When capitalism and philanthropy join hands: Why impact investment matters for India

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Impact financing is the financing of enterprises that promise financial returns as well as measurable socio-economic progress in a demography. Socio-economic progress usually relates to alleviation of poverty and improving standards of living. Some of the conventional areas attracting impact financing have been health care, education, finance and sustainable infrastructure like renewable energy, housing, public transportation, water and waste management and agriculture.

Today much of the clamour around the phrase ‘impact financing’ is due to the realisation that capitalism and philanthropy cannot achieve impact goals if they operate in silos. With this realisation also exist untapped opportunities. India offers a huge market potential for impact investors with its vast, underserved, unbanked population, aspirational lifestyle, increasing entrepreneurial mindset, fragmented infrastructure and a steady political climate.

Since the liberalisation of the early 1990s, the Government of India has made sustained efforts towards ensuring the availability of finance to impact sectors. The encouragement came in the form of active measures like liberalising foreign debt and equity investment regimes, promoting newer sources of financings like development finance institutions, and small finance banks, multilateral institutions, infrastructure investment funds, strengthening shadow banking regime, etc. Reactionary steps like leeway in taxation, rate cuts, subsidies and grants also played a pivotal role from time to time. This also inspired the bullish approach of some of the domestic investors. Admittedly resulting in a setback to some of the sectors due to weak underwriting and inadequate due diligence.

Rethinking impact and returns

As these sectors recover from the setback, India is also witnessing a digital revolution. The revolution is marked by the emergence of new markets. These markets stand on the strength of technology-aided services and access to untapped retail and intellectual capital. The products range from financial services, energy conservation, affordable housing and healthcare, space technology, underwriting solutions, data analytics to logistics. The impact crusaders today are not only large corporates, giant NBFCs and other conventional investors, but also the local technology-based facilitators finding their worthy place in the value chain.

Traditionally, the promise of return and impact for financing in this sector extended over a long tenure. Long-term private debt funding constituted an obvious and dominant share of these financings. These financings were often subject to cumbersome monitoring requirements and exposed to regulatory and market uncertainty. Financings in this sector were also severely limited by end-use restrictions on low-cost foreign funds. However, the last few years have seen sustained efforts on liberalisation and rationalisation of foreign exchange norms giving the much-needed relief to foreign investors in the form of shorter lock-in periods and fewer end-use restrictions, enabling investments in mature brownfield projects and emerging sectors alike.

Structuring credits — a few options

Outside of the regular FDI, bank and NBFC channels, some of the private debt investment regimes worth exploring would be:

- The liberalised ECB framework reducing the average minimum maturity requirement of borrowings to 3 years except for certain specified end uses where it is 5, 7 or 10 years;
- The voluntary retention route for FPIs with on tap limits for corporate bonds, voluntary maturity thresholds (subject to a minimum of 3 years) and exemption from concentration norms;
- The regular FPI route with minimum short-term maturity of 1 year for corporate bonds subject to monitoring of caps on total annual redemption at a portfolio level;
- The FVCI route with a combination of debt and equity-linked instruments in permitted sectors such as infrastructure, biotechnology, R&D in pharmaceuticals, and start-ups (agnostic to sectors) etc.;
- The AIF route which is virtually without any material restrictions on maturity and end use.

Key takeaways for investors

Investors can now structure products that cater to both returns and impact in short term-safeguarding against regulatory and market uncertainty. Financing can be provided directly to impact entrepreneurs, allied services providers, and even to the investors looking to build or having an established portfolio of such investments.

Of course, as markets evolve, concerns of effective underwriting, consumer protection, data protection and privacy, adverse social, economic and environmental impact will loom over. However, due diligence, monitoring and supervision from investors will go a long way in inducing best practices and protecting interests.

With a general permission for security over Indian assets for such debt investments and recognition of these investors as ‘financial creditors’ under the Insolvency and Bankruptcy Code of 2016, concerns from insolvency perspective also stand mitigated.

Promising future

With some of the traditional concerns around debt financing being addressed, technological innovation and regulatory recognition of it have made it even more promising. Like the previous decade was marked by reforms and innovations, 2020-2029 would be a decade of systematic landscaping of impact ventures, and investors can play a decisive role in steering, and profiting from this growth.

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