IIC IMPACT INVESTORS COUNCIL

D&A Desai & Associates

UNLOCKING THE PROMISE OF
BLENDED FINANCE IN INDIA

White paper by the Impact Investors Council and Desai & Associates

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Abstract

Over the past few years we have witnessed how the Covid-19 pandemic has compounded existing inequalities in India, across critical sectors such as healthcare, education and MSMEs. Therefore, the need of the hour is to look beyond traditional models of socio-economic development and embrace more innovative models of financing social impact such as blended finance. This white paper - "Unlocking the Promise of Blended Finance in India" - is the first in a series of such analytical outputs that are a part of a broader effort by Impact Investors Council (IIC) and Desai & Associates (D&A) to socialise the development community and the Indian government on the benefits of blended finance to support their financial and development agendas.

While there has been active discussion on 'social finance structures' such as impact bonds, debt guarantees, and interest subvention, there has not yet been coordinated action both among policymakers and the investment and development finance community in India on how to best leverage such innovative Blended Finance tools to achieve our ambitious development goals. To frame a common agenda, this paper evaluates the overall, emerging Blended Finance sector in India – defined as the use of financial instruments to combine or 'blend' private, public and philanthropic capital to

(i) increase the amount of capital available for development

(ii) allocate this capital more efficiently and effectively towards achieving development outcomes.

Starting with the need for expanding Blended Finance given the post pandemic stress and constrained financial capacities, it sets the definitional context for Blended Finance overall and four specific categories of interventions or types of innovative finance structures (concessional capital, risk mitigation tools, support mechanisms and results-based financing). It then lays out the benefits and challenges for each major stakeholder (Sarkaar, Bazaar, Samaaj) before mapping the framework of Blended Finance interventions to the Indian development context, with examples of seven innovative finance transactions that have been happened in key social sectors including education, healthcare, financial inclusion, climate and agriculture. It concludes with ideas for the road ahead for policymakers, investors and social enterprises alike in working together to harness the power of Blended Finance for unlocking development capital and sector-specific recommendations to the Government on key interventions it can undertake.

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01

The Need for Blended Finance in India

2022 is a landmark year for India as we complete 75 years of our independence. In these last decades, India has not only uplifted millions of people out of extreme poverty while remaining a democracy but also established itself as a global socio-economic power. However, this is also the year that the world begins to emerge from the Covid-19 pandemic that has stalled global growth for the past two years. In India, the pandemic has exposed the gaping inequalities that exist across our society, from the lack of a robust healthcare infrastructure, particularly in the country's rural hinterlands, to the destruction of livelihoods within marginalised communities.

As we now look ahead to shape our nation for 100 years of independence, it is more important than ever to work towards building a socio-economic model that is resilient and equitable. However, doing so will not be easy. India's Sustainable Development Goals' (SDG) annual financing gap, which was already large, is estimated to have almost doubled post Covid. As per the OECD, the total global SDG financing gap has increased from $2.5 to $4.2 trillion, with India's share being ~25% pre Covid. At the same time, as per the government, central and state funding for the social sector has grown to ~30% of the Nominal GDP (Rs. 72 Lakh Cr in FY22 vs Nominal GDP of Rs. 236 Lakh Cr) but is still deeply constrained by limited resources. To make matters worse, Covid induced economic shocks have led to a demand failure as the loss of incomes reduces domestic consumption, the engine of India's economic growth.

Therefore, with mounting pressure to demonstrate greater impact, it is imperative to facilitate radical collaboration between the three pillars of Indian society: Sarkaar (government sector), Bazaar (commercial sector) and Samaaj (social sector). There is a need to augment the flow of commercial capital to India's social sector where non-profits and social enterprises continue to remain sub-scale due to a lack of timely, low-cost and patient capital. The government has to play an active role in facilitating this capital flow through conducive regulatory and policy support. Given these challenges, it is time to look beyond traditional models of socio-economic development and embrace innovative financing mechanisms such as Blended Finance. The use of Blended Finance, can not only augment the flow of commercial capital for development, leveraging precious philanthropic and government funds to crowd in private capital, but also apply such capital more judiciously towards development outcomes that are measurable.

02

Defining Blended Finance

The market flow of commercial finance is determined by the balance between private costs and private returns as assessed, perhaps differently, by the borrower and lender. The access of borrowers to commercial finance also depends on the assessment of the risks of default by the lender. The primary role of blended finance is to correct the gap between the level and direction of finance flows required from a social perspective and the flows that are determined by prevailing market conditions. One example of such a gap is when an investment generates benefits which are not captured in the returns accruing to the borrower. For instance, when someone borrows funds for forest development, they may realise the returns from the sale of forest products. But the benefits that would accrue from the positive impact of forest development on water and soil management, to take just one positive externality, will not accrue to the borrower. One role of blended finance is to compensate for such positive externalities by combining commercial borrowings with grants or subsidised loans from the government and philanthropic resources. Another important dimension of blended finance is to correct for cases where there is a biased assessment of risk by commercial lenders, a market imperfection that is quite common for potential borrowers who are on the fringes of society. This would be done by public or philanthropic finance that underwrites the perceived lending risk. Hence, from an economic perspective, the primary role of blended finance is to correct market imperfections and move the flow of finance closer to what is desirable from a social or public good perspective. Blended Finance must not be seen as a charitable activity but as an essential component of socially optimal management of the financial system.

As per the World Economic Forum and Organisation for Economic Cooperation and Development "Blended Finance is the strategic use of development finance and philanthropic funds to mobilise private capital flows in support of SDG related investments in developing countries." The International Finance Corporation adds an important point on its relevance, that "Blended Finance is a critical tool that can mitigate early-entrant costs or project risks, helping re-balance risk-reward profiles for pioneering investments and enabling them to happen."

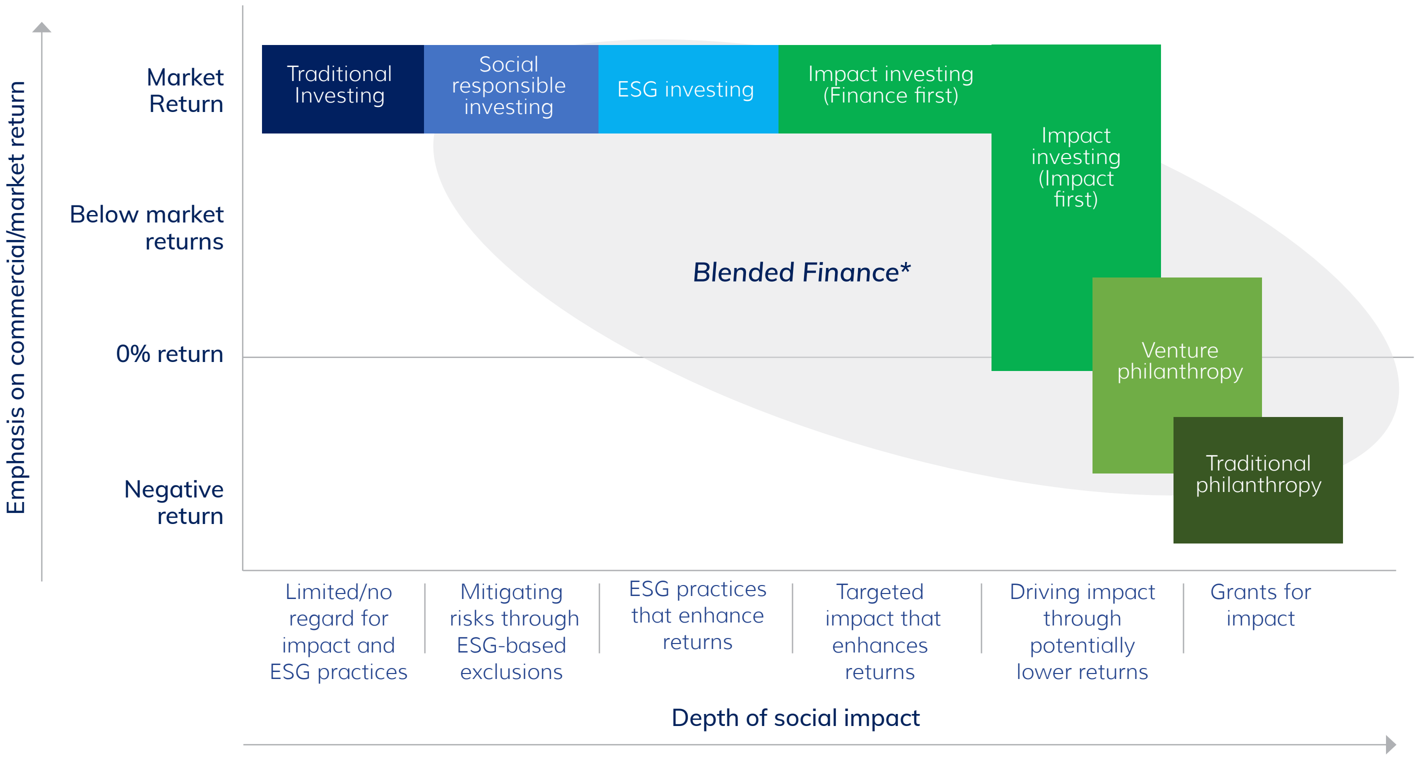
There are three 'dimensions' which are thus essential to any Blended Finance intervention:

- **Leverage** – Use of development finance and philanthropic funds to attract private capital
- **Impact** – Investments must be targeted towards concrete social or environmental impact
- **Returns** – Financial return for a set of investors, based on risks and pricing of impact

Overall, Blended Finance enhances the impact of philanthropic and government funding by leveraging the funds to unlock potentially trillions of dollars of commercial capital available in global market and thus mobilising commercial capital to finance socio-economic development Blended Finance structures are used to re-balance the risk–reward profiles of pioneering, high-impact investments that would otherwise be deemed too risky to fund. The catalytic nature of such transactions allows governments and foundations to address market failures by utilising their corpus of funds more efficiently and judiciously.

The figure below visualises how Blended Finance spans across the spectrum of financial returns and social impact. The innovative structuring approach brings together stakeholders with different risk appetites by aligning their incentives. For commercial investors, this means greater flexibility in capital allocation, while foundations and governments benefit from enhanced social financing. Furthermore, while different investors in a Blended Finance structure will usually have different return expectations, overall, the transaction expects to yield a positive financial return.

Blended Finance should thus be seen as a framework for investment rather than an investment class per se. Its application extends across segments on the social finance spectrum from ESG (market return) to impact first investing (below market return) to venture and traditional philanthropy. As its name implies, Blended Finance involves different types of investment working for a particular development purpose with a re-balancing of risks/returns.



*while different investors in a blended finance structure will have different return expectations, overall, the transaction expects to yield a positive financial return.

Exhibit 1: Blended Finance the Social Finance Spectrum

03

Blended Finance Interventions / Structures

Blended Finance structures can be categorised into four thematic archetypes based on the mode of intervention. It is important to note, however, that no matter the structures utilised, the goal is to help bridge financing gaps for large-scale development initiatives by overcoming barriers that may deter public & private funders from deploying capital for social impact.

Concessional Capital

Concessional capital encompasses the universe of catalytic funding from development organisations with the intention of bearing below-market returns and/or absorbing higher investment risk. This re-balancing of the risk-return profile through the use of catalytic capital helps make investments in the social sector more worthwhile for commercial investors who are looking for market returns but maybe risk averse. Common forms of concessional capital include subordinate and flexible debt, junior and first-loss equity and returnable grants.

Risk Mitigation Tools/Guarantees

Risk mitigation tools essentially function as a form of insurance for commercial investments into social impact. Unlike concessional capital that is often deployed hand-in-hand with commercial capital, risk mitigation guarantees a portion of future losses on an investment. In effect, such tools help augment market efficiency because capital is only used to cover losses when they actually occur. Furthermore, the very act of insuring potential downsides for investors helps amplify the flow of commercial capital into the social sector. Common forms of risk insurance include first-loss credit guarantees, advanced market commitments and local currency hedging.

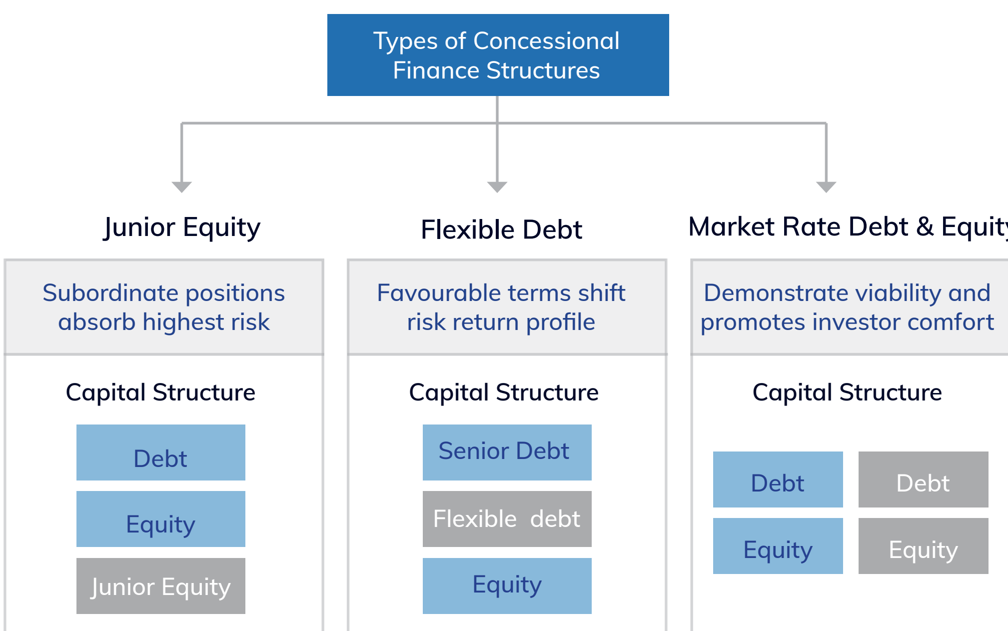


Exhibit 2 : Types of Concessional Finance Structures

- ***Support Mechanisms***
  Support Mechanism structures come in diverse forms and are often used to complement the other archetypes of Blended Finance. They aim to strengthen the quality, efficiency and sustainability of development projects and improve the financial viability of Blended Finance transactions by increasing the probability of financial close. Such structures also help cover transaction related costs while supporting capacity and pipeline building efforts with respect to end beneficiaries. Common forms of support mechanisms include technical assistance facilities, design stage grants and project preparation facilities.

- ***Results-based Financing***
  Results-based Financing is an innovative, outcomes-oriented or pay-for-success approach that incentivizes providers, and the investors providing their working capital, based on achievement of agreed-upon, measurable performance targets. Such structures are unique because capital is not deployed to satisfy the cost of inputs but to reward the achievement of desired outcomes by end beneficiaries. This ensures that all stakeholders are well aligned in their incentives as their level of financial return is correlated to the success of the development program. Results-based financing is one of the more novel domains of blended and innovative finance and is becoming increasingly popular due the accountability and efficiency it begets. Common forms of Results-based Financing include Social/Development Impact Bonds (as shown in the figure below), conditional cash transfers, debt swaps and outcome-linked interest rate loans.

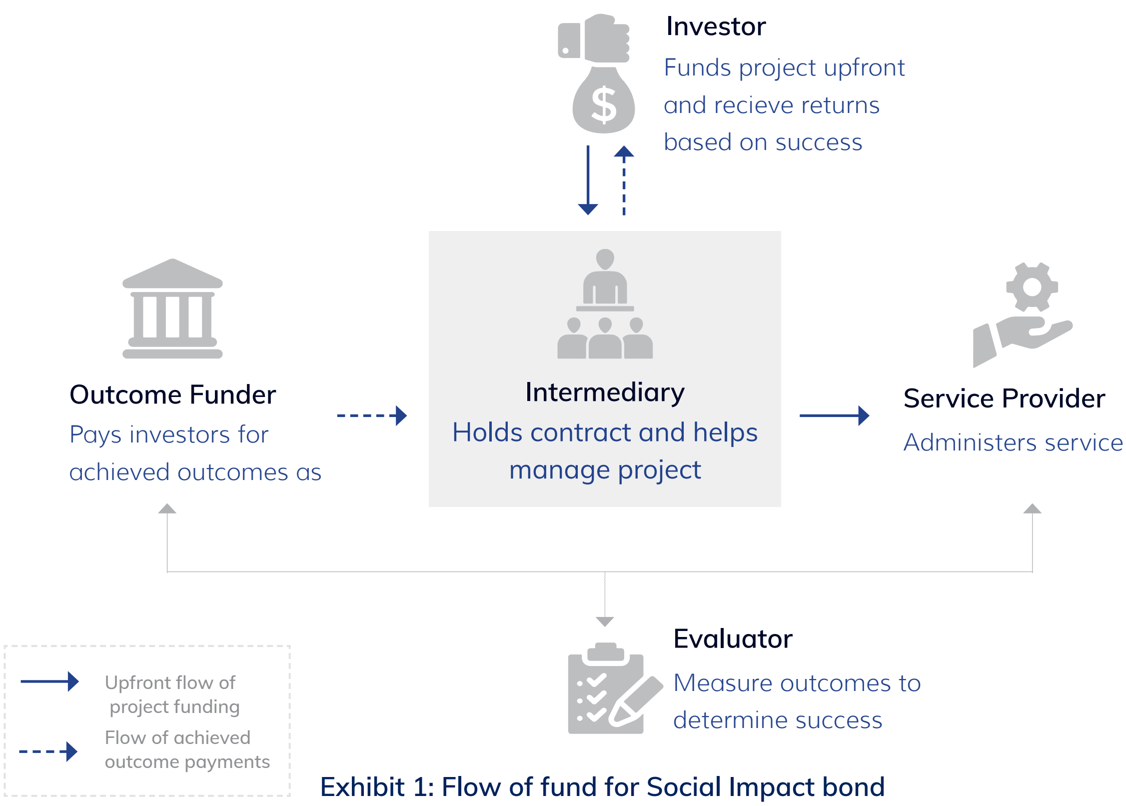


Exhibit 1: Flow of fund for Social Impact bond

04

Benefits for Stakeholders – Sarkaar, Bazaar, Samaaj

Blended Finance interventions help support the socio-economic agenda of all stakeholders in India's development ecosystem. By facilitating robust public-private collaboration, Blended Finance structures present a strong and unique opportunity for investors, foundations and government to collaborate in a way that build upon each other's strength while mitigating risks.

- *Sarkaar (Government / Policymakers)*
  Blended Finance can strengthen the government's efforts to support underserved and marginalised sections of society. The use of innovative financing structures can increase both depth and breadth of government programs to drive large scale impact through the following: support mechanisms include technical assistance facilities, design stage grants and project preparation facilities.

  1. Promoting Efficiency:
     Public funding for development is constrained by limited resources and it is therefore important to unlock additional sources of capital. Blended Finance not only allows governments to allocate funds more efficiently but also improves the robustness of existing social programs through private sector rigour and incentive structures for over-performance.

  2. Supporting Long-term Sustainability:
     Blended Finance creates an ecosystem that drives more resources from capital markets to the development sector, helping support broad based economic growth. Such a scenario uplifts a nation's economic potential in the long-term and strengthens the financial position of governments.

- *Bazaar (Markets / Private Sector)*
  Commercial investors in India (and the global South) have traditionally been wary of investing in the development sector due to unfavourable risk-return tradeoffs. However, the use of Blended Finance structures can support investors looking for market returns through the following:

  1. Risk Mitigation:
     The biggest deterrent to attracting more capital from VCs, PEs and other asset managers towards social impact is the high perceived risk associated with such investments. By shifting a part of this transactional risk away from investors, Blended Finance makes commercial investments into development sectors much less risky.

  2. Pipeline Building:
     Commercial investors may also be wary of investing in the development sector due a lack of opportunities that meet their standards for technical viability and proficiency. Blended Finance interventions improve the probability of an investment's financial and social success through capacity building and project support.

- *Samaaj (Society / Social Sector)*
  India's social sector is highly underfunded and thus limited in its scope and ability to drive large scale impact. Blended Finance structures can catalyse the flow of capital into the sector and support the development agenda of non-profits and foundations through the following:

  1. Scaling-up Interventions:
     Blended Finance structures help crowd-in commercial capital to amplify the development agenda of the social sector and support the deployment of innovative initiatives that would otherwise not have received funding.

  2. Promoting Accountability:
     Blended Finance promotes an emphasis on developing a performance management system that provides critical and timely feedback to non-profits and foundations/donors on their operations and helps achieve better results.

05

Key Challenges in Blended Finance

Despite Blended Finance's immense potential to create sustainable, catalytic impact, the ecosystem is still in its infancy in India. Building an environment that is conducive to the designing, structuring and execution of Blended Finance will require regulatory and financial reforms that can help attract more commercial investors into the sector. Some of the key challenges to the scaling up of India's Blended Finance ecosystem are highlighted below:

- *Restrictive Regulation:*
  In India, for funds to be recognized as charity, they need to be expended through non-profits. Therefore, the blending of commercial and philanthropic capital is difficult in the Indian regulatory landscape, since the current policy framework does not allow charitable capital to be invested into for-profit activities. This is in contrast to geographies such as the United States, where Program Related Investments (PRIs) allow charities to engage in for-profit activities directed towards social welfare, while Indian law does not approve charitable expenses to seek return on capital.

- *Non-standardised Impact Measurement:*
  The lack of standardised metrics and dearth of existing baseline data make it hard to define target outcomes in development programs. This lack of uniformity restricts the scaling up of Blended Finance transactions due to diverging views on how social impact should be measured. The considerable work being done to align impact measurement and management helps mitigate this risk.

- *Fear of Market Distortion:*
  The use of concessional capital to de-risk investments for commercial players has the potential to be negatively construed as an unnatural "subsiding" of market returns. Therefore, it is important to demonstrate that Blended Finance addresses market failures by benefiting all stakeholders involved.

- *Complexity in Structuring:*
  Blended Finance brings together entities that are experts in their respective domains, be it investing or philanthropy, but do not always have a good understanding of one another's perspectives. This lack of shared understanding adds to the complexity of structuring Blended Finance transactions that involve participation from multiple stakeholders who may or may not be able to align their goals.

06

Global Market Landscape and Trends

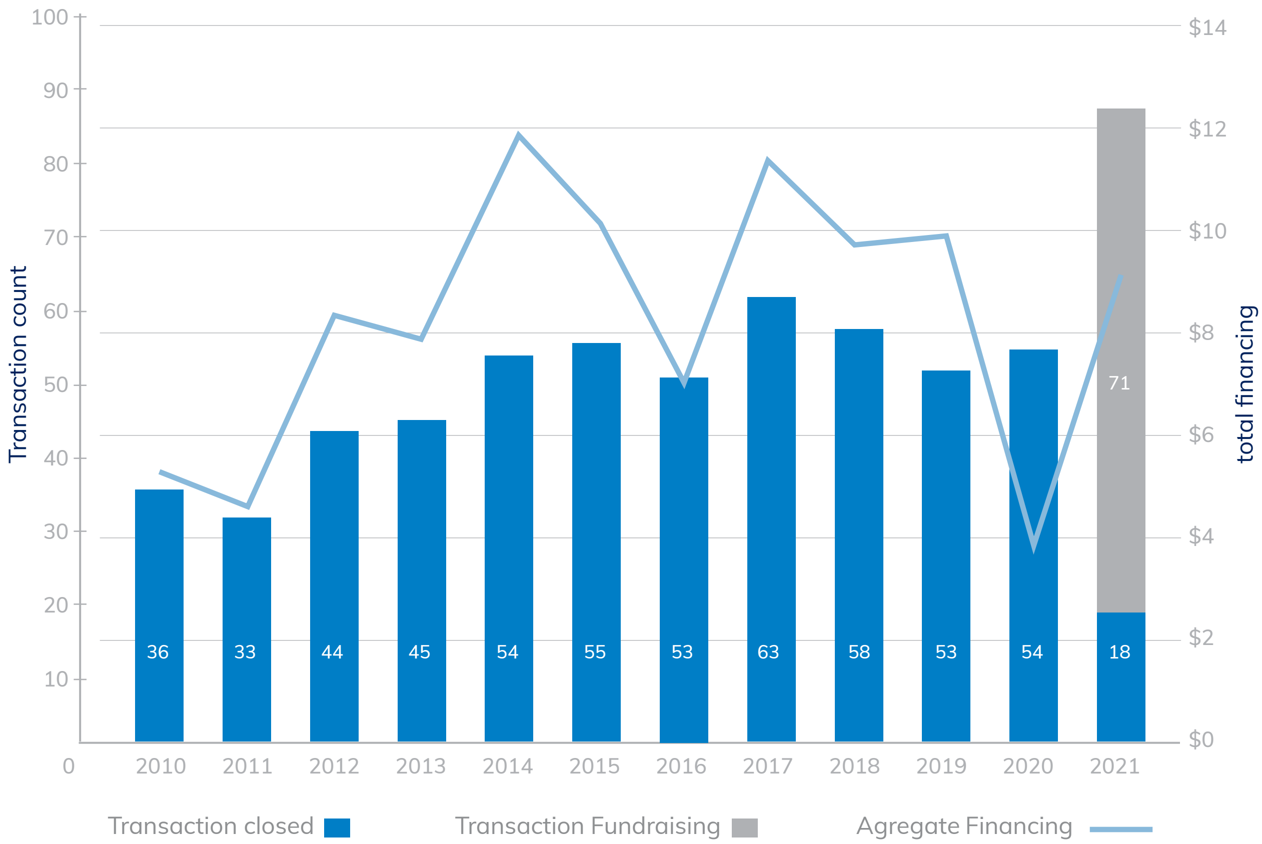


Exhibit 4: Growth in Global Market for Blended Finance (2010-2021)

Blended Finance structures have seen increasing traction from investors across the globe in recent years. To date, according to Convergence data, more than $160 billion in capital has been cumulatively deployed through over 4,000 Blended Finance transactions across sectors and geographies. The market has experienced a steady annual deal count over this period, averaging 55 closed transactions per year. The preliminary count for Blended Finance deals launched in the first half of 2021 is 89 of which 18 have already achieved financial close.

Geographically within emerging markets, Sub-Saharan Africa has been the most active region for Blended Finance transactions to date, representing more than 40% of the market historically, and demonstrating the relevance of Blended Finance for the most difficult development challenges.

The ecosystem in India has also witnessed sustained growth, and given the right support, is poised for accelerated adoption of more such innovative financing structures.

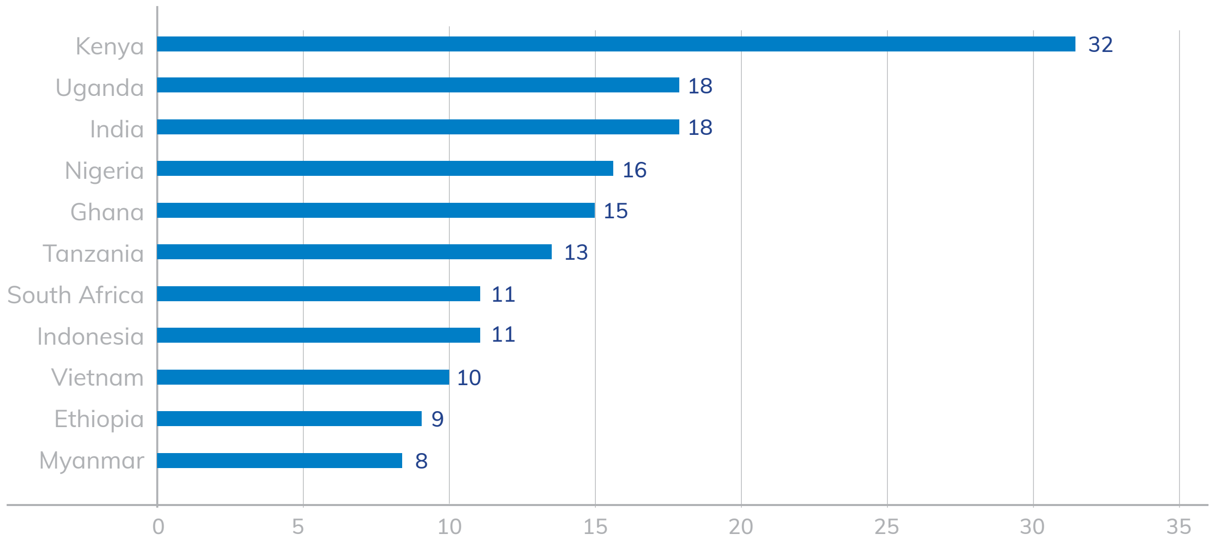


Exhibit 5: Top Countries for Blended Finance Transactions (2018-2020)

In terms of different Blended Finance structures, concessional capital has been the most widely used approach accounting for more than 80% of all Blended Finance transactions in 2020. The primacy of concessional structures reflects the level of comfort stakeholders have with this archetype. In particular, the flexibility of concessional capital given its many forms, be it subordinate debt or junior equity, makes it particularly attractive for commercial investors looking to de-risk their investments (even more so during the Covid-19 Pandemic). In recent years, however, we have seen greater innovation in financing structures with the rise of outcomes-based impact bonds and credit guarantee agreements that are also gaining traction.

A sectoral overview shows us that the energy sector has consistently accounted for the largest number of Blended Finance transactions in the market, over 30%. It is one of the few sectors where Blended Finance is commonly incorporated in project financing. Financial services, particularly in microfinance and small and medium enterprise (SME) banking, has the next biggest share while the Agriculture sector has seen its share rapidly grow over the decade.

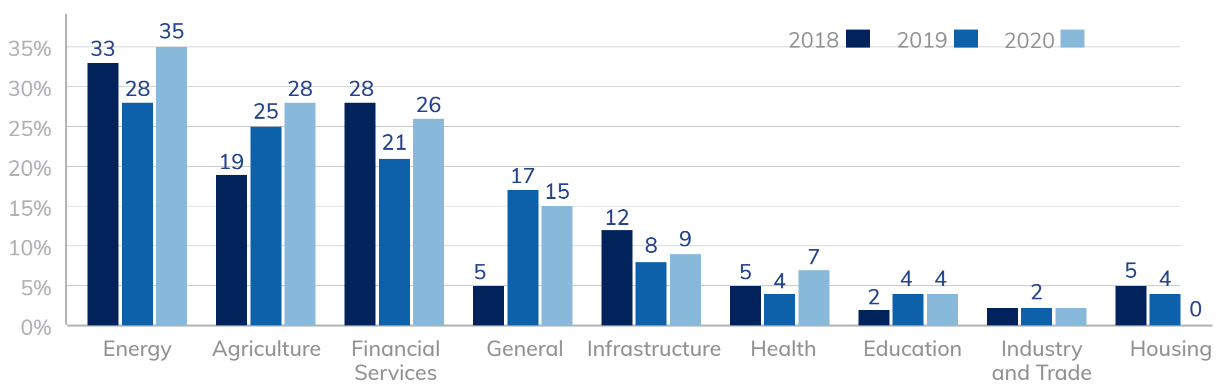


Exhibit 6 : Blended Finance Market by Sector

07

Blended Finance in India: Sector Interventions and Examples

Blended Finance structures have seen increasing traction from investors across the globe in recent years. To date, according to Convergence data, more than $160 billion in capital has been cumulatively deployed through over 4,000 Blended Finance transactions across sectors and geographies. The market has experienced a steady annual deal count over this period, averaging 55 closed transactions per year. The preliminary count for Blended Finance deals launched in the first half of 2021 is 89 of which 18 have already achieved financial close.

Impact funders and social entrepreneurs are well aware that our development challenges are highly specific to specific sectors, which have different types of risks and levels of ecosystem development. We have identified in the table below the relevance of different Blended Finance interventions for major sectors critically important for India's socio-economic development, and shared examples of different Blended Finance transactions that highlight each use case. While some financing structures are well suited to achieve desired outcomes across the board, some are better suited to unique, sector-specific business models. For example, the use of investment support mechanisms can help improve project viability and cover transactional costs universally. On the other hand, guarantee structures are better suited for sectors that involve a substantial use of credit, most notably financial inclusion. We have already seen the use of impact bonds in education/ skilling and healthcare, and are likely to see their application in climate related areas where in some ways measurement challenges are lesser (i.e. of measuring environmental outcomes like tons of waste versus social outcomes like healthcare levels). Concessional capital has a broad relevance and has been used across sectors including healthcare and agriculture due to its ability to de-risk and crowd-in new investments.

<table>
<tr><th></th><th>Risk transferred to private investors</th><th colspan="2">Risk borne by public / philanthropic investors</th><th>Risk mitigation strategy</th></tr>
<tr><th></th><th>Result based Financing (DIBs , SIBs etcs)</th><th>Guarantee Structures (FLDGs , SLDGs etc.)</th><th>Concessional Capital (sub-debt, Jr.equity etc.)</th><th>Support Mechanism (Technical Assistance etc.)</th></tr>
<tr><td>Skilling and Education</td><td rowspan="2">i. Securing multi-year upfront financing
ii. Reducing donor risk as outcome funding is dependent on success</td><td rowspan="2"></td><td></td><td rowspan="5">i. Developing a stronger pipeline of investable projects through capacity building
ii. Addressing technical viability by absorbing project related costs
iii. Accelerating commercialization of solutios through post investment support</td></tr>
<tr><td>Healthcare</td><td rowspan="4">i. Crowding-in commercial capital through favorable consessionality in capital
ii..De-risking investments in early stage, innovative ventures</td></tr>
<tr><td>Financial Inclusion</td><td></td><td>i. Rebalancing risk-reward spectrum for last-mile lenders
ii. Crowding-in commercial capital through leverage</td></tr>
<tr><td>Climate</td><td>i. Funding measurable outcomes taht directly mitigate climate change
ii. Facilitating robust performance and climate impact measurement</td><td rowspan="2"></td></tr>
<tr><td>Agriculture</td><td></td></tr>
<tr><td>Case study #</td><td>1. 2.</td><td>4. 5.</td><td>3. 6. 7. 8.</td><td>3. 7. 8.</td></tr>
</table>

Exhibit 7: Mapping Blended Finance Interventions to Social Sectors

The last few years have seen the emergence of a vibrant social finance ecosystem in India. The tables below outline some examples of Blended Finance transactions in India that have helped create both financial returns and social impact. As evident, such structures are able to achieve their stakeholders' desired outcomes without being limited by sector, fund size or blending approach.

Further case studies of each of the eight examples is provided in the appendix.

Case study #	Name	Sector	Structure (s)	Geography	Size ($Mn)	Indian Government Involvement	Concessional Risk/ Guarantee/ TA	Outcomes
1.	Skill India DIB	Skilling	Impact Bond	India	14.4	Yes	NSDC, MSDF	50,000 Youth supported through training; 60% of girls
2.	Educate Girls Bond	Education	Impact Bond	India	0.42	no	UBS Optimus Foundation	Learning outcomes for students grew by 79% more than their peers in other schools
3.	Samridh BF Facility	Healthcare	Concessional Capital +TA	India	250	Yes	USAID, Rockefeller, Donors, CRS etc	Supporting 40+ healthcare innovators using market forces to empower vulnerable populations
4.	Watercredit Investment-Fund	Financial Inclusion/ WASH	Guarantee	India, Indonesia, Cambodia, and the Philippines	50	no	WaterEquity	200K+ people given access to sanitation, 90% borrowers women
5.	CDC NAC Pooled Bond Issuance	Financial Inclusion	Guarantee	India	43	no	NAC, Arohan, ASA, Chaitanya	Provide 630K+ new loans to underserved female and rural borrowers.
6.	The solar energy transformation (SET) Fund	Climate	Concessional Capital	South Asia, Sub-Saharan Africa	70	no	US DFC, Ikea Foundation	Provide 2.8 Mn people with improved access to clean energy and mitigate over 480K tons of CO2 emissions annually.
7.	Sub-national Climate Finance Initiative	Climate/ Agriculture	Concessional Capital +TA	Global	150	no	Green Climate Fund, IUNC	Support small-and-medium size sustainable infrastructure projects in developing countries.
8.	Seaf India Agribusiness fund (SIAIF)	Agriculture	Concessional Capital +TA	India	41.8	Yes	Omidyar Network, SIDBI	48K+ jobs created to MSMEs and increasing revenues by $760 Mn

Exhibit 8: Examples of Blended Finance Transactions in India

08

Blended Finance in India: Ideas for the Way Ahead

Given such a range of possibilities and evidence of a thriving ecosystem of both funders and service provider, Blended Finance can clearly play a key role in the collective responses of the government, foundations and investors to accelerate India's socio-economic development. Despite the challenges to the full development of a fully efficient social capital market, be it regulatory or financial, the specific models and interventions that have been outlined can help India create an enabling and collaborative environment to drive last-mile impact.

Re-imagining the traditional grant-making model to help mobilise commercial capital would not only augment resources for national development efforts but foster an ecosystem that can revolutionise the way we think about financing social impact. This requires coordinated action among multiple stakeholders and is thus greatly facilitated by government recognition of the importance of social finance broadly and developing an enabling regulatory environment as evident from the CSR regulations to emerging standards on ESG to recent budget

announcements on creating government-backed blended finance vehicles for action areas like climate to the Social Stock Exchange, where blended finance structures could be listed. To conclude the white paper, we outline specific ideas and recommendations on Blended Finance initiatives that the Government of India (GoI) could adopt in key social sectors:

Agriculture

India faces inherent technical challenges when it comes to agriculture, particularly with respect to subsistence farmers. Most agriculturists in India do not have the resources and know-how to adopt newer technologies and innovations, a scenario that leads to subdued crop yields and therefore lower incomes, on already small plot sizes. This vicious cycle continues to hamper India's economic growth as the agriculture sector continues to be the nation's biggest employer.

To mitigate this predicament, GoI can set up a Technical Assistance (TA) Facility to support and help facilitate the adoption of precision-ag deep-tech technologies across the agri-value chain through capacity building efforts. This is particularly important in areas such as the processing of crop stubble, the burning of which contributes to high levels of air pollution in North India, a major public health hazard, and across value chains that are water and energy intensive.

Furthermore, a dedicated Agricultural Fund of Funds (FOF) can be set up with allocations for equity funds, debt funds and ecosystem development funds focusing on agri innovations. The FOF could take anchor positions in specialised agri-equity and debt funds, incubators, accelerators and other that help drive impact while creating a strong business ecosystem.

Education, Skilling and Healthcare

India continues to struggle with poor learning outcomes and high rates of youth unemployment. Therefore, there is a pressing need to unlock greater flows of capital into education and skilling. However, given the inherent risks, it is important to finance projects that can show measurable improvement in outcomes, thereby building confidence in the sectors' financial viability.

Healthcare is the other critical driver of socio-economic development and a priority sector which, like education, faces issue of capacity, quality and productivity with vast urban-rural disparities but increasing investment and innovation due to technology adoption, accelerated by the pandemic. Here also, for providing basic services to highly marginalized segments of the population, commercial investment will not be available, and philanthropy will not be enough.

A 'pull-based' approach that attracts diverse sources of capital is therefore critical. A powerful tool that helps achieve these aims is that of Results-based Financing, and in particular Impact Bonds. Through impact bonds, private investors can help absorb the initial financial risks involved in projects that focus on improving learning outcomes or healthcare levels. Once outcomes are met or exceeded, the outcome payer pays back the private investors the principal plus added interest proportionate to the level of the bond's success, incentivizing market efficiency. Government participation as outcome payer would attract significant interest from risk investors to finance non-profits; currently most bonds have foundations as outcome funders.

The private capital invested in such impact bonds can be seen as recyclable grants where the risk investor is likely to re-invest the proceeds receiving from the outcome funding in newer impact bonds once the desired outcomes are established. To build the ecosystem for impact bonds the Government can set up an 'Outcomes Lab' on the lines of the UK parallel to help finance and catalyse the design of such innovative results-based financing structures.

Financial Inclusion

The universe of financial inclusion, directly or in-directly, plays a critical role in shaping the flow of capital across sectors be it through agri-financing, health financing or edu-financing. Microfinance is a well known success story as is housing and vehicle finance. However, the most important financial inclusion focused innovations – both in variety and scale – have been to support micro, small and medium enterprises (MSMEs), the engines of India's economy.

A significant portion of India's MSMEs' working capital needs are funded through small, impact driven NBFCs. There is a need to recognize and support such impact NBFCs at a regulatory level to help unleash the full potential of MSMEs. Such an effort would go a long way in increasing rural incomes and decreasing unemployment rates given the employment they generate. In order to do this, GoI can look at setting up a dedicated Credit Guarantee Fund for Impact-driven Early-stage NBFCs. The corpus can be allocated between industry bodies and government in a predetermined ratio and be used to reassure impact NBFCs that, in the event that an MSME unit, fails to discharge the liabilities, the guarantee fund can cover the losses.

Furthermore, innovative impact-linked debt instruments that offer interest rebates can be considered across a variety of sectors for social or environmental performance of the MSME that is receiving the loan. Loans can be provided by the government to impact NBFCs that are focusing on last-mile inclusion. Depending on the NBFCs level of engagement with first to credit customers and MSMEs, low cost refinance or interest rebates can be offered to such NBFCs to pass on the benefits of concessional capital to the most underserved borrowers.

Climate Change

Climate Change mitigation, adaptation and resilience has taken centre stage in global sustainable development as the world moves towards a carbon neutral future. India has itself announced that the nation would be carbon neutral by 2070, requiring the GoI to take a proactive role in climate financing in collaboration with large foundations and development finance institutions to fund the transition costs and emerge as a climate competitive producer.

There is an urgent need to support innovators who can develop indigenous technologies to drive decarbonization. GoI can help establish accelerators and incubators that support early-stage climate innovations such as The ACT4Green accelerator programme by the Foreign, Commonwealth and Development Office (FCDO) of the UK Government. The early-stage support can be in the form of catalytic grants, flexible equity and capacity building.

We can also set up a Sustainable Finance Pooling Vehicle (SFPV) under the Ministry of Environment, Forest and Climate Change (MoEF), taking inspiration from SIDBI's SMILE fund that provides catalytic debt to MSMEs. Such a SFPV can support decarbonization in high polluting sectors such as Steel and Petrochemicals by funding the adoption of cleaner technologies through innovative financing mechanisms. GoI can also look at setting up a FOF that invests in funds managed by impact investors focusing on climate-tech investing.

Below is a summary of the above recommendations which collectively form an ambitious agenda, but one the government must consider seriously given the potential of Blended Finance as outlined in this white paper, to unlock the development capital to fuel's India rise this century.

Sectors	Recommendations for Government of india (GOI)
Agriculture	i. Launching a Technical Assistance (TA) Facility to support and help facilitate the adoption of precision-ag deep–tech technologies. ii. Establishing a dedicated Agricultural Funds of Funds (FOF) with allocations for equity funds, debt funds and ecosystem development funds.
Education, Skilling and Healthcare	i. Participating as an outcome funder in impact bonds to attract more commercial capital. ii. Building the ecosystem for impact bonds by setting up an 'Outcomes lab' on the lines of the UK.
Financial inclusion	i. Setting up a dictated Credit Guarantee Fund for impact-driven early-stage NBFCs to strengthen ecosystem development. ii. Funding impact NBFCs through impact-linked debt instruments offering rebate propotional to measurable social impact.
Climate change	i. Establishing accelerators in incubators that support ear ly-stage climate innovations ii. Setting up a Sustainable Finance Pooling Vehicle (SMPV) to fund decarbonization in higher polluting sectors.

Exhibit 9 : Sector-wise Blended Finance Recommendations for GoI

About IIC

Impact Investors Council, India (IIC) is a member-based industry body to help build the impact investing eco-system, present a compelling and comprehensive India Impact story and strengthen Impact Investing in India. IIC is registered as a not-for-profit entity, Section 8, 80G, 12AA company and is funded through membership fees from members. IIC enjoys active support from over 50 prominent impact Investors and ecosystem players.

About D&A

Desai & Associates (D&A) is an innovative finance focused research, investments and advisory firm helping funders, founders and policymakers identify, structure and deploy innovative solutions to sustainable development challenges in climate, inclusion and livelihoods. Its mission is to drive better capital allocation and tri-sector collaboration on intersectional development issues and help democratize knowledge to deepen the capacity of the social and sustainable finance ecosystem in emerging markets.

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Appendix: Case Studies

1. Skill India Impact Bond

Instrument: Development Impact Bond (Multi-provider)

Geography : *India* **Sector** : *Skilling* **Size** : *US $14.4 Mn*

The National Skill Development Corporation (NSDC) launched the first-of-its-kind Impact Bond for skilling in India in collaboration with global partners in 2021 - HRH Prince Charles's British Asian Trust, the Michael & Susan Dell Foundation (MSDF), The Children's Investment Fund Foundation (CIFF), HSBC India, JSW Foundation and Dubai Cares, with FCDO (UK Government) & USAID as technical partners. The Skill Impact Bond involves US$ 14.4 million of outcome funding which will benefit 50,000 youth by making them employment ready.

NSDC and MSDF are the risk investors and have committed US$ 4 million to provide upfront working capital to the service providers to implement the programme for the lifetime of the impact bond, in this case four years. 60% of the target beneficiaries are women and girls and the objective is to equip them with skills and vocational training. The bond aims to provide access to wage-employment in Covid-19 recovery sectors including retail, apparel, healthcare and logistics.

2. Educate Girls Impact Bond

Instrument: Development Impact Bond (Single-provider)

Geography : *India* **Sector** : *Education* **Size** : *US$0.42 Mn*

Educate Girls along with UBS Optimus Foundation (UBSOF) and Children's Investment Fund Foundation (CIFF) launched the World's first Development Impact Bond (DIB) in education. This 3-year (2015-2018) project tied repayment of initial investment to pure outcomes and was intended to be a proof-of-concept. The DIB had a project budget of US$ 270,000 and reached 7,300 children, covering 166 schools across 140 villages in Bhilwara, Rajasthan. Its targeted outcomes were increased enrolment of marginalised girls and children's progress in literacy and numeracy outcomes, assessed by independent evaluator, IDinsight, over the course of the 3 years' tenure. Results-based financing consultancy, Instiglio, designed the DIB and provided performance management support to Educate Girls.

3. SAMRIDH Blended Finance Facility

Instrument: Concessional Capital + Technical Assistance

Geography : *India* **Sector** : *Healthcare* **Size** : *US $ 250 Mn*

Sustainable Access to Markets and Resources for Innovative Delivery of Healthcare (SAMRIDH) is a blended finance facility supported by the United States Agency for International Development (USAID) in collaboration with Atal Innovation Mission (NITI Aayog), Principal Scientific Advisor to the Government of India, the National Health Authority, Indian Institute of Technology (IIT Delhi), AxisBank, IndusInd Bank, Caspian Debt, Rockefeller Foundation, Crypto Relief and NATHEALTH, and is managed by IPE Global.

SAMRIDH has mobilised a capital pool of $250 million to offer both grant and debt financing provision to healthcare enterprises and innovators, to augment their capacity for production and supply of high impact health solutions. This is complemented with a strong technical assistance and capacity building component. Since its launch in 2020, Samridh has made over 20 investments in health-tech innovations and service delivery models with an explicit focus on inclusion for the most vulnerable populations and pandemic-induced priorities.

4. WaterCredit Investment Fund 3 (WCIF3)

Instrument: Guarantee Structure

Geography : *Asia* **Sector** : *Water & Sanitisation* **Size** : *US $ 50 Mn*

WaterCredit Investment Fund 3 (WCIF3) is a blended fund that provides debt financing to financial institutions and enterprises serving the water and sanitation needs of families living in poverty in Asia. WCIF3 was launched by WaterEquity, an impact investment manager established by Water.org co-founders Gary White and Matt Damon. WCIF3 is WaterEquity's first fund to use Blended Finance and consists of tiers of equity, catalytic debt facilities including multiple zero- and low-interest loans, and a first-loss guarantee. This risk mitigation structure allows the fund to on-lend at considerably lower than market rates, required for the adoption of 'push-based' items like construction of water or sanitation facilities in rural areas.

WCIF3 achieved its final close at $50 million in March 2019, attracting investments from a range of impact investors, including foundations, high net-worth individuals, and development finance institutions and has focused its deployments to microfinance institutions.

5. CDC NAC Pooled Bond Issuance

Instrument: Guarantee Structure

Geography : *India* **Sector** : *Financial Inclusion* **Size** : *US $ 43 Mn*

The CDC Group, a development finance institution (DFI) and an impact investor in the UK, has partnered with Northern Arc for its first-ever pooled bond issuance (PBI) transaction in India. CDC's US$ 43 million investment in a pool of senior secured non-convertible debentures (NCDs) will provide systemic liquidity to six leading Indian microfinance institutions including Annapurna Finance, Arohan Financial Services, ASA International, Asirvad Microfinance Limited, Chaitanya India and Fusion Microfinance.

This investment is expected to support the MFIs in providing over 630,000 new micro-loans to low-income households, primarily female and rural borrowers, increasing their access to finance and enabling them to manage cash flow and maintain or grow their businesses.

6. Solar Energy Transformation (SET) Fund

Instrument: Concessional Capital

Geography : *South Asia* **Sector** : *Climate* **Size** : *US $ 70 Mn*

The Solar Energy Transformation (SET) Fund managed by SunFunder is a $70 million fund that aims to increase access to capital for high impact beyond the grid solar companies and projects across Sub-Saharan Africa and parts of Asia for the over 2.2 billion people around the world have either no access to grid electricity or have unreliable power and for whom solar energy can solve a large part of the problem in an economical and scalable way.
By financing solar businesses through the SET Fund, SunFunder expects to directly impact 2.8 million people with improved access to clean energy and mitigate over 480k tons of CO_2 emissions annually.

7. Sub-National Climate Finance (SCF) Initiative

Instrument: Concessional Capital + Technical Assistance

Geography : Global

Sector : Climate

Size : US $ 750 Mn

SCF is expected to be the first Private Equity fund to feature a Technical Assistance Facility that provides local government capacity building and certifies all projects for SDG impact prior to investment. SCF seeks to remove barriers to the sourcing, financing and sustainability certification of mid-sized sub-national infrastructure projects by (1) De-risking projects through concessional finance and technical assistance, while offering larger investable opportunities through the fund format; (2) Sourcing deals through a Technical Assistance Facility (TAF) which will also ensure standard governance, reporting, and local government capacity building; and (3) Certifying all projects using internationally recognized methodologies for environmental and social impact.

The Consortium estimates that the SCF concessional tranche could mobilise 4x private finance at the fund level and up to 24x at the project level. With a target fund goal of USD 750 million, the initiative could generate up to 1.8 GWh of renewable energy per year, create 20,000 direct jobs, avoid 3.8 million tonnes of CO_2 annually and, over its lifetime, improve urban living conditions for 17 million city dwellers.

8. SEAF India Agri-Business Fund (SIAF)

Instrument: Concessional Capital + Technical Assistance

Geography : India

Sector : Agriculture

Size : US $ 42 Mn

SEAF established the SEAF India Agribusiness International Fund (SIAIF) in 2010 to target promising SMEs across thirty-three identified sub-sectors of India's agribusiness value chain. SIAIF offers equity, mezzanine investment as well as term credit to such enterprises. Bolstered by a local team of experts in agribusiness finance, SEAF applies its global agribusiness experience, along with local sector knowledge, to generate substantial growth in Indian SMEs. SIAF provides long term investments with a double bottom line mission: to promote socially responsible economic development in India while generating a competitive return on investment.

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Endnotes and References

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