Challenges faced by social entrepreneurs in india

India achieved an average growth rate of 7. 7% from 2002-07; however the dividends of this growth have not trickled down to the bottom of the pyramid (Planning Commission of India 2007). According to UNICEF, 42% of India's population is below the international poverty line of US$1. 25 per day (UNICEF 2005).[1]India's Eleventh Five Year Plan (2007-12) aims to reduce the head-count ratio of consumption poverty by 10 percentage points. However, to solve complex problems such as poverty the government, business and citizen sector need to work together and create innovative solution to pressing problems. In fact, Indian government has recognized the positive impact of citizen sector and has provided increasing levels of funding, under the five-year plans. It is estimated that India has 1. 2 million to 1. 5 million Non-Governmental Organizations (NGOs) operating currently. The purpose of this paper is to highlight the legal, tax and regulatory challenges faced by social enterprises and recommends policy action. The paper is organized as follows: Section II puts forward a definition for social entrepreneur; Section III features two pioneering social entrepreneurs; Section IV focuses on the challenges faced by social entrepreneurs in India; and Section V provides recommendations to counter these challenges.

II. DEFINITION OF SOCIAL ENTREPRENEUR

Social entrepreneurs are not the creation of the modern society. Historically, individuals and groups have combined the concept of entrepreneurship with social value creation to transform a current state of ' unjust equilibrium' for a targeted group of society (Roger and Osberg 2007). For example, Florence Nightingale built the foundation for the modern nursing profession at a time when nursing was not considered a respectable profession and lacked any codes, ethics and formal training. Further, this phenomenon was not limited to the developed world even the developing world had its share of social innovators. In 1920s, Jamnalal Bajal, founding father of a successful Indian enterprise Bajaj Group[2], popularized the importance of business ethics and launched social initiatives to eradicate the malice against ‘ untouchables’ in Indian society. While social entrepreneurs have existed throughout history, the concept of social entrepreneurship is a relatively recent one. Drawing from social entrepreneurship literature, following are five key components of the concept: (1) creating social value that transforms the lives of those who lack the capacity to change the social and economic ecosystem (2) recognizing and capitalizing on the opportunity embedded in the current state of affairs (3) innovating and dislodging the present system of doing things (4) willing to take risk in this process and undeterred by scarcity of resources (5) forging a new, stable equilibrium that uplifts the lives of the targeted group and expanding this cycle to other geographical locations (Peredo and McLean 2006) (Roger and Osberg 2007) (Bolton and Thompson 2004). Having emphasized the social entrepreneurs of the past, it is fitting to draw attention to their modern counterparts.

III. SUCCESS STORIES OF INDIAN SOCIAL ENTREPRENEURS

Vikram Akula, SKS Microfinance

In 2006, Vikram was named by TIME Magazine as one of the world’s 100 most influential people and was awarded Social Entrepreneur of the Year by Schwab Foundation. Vikram recognized that the traditional banking institutions in India failed to reach out to millions of poor due to lack of collateral and high transaction cost; forcing the poor to be trapped in the vicious cycle of small debt-heavy interest by exploitative money lenders.

Vikram launched SKS Microfinance in 1997. SKS Microfinance applies global business best practices to the field of microfinance. It was launched to address a fundamental flaw in microfinance, namely, the inability to scale to large numbers. SKS has overcome this challenge by applying three innovative principles: using a profit-oriented model to overcome capital constraints; leveraging best practices for scaling from the business world to overcome capacity constraint; and using technology to automate processes and lower costs. SKS’ commercial model has led to sustained growth rates of more than 128% and as of November 2009, SKS had US$ 641 million worth of outstanding loans to more than 5. 3 million poor women. SKS Microfinance is a recipient of the Grameen Foundation USA Excellence Award, CGAP Pro-Poor Innovation Award, and Digital Partners SEL Award (SKS Microfinance 2008).

Harish Hande, SELCO

Dr. Harish Hande is widely recognized as an international expert in the field of renewable energy. He is also a recipient of the Social Entrepreneur of the Year 2007 by Schwab Foundation. For him the fact- that 57% of India’s population did not have electricity was an opportunity to create affordable solar light system for the poor. To do so, he formed SELCO and pioneered linkages between technology, financing, energy services, income generation and quality of life. With the help of innovative financing, poor can get access to solar light system and are empowered to improve their quality of life by better education outcomes and additional income through the new found resource. SELCO has reached 80, 000 clients across Karnataka and Kerala, and has recently moved into Gujarat (Schwab Foundation 2007).

These enterprises were, and remain, lucky to attract premier venture capitalists (including Vinod Khosla, founder of Sun Microsystems, and Sequoia Capital) to invest in their ventures. Most of the social enterprises face multiple barriers to entry – access to finance, bureaucratic delays, taxation and so on. The subsequent section elaborates on the challenges faced by Indian social entrepreneurs.

IV. CHALLENGES FACING SOCIAL ENTREPRENEURS IN INDIA

This section draws heavily on the study conducted by Schwab Foundation in 2005; the report “ Fostering Social Entrepreneurship” is based on surveys and interviews of social entrepreneurs in India and other jurisdictions (Schwab Foundation 2007). There are many factors which may potentially enhance or inhibit the development of a social enterprise in a country. These include social attitudes, religious beliefs and prevailing cultural factors. In addition, legal, regulatory and taxation rules will also play an important role. However, this paper focuses on the legal, tax and regulatory barriers as these fall under the direct policy realm and thus can be transformed. Below is a brief description of the key challenges highlighted in this paper:

(a) Forms of establishment and Access to finance: Firstly, lack of standardized legal model for social enterprise is a common flaw in most countries. Secondly, access to finance is often a major issue given the weak business model and the associated risks.

(b) Taxation: While non-profit organizations are exempt from taxes, tax authorities have not come to terms with social enterprises with profit motive.

(c) Bureaucracy/Regulation: Burden of regulation and bureaucracy is often regarded as excessive especially for small and medium scale social enterprises.

Forms of establishment and Access to finance

Indian legal system offers a vast range of legal frameworks to organize economic and social activity. However, there is a lack of a specific coherent legal model for social enterprises. Social enterprises created for charitable or religious purposes or for the promotion of science, literature, education, sports, or fine arts can be registered as charitable and educational societies; trusts; or as companies licensed under section 25 of the Companies Act (1956). On the other hand, the informal institutions that undertake microfinance services as their main activity are generally referred to as micro Finance Institutions (“ mFIs”). (Schwab Foundation 2006)

Any entity can choose a mix of equity, debt and grants (or donations) to further its goals. However, finding venture capitalists and shareholders willing to take on the higher risks involved in a social enterprise is difficult. Further, banks and other financial institutions are averse to granting loans to social enterprises given their low asset base and profit margins. Despite, the above challenges it is the regulation controlling foreign contributions which has been regarded as the biggest hindrance by social entrepreneurs in the survey conducted by Schwab Foundation. Under the Foreign Contribution Regulation Act (1976) (“ FCRA”), no association which has a definite cultural, economic, educational, religious or social programme can accept foreign contributions unless such an association is registered with the Central Government. Further, Central Government registers an entity only after three years of entity's existence. This makes the struggle for survival in the crucial initial years steeper. Lastly, if an entity is not registered with the Central Government, it may accept foreign contribution only after obtaining the prior permission of the Central Government. The association has to furnish information to the Central Government with regard to the amount, source and manner, in which the foreign contribution is received, and the purpose for which and the manner in which such foreign contribution will be utilized (ibid.).

Taxation

The Indian Tax Act (1961), states that entities set up for " charitable purpose" are exempt from tax, provided their activities fall under any of these four heads: (i) relief of the poor; (ii) education; (iii) medical relief; and (iv) advancement of any object of general public utility. In addition, upon fulfillment of certain conditions, the income from property held for charitable or religious purposes is also exempt from tax. Further, fiscal incentives and concessions may be granted to entities set up for certain purposes such as charitable or educational purposes, infrastructure services and to induce relocation of industries to developing areas. However, by law charitable or educational societies are not-for-profit entities and any profits earned must be deployed back in the organization and not distributed amongst members. This creates tax consequences for entities that are able to generate profits through their operations (Schwab Foundation 2006).

Moreover, the tax reforms in 2001 (Finance Act 2001 and 2002) reduced the percentage of accumulated profits that could be carried forward as well as the timeframe for such appropriations (Ministry of Home Affairs, India 2002). [3]This reduction in the time has an important impact in the ability of social enterprises to expand. The Act also provided that the accumulated endowment money can only be invested in government securities (which yield a very low rate of return). It is therefore not surprising that taxation issue is highlighted in the social entrepreneur interviews conducted by Schwab Foundation.

Bureaucracy/Regulation

Currently, there are several pieces of legislation concerning incorporation, compliance and monitoring of social enterprises and these are overseen by different departments in various government ministries. Further, due to limited use of e-government platforms and lack of communication between various government ministries the entrepreneurs struggle to obtain simple clearances and exemptions. In the survey conducted by the Schwab foundation, [the] " extensive reporting requirements if an organisation receives grants from the Indian government or from external organisations" is cited as a hindrance to promotion of social entrepreneurship (Schwab Foundation 2006).[4]

V. RECOMMENDATIONS

Consolidation of legislation and creation of mega-regulator

As elaborated earlier in the paper, Indian social entrepreneurs have to deal with government departments at national, state and local level to obtain various clearances. For instance, a social enterprise operating in a cluster of villages has to be registered with Central government body to obtain foreign donations. Therefore, simplifying and consolidating the legislation and reducing red-tape are the crucial first steps. In order to simplify matters, existing legislation for the incorporation and governance of social enterprises should be reviewed, consolidated and amended on a national level so that the regulations governing social enterprises can be standardized and more easily understood by those who want to become involved in this sector (Schwab Foundation 2006). Further, to ensure transparency and accountability in the operations of a social enterprise widely accepted systems, procedures and standards must also be set. Next, a mega-regulatory body must be created that acts as a single window for incorporation, approval, monitoring and compliance. This body should have state-level centres to reach out to remote parts of the country. These measures would reduce the transaction cost for entrepreneurs and the information asymmetry between regulators and entrepreneurs (regarding various rules enterprises have to abide by).

Taxation and Restriction under the FCRA

The narrow classification of charitable and educational societies and requirement to operate as non-profit to obtain tax exemption stifles innovation in this sector. Further, bureaucratic delays in issuing tax-exemption certificates lead to a cycle of excess-taxation followed by slow refunds. The tax law should be based on the understanding and appreciation of the business model a social enterprise. Research and international case studies must be the basis for tax reforms in the social enterprise sector. The objective is to have a set of simple and standardized rules and initiate the use of e-government tools government wide.

The Home Ministry, which is currently in charge of the FCRA regulation, prohibits entities with less than three years of existence and unregistered, with the Ministry, from obtaining foreign contributions. Access to finance is critical in the start up phase therefore this regulation should remove the three year requirement. Further, the responsibility this portfolio should fall under Finance Ministry as it is in the interests of the Finance Ministry to encourage the growth of social enterprise (Schwab Foundation 2007).

Capacity building and information technology

To initiate dialogue between social entrepreneurs and government an enterprise developmental agency should be established. The goal of such an agency is to create partnership (between entrepreneurs and government), help enterprises in financing, capabilities and management development, technology and innovation, and access to markets. The agency should place leading social and corporate entrepreneurs, academicians, lawyers and other professionals on its board to attain credibility and direction. SPRING Singapore is one such example; the agency focuses on growing innovative companies and fostering a competitive SME sector in Singapore (SPRING Singapore 2009). Lastly, E-government tools can improve productivity, inform entrepreneurs of the regulatory issues, reduce rent-seeking (bribes) by officials and open communication line between entrepreneurs and government.

VI. CONCLUSION

Indian social enterprise sector has witnessed growth despite the odds against it. To promote the growth of this sector it is critical to understand the economics and value-creation model of social enterprises. The legal, tax and regulatory ecosystem must be consistent with business models of social enterprises. Further, adoption of information technology and e-governance are important to facilitate engagement, capacity building and monitoring of social enterprises. (Word Count: 2, 312)