Impact Bonds - Bridging Funding Gaps for SDGs

What is the issue?

- According to a study, the estimated financing gap for achieving the Sustainable Development Goals (SDGs) stands at Rs. 533 trillion.
- It highlights the dire demand for financing to achieve the SDGs, wherein Impact Bonds could help.

How can the private sector contribute?

- Besides government, the private sector could potentially be of aid in bridging the financing gap in achieving the SDGs.
- Many companies are also leading efforts in provision of clean water, sanitation and healthcare.
- The Corporate Social Responsibility (CSR) spending requirements stipulated in the Companies Act of 2013 is helping significantly.
- In the 2015-16 financial year, a total of around Rs 9,800 crores was spent for CSR.
- However, these efforts remain at a small scale and are often fragmented.
- Government agencies are hesitant to scale up these innovative and new projects.

What are the limitations?

- Governments de-prioritise such projects and hesitate to spend taxpayers' money.
- It's because there is a potential risk of failure in these projects.
- The financial and political ramifications of failure could be devastating.
- Besides, many successful projects that have been scaled up often lack a proper system of checks and balances.
- It is simple to ensure the effectiveness and efficiency of small-scale projects through close monitoring.
- But such monitoring is not feasible for national or state level projects.
- This often leads to leakages and an overall deterioration in quality of output.
- To address this, many funders (government and foreign agencies) have implemented homogenous and rigid practices across the board.
- But again this causes the third problem of excessive rigidity.
- Resultantly, local project implementers are unable to make changes and

adjustments to a project based on local circumstances.
- This often leads to a drop in the overall efficiency and effectiveness.

How can Impact Bonds (IBs) help here?

- Essentially, IBs are non-marketable bonds where repayment is contingent on the outcomes of the project they fund.
- E.g. Impact Bond in education - an NGO that has perfected an intervention to improve reading and math skills of rural children in Bihar
- With Impact Bond, governments can raise capital for scaling up these interventions, without incurring huge risks.
- The government can issue Impact Bonds to private impact investors to raise upfront capital for the NGO to scale their project.
- Unlike normal bonds, for IBs, repayment by the government is only triggered if certain pre-determined targets are achieved.
- The targets would generally be measurable by quantitative metrics such as average reading scores in standardised tests.
- The targets are generally evaluated by an independent evaluation agency.
- If the targets are met, the government pays back the principal along with a return to the private investors.

Why are IBs a better option?

- Through IBs, NGOs get the capital they need to scale up their innovative solutions.
- Likewise, private investors get an opportunity to make profits from projects that do social good.
- On the other hand, the government transfers the risk of failure onto private investors and only pays for successful projects.
- Given that investors lose all their money if the project fails to deliver, they prefer keeping themselves updated, and scrutinise the progress.
- This would automatically both improve transparency and add a layer of checks to ensure success of the projects.

- Being outcome-based, Impact Bonds promote innovation by giving a substantial degree of freedom to the service providers.
- No other existing funding contracts provide this mix of benefits in funding for large scale innovative social projects.

What is the way forward?

- Impact Bonds provide an incredible opportunity for local, state and central government agencies.
- It can be used to leverage India’s private sector to source funding for the

implementation of innovative solutions to reach SDG targets.

- But there is a need for mature engagement from both the government and private investors for successful use of IBs.
- The bond should be transparent and enlist all relevant details for stakeholders to understand the risks involved and their severity.
- Ensuring such high requirements of transparency and cooperation from Indian private and public sectors is a challenge.

Source: Business Standard

SHANKAR IAS PARLIAMENT
Information is Empowering