as the Government, SEBI, private investors and the social sector have come together to achieve this shared objective of bringing market capital to the social sector.