**TISS-NORRAG – Teaching Case Study on India Education Outcome Fund and the Development Impact Bond**

**Transcript of Interview with Mr. Nirav Khambhati, Kaizen Private Equity**

**M: I have a bunch of questions on these two broad areas but feel free to go in any order. Firstly, I wanted to actually understand how Kaizen got involved, when did it get involved, why and how did it come in the picture and are you also involved in the impact bond on language learning.**

R: Yeah so actually Kaizen’s involvement in this is quite fortuitous but before I get there let me just tell you about what Kaizen does. Are you aware of who Kaizen is and what we do?

**M: Yes, I have gone through your website, I have also looked at your south East Asia report, I was not able to download the India report for some reason but I…**

R: I can send that across to you, so essentially the point that I wanted to make is that we are an entirely education focused entity and we only make education investments right now in south and south east Asia and now looking at other geographies as well including Africa. So as luck would have it I mean when I was leaving Tata’s to join Kaizen in around December of 2017 there was this announcement around India Education Outcome Fund and in that press release there were names like Amit Bhatia and Ashish Dhawan and Ashish Dhawan I have known for some time, so I essentially reached out to him and I said I mean this sounds very interesting I would like to know more which is when he put me in touch with this gentleman Amit Bhatia who at that point was sort of in some ways chief convener for this initiative, he is the CEO of Global Steering Group, so I met Amit and Amit at that point said at this point in time you know we are in a phase where there’s a lot of thinking to be done for us to put various pieces together and there was a working group established with the likes of McKinsey and Nishith Desai Associates, Asha Impact and a bunch of other well-meaning individuals who were part of this core group doing brainstorming and trying to sort of chart the way forward and I actually joined that group on Amit’s invitation and I started participating in their deliberations, so that’s how I got involved and then in the process you know one realized that there is a role for a venture investor in the whole construct of DIBs and SIBs I mean I got to learn about all that only once I became part of the initiative and then subsequently when I moved to Kaizen I realized that Kaizen there was already an effort underway to see how Kaizen can do more at the bottom of the pyramid and be more impactful in what we do with our funds. So I thought the two fitted well together which is when I sort of explained the concept to the partners at Kaizen, it took some time for them to understand and fully grasp the concept but at some point we realized that you know the entire effort can be very synergistic with what we were trying to do at Kaizen and that’s how the involvement began.

**M: Approximately what time period was this?**

R: The first meetings happened in December of 2017, I joined Kaizen in April of 2018, so four months prior to my joining Kaizen I started sort of involving myself in the IEOF discussions.

**M: So are you also involved with the new impact bond which is going to be launched now in Haryana, is Kaizen also involved?**

R: No, we are not involved in the impact bond. So at one point in time the thinking and how Kaizen got involved was that there is a large fund setup I think the numbers quoted at that point was about a billion dollar fund which gets setup on the outcomes side and then there is a corresponding about 700-800 million dollar fund which gets created on the risk side and our intention was to partner as a risk capital provider for the full effort, I think what has happened subsequently is maybe in the process of trying out, testing out this space I think IEOF is also looking at some experiments which are more I think finite and smaller, the effort that’s going on in Haryana is part of that. So from our perspective I think what we would do is look at this as a fairly large fund like initiative, given the nature of our operation it will be difficult for us to participate on a one off project, because what happens is when things move forward we raise a fund and then out of the fund we deploy. So therefore, at this stage we have not participated in what they are doing in Haryana.

**M: Okay so currently the involvement is only with the IEOF and raising risk capital overall.**

R: Yes.

**M: So what does that actually entail I mean has that work already started, what does that role entail?**

R: So like I said when I brought this to Kaizen there was already some thinking underway at Kaizen for Kaizen to be more impactful at the bottom of the pyramid, so what we are doing right now is we have an initiative that is underway and which is in advanced stage and IEOF from our perspective the risk participation in IEOF is a subset of the larger initiatives which is underway, so that larger initiative is essentially around bringing smart capital to affordable private schools in emerging nations. It’s called the Kaizen Edu Finance Fund KEF as we call it or Kaizen Edu Finance and the idea there is basically as you know in emerging markets where the government systems are failing, lot of parents are sending their children to these affordable private schools. So today in India as many as 40 to 45% of all school going children attend these affordable private schools and there’s a fairly large migration underway from government schools to these affordable schools because parents are not happy with the quality of education the children receive at government schools and plus the teaching in some of these affordable schools is in English which is seen as something which enhances career prospects. So the thing that these entrepreneurs who are running these schools mostly lack is access to affordable capital that is because most of them have been teachers in their previous lives and now are trying to setup something of their own, they have very little capital of their own or from the family and the local loan providers charge them exorbitant rates, so now this is a well-documented issue and you know there’s lot of research globally that has been done around the issue of affordable private education and the challenge of financial access that these entities face.

India today is at the forefront globally of solving this problem. So, there are organizations like Varthana and ISFC to become very large and successful schools-focused financing entities. And they have been funded by global impact investors, they have been given debt by global impact investors and they in turn then use their capillary to reach out the affordable private schools. In fact, Varthana we are an early investor as Kaizen in Varthana, so we have seen this phenomenon happening first hand and we truly believe that this is one thing which is the ability to make very large difference in education globally.

The other thing that affordable private education is yet to prove is that they actually end up delivering better quality then government schools. What has been documented is that they do offer almost the same quality but at 1/3rd the cost, that has been documented but whether they have the ability to deliver better quality is yet to be proven and that too at scale.

Another thing that we are doing with the fund is that we are creating a rewards and recognition mechanism so that schools that are able to demonstrate improvement get very significant financial rewards in form of not just loan rebate but also principal rebate, so interest and principal rebate. So, our main fund with KEF Kaizen Edu Finance itself is a blended financial instrument. So, we take commercial capital and impact capital into the fund and that is used for giving loans to schools. On top of that there are philanthropic organizations who are partnering with us and they fund the rewards and recognition and they are happy to do that because from their perspective this is a performance linked award, so they don’t have to spend anything until the schools have actually demonstrated the improvement.

Now from our perspective the IOEF initiative is a subset of this fund as we are raising this fund, so we just begun the effort of fund raised in September, it is a 150 million dollar fund with a 50 million green shoe option and we so far received very encouraging response from investors from all over the world., we are targeting the first close by early next year and as part of that as and when the IEOF efforts mature we would also consider participating in the IEOF initiatives as risk investors using that part.

**M: Okay, so currently the funds that you are raising are a part of the Kaizen Edu Finance and as and when there are products that get developed and IEOF also expands then you could divert some of it.**

R: Yes, we would consider participating in those initiatives using Kaizen Edu Finance.

**M: So, when is that approximately going to happen is that something that is going to happen in early 2020 or is it something…**

R: Yes, so we will have funds ready by early 2020 and then it will be for IEOF to bring those products to us and we will consider investing in them.

**M: Okay, so will there be some kind of decision making that will happen when IEOF comes with specific products or there are certain broad parameters that have been agreed upon and if they fit that criteria automatically Kaizen will put in the money, how is that going to be deployed?**

R: At this point in time these parameters have not been agreed, but the idea would be to sort of have broad guidelines in place such that you know it’s almost like an iterative and joint process, so essentially what will happen is in reality when the products get created then itself in the process of creation itself Kaizen will be involved. So in some-ways there is already a buy-in from Kaizen side when the product is ready.

**M: Okay.**

R: It will be a co-creation process..

**M: Okay and Kaizen is the only agency looking at the risk investments, right, currently for IEOF.**

R: That you will have to check with Ashutosh.

**M: Yeah for the IEOF that is what I understand. Was there some kind of I mean you gave me the background and how people got in touch and how it all evolved but was there some kind of prerequisites which Kaizen had to meet in order to be already the record and the work that Kaizen had done was evidence of the credibility of what you could offer.**

R: I would think so, I would think so, I mean IEOF would be best place to answer why they selected Kaizen but from our perspective you know this naturally falls into our scheme of things because of its education focus and because of the fact that we are fully education focused and impact focused, so that way I mean I think there’s a good fit plus education is a sector which is not an easy sector to invest in, as I said education is not for tourist investors, you know it needs somebody who has been there done that, who is familiar with the dynamics of investing in education. I suppose as we are all evolving as entire IEOF ecosystem is evolving maybe if I were IEOF I would want to start with people who got an experience and then over a period of time as the asset class gets more well defined and proven then also invite others to participate. In a concept like this there can’t be exclusivity you know because then you know we are defeating the purpose. The basic idea is to make this as large and as well wide as possible so that they can bring as much financial muscle to solving India’s educational problems as possible, so the concept of exclusivity would defy that logic but at the same time having too many partners early on would lead to suboptimal attention from each of the partners and that could also be counter-productive.

**M: Right. So I think it’s quite an early stage and in some sense IEOF is also is making tremendous progress in terms of detailing how it is going to actually pan out but some of these processes and identifying key stakeholders at the beginning is a very crucial part and some of this will actually build on each other as months and years go, that’s what I think.**

R: Right.

**M: So apart from what you mentioned what you will be doing as part of the Kaizen and you finance itself raising of funds and funds coming from both commercial as well as philanthropic. Is there a different process that you intend specifically in order to raise funds for the IEOF or it’s going to be from the same pool, so it’s the same process that you would follow in any case for the Kaizen Edu Finance fund that you have?**

R: Well I think the sense that we have at this point in time is that in terms of raising investment there is unlikely to be a very large difference and in fact the fact that we are able to club the two processes would bring efficiencies to both the processes, I mean today if we were to just raise funds for IEOF then given that we are just starting off the block you know the cost of raising that would be disproportionate to the amount raised but at the same time because it’s part of a larger thing you now the cost get spread out and therefore it’s easier for us to be more cost effective for both Kaizen Edu Finance and for IEOF, so I think therefore the process is not likely to change, the kind of investor groups also that we are talking to, the motivation is not very different, so from that perspective again you know there is lot of synergy. One thing I would say is at this point in time IEOF end beneficiaries seem to be at this point in time students who are attending government institutions and they are more inclined to work with the public system and improve the public system and the focus that we have is for the Kaizen Edu Finance is work with the private system, the affordable private system and bring more effectiveness with that system. Now in a place like India now lot of South Asian countries including whether it’s Pakistan or Bangladesh I think both these systems have become fairly large and therefore both of these have to be addressed to bring about a holistic change. So I think to that extent we are glad that we are on both sides because of this blending.

**M: But in terms of investors are there any who are keen on investing in the private low fee paying affordable schools and other set of investors interested in the government because government has a different set of risks associated with any intervention happening in the government sector and the risks are quite different in the affordable private school sector, so are these the same kind of investors for these two segments?**

R: Yes, absolutely because end of the day they are interested in improving education for the under privileged. As a matter of fact a lot of them don’t realize till we tell them how significant is India’s private education system because in lot of places private is considered as synonymous to elite and therefore one of the biggest education that we have to do is you know that more than 90% of the schools in India private schools charge less than 250 dollars a year fee or 25 dollars a month fee and that itself comes as a huge moment of truth for most of the investors. So from our perspective you know we have not come across investors saying you know we only want to invest in government projects or we only want to invest in private sector projects.

**M: Okay.**

R: Yes now actually let me correct that, we have come across so far one investor foundation of a large multinational organization and they had told us that listen from our perspective all education should be free and therefore should only be done as public service because private education brings in some ways imbalance and therefore vitiates the already very stark income disparity, yeah so we have come across one, we have not come across anybody who says we don’t want to deal with government system because they are very familiar with the fact that education equals to government. As a matter of fact education as a category is unfortunately very underinvested in, I mean today less than 4% of the global impact capital goes towards education and that is very unfortunate because education is fundamental for solving many of the world’s problems and unless the SDG goals in education are met it will be very difficult for the world to meet SDG goals on a number of other parameters, so education is extremely critical and yet highly underinvested. One of the reasons why that happens is because investors have this perception that it belongs to the government and like you said governments can be tricky to deal with and it’s very difficult and time consuming to show any meaningful difference because there is always this criticism that a lot of good things get discussed but eventually very little gets implemented. But nobody has sort of come to us and said so far that they will only invest in private education and we will not invest in government education, but the fact is that instruments like what IEOF are creating would facilitate government school interactions because you see nobody is averse to dealing with the government schools, everybody is averse to dealing with the government policy makers, so therefore if the outcome funding is coming from somebody else and the risk funding is coming from somebody else then you know even for commercial investors it starts making sense, I mean when I said earlier that nobody then I meant more like the commercial investors don’t want to sort of necessarily deal with the government because of the uncertainties that we just talked about, of course the philanthropic investors are always very keen on working with the government like the foundations and NGOs etc but when it comes to commercial investors there is a certain wariness but if an instrument like IEOF can be created which sort of gives a clear assurance to these entities because the outcome payer is again a private entity then at least that gives a starting point for commercial investors to also look at government organizations from an impact investing perspective, so these are not you know breaking through the roof kind of returns but these are more returns which are above bank rate and safer they are not as risky as equity.

**M: So, in terms of investors the categories that you mentioned these are all institutional, am I right?**

R: Well earlier till about a few years back these were all institutional investors and mostly the developmental financial institutions, the DFI’s, now what we are also seeing thanks to all the good work that is being done in the world of impact investment and blended finance and so on we also see that a large number of the financial institutions themselves whether it is banks or the insurance companies or pension funds they have significant impact allocation. So, they sort of invest from these impact allocations of theirs because there they have the ability to settle for slightly lower rate of return or on the other hand, they are slightly more risk-taking in trying to participate in very different kinds of projects.

**M: Okay but there are no individuals as investors high net worth individuals or…**

R: I am sure there are, well those who really have large ability to put money have themselves created these foundations, right, whether it is the Bill and Melinda Gates Foundation or Ford foundation, so it’s a matter of how this is structured but given this ticket size that they work with I think instead of doing it as individuals they would rather create an entity and invest from that.

**M: Okay and in terms of targets you had mentioned 150-million-dollar fund and that is for the Kaizen Edu Finance I suppose.**

R: Yes.

**M: Right. So, as part of that is there a target already set for how much would IEOF require?**

R: Well at this point no, it will all depend on you know again what are the kind of targets that we get from IEOF for the risk fund that they want us to raise and the 150 therefore is flexible I mean we can always increase the size if IEOF wants us to raise more fund, I mean as investors what everybody would want to see is a definite pipeline of projects, they would not like their capital to lie idle. So, once that visibility around the pipeline is in place, I think finding capital should not be a big problem.

**M: Okay and is CSR also one of the critical sources of funds or CSR was the other way that they have very different method of investing, I mean it was just a question that came to me.**

R: Yeah so technically just from on the basis of first principles CSR should also be you know part of the investor pool because there may be different kinds of CSR organizations with different kinds of priorities, I mean one CSR organization may say that I don’t want to give away money but I want to use that money so that I can recycle that money and therefore maximize the impact. The other CSR organization may say no I am very glad just giving that away, so at this point in time the regulation in India does not permit the former and does not allow CSR organizations to invest in risk funds of the type that we are raising. So, CSR entities will more likely come on the outcomes funding side.

**M: Okay, I see they are not allowed to the regulations [30:08 inaudible].**

R: The losses they have to put aside 2% and spend the rest it in a specified period of time and if you put that in a risk fund and the project is successful you get that money back, so you have not technically spent it.

**M: Is there any effort being made to address that kind of a bottleneck because in that sense it’s a limitation that is not letting some of the CSR’s that might be interested in this kind of a project.**

R: Well actually I don’t see that as a limitation because even if that money goes towards outcome side there is still that much larger pool being created for risk investors to back, you know the most difficult part always is the outcome fund simply because that’s a money which you are actually spending and typically as I am given to understand most countries the outcome funding comes from the government.

**M: Yeah.**

R: What IEOF is trying to do in phase one is raise that from non-governmental sources, that is always going to be challenging and therefore even if CSR money can go towards outcome funding it will only help lubricate the system.

**M: Right because that is otherwise going to be more difficult in the absence of the government still, I mean I don’t think the government is ready yet to come in and become an outcome payer yet, so till then at least the CSR could do that.**

R: Exactly, the CSR money can come in, show the use cases, establish the asset class and then the government could at some stage come in and start participating at which point in time the CSR money then could go towards the risk fund.

**M: Right okay. So, at this point of time what are the risk investors interested in because there’s this question always is, they really interested in getting financial returns or are they happy to just see some social impact. So, what are the risk investors really looking for?**

R: So the term risk investors today has a full spectrum of investors, right and it will be difficult for me to say that there’s only one category but there is a category of risk investors which would want to see the right balance between social impact and financial returns, they are willing to say that listen we do realize that we could have made more money by putting our money or our investment in another place in another asset but given that you are creating this level of impact we are happier to settle for a lower return but make sure that you deliver the impact.

**M: Okay, yeah so I guess having a combination of commercial as well as philanthropic foundations they would have different motivations that must help in balancing.**

R: So therefore one thing that we are doing right now with IEOF is we are creating different capital tiers, so let me explain, let’s say hypothetically I mean because of confidentiality reasons I cannot give you the exact numbers but let’s say hypothetically the overall returns that the fund is generating is a 10%. So what we do is we typically split that entire capital into two parts, on one hand we have commercial investors, so just again just to illustrate the point let’s say 50% of the money comes from commercial investors who say that I will only work if the returns are 12% and I want certain amount of safety. On the other side there are these impact investors who are saying I am willing to settle for a return of 8% and given that my objective is impact I am willing to take some risks, so the capital is raised in various tiers, so the senior tier which is the safer tier comes from commercial investors and the junior tier comes from the risk investors, now actually what also ends up happening in reality is that at the senior tier because the risk is taken away they are happy for lower returns because all the first loss is taken by the junior tier, so the risk investors or the impact investors could also theoretically make higher return because they have taken higher risk. So, in this example of 10% the junior tier money will come in and get 12% return but they also have a higher risk and the senior tier will come in at 8% but they are shielded from risk by the capital which is available at the junior tier. So, until the senior tier is paid off fully the junior tier doesn’t get any money. So that’s an interesting thing that’s happening in the world of social finance which is there are lots of these innovations which are happening every day and people are trying to say how is it that instead of using impact investments will just make a difference, how can we use impact investment in a catalytic manner so that it draws in far more commercial capital into the space.

**M: Correct.**

R: There are many, many ways of creating that catalytic effect like for example if you are going to frontier markets then the impact capital maybe used to provide currency protection, so the risk of operating in those markets in some ways can be alleviated for the commercial investors or it can be used for example like I said for first loss protection so let’s say if there are today in India because of the collapse of some leading financial Institutions getting credit has become difficult for financial intermediaries, so you know the impact investors can come in and say that we will protect these commercial investors against an event of default up to certain amount and therefore the commercial investors will feel safer and direct more of their capital towards this impact projects.

**M: Yeah this is actually quite interesting in my earlier interviews also with Ashutosh, we were just discussing how… I mean I was asking question about innovation and really where would you point out that innovation is taking place and there are a number of areas where structuring these various instruments itself is, I think a big component of innovation and resonates with what you just said, this was not so a few years ago.**

R: Right.

**M: Just one clarification, the institutional investors could be both domestic as well as international, am I right?**

R: Yes absolutely.

**M: Okay, so I don’t have any questions in the first part, I will just move on to the second and some of what you have said…**

R: Sure, but we have only 13 more minutes.

**M: Yes absolutely. I just wanted to know some high points in terms of your experience so far what you find is the most challenging part of doing this right now.**

R: Well it’s the early inertia of the system to move, it’s a very path breaking concept so to speak and like most path breaking ideas which involve participation of many, many stakeholders to get all the stakeholders aligned and sufficiently motivated is the key thing and this therefore will obviously take time because we are talking on one hand of government on the other hand of policy makers, then actual implementation on the ground, risk investors, outcome funders, so there are many moving parts here and just getting everybody aligned is not going to be easy, it’s like when initial stock markets were created to make capital available to enterprises, I mean none of this would have happened over night, it would have taken time for some of these initiatives to start falling in place and that is the I would think the key thing which is ensuring that you know we can put as much might behind this as possible so that we can move faster because everything else is a minor issue I mean some people will say oh you know I am not getting enough returns, some others will say oh but you know I need more clarity of what will eventually happen or I need to wait and see how and when it will happen, these are all early teething issues which will all sort themselves out once we have some experience behind us.

**M: So, in terms of specifically at this juncture when this is beginning what are the key areas that one has to pay attention to as someone who is responsible for raising the risk capital, what would be the most important concerns and areas that you have to pay attention to now?**

R: I think the most part in my view would be how high do we aim for and what do I mean by that is if for example at this point in time when the overall level of uncertainty is still relatively high, if we had to caught up around how good or how precise the final outcome has to be or how high the final outcome has to be then what will happen is it will sort of in some ways start deterring the investors not because of anything else but because they haven’t seen anything like this and they are learning. At the same time if we aim too low then there will be critics who will say listen I mean this is just a way of diverting more money to the investors, so there is that conflict of interest here and balancing that conflict through an entity like IEOF is going to be the most critical part because they have been seen as neutral agencies by both the groups and they should have which they do enough credibility so that both the groups listen to them when they say listen we think that aiming at this level at this point in time in the history of what we are trying to create is the right level.

**M: Right and any specific insights you think because you have the experience of both having your own fund through the private equity but also now having had almost two years of discussions with the IEOF and thinking through and helping to set this up also in a way, what are the specific insights or any lessons that you think, anyone who is going to be studying this as a case study should actually take note of?**

R: I can’t think of anything which Ashutosh would not have already shared with you, I think maybe we all need to know that these kind of things take much longer than what any of us would like to sort of see and therefore patience is going to be quite essential and given the criticality of the task also ensuring that the right kind of entities are fully convinced and supportive is also going to be quite important, so I think one should not underestimate the level of effort and time that something like this ends up taking.

**M: And it’s also not like other mechanisms that are there in pure sense in the finance market, this is different, this is getting applied to education and the real world with different kinds of challenges so it has its own…**

R: Yes I mean so what we are trying to do is trying to create a language which both impact investors understand and financial investors understand and it’s like you know when you say how many yens is equal to one dollar, I am sure that wasn’t established on day one, it took a lot of time for people to arrive at a way of doing that thing. Likewise, how many children impacted and to what extent equals to one dollar of benefit, if you are trying to sort of arrive at that language that language is not going to happen on day one, there are too many variables at play there. So, coming up with that language will take time and we all have to patient because this is a problem really worth solving. This is not just a problem for education but every sector, impact sector, every SDG that we are trying to achieve all the 17 SDG have the same issue, but that’s okay, that should not dishearten us.

**M: Right and it’s amazing how some of these things are being tried in India for the first time and given the size and complexity of the problem plus the fact that…**

R: India is the most interesting impact laboratory in the whole world right now.

**M: Yes absolutely, I mean the more I am learning about this the more I realize this is I mean I can imagine for so many reasons this is brilliant time to also think about and explore all these various innovations at different levels.**

R: Yeah because no other place offers you the opportunity to solve these problems at the scale that India does.

**M: Right. So, I think I have taken almost an hour of your time and I think I have…**

R: I hope I was helpful for you.

**M: Yes this has been quite helpful and I know this is an initial period but yet Ashutosh suggested that it might be a good idea and I read your work and then I thought it would be really interesting, so what I will do is I will do two things, I will write up the transcript, get it done and email it to you for your reference.**

R: Sure.

**M: And if I have any burning question, I will email it to you in case of any specific detail that I need a clarification on.**

R: Sure. We are right now in midst of some submissions with USAID and so on, if I sort of get delayed in responding it’s not because of lack of interest it’s just because of other priorities which sort of…

**M: That is fine, I understand. Thanks for clarifying that. Thank you once again, thank you very much.**

R: Alright cheers.