Social Enterprises and Impact Investments: A study on challenges and perspectives of social enterprises and impact investors in Sri Lanka

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Abstract

The purpose of this paper is to explain the challenges faced by impact investors and social enterprises in realizing their goals and to understand the inter-connection between these two key stakeholders. The research was motivated by the visible trending growth of several social enterprises and impact investing entities in Sri Lanka over the last few years. The research adopted a qualitative method and conducted interviews with key stakeholders of impact investors, social entrepreneurs, and social enterprise intermediaries. The study analysed themes that include business and financial knowledge of social enterprises, communication and alignment between impact investors and social enterprises, size and scalability of social enterprises, policy and regulatory issues, and impact measurements. The study found that social enterprises in Sri Lanka face multiple challenges that restrain their progress. In addition to the basic problems such as the lack of business acumen and lack of access to funds, difficulties in measurements and demonstration of impact, and scalability are also significant factors that affect motivations of the impact investors. This implies existence of a mismatch of objectives of the key stakeholders, which remains a key determining factor in the process of integration of the multiple stakeholders. The role of intermediaries in the process of narrowing the gap is paramount. There is a need for interventions in strengthening social enterprises in terms of ability to demonstrate financial and social impact. The study also envisions policy level interventions that could provide much needed impetus to this sector, which will improve the recognition and status of social enterprises, and thereby contribute to the achievement of sustainable development goals.

Keywords: Social enterprise; Social entrepreneurship; Impact investing; Impact investor; Social impact investing.

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Introduction

The Social Enterprise (SE) business model is recognized as a vital tool to create positive social impact, promote social change, and achieve environmental sustainability while enhancing social inclusion of women and youth for economic development (Coomaraswamy, 2019; Gunawardena & Mudalige, 2019). SE is identified as a key driver for growth and for achieving the Sustainable Development Goals (SDGs) (Welamedage 2018, as cited in Hewage, 2018; Shi, 2018; Coomaraswamy, 2019). Furthermore, consumer purchasing trends of 'eco-friendly and social goods' drives the SE sector as consumers are increasingly moving towards ethical consumerism and businesses are motivated to creating a positive impact on society (Coomaraswamy, 2019; Hochstadter & Scheck, 2015). Accordingly, promoting SE is a fruitful method to create a community of socially conscious entrepreneurs who can work to address the development challenges of a country, whilst promoting economic growth through enterprises that generate financial returns.

Whereas SE remains a developing sector in Sri Lanka, the basic principles of SE have been in existence for a long time, and practiced by various organizations, such as non-government organisations (NGOs), co-operatives, charities, civil societies and other social organisations committed to developing a social economy (British Council, 2018). Nevertheless, research on SE remains limited in Sri Lanka as overall research and economic policy focuses on small and medium enterprises (SMEs), start-ups, entrepreneurship, and co-operative development (Lussier, et. al, 2016; Fernandopulle, 2019; Gunawardena & Mudalige, 2019). Therefore, there is scope to expand research and knowledge in the field of SE in Sri Lanka. Furthermore, the sector is poised for development through the active involvement of many industry stakeholders, regulatory authorities, and impact investors committed to driving the SE ecosystem in Sri Lanka.

Despite growing recognition of SE as a developing sector in Sri Lanka, the progress is curtailed by several challenges faced by SEs including regulatory and policy hurdles, financial barriers and the lack of formal recognition and awareness of entities committed to social change (British Council, 2018).

Among the aforesaid challenges, accessing and raising capital has been identified as a primary challenge faced by SEs world over, including in Sri Lanka (Gunawardena & Mudalige, 2019). For instance, the lack of bankable assets, low profit margins, high interest rates and lack of guarantors for loans are considered specific financial barriers of local SEs (Welamedage, 2018 as cited in Hewage, 2018; Fernandopulle, 2019). Likewise, conventional funding models of philanthropic grants and state-funding are limited to specific projects, and with restricted budgets, which limits the overall development of a SE (Glanzel & Scheuerle, 2015).

In this background, Impact investment is being increasingly considered as a viable solution to the funding challenges faced by SEs (Perera, 2019; Coomaraswamy, 2019). Impact investing refers to investing with the objective of generating positive, measurable, social, and environmental impact, alongside a financial return (GIIN, 2020). Accordingly, impact investment places equal importance on the financial, social, and environmental benefits, and as such, is better aligned with the objectives of SEs than traditional funding models. Impact investment insists on refocusing the funding model to attract high risk-taking investors driven to capitalise on returns of socially oriented inventive projects, rooted in social impact with financial returns.

Globally there has been a shift of philanthropic investors toward private and institutional investors including high net worth individuals, fund managers, pension funds, banks, and development finance institutions interested in Social Impact Investing (SII) (Glanzel & Scheuerle, 2015; GIIN 2020). This trend is evident in Sri Lanka as well, with key players in the local market being actively engaged in cultivating an impact investment ecosystem, which is seen as an irrefutable need to advance the SE sector (WUSC, 2018). Furthermore, whereas some empirical studies have been conducted in Sri Lanka to understand the status of SE and the status of impact investment (British Council, 2018; GIIN, 2015), there is less research dedicated to identifying the challenges faced by both impact investors and SE investees in Sri Lanka. Therefore, there is a need to study the nuanced relationship between impact investors and SE investees and the effect their individual perceptions have on the success of SE ventures.

Understanding the dynamics and relationship between impact investors and SE investees is essential to achieve the objectives of generating social and commercial value through successful SEs (Agrawal & Hockerts, 2019). Understanding such dynamics could also help in distinguishing impact investment from traditional forms of investment such as venture capital, bank loans and grants (Agrawal & Hockerts, 2019). Accordingly, the objective of this paper is to examine factors that affect impact investors when investing in SEs, and to study how these factors influence SEs in the process of attracting impact investors in Sri Lanka. The research also aims to examine the perceived gap between the supply and demand side of SII regarding funding of SEs by IIs in the context of Sri Lanka.

Literature Review

Social entrepreneurship can be considered as a subsector of entrepreneurship (Gunawardena & Mudalige, 2019). Whereas entrepreneurs have similar characteristics, a distinction can be drawn between a 'business entrepreneur' and a 'social entrepreneur' based on a need for a stated social mission by social entrepreneurs (Hilal, 2018). In this same manner, it is necessary to distinguish a SE from NGOs, charities, and co-operatives and from principles of corporate social responsibility (CSR), based on the income generation objective along with the social mission. Moreover, SEs are considered more economically self-sustainable than charitable organisations as they generate monetary returns to support business goals (Gunawardena & Mudalige, 2019). Some have expanded the scope of 'social entrepreneurship' as 'transformational entrepreneurship', as a mechanism to balance disparities of a social and economic nature to create overall value for society (Marmer, 2012; Krasniqi, 2019).

It is evident that there are differing views of social entrepreneurship (1) 'as generating earned income while pursuing social outcomes', (2) 'as change agents in the social sector', and (3) as a combination of the elements of entrepreneurship and a social mission, including to pursue economic, social and environmental goals, which corresponds to Emerson's principle of 'blended value' (Santos, 2010; Dharshani, 2015; Dharshani, 2016). While there are differing views, a common characteristic found in literature explains it as "entrepreneurial activity with an embedded social purpose", which forms the basis of defining a SE (Austin et al., 2006, as cited in Santos, 2010; Dharshani, 2015; Dharshani, 2016).

On the question of entrepreneurship motivation in Sri Lankan entrepreneurs, it is argued that they culturally differ from Western entrepreneurs based on a need to satisfy social intimacy and collectivism over individual achievement (Gamage et al., 2003 as cited in Lussier, et. al, 2016). Further, some common characteristics identified in Sri Lanka include 'businesses dealing with social and environmental problems, with the objective of creating jobs and generating income, and reinvesting profits to the business to maximise the social impact for improvement of community and overall society' (British Council, 2018).

Impact Investing

Impact investment refers to finding investment opportunities that could create positive social and environmental impact (Hochstadter & Scheck, 2015; Shi, 2018). Key characteristics of impact investment include a range of financial and non-financial return expectations, including a minimum return of capital and asset classes; impact measurement and management of investment progress; and social and environmental performance with transparency and accountability (GIIN, 2020). Accordingly, impact investment is a combination of conventional financial decision-making and philanthropic intentions, as its combined objective differentiates impact investments from traditional grant funding and traditional investments (Hochstadter & Scheck, 2015).

Impact investment is also understood in connection with a broader movement of 'ethical and socially inclusive capitalism' based on concepts of ethical consumerism, business ethics, CSR and social return on investment and the rise of social entrepreneurship through the combination of social, environmental, and economic factors (Hochstadter & Scheck, 2015). In addition, scholars have developed a concept of "blended value" as the objective of impact investment on the basis it considers both measurable social impact and financial returns (Castellas et al., 2018; Cohen, 2018).

Institutional Approach

Institutional approach is argued as a valid theoretical framework for studying social entrepreneurship and impact investment, especially through use of the institutional-logics perspective (Hadad, 2017; Castellas et al., 2018). The concept of institutional complexity is more evident in SE and impact investment, as it is an emerging field, wherein the dominant logics are yet to be defined when trying to achieve blended social and financial returns (Agrawal & Hockerts, 2013; Castellas et al., 2018).

The institutional logics framework can be applied to understanding the mission drift between competing goals of social value generation and income generating and how these competing goals can be managed without loss of legitimacy to the field (Castellas et al., 2018; Agrawal & Hockerts, 2019). On principle, SII is supposed to have an equal consideration of social and commercial logic to balance social and financial impacts. However, studies to date have shown that hybrid goals of organisations result in conflict, as individual stakeholders are driven to make decisions based on the dominant institutional logic they most relate to, impacting the overall organisational performance (Agrawal & Hockerts, 2019).

A common outcome of these studies is that impact investment investees are more focused on the investment logic whereas SE investees are more driven by the social logic, which results in conflict between investors and investees (Glanzel & Scheuerle, 2015; Castellas et al., 2018). Further, critical review of the definitions of 'social entrepreneurship' leads to contrasting views being raised on the importance placed on the economic outcomes in comparison with the social missions to be considered a true SE (Darshani, 2015).

Empirical Review

Glanzel and Scheuerle (2015) identified SII as an area of friction on market and civil society logics. The factors identified as affecting social impact investments include insecure income models of SEs due to varied funding models; lack of business skills of social entrepreneurs and differing perceptions of risk (i.e. SEs are considered high risk investments). On the other hand, inability of investors to adequately value social returns and lack of measurement tools to effectively demonstrate social impact were also considered as factors adversely affecting SEs.

A study using the institutional logics perspective argued that the commercial logic plays a dominant role in SII (Castellas et al., 2018). Factors that affect social impact investment decisions under this perspective include investors pursuing asset classes with larger scale impact (i.e. green bonds are preferred by investors); and investors focus on disadvantaged populations over outcome areas. It was also identified that investors prefer mature stage investments with less support at start-up and seed stages. Further, application of traditional investment assessment mechanisms in impact measurement resulted in greater focus of commercial logic, which was found as a constraining factor (Castellas et al., 2018).

Similar studies further identified factors such as the lack of ability of SE investees to create 'measurable and scalable' social value as a major challenge. Problems relating to regular social impact measurement and reporting on agreed goals; and frequent communication and engagement between investors and investees for greater alignment are also identified as factors that affect outcomes of SEs (Agrawal & Hockerts, 2019).

In the non-profit sector, the barriers faced by the demand side of social impact investments are significant. For instance, organisation size and scalability of investments; lack of knowledge of the market and lack of financial literacy by SEs are considered major factors affecting non-profit SEs. Further, SEs also face regulatory and policy hurdles (Phillips & Johnson, 2019).

Other studies have found that SEs also face the common challenges faced by other small enterprises, which include having inadequate capital, issues connected with maintaining good records and financial controls, lack of prior management knowledge and experience, and poor business planning (Lussier, et. al, 2016). One study argued that identification of the factors that determine success or failures would assist not just entrepreneurs, but also other stakeholders including investors and institutions providing capital (Lussier, et. al, 2016). Other studies argued that strategic orientation relating to how SEs work in alignment with external stakeholders, including customers and rivals, was considered an important factor for enterprise success (Gunawardena & Mudalige, 2019). This finding is reflective of a global perception that consumer behaviour is a catalyst for change in business practises (Cohen, 2018). Further, studies relating to access to finance of SEs identified that investees prefer debt over equity, particularly for growth and mature stage entities, even if investors prefer to make equity investments (GIIN, 2015). Other studies observed that local entrepreneurs are cautious about partnering with investors outside the family circles (Perera, 2018).

While the studies have identified factors that impact social enterprises and impact investors, how these two important stakeholders experience the challenges in the context of Sri Lanka needs to be analysed. In a changing context, where the national social welfare orientation is also undergoing challenges, it is pertinent to see how SEs can place themselves within this context.

Methodology

The study adopted a qualitative method, to critically analyse the perspectives of impact investors and SEs on key themes, and as studies on SEs are still explorative in Sri Lanka. The main method of data collection was semi-structured interviews. The use of interviews is reflective of the position that personal interactions with the participants would facilitate obtaining valuable insights of concerned parties on key issues. Interviews were conducted through telephone and online video conferencing as they provided an advantage of interviewing practitioners in the field, including participants who were abroad. Further, it facilitated to overcome certain covid-19 related restrictions that continued in 2021.

It was imperative to have research participants who are aware of the principles of impact investment. Therefore, the primary sampling strategy adopted was non-probability purposive sampling, where the participants were selected based on their expertise in the sector. It also adopted a convenience sampling as a strategy to identify research participants based on accessibility and availability. Accordingly, the study sought to interview business leaders with experience of impact investment, including directors of the key impact investment companies, and co-founders of SEs in Sri Lanka. A total of six key personnel from SEs (Identified as SE1 – SE6) and seven business leaders from impact investment (Identified as II1 – II7) were interviewed.

The study adopted a thematic analysis method and identified themes that were found in studies by Glanzel and Scheuerle (2015), Castellas et al., (2018), Agrawal and Hockerts, (2019) and Phillips and Johnson, (2019). The analysis also applied the institutional logics theory to interpret each factor by applying the social or commercial logic to assess the conflict and gap between the supply and demand side of SII.

The key themes identified are set out in Figure 1 below.

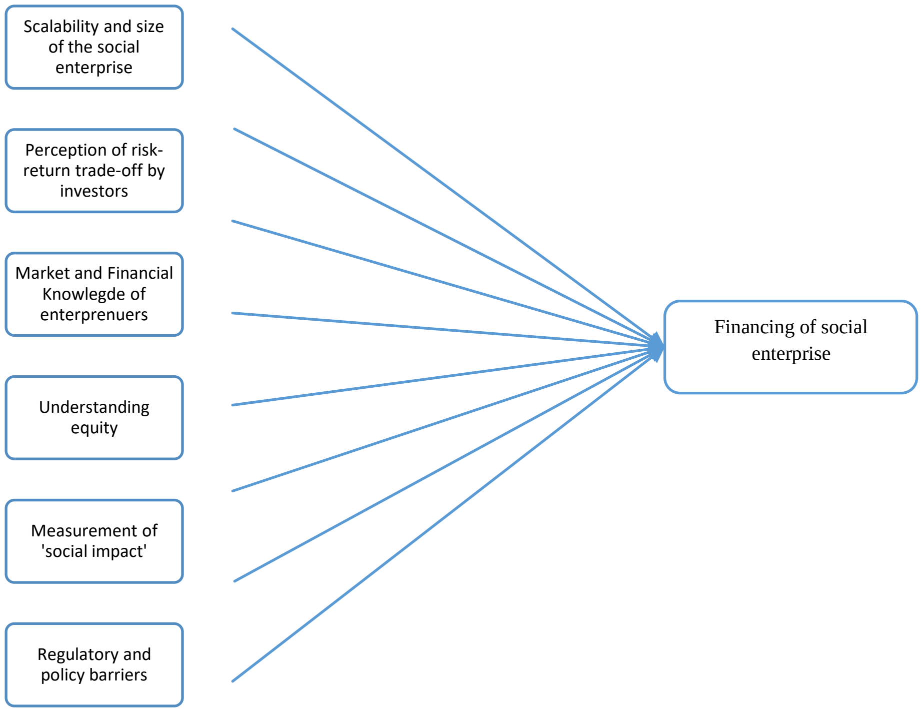

Figure 1. Factors affecting financing of SE (Developed by Authors, 2020)

Findings and Discussion

Perceptions about SEs and Impact Investors: SE is generally understood as an organisation with a vision to make a positive contribution to society and the environment while also generating a financial profit. There is also a perception that political and governance problems can be addressed by the SEs. However, discussions with business leaders revealed that many enterprises were unaware of their identity as a SE, even though they fall within the definition. For instance, enterprises working in fair trade, organics, and in rural areas may be operating as self-funding enterprises that create impact in the community but are unaware of their significance as SEs. This lack of assertiveness leads to poor, or sometimes, no access to the support available to them within the impact investment sector.

With regards to impact investment, there is a common perception that impact investing is a relatively new concept to Sri Lanka, but, as with SE, the focus is on 'dual returns' of societal impact and financial profits. Identifying these investors as non-traditional investors focused on creating products and services through enterprises that results in social impact is in line with concepts such as 'blended value, 'impact-first' 'profit-with purpose' found in studies of Besley and Ghatak (2017), Cohen (2018), Castellas et al., (2018); Glanzel and Scheuerle, (2015) and Hochstadter and Scheck (2015). It can be stated that there is a strong combination of both commercial and social logic in defining SE and impact investment, which transcends into the sphere of social impact investments.

It is realized that there is active engagement and commitment to develop the sector by stakeholders that promote the idea of impact investing. For instance, there are intermediaries, such as the Lanka Impact Investment Network (LIIN), that aim to bring together individuals looking to invest, with social entrepreneurs looking for an investment. Such networks also provide a platform to facilitate achievement of important goals that include promoting social entrepreneurship, accessing social impact funds, empowering female entrepreneurs, and overall training and support services to the SE sector. The remark on LIIN initiatives such as '…it's been truly positive, because the impact investment has focused on the actual needs of the entrepreneurs a lot (SE4)' is indicative of this contribution.

As such, there is a shared understanding that the SE sector can be considered as the future of business. The potential of this sector is recognised as development of organizations that make profit while prioritizing people and planet (SE4). There is wide agreement that growth of this sector would require collaboration between SEs and impact investors that would increase enterprise readiness, and help increase the number of companies and high net worth individuals entering the space (SE2,II5,II7). '…there should be impact investors and there should be SE readiness. If you don't have SEs who are capable of attracting this investment, there is no point developing the impact investment space (SE2).'

However, there is still a lack of complete understanding of SEs and their potential in promoting sustainability in the local market, resulting in a mismatch and lack of alignment of objectives between impact investors and enterprises (SE2,SE4,II5,SE6). Therefore, this indicates that the growth of the sector is largely dependent on creating awareness, sharing knowledge, and capacity building to move towards more cooperation between these two key stakeholders (SE2, SE4,II5,SE6,II7).

Size and scalability: A consistent theme identified was the concentration of impact investments in "big ticket sizes", that is investments moving to larger companies due to greater returns. The large investment funds and international investors seem to favour sizeable investments in the million to multimillion dollar range to cover the cost of the fund, which is more than the funding required by the majority of local SEs (SE4). The local ticket sizes range from USD 1000 to USD 300,000, which is a middle level range, because many enterprises are operating at micro and small level, rather than medium and corporate level (SE1,SE2,SE4,II7,II2). This poses significant challenges in scaling up the SE businesses.

"We need to create small tickets and small funds and maybe create about a dozen SEs that can go up to the 100,000 dollars and above scale (SE2)." This refers to an understanding that more local investors need smaller ticket sizes, which will increase alignment between local investors and enterprises (SE1, SE4). On the other hand, scalability of an enterprise is considered as an important determinant by impact investors. "It is essential to have scalability and sustainability of both financial and social returns" (II3).

Finding high calibre enterprises with high impact and high returns was identified as a challenge faced by investors, as many enterprises fail to meet investor expectations (SE2,II7). However, this challenge has also been attributed to the fact that the market in Sri Lanka is still at the emerging stages.

"If you are an impact investor who is looking at scale, scale of the business, scale of the impact, Sri Lanka is still a relatively new, immature market (II5)."

Therefore, this finding establishes that scalability and size of SEs increases the likelihood of investments in SEs by impact investors. This finding further supports the findings of previous studies, that scalability of a SE, including the ability to make large scale measurable impact, and the actual size of the enterprise itself, are essential factors for investment decisions (Castellas et al., 2018; Agrawal & Hockerts, 2019; Phillips & Johnson, 2019).

Risk-return trade-off: In line with earlier findings, there is an understanding that local investors in Sri Lanka identified a higher risk in investing in SEs and that investors are not primarily focused on risk-return trade-off (Glanzel & Scheuerle, 2015; Castellas et al., 2018). The risk is higher for local investors as a majority of the investments are made by individuals with their own private wealth, rather than through funds (SE2,II5,II7). However, there is also a belief that investors share the same risk as entrepreneurs and as such, there should be more acceptance by enterprises of the impact investors challenges as well.

"…Impact investors also share the same risk as the entrepreneurs. So, if the business does well, yes, they'll take a sizeable investment-linked return but if the business goes down, of course they lose out everything as well (II5)."

There is an overall understanding by SEs and impact investors alike that investors do expect a return and are not operating on a philanthropic model (SE2,II3,SE4,SE6).

"In most cases, Sri Lankan impact investors expect a reasonable financial return, because they are investing their money. They are investing money first for impact - social or environmental impact. The second is the financial return. (SE2)"

This finding reveals the fact that SEs in Sri Lanka depends more on private funding than institutional funding. Furthermore, there exists a focus on making enterprises 'financially sustainable' and generating 'responsible profits', although impact is the primary objective (SE2, II3). There is also an emphasis on profits being directed towards the main purpose, at a minimum of 50 percent, and the need to, at minimum, have a breakeven model (SE4, SE6). Therefore, there could be greater alignment with the new paradigm of 'risk-return-impact' as indicated in previous studies such as by Cohen (2018). A positive perception of risk-return trade-off can increase the likelihood of impact investors investing in SEs.

It is observed that while investors have a 'dual intention of earning profits and realizing social impact', they tend to give more prominence to the impact. The following expressions indicate this preference:

"They are more concerned about the impact than the return; but that doesn't mean that they are less interested in returns, it's just that the primary focus is on the impact (II3; II5)";

"More prominence is given to the impact that you can create (SE6)".

"There are some investors that are fully focused on impact returns, and there are others often wanting commercial returns with impact, which is a much more challenging thing for the SE (SE4)."

"Impact investors that are based in Sri Lanka have different motivations for getting involved, and some of them have a much stronger focus on social and environmental impact than others (SE4)."

Accordingly, there seems to be a greater focus on the social logic than commercial logic in impact assessment in Sri Lanka, which is somewhat different to international studies which found a dominance of commercial logic (for instance in Castellas et al., 2018). It can be argued that greater focus on social returns, in the Sri Lankan context, increases the likelihood of impact investors investing in SEs. However, it is evident that Sri Lankan SEs are finding it challenging to meet the multiple goals of impact investing, particularly at their early stages of development.

Measurement and valuation of social impact: Impact measurement consists of two aspects which are measurement and reporting (SE1), and further, it should have a 'financial indicator' and an 'impact variable' (SE6). Whereas there is recognition of international tools developed by leading institutions, the observations suggest that impact is measured on a case-by-case basis with curated tools for individual enterprises in Sri Lanka (II3,SE4,II5,II7). Defining 'impact' itself varies, where certain enterprises consider impact in terms of the number of jobs created, or livelihoods improved. The expected impact ranged from ten to forty percent as the minimum positive social and environmental impact to be made by SEs (II5, SE6,II7).

Additionally, SEs face challenges in demonstrating the impact, despite claims of creating impact. The complexity of the social or environmental objectives also poses difficulty in valuing the impact, thereby causing a difference between expectation and actual returns (SE2, II3). However, in certain cases enterprises have created more impact than expected by the investors (II7). It is also observed that SEs in Sri Lanka lack commitment to systematically measure and report the impact, as it is not a legal requirement. Some enterprises also doubt the necessity of measuring and reporting impact (SE1).

Moreover, it is pertinent to note that Sri Lankan SEs are facing challenges in reporting their performances because they are still in the process of maturing. Lack of access to standard measurement tools, and lack of ability to effectively deploy these tools remain a challenge.

"When you think of impact measurement tools, it's quite expensive…for start-ups to bear, and whether the return will be realized is a key question (II7)."

Successfully measuring impacts and demonstrating them as socially relevant is a key determinant in having access to impact investments, as observed in prior studies, for instance in Agrawal and Hockerts (2019), and Phillips and Johnson (2021), and the inability to access and utilise relevant impact measurement tools poses a significant challenge.

Market knowledge and financial acumen: As observed, a fundamental challenge faced by the SE sector is the lack of market knowledge and financial acumen of SEs. Investors find that SEs lack business basics, such as general management skills, financial management skills, and human resource capacity, which severely impact their decision-making when searching for enterprises with operational efficiency and scalability (SE2, II3, II7). Another challenge that impact investors strive to overcome is getting social entrepreneurs and enterprises to operate in a structured manner, with an appropriate business plan, a proper accounting system, and a clear focus on how they are going to create impact (II5). On the other hand, there is an expectation from the enterprises for support and training from investors in these particular areas, that would ultimately increase the capacity of these enterprises, which are mostly small and vulnerable.

"The problem is our investors do not understand that investing is not merely about giving money. Investment is about spending a lot of time and expertise and energy to build a company" (SE1).

It was observed that while some investors play only a passive role by confining their involvement to providing money, others play a more active role. In addition to providing money, they would also contribute knowledge, expertise, training, creating networks and sharing those networks (II5). This finding reveals the diversity of investors which contribute to different outcomes of impact investment. Such realities point to the need for further training and education for intermediaries to address this mismatch between investing styles (SE4).

The above observations support earlier findings which highlighted challenges of the SE sector related to lack of business skills, financial literacy and market knowledge and insufficiency of entrepreneurial training programmes, assistance, and guidance (for instance in Glanzel and Scheuerle, 2015; Castellas et al., 2018; Agrawal and Hockerts, 2019).

Understanding equity: A key characteristic of the SEs is their dependency on traditional forms of finance, such as 'bank loans and microfinancing' (II7), which seem to serve a short-term purpose. The shift towards a more long-term patient-capital type approach adopted by impact investors remains a challenge (II5). Poor understanding of SEs on the concept of equity, and the reluctance to allow an external party to be involved in the business operations, seems to make SEs wary of equity financing (SE4,II3,II5).

"To be honest, I'm not certain that equity makes the most sense for a lot of the enterprises …there are many enterprises that aren't comfortable with it, they don't understand how you value companies, how you have shares, all of that. That's a huge challenge. (SE4)"

A key challenge related to the equity model is the lack of innovative exit-strategies which are purpose-driven. For instance, customers, suppliers, or workers becoming the owners is considered more desirable, rather than traditional exit-strategies of buyouts or acquisition by larger companies (SE4). Models suggested by SEs include exploring opportunities related to debt, such as bank guarantees (SE4), becoming self-sufficient by raising funds, for instance, through crowdfunding (SE6), engaging banks in the impact investment sphere to make the banking system SME sustainable (SE2, II7), and mobilising the diaspora community and other high network individuals for investments (SE2). These views point to a tendency of SEs to seek less risky options for financing, as opposed to equity.

Accordingly, this finding indicates the existence of a mismatch or misalignment of interests between impact investors and SEs, particularly in terms of funding arrangements. For instance, lack of financial acumen by SEs is considered by the investors as a hindrance, while SEs have expressed the need for developing such capacity at the early stages of their development.

Lack of communication or gaps in communication between SEs and investors appear to be a contributing factor for such misalignments of objectives.

"…often the challenge has to do with communication and making sure that there is an alignment … it's hard to know, what are their expectations regarding returns and those kinds of things (SE4)."

This study further identified differences of expectations in the areas such as exit strategy, equity investments, requirement of honesty from enterprise when seeking investments, and understanding of the role of investors as business partners and shareholders of the company. Similar discrepancies were identified by previous studies in areas such as conflicts of control, co-decision rights, investor expectations of transparency and accountability and need for frequent communication and engagement (for instance in Glanzel and Scheuerle, 2015; Agrawal and Hockerts, 2019).

Accordingly, bridging this gap is an important intervention needed for the SE industry. While a certain degree of alignment can be seen, there is a need for matchmaking to improve understanding of objectives by both stakeholders. The ability to understand and arrive at common goals is considered essential to avoid mismatch and ensure mutually beneficial returns of investment.

Policy level challenges: SEs face challenges within the existing regulation as there are restrictions on including social objectives in private limited companies. Although these enterprises can be registered as companies limited by guarantee, such registrations have restrictions in terms of acquiring equity-based capital (SE2, SE6). The importance of having specific legal recognition would give SEs a unique identity and status (SE2, SE4).

"…the key thing is there needs to be some kind of legal recognition to social enterprises. And with that legal recognition will come benefits, and incentives for investors (SE1)."

Policy level interventions, not only to create more understanding of the concept and to attract investors, but also to provide benefits such as business incentives and tax rebates to impact investors, are essential (SE2,II3).

"If we are to create a formidable ecosystem, there must be incentives coming in for impact investment…there has to be a consistent government policy and a real focus on social entrepreneurship and impact (II5)."

There is also an understanding that policy should be targeted to benefit both investors and entrepreneurs, including companies that source from SEs (SE4). Furthermore, it is a common perspective that the government should assist with funding, for instance through intermediaries, to prepare enterprises and to safeguard investments through guarantee schemes, (SE1, SE2, II3,115,II7).

Concluding Remarks

The primary aim of the research was to understand the inter-connection between impact investments and SE development. Further, understanding the perspectives and challenges of both stakeholders, impact investors and social entrepreneurs, was also a major objective. Through this study, it was identified that SEs in Sri Lanka face various fundamental challenges such as the lack of access to funding. Moreover, small size and lack of scalability, weak market access, and poor financial knowledge are also major contributors to this state. Equally, these factors further affect the motivation of impact investors to engage in the SE sector.

While there is convergence on the motive of social impact, a certain degree of divergence in terms of approaches to realize the impact exists. While impact investors favour a more corporate approach to value creation such as, large ticket sizes, risk-return considerations, and equity-based funding, the SEs readiness to adopt such practices is weak as they are at an early stage of development. SEs prefer more traditional, state-led, or non-profit sources of funding to minimize risk, as they face capacity constraints including in measuring and demonstrating impact. SEs also believe that capacity building should be an integral part of impact investment.

Nevertheless, a positive factor identified from this study is the prominence given to the social impact by all stakeholders. Such a social orientation could prove advantageous for the growth of the SE sector in Sri Lanka. Furthermore, the role of intermediaries in strengthening SEs, facilitating alignment of objectives, and fostering cooperation is imperative.

Recommendation

SEs are found in a variety of sub-sectors in Sri Lanka including cooperatives and micro-enterprises, that have the potential to reduce economic inequality. Therefore, a national level policy framework is imperative to promote these enterprises and foster social entrepreneurship. Development of these enterprises can produce important social and financial outcomes concerning many people involved in the SE sector. An enabling policy intervention, particularly in the areas of legal recognition, and special tax policies, may be needed to promote different actors to engage in the development of the SE sector.

Further, scalability and impact measurement remain a significant issue faced by SEs, particularly in terms of accessing funding and aligning their objectives with that of other stakeholders. Therefore, it is vital to engage more industry stakeholders including business chambers and the corporate sector to promote their current interventions, such as by broadening the scope of CSR activities which are adopting more sustainability related principles and practices. The need for greater collaboration between the different actors and integration of their activities will help achieve greater social and environmental impact and improve the ability of SEs to scale up and demonstrate impact.

Finally, a major concern of impact investors is the lack of social entrepreneurship abilities, which hinders innovation, growth, and expansion of the SE sector in Sri Lanka. Accordingly, while there are initiatives already undertaken by certain intermediaries on training, education, ideation, incubation and capacity building of SEs, there is a greater need for broadening such initiatives to develop the SE sector further. Advocacy and policy level interventions are also required to ensure that the concept of SE is engrained in the business education system of the country at different levels.

While the study has been able to shed light on certain relevant themes in the context of Sri Lanka, understanding the issues connected with SEs in Sri Lanka would need analysis on more social, economic and cultural factors. Sample size, covid-related difficulties faced in conducting physical interviews posed limitations in analysing wide range of factors that could explain the status and development of a SE eco-system in Sri Lanka. Given the emerging stage of academic research in this field in Sri Lanka, further research is needed to understand in depth the factors that influence SEs and to test the propositions identified through this study.

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