Innovative Finance for Development

A Guide for International NGOs

InterAction
A UNITED VOICE FOR GLOBAL CHANGE

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Acknowledgements

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This report builds on the existing knowledge, experience, and research of experts and practitioners from the public and private sectors. The content in the pages that follow would not have been possible without the data, insights, and perspectives shared by individuals from dozens of organizations.

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Acronyms

AMC	Advance Market Commitment
AUM	Assets Under Management
CCT	Conditional Cash Transfer
DIB	Development Impact Bond
EEZ	Exclusive Economic Zone
FTE	Full-time Equivalent
GIF	Global Innovation Fund
GP	General Partner
HRITF	Health Results Innovation Trust Fund
IF4D	Innovative Finance for (International) Development
IIF	Impact Investment Fund
LP	Limited Partner
M&E	Monitoring and Evaluation
MFI	Microfinance Institution
MIF	Microfinance Investment Fund
MPA	Marine Protected Area
NEF	Near East Foundation
NGO	Nongovernmental Organization
PGH	Pledge Guarantee for Health
R&D	Research and Development
RCT	Randomized Control Trial
SDG	Sustainable Development Goal
SeyCCAT	Seychelles Conservation and Climate Adaptation Trust
SIB	Social Impact Bond
SLE	Separate Legal Entity
SVF	Social Venture Fund
TNC	The Nature Conservancy
USAID	U.S Agency for International Development

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I. Introduction

What is Innovative Finance?

The sources of financing available for international development have been changing rapidly. International development partners are thinking beyond aid to private finance and new forms of development cooperation. Over the last decade, innovative finance for international development and humanitarian programs (IF4D) has expanded, and more and more international nongovernmental organizations (NGOs) are making the strategic decision, or contemplating the decision, to adopt innovative finance as part of their business plans.

IF4D covers a wide range of financing instruments with varied roles for developing country governments, bilateral and multilateral organizations, foundations, private donors, investors, NGOs (which may or may not be project implementers), intermediary organizations, and research and evaluation groups. Although there is no single agreed definition of innovative finance, in this report InterAction takes the broadest definition of IF4D: any instrument beyond a traditional grant that mobilizes new capital and/or improves the efficiency or effectiveness of existing capital to tackle social and environmental problems. It is important to note that "innovative finance" is not necessarily about financial innovation. The "innovation" can stem from introducing a new financing product, repurposing an existing product, or crowding in new players (Figure 1).

Importantly, the objective of using an innovative finance approach is to achieve a desired outcome as efficiently and effectively as possible. There is often a misperception that the purpose of new partnerships through innovative finance is to gain additional financing; the attraction of some financial instruments is in fact their ability to crowd in new players or raise new financing, but the true potential of innovative finance is in its ability to change incentive structures, improve program delivery, and provide new solutions to development challenges. Different financial instruments are geared towards solving specific problems with traditional or alternative approaches and overcoming market failures.[1] There is significant potential to use these instruments to meet the needs of the poor and underserved.

About this Report

Through innovative finance instruments, NGOs and their partners have the potential to increase financing for development—attracting not only the funding but also the know-how and perspectives of new private sector actors who want to have a positive impact—and make existing financing more effective.

1 Keohane, Georgia. *Capital and the Common Good: How Innovative Finance is Tackling the World's Most Urgent Problems*. New York: Columbia University Press, 2010, p. 2.

Figure 1. What makes innovative finance innovative?

SOURCE OF INNOVATION	*Explanation*	*Example*
NEW PRODUCTS	Require some degree of financial engineering and may one day be considered their own asset class	Development Impact Bond (DIBs), where private investors provide working capital to implementing agencies to roll out social programs and are reimbursed by donors (principal plus interest) if pre-agreed social targets are achieved.
NEW PURPOSE	Re-purposing existing products in new or innovative ways, or applying them in a new context	Index-based weather insurance, where the subscriber is compensated for production loss when a reference index, like rainfall, is triggered, instead of actual losses.
NEW PLAYERS	Crowding in new players who may not otherwise fund/invest in development initiatives	Crowdfunding, which raises monetary contributions from a large number of people and leveraging their networks for greater exposure (e.g. Kiva).

There is mounting evidence of NGOs using financial instruments—beyond traditional grants—to mobilize new forms of capital and to improve the efficiency or effectiveness of existing capital to tackle social and environmental problems. However, the number of NGOs involved is still apparently limited.

In a recent InterAction survey, NGOs cited lack of information about different financing instruments and how they work, and lack of information about IF4D opportunities and partners, among the top challenges in their efforts to explore new financing options.

This report explains key IF4D instruments and how they have been, or can be, used. It is intended for a broad audience but highlights the role of NGOs in implementing IF4D instruments in order to increase the information available to NGOs and help to inform their decision-making about these new financing approaches.

The report is the culmination of an InterAction project, supported by The Rockefeller Foundation, to explore the state of IF4D in InterAction's membership, and to develop resources for its members, which generally have not been familiar with IF4D. InterAction launched a survey in February 2017, drawing upon its network of nearly 200 NGOs and other industry leaders and then developed a landscape report based on the survey results.[2] InterAction has also hosted trainings and events to enhance understanding among its members and the public.[3]

Part II of the report describes the results of an InterAction member IF4D survey and what InterAction members are doing with regard to IF4D instruments. Part III provides a practitioner-oriented guide to 17 IF4D instruments. It begins with a comparison chart providing an overall framework for considering which instrument could be applied. It then offers a more in-depth review of each instrument, beginning with a summary snapshot table for that instrument, followed by a more extensive presentation of key factors NGOs should understand and consider. Part IV shares case study examples of NGO experiences implementing IF4D instruments to date to help practitioners better understand the opportunities and challenges. In Part V, we offer our conclusions, lessons learned, and recommendations about how NGOs can most effectively use innovative finance to increase their impact and make progress towards shared international development goals.

2 Innovative Finance for Development: A Snapshot of InterAction Members' IF4D Activities," InterAction, 2017. https://www.interaction.org/sites/default/files/InterAction%20IF4D%20Public.pdf.

3 For the list of past trainings and other events hosted by InterAction on IF4D, see: https://www.interaction.org/project/innovative-finance-development/events.

II. What are InterAction members doing around IF4D?

The first step of InterAction's IF4D project was a survey of InterAction's membership—178 member NGOs at the time the survey was taken—to understand their experiences with innovative finance approaches. The survey asked participants to record as many IF4D projects as possible, of any size, location, and level of success, going back 10 years; to describe their specific role in the transaction at any part of its cycle (i.e., ideation, design, structuring, capital raising, implementation, or monitoring and evaluation); and to share information about any internal challenges and constraints to adopting innovative financing instruments.

InterAction launched the survey in February 2017 and supplemented it with pre- and post-survey in-depth interviews with impact investment industry leaders and other key informants. We received a total of 58 survey responses, of which 50 were completed in time for the analysis. Participating NGOs designated one individual to complete the survey (the organization's CEO, CFO, or another member of the leadership team) and answered between two and fourteen questions depending on the organization's level of involvement with IF4D.

The survey results culminated in a report about the landscape of innovative finance for international NGOs. The report is publicly available and includes details about the research methodology, definitions of survey terms, participating NGOs, and the survey findings.[4]

Key Findings from the Survey

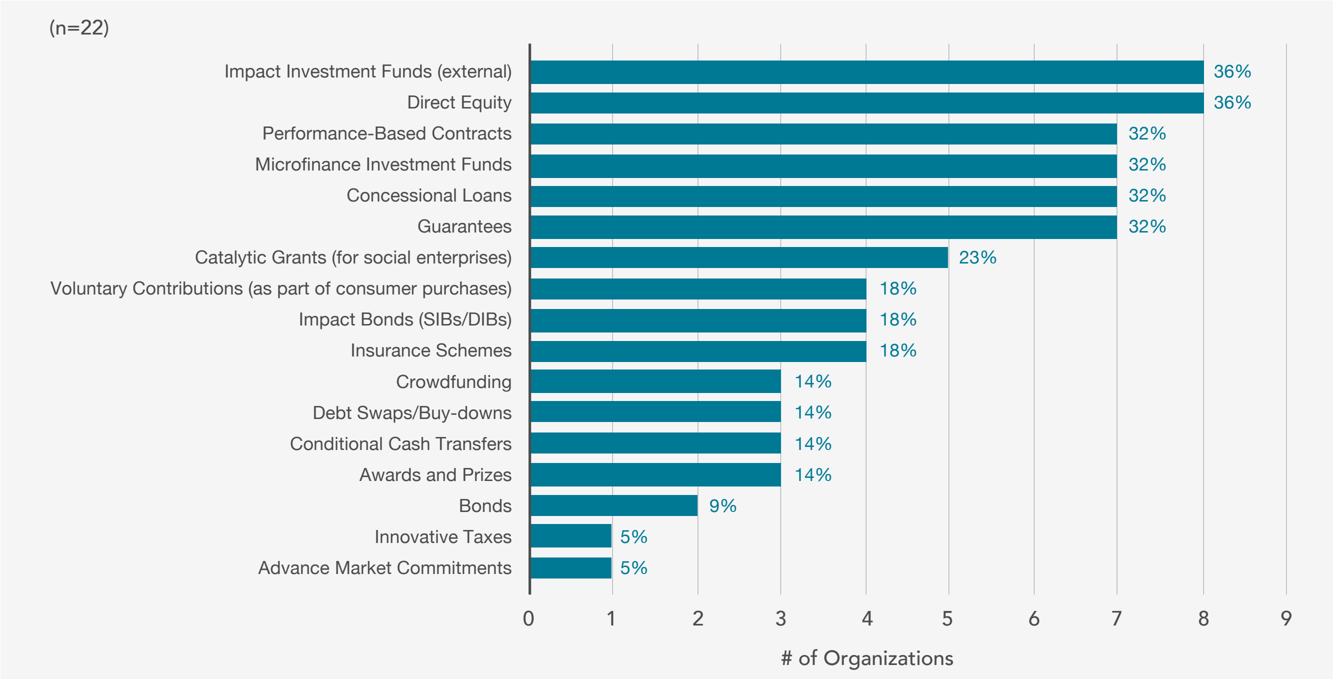
The survey results provided several insights about NGOs' engagement in innovative finance approaches to date, the types of financial instruments they prefer, organizational motivations, barriers, and resource needs to build their capacity. This section summarizes key findings.

There are more NGOs seeking to expand their activities in, or to enter, the IF4D market than NGOs already in the space. Forty percent of respondents (20 count) are either actively implementing/ expanding activities (34%) or piloting an initiative for the first time (6%). Of the 60 percent of respondents who are not currently implementing any IF4D activities, exactly half (15 organizations) are actively exploring opportunities.

Among organizations implementing IF4D approaches, the most commonly used options have been performance-based contracts and approaches traditionally associated with impact investing (Figure 2). Impact investment funds and direct equity were the most commonly used approaches (with 36 percent of implementing organizations reporting using each). While 32 percent of implementing organizations reported using performance-based contracts, other forms of results-based approaches were among the least commonly used.

4 "Innovative Finance for Development: A Snapshot of InterAction Members' IF4D activities," InterAction, 2017. https://www.interaction.org/sites/default/files/InterAction%20IF4D%20Public.pdf.

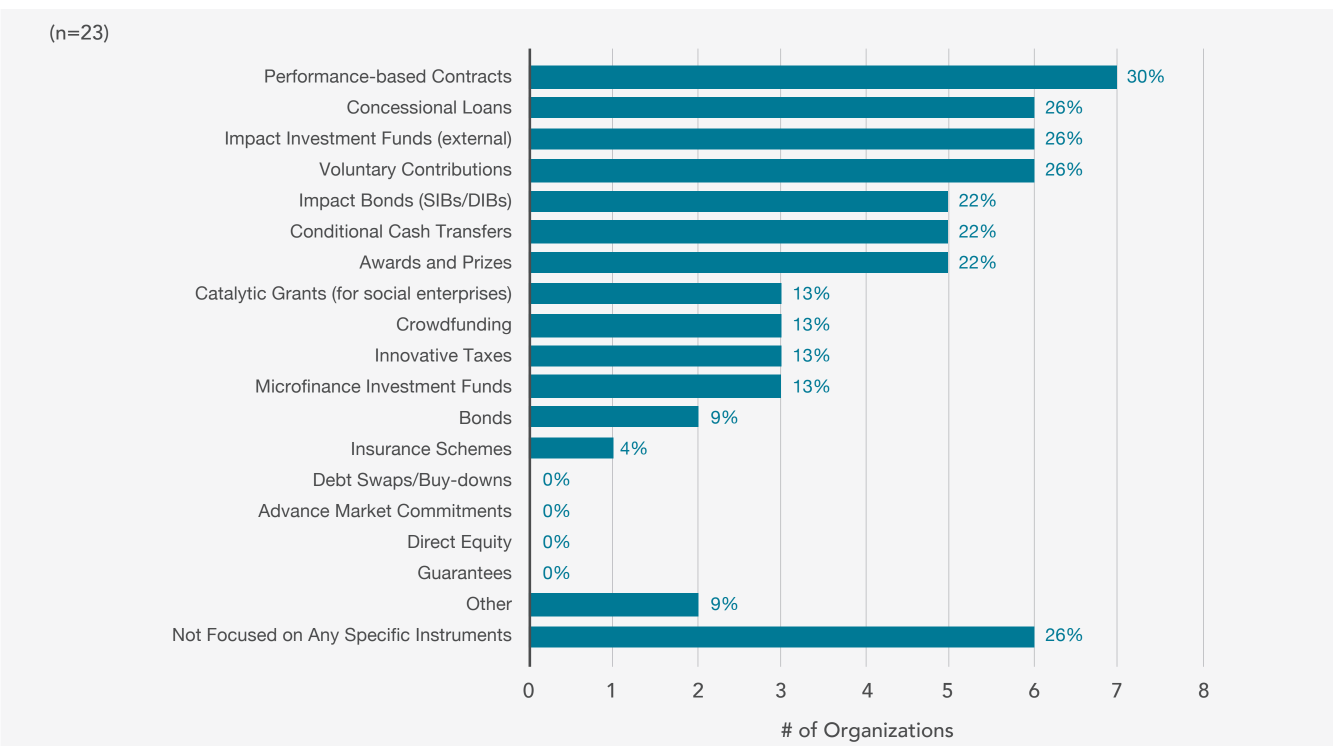
Figure 2. Most commonly used instruments by organizations currently/previously implementing IF4D



Source: InterAction 2017 member survey.
Note: DIB = development impact bond; SIB = social impact bond.

In contrast, organizations that have not yet implemented IF4D approaches expressed more interest in various results-based approaches than impact investing (Figure 3). Among the top seven instruments of interest, four are results-based: performance-based contracts (30%), impact bonds (22%), conditional cash transfers (22%), and awards and prizes (22%). Performance-based contracts, impact investment funds, and concessional loans ranked in the top five for both implementing and non-implementing organizations.

Figure 3. Instruments of most interest to organizations that want to enter the IF4D market for the first time



Source: InterAction 2017 member survey.
Note: DIB = development impact bond; SIB = social impact bond.

The dichotomy between organizations that have and have not yet implemented IF4D reflects a mismatch between IF4D in practice and expectations of IF4D. Among organizations implementing IF4D, the most common role for an NGO was investor (35%), followed by intermediary (21%), recipient (13%), and technical assistance (6%). In contrast, non-implementing organizations expressed most interest in being a recipient (70%) or a provider of technical assistance (52%). Thirty percent expressed interest in being advocates, 22 percent in serving as intermediaries, and 4 percent in being investors.

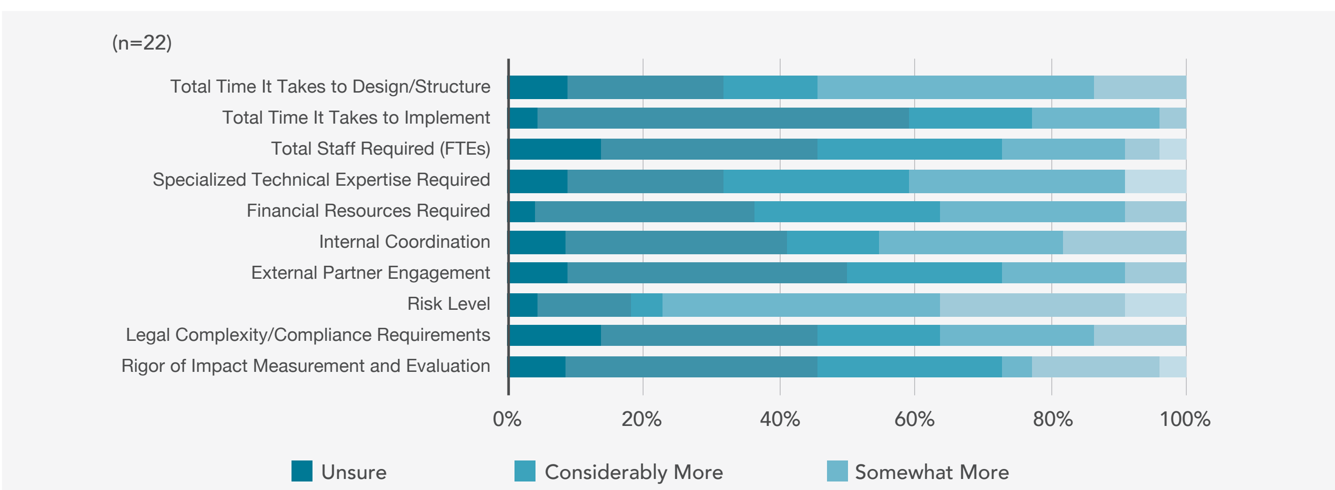
There are also some discrepancies in how more- and less-experienced organizations described the motivations for their interest in IF4D. The top motivations for organizations implementing IF4D approaches are to create more sustainable funding flows or recycle capital (82%), scale or expand the reach of existing programs (77%), and drive efficiency and value for money (44%). For non-implementing organizations, by far the most commonly cited motivation was to diversify funding sources (91%), while scaling/expanding the reach of existing programs and creating more sustainable funding flows also ranked high (70% and 57% respectively). "Drive efficiency/value-for-money" ranked lowest among non-implementing organizations (17%) despite the predominance of results-based approaches in the instrument types of most interest to them, reflecting a possible lack of understanding of the objectives of different approaches by these organizations.

For the most part, implementing and non-implementing NGOs have a common perception of the assets they bring to the table in IF4D. Implementing and non-implementing organizations ranked reputation/credibility, technical expertise, sector expertise, and local knowledge as their top four assets, though not in the same order.

IF4D activities place a bigger burden on NGOs across various dimensions compared to traditional grants. A majority of implementing organizations indicated that, in comparison to traditional grants, their IF4D engagement(s) require more of the following: time to implement (73% of implementers), external partner engagement (64%), rigor of impact measurement and evaluation (64%), total staff involved (59%), financial resources (59%), specialized expertise (50%), and legal complexity/compliance (50%) (Figure 4).

Contrary to popular belief, IF4D approaches are not necessarily riskier than traditional grants. When asked how IF4D compares to traditional grants, the only dimension where the majority of implementing organizations (50% or above) indicated as "roughly the same" or "less" than traditional grants is around risk level (73%) (Figure 4). This goes against the widespread perception among newcomers and non-implementers that IF4D activities are inherently more risky than traditional grants.

Figure 4. How IF4D engagements compare to traditional grants

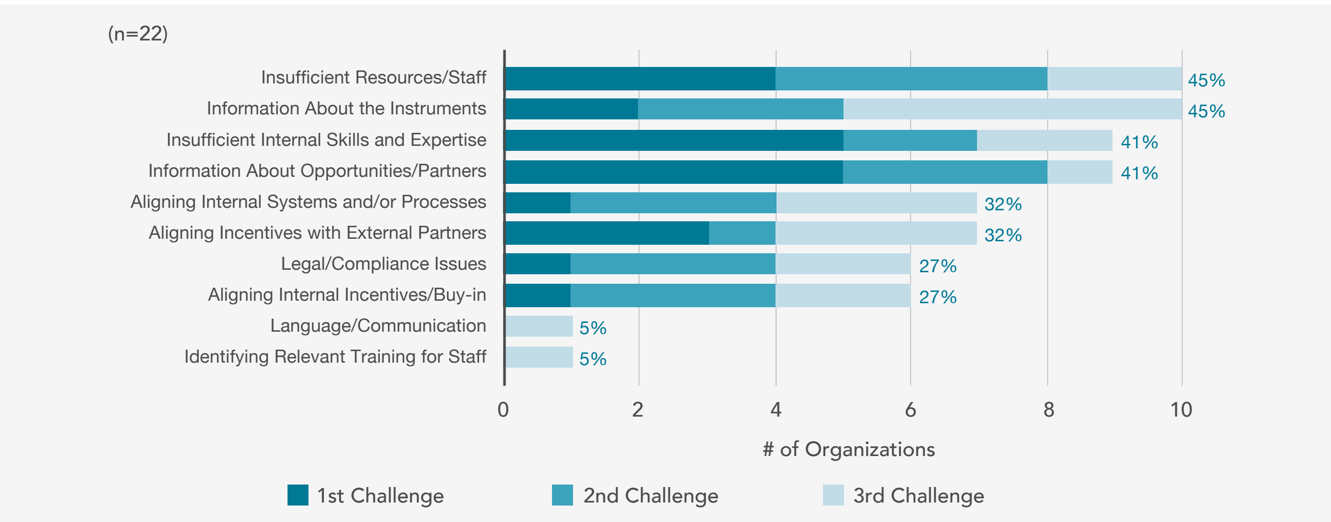


Source: InterAction 2017 member survey.
Note: FTE = full-time equivalent.

Both implementing and non-implementing organizations face significant informational barriers to strengthening their engagement in IF4D. There is still a significant informational gap for both those expanding beyond their current portfolio and those engaging for the first time (Figures 5 and 6), although they differ in degree. Forty-five percent of implementing organizations cited "information about the instruments and how they work" as a top 3 challenge (compared to 61 percent of non-implementing organizations), and 41 percent cited "information about opportunities and partners" as a top 3 challenge (compared to 57 percent of non-implementing organizations).

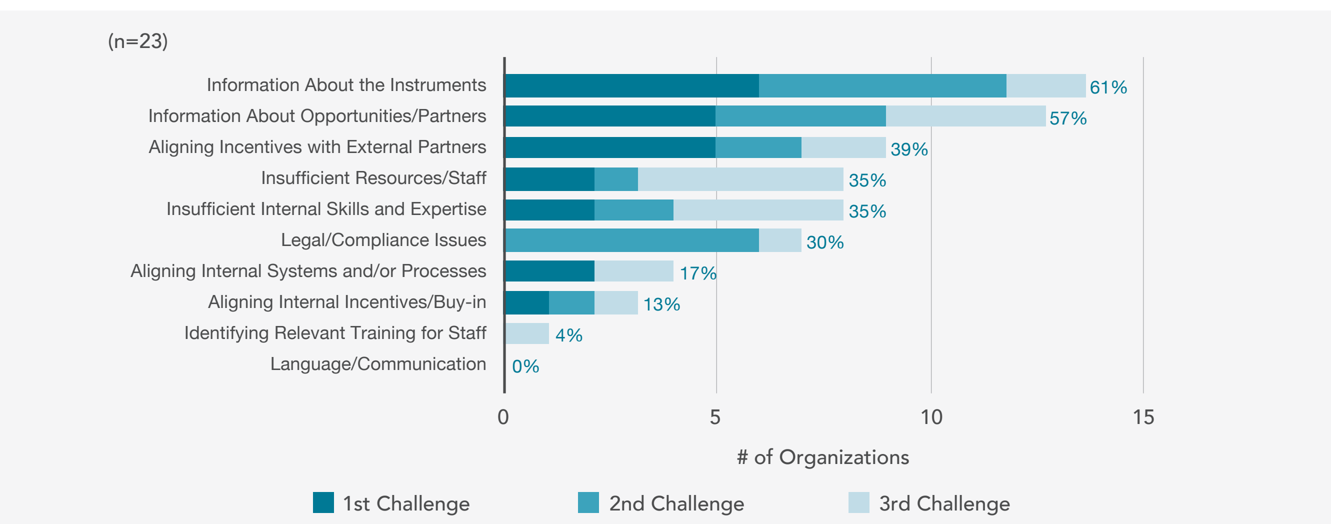
Insufficient internal capacity to engage in IF4D is also a significant reported barrier for both groups, although more so for implementing organizations than non-implementing organizations (Figures 5 and 6). "Insufficient resources and staff" and "insufficient internal skills and expertise" were cited as top challenges in both groups, although again they differ in their degree: 45 percent of implementing organizations cited "insufficient resources and staff" as a top 3 challenge (compared to 35 percent of non-implementing organizations), and 41 percent cited "insufficient internal skills and expertise" as a top 3 challenge (compared to 35 percent of non-implementing organizations).

Figure 5. Top 3 challenges among currently/previously implementing organizations



Source: InterAction 2017 member survey.

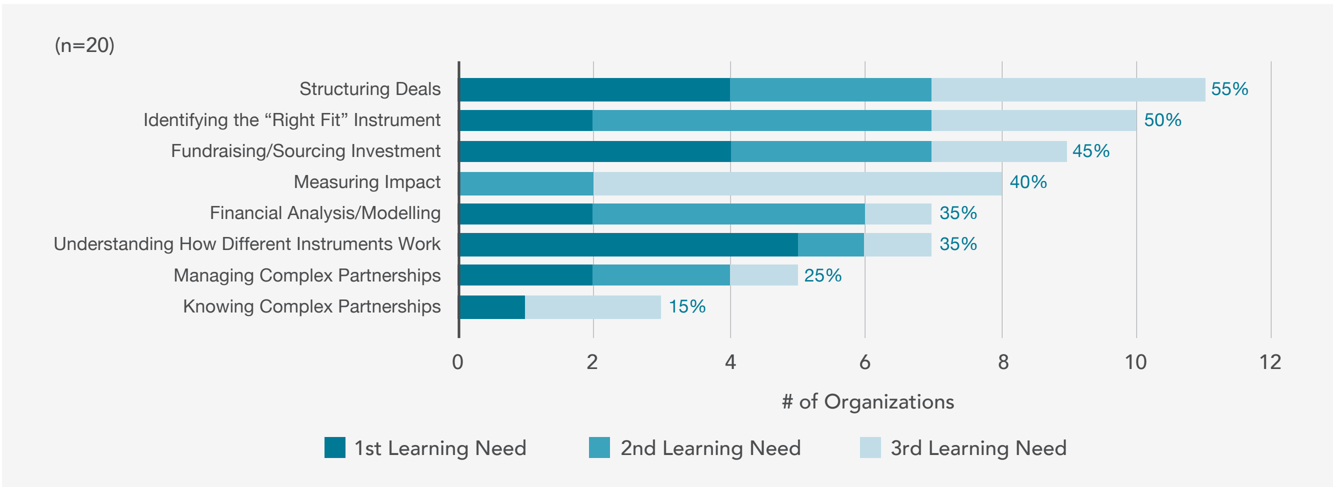
Figure 6. Top 3 challenges among organizations entering the IF4D market for the first time



Source: InterAction 2017 member survey.

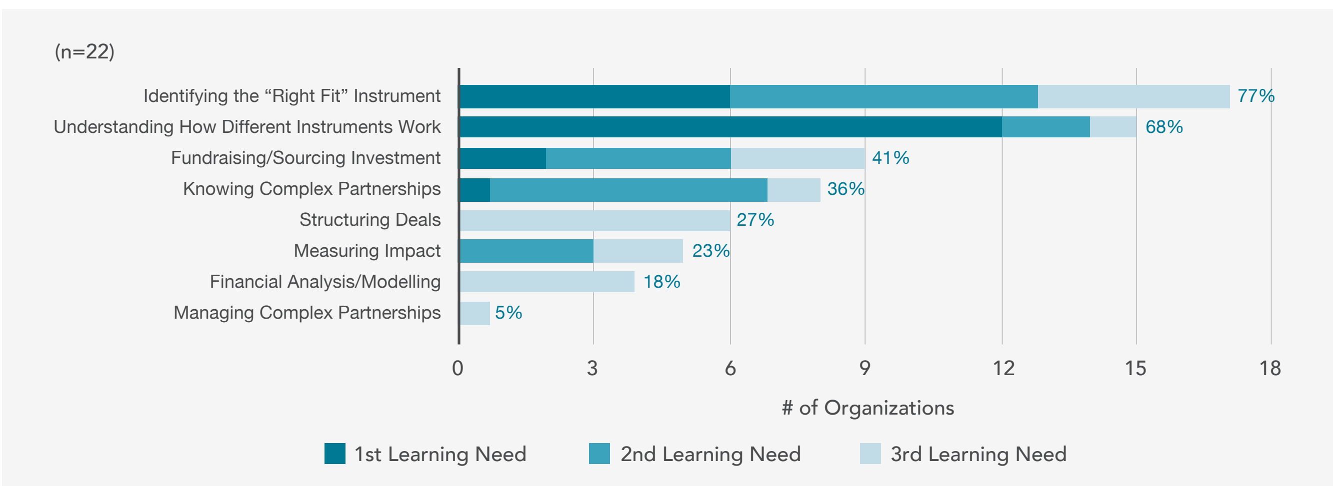
Organizations both experienced and new to IF4D expressed having learning and resource needs, particularly around identifying the right fit instrument, sourcing investment, and needing toolkits and frameworks. A higher proportion of implementing organizations need support for the practical/operational aspects of IF4D, while a higher proportion of non-implementing organizations need support to understand the basics. Both implementing and non-implementing organizations need significant support in identifying the "right fit" instrument for their organization and sourcing investment (Figures 7 and 8). The biggest resource needs identified by both groups are (1) "connecting with funders/investors" and (2) "toolkits and frameworks" (Figures 9 and 10).

Figure 7. Top learning needs among organizations currently/previously implementing IF4D



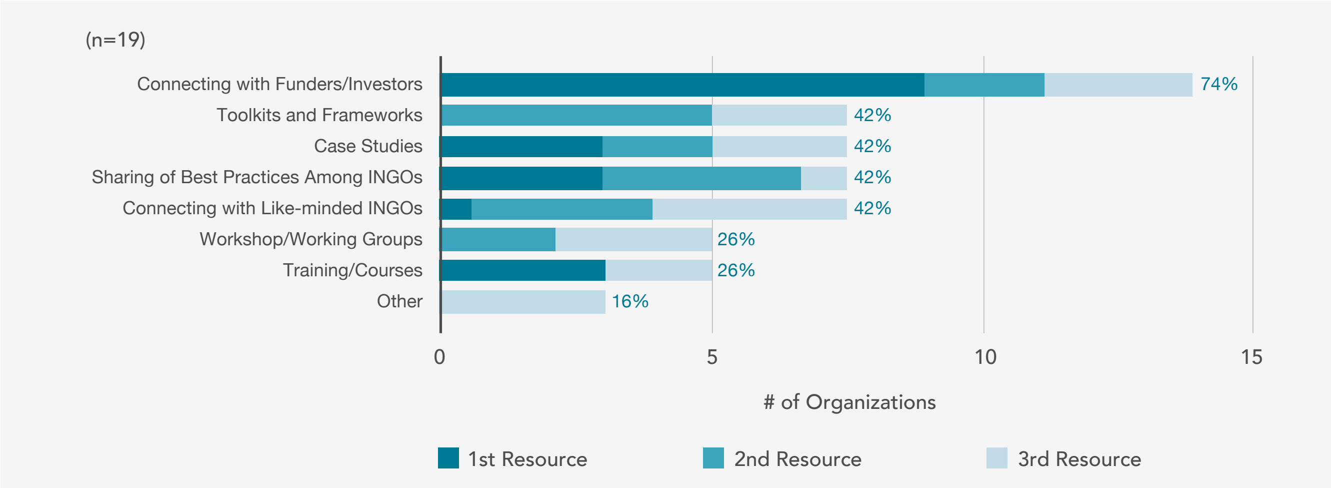
Source: InterAction 2017 member survey.

Figure 8. Top learning needs among organizations entering the IF4D market for the first time



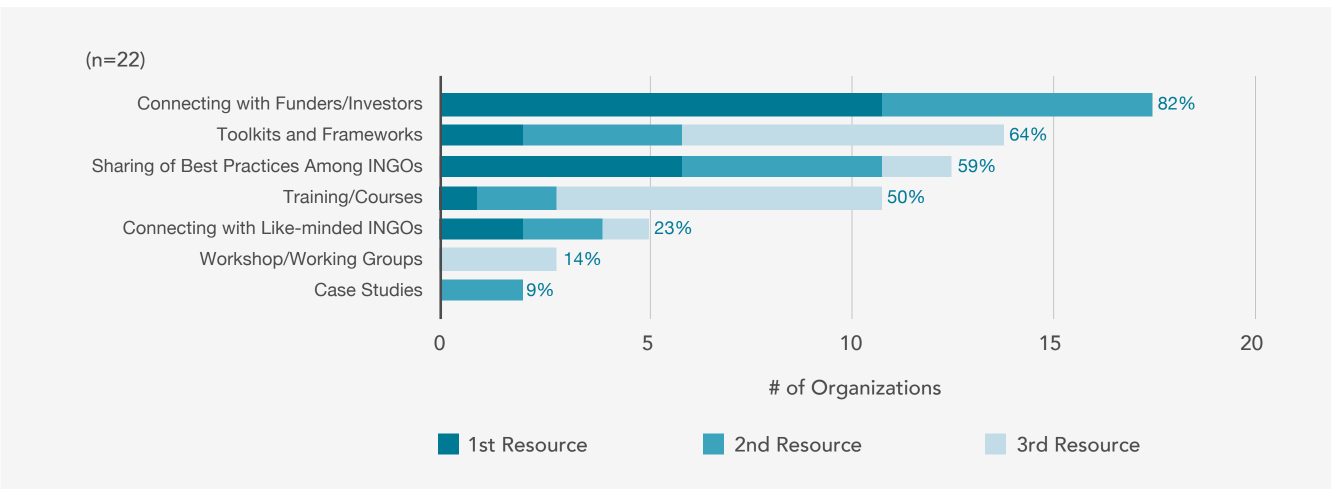
Source: InterAction 2017 member survey.

Figure 9. Top resource needs among organizations currently/previously implementing IF4D



Source: InterAction 2017 member survey.
Note: INGO = international NGO.

Figure 10. Top resource needs among organizations entering the IF4D market for the first time



Source: InterAction 2017 member survey.
Note: INGO = international NGO.

Demand for IF4D is strong. Regardless of whether or not they have had any experience with IF4D yet, the majority of NGOs surveyed are actively exploring opportunities.

NGOs have an incomplete understanding of the objectives and benefits of IF4D. Compared to more experienced respondents, those newer to IF4D expressed far stronger interest in being a funding recipient. This illustrates that a more constrained funding environment is pushing more NGOs to look to IF4D for its revenue-generating potential rather than its other potential benefits.

There is overlap in the most salient challenges for both NGOs with experience in IF4D and the novices. Both types need support in identifying the right instruments for their organizations and connecting with partners and opportunities.

NGOs want to learn more about IF4D and need additional resources to be able to implement IF4D effectively. NGOs have significant learning needs, ranging from the most basic and conceptual levels to highly technical aspects of implementing different instruments, depending on their level of experience.

There is an opportunity for NGOs to learn from each other about IF4D. A majority of NGOs expressed interest in sharing of best practices, and an even larger majority expressed interest in toolkits and frameworks that NGOs can help adapt and create as their experiences expand.

III. IF4D Instrument Guide

How to Use this Guide

Because IF4D includes of a wide range of instruments, actors, and roles, presenting all instruments in a single, coherent framework or decision tree is challenging. However, there are three overarching questions NGOs should consider as they start on their innovative finance journey:

1. What is my primary objective?
2. What role can my organization play?
3. What is the feasibility?

The instrument guide was developed with these questions in mind to help NGOs navigate among the different instruments. This section reviews those questions before turning to the instruments themselves. For the instruments, this section first provides a summary comparison chart covering all the instruments (Figure 11). It then discusses each instrument separately, starting with a summary snapshot of that instrument followed by an extensive set of key factors regarding that instrument that NGOs should understand and consider.

The Three Overarching Questions You Need to Ask

WHAT IS MY PRIMARY OBJECTIVE?

The guide classifies each of the 17 instruments it covers according to its primary function or objective, which, in turn, links back to the definition of innovative finance and the three common themes that emerged during our research: crowding in the private sector, improving the efficiency of existing funds, and/or raising additional funds. These objectives are not intended to be mutually exclusive, as some instruments can serve multiple objectives. For example, crowding in the private sector often also entails raising additional funds; however, raising additional funds does not always require private sector involvement, whereas crowding in the private sector typically requires certain unique features, such as the ability to generate a financial return.

The instruments that fall under each objective typically share some common characteristics. As alluded to above, the instruments under the objective of **crowding in the private sector** involve tools typically associated with impact investing, or investments made with the expectation of both a social and financial return. Loans and equity (ranging from concessional to risk-adjusted market rate) are the two most common tools private investors use to deploy their capital. They can either do this directly, or through third-party managed investment funds (e.g., microfinance funds, impact investment funds), which pool capital from multiple investors. Bonds are a type of debt instrument, similar to loans, the only difference being that the capital from a bond is sourced from public markets (i.e., listed on a public stock market), whereas traditional loans are sourced from private lenders. The other two instruments that fall under this objective (catalytic grants and guarantees), do not generate financial returns to the issuing entity per se, but rather are increasingly used by donors and philanthropic organizations to fill specific market gaps (e.g., to help social enterprises become "investment ready") or de-risk investment seeking more commercial rates of return.

Two types of instruments fall under the objective of **improving efficiency**. The first type is instruments typically referred to as "results-based financing." This term acts as a fairly loose umbrella covering a wide range of instruments with one thing in common: at least some portion of payment is tied to the achievement of pre-agreed results, and where the price is agreed to in advance and the results verified by an independent evaluator. At their most basic level, these instrument focus resources away from inputs, processes, and receipts (how money is *spent*) to outputs, outcomes, and impact (what that money *achieves*), thus allowing for greater flexibility and innovation in how services are delivered and/or products are developed. The other type of instrument included under this objective is insurance, which achieves efficiency not by tying payments to results, but rather by improving the timing of financial flows (in the event of a covered loss).

The third and last objective, **raising additional funds**, refers to any instrument in which the only objective is to increase the overall volume of funding available for development by securing funding that would otherwise not be committed/earmarked for a development purpose, regardless of the source (public or private) or the means by which it is raised (voluntary or compulsory). There are currently three such instruments that are potentially relevant for NGOs: crowdfunding, voluntary contributions, and innovative taxes.

Figure 11. Innovative finance toolbox

Innovation Finance Toolbox

CROWD IN PRIVATE SECTOR	IMPROVE EFFICIENCIES	RAISE ADDITIONAL FUNDS
• Microfinance Investment Funds	• Performance-based contracts	• Innovative taxes
• Impact Investment Funds	• Impact Bonds (SIBs/DIBs)	• Crowdfunding
• Direct equity	• Debt-swaps/Buy-downs	• Voluntary Contributions
• Concessional loans	• Conditional Cash Transfers	
• Guarantees	• Awards and Prizes	
• Catalytic Grants	• Advance Market Commitments	
• Bonds	• Insurance Schemes	

Note: DIB = development impact bond; SIB = social impact bond.

WHAT ROLE CAN MY ORGANIZATION PLAY?

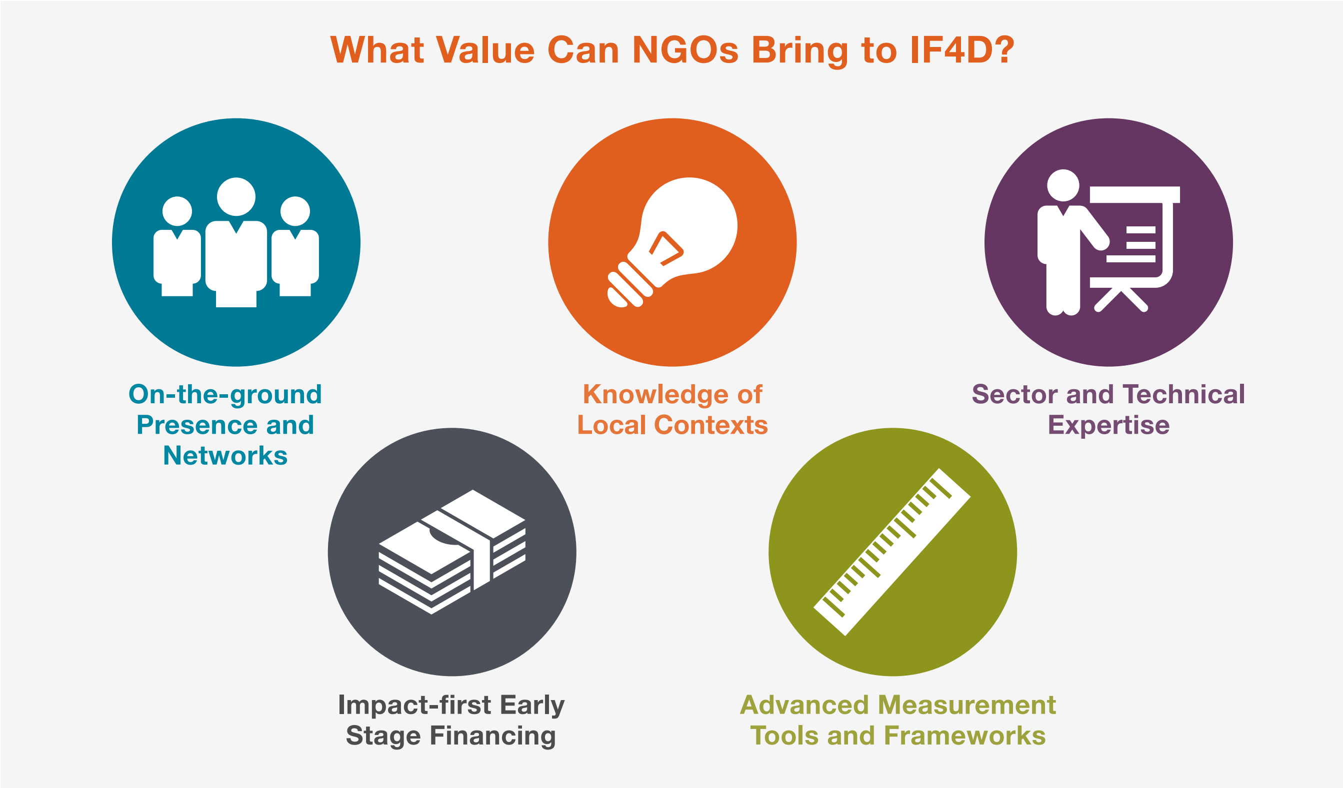
Many NGOs that are new to innovative finance are inclined to think that the most natural role for them to play (in some cases the *only* role they can play) in innovative finance is to be the recipient of someone else's funds. However, that is far from the truth. In reality, NGOs can play a variety of different roles. Possible roles for NGOs include the following, with some more common than others, depending on the instrument:

- **Investor:** putting up capital with the expectation of a financial return (or, at a minimum, a preservation of capital).
- **Donor:** putting up capital with no expectation of repayment or a financial return.

- **Recipient:** being on the receiving end of a donor's or investor's capital, as a service provider or social enterprise.
- **Intermediary:** facilitating or managing flows of capital between two or more parties (but not the direct investor, donor, or recipient).
- **Technical assistance provider:** providing specialized services or expertise (sometimes under contract) (e.g., data sourcing/verification).
- **Evaluator:** independent evaluator/verifier of results achieved.
- **Advocate or convener:** lobbying for reforms and playing a convening role among different stakeholders.

What role(s) NGOs play should be informed by two questions: *what role can we play* and *what role should we play?* The first question may depend on factors such as legal restrictions (e.g., nonprofits cannot distribute ownership shares, as required in an equity investment, unless they set up a for-profit subsidiary). The second question is a more subjective one and should be informed by the NGO's core assets and competencies. NGOs should ask, what do we bring to the table? For some it might be a pool of unrestricted funds that the organization can put at risk, for others it might be on-the-ground presence and networks developed over decades that might help facilitate deal flow for an impact investor (Figure 12).

Figure 12. What value can NGOs bring to IF4D?



WHAT IS THE FEASIBILITY?

Different instruments will vary in their level of risk, costs incurred, and overall complexity, from an operational and/or legal standpoint. One must weigh these factors against the benefits and explore whether alternative financing mechanisms may achieve the same or similar result with less time, effort, and resources required. It is not possible to provide a definitive guide of all the different steps required to engage in each instrument and the associated costs because there is no one-size-fits all approach and many possible solutions to a given challenge. Nevertheless, Figure 13 highlights some key factors that need to be considered.

Understanding the Instruments: a Comparative View

The remainder of this section first presents a summary chart covering all of the instruments reviewed for this report (Figure 13). It then discusses each instrument separately, providing first a summary snapshot of that instrument and then an extensive set of key factors for each instrument that NGOs should understand and consider.

Figure 13. Instrument Comparison Chart

Instrument Name	Primary Objective	Potential NGO Role(s)	Pros	Cons	Best suited for when...	Feasibility – Key factors to consider
Microfinance Funds	Crowd in Private Sector	• Investor • Donor • Recipient • Intermediary • Provider of technical assistance • Advocate/ convener	• Risk diversification • Flexibility • Scale • Common structure • More financial discipline	• Management fees • Less control over investment (for investors) • Lack of liquidity • Lack of standardization	• Investors lack in-house resources and/or expertise to source and assess deals • High strategic alignment with other investors • Fund manager with track record of raising funds and building pipeline	• High operating costs compared to traditional funds • Takes time to agree key features and set up • Competitive space (for raising funds) • Pipeline risk • Difficult for first-time fund managers
Impact Investment Funds	Crowd in Private Sector	• Investor • Donor • Recipient • Intermediary • Provider of technical assistance • Advocate/ convener	• Risk diversification • Flexibility • Scale • Common structure • More financial discipline	• Management fees • Less control over investment (for investors) • Lack of liquidity • Lack of standardization	• Investors lack in-house resources and/or expertise to source and assess deals • High strategic alignment with other investors • Fund manager with track record of raising funds and building pipeline	• Takes time to agree key features and set up • Competitive space (for raising funds) • Pipeline risk • Difficult for first-time fund managers
Direct Equity	Crowd in Private Sector	• Investor • Provider of technical assistance • Advocate/ convener	• Ability to influence management • Higher risk but higher returns • Potential for faster growth/scale	• Lack of proven, scalable models • Long investment periods • Lack of viable exits	• Earlier stage for-profit enterprises (uncertainty around cash flows) • High growth potential (ability to generate 3-5x revenues over 5 years)	• Due diligence can be costly • High time commitment and specialized expertise often needed to support earlier stage enterprises through growth
Concessional Loans	Crowd in Private Sector	• Investor • Recipient • Intermediary • Provider of technical assistance • Advocate/ convener	• For investors, lower risk • For recipients, low-cost capital and no loss of ownership	• For investors, lower returns, no ability to influence management • For recipients, requires demonstrated cash flows, penalties for missing payments	• Activities that generate regular and predictable cash flows that can be used to make interest payments • Funding expansion, inventory, or to smooth out seasonal fluctuations in revenue	• Due diligence can be costly (for investors) • Term sheet templates available but takes time to agree terms • Default and currency risks
Guarantees	Crowd in Private Sector	• Investor • Donor • Recipient • Intermediary • Provider of technical assistance	• Catalytic/crowds in new players by lowering cost of capital, risk sharing • Common structure with pre-existing templates available	• Potential moral hazard and/or market distortion if not used appropriately • May come with restrictions on how funds are spent	• Sector agnostic though most common in infrastructure and growth financing for enterprises • Large amounts of private capital needed to fill financing gap	• Careful design needed to avoid perverse incentives/market distortion • For some donors, may be difficult to commit funds without assured payout • Agreeing terms and conditions takes time and resources

Catalytic Grants	Crowd in Private Sector	• Donor • Recipient • Intermediary • Provider of technical assistance	• For donor, no changes required in procurement, potential to crowd in new players • For recipient, no need to pay back funds	• For donors, can crowd out commercial investment if not used appropriately • For recipient, can come with restrictions, high administrative and reporting burden	• Activities with high degree of uncertainty of success (e.g., research and development [R&D])	• Most familiar to donors/nonprofits but administrative burden can be high/out of reach for earlier stage enterprises
Bonds	Crowd in Private Sector	• Investor • Recipient • Provider of Technical Assistance • Advocate/ convener	• For investors, stable returns/low-risk investment • Ability to raise and deploy large amounts of new capital at a discount • Common structure/ very familiar in capital markets	• Underlying projects must generate consistent income (to pay regular coupons to investors)	• Large-scale projects that generate cash flows over a long investment horizon • Requires high public awareness of social issue/salience among targeted investors	• High cost (could be in the millions, depending on the value, complexity, taxes, risk profile of the issuer and other factors) • High level of coordination required (e.g., financial intermediation, regulatory bodies).
Performance-Based Contracts	Improve Efficiencies	• Donor • Recipient • Intermediary	• Risk transfer (for donors) • Greater flexibility in how funds are used (for recipients) • Greater transparency, more rigorous measurement, focus on learning	• Requires recipient to absorb some financial risks • Defining metrics and measurement frameworks can take significant time and resources	• Clear benefit to risk transfer (to service provider) • Desired results are clear and measurable • As a way to scale proven models efficiently/ensure quality of implementation • Service provider has access to pre-financing/ risk capital	• Higher than typical start-up costs to agree metrics, payment triggers and measurement approach • Typically, high measurement costs compared to traditional grant
Impact Bonds	Improve Efficiencies	• Donor • Investor • Recipient • Provider of technical assistance • Intermediary	• Leverages private investors • For recipients, no need to change underlying business model; greater flexibility in how funds are spent • Risk transfer (for donors) • Greater transparency, more rigorous measurement, focus on learning	• Complex structure • Low familiarity among mainstream investors, donors and nonprofits • High transactions costs/lack of standardized templates	• Clear benefits to risk transfer (to investors) • High alignment among governments, donors, investors and service providers around what the desired outcome is and how to measure it • Service provider with strong culture of performance management, basic systems and processes in place to track outcomes • Some initial evidence behind an intervention but more room for experimentation or uncertainty about taking it to scale	• Highly complex to structure • Long development time • High cost of measurement and verification
Debt-Swaps/ Buy-Downs	Improve Efficiencies	• Donor • Intermediary	• Incentivizes (governments) to devote more resources to a specific development challenge • Donors only pay for results	• Some results more difficult to measure (e.g., policy reforms), can take long time to realize, and may not be sustained after transaction • Less common (esp. for NGOs), complex to structure	• Debtor government or institutions committed to social or environmental issues • Lender government willing to swap/convert debt • Desired results are clear and measurable	• High costs (structuring, legal) • High level of coordination required • Long time to structure
Conditional Cash Transfers	Improve Efficiencies	• Donor • Intermediary	• Incentivizes individuals to adopt positive behaviors • Risk transfer (for donors) • More cost-effective than alternative, in-kind support • Strong evidence base	• Presumes existence of social infrastructure and support services • Potential for corruption • Risk of unintended consequences (if not designed properly)	• Desired results are in individuals' control • Strong social infrastructure and social services in place and people have access • Strong political buy-in/ support	• Common structure, familiar to NGOs, but requires careful design and monitoring to avoid corruption and unintended consequences • Targeting of poor households can be challenging • Success highly dependent on continued political buy-in and support

Awards and Prizes	Improve Efficiencies	• Donor • Recipient • Intermediary	• Incentivizes or accelerates discovery of new solutions • Stimulates competition • Risk transfer (for donors)	• Recipient assumes all risk • Requires access to pre-financing/ risk capital (typically in the form of unrestricted funds)	• When solutions to a challenge are not known and innovation is needed • When there are many possible solutions to a challenge, and there is a benefit to a competitive process	• High upfront costs (for recipient) • Metrics and measurement can be complex/take long time to develop
Advance Market Commitments	Improve Efficiencies	• Intermediary	• Addresses market failure to develop life-saving products targeting low-income households • Stimulates competitive market • Clear benefits for both public and private partners	• Requires donors making large long-term commitments in the face of uncertain market demand	• Desired product does not exist, or is in early stages/needs more R&D • One of the constraints to product development is unclear market demand • Particularly applicable to investments in drug development and agricultural products	• Long time to align stakeholders and agree terms • Long time to develop the product and bring it to market • Requires complex financial management and procurement systems
Insurance Schemes	Improve Efficiencies	• Recipient • Provider of technical assistance • Advocate/ convener	• Smooths impact of external shocks • Creates incentives to invest in resilience/prevention • Pooling of risk, which drives down costs	• Requires willingness and ability to pay (for insured) • Requires reliable data on risk and vulnerability • Complementary measure (insufficient to prevent loss of life/assets on its own)	• Availability of/access to reliable data • Willing and able payers of premiums	• Costs and feasibility highly context and issue specific • Requires high degree of specialized skills (to be able to assess and price risk)
Innovative Taxes	Increase Resources	• Advocate • Provider of technical assistance • Recipient	• Significant, predictable revenue source • Raises public awareness of issues	• Requires legislation • Highly dependent on political buy-in and broad public support	• Large financing gap • Broad public awareness and support for the social issue and proposed tax • Desired results are tangible and within reach • Strong governance systems and processes in place to avoid corruption, fraud and waste	• Complex to set up but simple to administer once required systems and processes are in place • Requires securing political buy-in and legislation
Crowdfunding	Increase Resources	• Investor • Donor • Recipient • Provider of technical assistance	• Scalable • Cost-effective • Attracts funding for projects that are otherwise too risky for traditional donors/investors	• Unpredictable funding flows • High competition • Weak transparency/ monitoring of results after funding is mobilized	• Initiative too risky for traditional donors/ investors • Social issue has high salience/public appeal	• Easy to set up • Developing an effective communication strategy and crowdfunding campaign can take time, resources, and expertise
Voluntary Contributions	Increase Resources	• Donor • Recipient • Provider of technical assistance • Advocate/ convener	• Potential for significant revenue generation • Raising awareness of issues and attracting new donors • Scalable	• Unpredictable funding flows • Weak transparency/ monitoring of results after funding is mobilized	• When funds need to be mobilized quickly • To supplement funds provided by governments or other donors • Social issue has high salience/public appeal	• High start-up costs • Developing an effective communication strategy and outreach campaign can take time, resources, and expertise

The instruments

This subsection reviews 17 innovative financing instruments. These include:

- Microfinance Investment Funds
- Impact Investment Funds
- Direct Equity
- Concessional Loans
- Guarantees
- Catalytic Grants
- Bonds
- Performance-based Bonds
- Impact Bonds
- Debt Swaps/Buy-downs
- Conditional Cash Transfers
- Awards and Prizes
- Advance Market Commitments
- Insurance Schemes
- Innovative Taxes
- Crowdfunding
- Voluntary Contributions

The material for each instrument begins with a summary snapshot table, followed by a longer overview covering:

- What the instrument is
- How it works
- Key players
- Role(s) for NGOs
- Market size/share
- Objective(s)
- Pros
- Cons
- Risks
- When to use the instrument
- When not to use the instrument
- Monitoring and evaluation (M&E)
- Costs
- Complexity (legal and operational)
- Example(s)
- Information on additional resources

MICROFINANCE INVESTMENT FUNDS

SNAPSHOT

Instrument:
Microfinance Investment Funds

NGO Role(s):
- Investor
- Donor
- Recipient
- Intermediary
- Provider of technical assistance
- Advocate/Convener

Objective(s):
- Crowd in new players
- Increase revenues

Feasibility – Key Factors:
- High operating costs compared to traditional funds; high management fees
- Fairly common structure but time-consuming to agree key features (tax, jurisdiction, governance, etc.)
- Fundraising and pipeline development can take a long time, especially for first-time fund managers

WHAT IS IT

Microfinance investment funds (MIFs) are financing vehicles which have been **specifically set up to invest in microfinance assets** and in which social or commercial, private or institutional investors can potentially invest.[5]

HOW IT WORKS

Investors deploy capital into a MIF, which then makes debt and/or equity investments into a diversified portfolio of microfinance institutions (MFIs), which then lend directly to micro-entrepreneurs. The microfinance fund pays investors back their principal plus a financial return based on the performance of the underlying assets. MIFs are typically managed by professional fund managers, who charge a management fee (usually a fixed percentage of assets under management).

Microfinance investment funds can take on a variety of different legal forms, including both nonprofit and for-profit models, and can range from more commercially oriented funds (expecting risk-adjusted, market-rate returns) to more socially-oriented funds (expecting capital preservation and little to no financial return).

MIFs have become a core part of the provision of funding to microfinance institutions.

KEY PLAYERS

- **Investors –** private donors, development agencies, and/or institutional investors (pension funds, insurance companies, mutual and investment funds, and any other large-scale investors) who invest in the MIF and become limited partners (LPs).
- **Donors –** development agencies, charities, and other philanthropic entities who provide grant capital to cover operating costs or offer first tranche losses.
- **Intermediaries –** fund managers (typically a professional firm charged with making investment decisions) conducting due diligence and managing investments on behalf of the MIF; entities serving in this role are also sometimes call called the general partner (GP).
- **Recipients –** the direct recipients are typically microfinance institutions (MFIs), or any organization offering financial services to low income populations, and into which MIFs invest directly. MFIs can take a variety of legal forms, including credit unions, commercial banks, NGOs, cooperatives, and sectors of government

5 Goodman, Patrick. "Microfinance Investment Funds: Key Features," ADA – Appui au Développement Autonome, February 2005. https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-microfinance-investment-funds-key-features-feb-2005.pdf.

banks. Indirect recipients are the direct borrowers (typically micro-entrepreneurs) taking out loans and other financial services from MFIs.

- **Providers of technical assistance –** any organization providing direct technical assistance to MFIs or direct borrowers of MFIs.
- **Advocates/convener**s **–** organizations that help promote best practices, create partnerships, and increase the scale of the sector; rating and certification organizations that help verify the social and environmental performance of MIFs.

NGO ROLE(S)

- **Investor –** NGOs can invest in an MIF and generate a financial return (most often on concessional terms), provided that doing so does not violate bylaws/affect the NGO's nonprofit status
- **Donor –** NGOs can provide catalytic grants to reduce risk for more commercially-oriented investors as a way of crowding them in.
- **Recipient –** NGOs can serve as the MFI accepting an investment from a MIF.
- **Intermediary –** NGOs can be fund managers, or general partners, of a MIF: setting up the fund and raising the necessary capital to make investments.
- **Provider of technical assistance –** NGOs can work directly with MFIs or entrepreneurs to build their capacity, for instance by providing financial literacy (to entrepreneurs), or developing tailored financial services, assessing credit worthiness, providing links to hard-to-reach populations, etc. (for MFIs).
- **Advocate/convener –** NGOs can help develop and promote best practices.

MARKET SIZE/SHARE

Since their creation in the early- to mid-1990s, MIFs have emerged as the main channel for investors (both public and private) to invest in the microfinance market. Fund setup peaked during 2005–2010, due mainly to the declaration of 2005 as the "International Year of Microcredit" by the United Nations and the awarding of the Nobel Peace Prize to Mohamed Yunus and Grameen Bank in Bangladesh in 2006—a development that put a global spotlight on the sector and attracted growing attention from private and institutional investors.[6]

In 2016, a record number of MIFs (94) managed US$11 billion in assets, up from 40 MIFs managing US$2 billion in 2006, an increase equivalent to a robust 20 percent growth rate on a compound annual basis.[7]

Although the regions of Eastern Europe and Central Asia and Latin America and the Caribbean dominate the MIF market in absolute terms (US$2.8 billion and US$2.7 billion respectively as of December 2015), they are declining as a share of the overall market. Overall, South Asia is the fastest growing region for MIF investment.[8]

OBJECTIVE(S)

- Crowd in private sector
- Increase revenues

PROS

- Risk diversification – allocation of resources to a wider and more diversified group of MFIs, low correlation with world markets, etc.
- Ability to "blend" different investors with different risk/return profiles, thus attracting more funding than otherwise possible

6 "Microfinance Funds – 10 Years of Research and Practice," CGAP and Symbiotics, December 2016, p. 17. http://symbioticsgroup.com/wp-content/uploads/2016/11/201612-Symbiotics_10yMIV_whitepaper.pdf.

7 "Microfinance Funds – 10 Years of Research and Practice," p.3.

8 "Microfinance Funds – 10 Years of Research and Practice," p. 27.

- Flexibility – once a fund has been set up it is more flexible to operate than development or donor agencies (due to lighter management structures and more flexible regulations of such vehicles)
- Greater financial discipline (due to greater transparency and disclosure requirements, plus competition with other actors)
- Ability to reach a larger number of MFIs
- Potentially more cost-effective than investing directly (especially for investors who do not already have the resources or specialized expertise to source and assess MFIs in-house)

CONS

- Less control over investment decisions for investors
- Lack of standardization (thus can be difficult to assess performance compared to traditional funds)
- Balance between social and financial can be difficult to strike, especially with multiple investors whose interests may not always align
- Management fees (for investors) – more expensive to set up and operate (compared to traditional funds)[9] – requires certain size/deal flow to be financially viable (or will depend on subsidies)
- Lack of liquidity
- Difficult to raise capital, especially for first-time fund managers

WHEN TO USE IT

Investors/LPs:

- Lack of in-house resources and/or expertise to source and assess deals (particularly if the cost of acquiring such in-house resources and/or expertise exceeds the management fee for a fund)
- Comfortable taking more "hands off" or arm's-length approach to investment decisions and day-to-day management
- Strong alignment with other investors
- High likelihood of crowding in additional investment (that otherwise would not have been deployed)

Fund managers/GPs:

- Scale and flexibility are top priorities in entering the market
- Ability to raise sufficient capital in a competitive space
- Prior success in origination/sourcing MFIs
- Experienced staff (in investment processes), or ability to recruit staff with such experience

WHEN TO NOT USE IT

Investors/LPs:

- Want to be more actively involved in investment decisions
- Misalignment with other investors
- Sufficient in-house capacity/expertise to make direct investments (although the benefits of risk diversification may still make fund investments a good complementary option)

Fund managers/GPs:

- Insufficient track record in sourcing deals (investing on-balance sheet or acting as a facilitator for existing funds may be a good preliminary step in building this track record)
- Lack of strong existing relationships with potential investors/LPs

9 "Microfinance Funds – 10 Years of Research and Practice," p. 15.

M&E

- Most MIF funds report on a common set of environmental, social, and governance (ESG) indicators, a practice that began only recently in 2006–2008. The most common indicators for MIFs include: outreach (# of active borrowers financed by the MFI in which the MIF invests); average loan size; percentage of loans going to women (the primary target of microfinance); percentage of urban vs. rural clients; and product offerings (e.g., microenterprise loans, household consumption, etc.).[10]
- Efforts have also been made to adopt certain standards for client protection (e.g., responsible lending practices), environmental impact, and governance.

RISKS

- Mission drift (compromising your core mission and/or values for financial gain)
- Assets being tied up for long periods of time due to lack of viable exit options (for investors)
- Dependence on subsidies (due to high operating costs)

COST

- Management fees—which account for the majority of MIF costs and include all administration, investor relations, and distribution costs—stood relatively stable at around 1.6 percent of assets since 2009 (as of December 2015); they are lower for fixed income funds, at approximately 1.3 percent, and higher for equity funds, at over 2.5 percent.[11]
- Other MIF operating expenses—which include accounting, audit, custodian, transfer agent and legal fees, as well as marketing and general administration costs—stood at around 1 percent over the same period and have shown more volatility.

COMPLEXITY

- Fairly common structure, but figuring out all the key elements (tax, jurisdiction, governance, etc.) can be time consuming
- Fundraising can take a long time, particularly for first-time fund managers
- Pipeline can take a long time to develop

EXAMPLE

Grameen-Jameel is a nonprofit microfinance fund (fixed-income) jointly owned by Grameen Foundation and Abdul Latif Jameel Community Initiatives, a subsidiary of Abdul Latif Jameel. Grameen-Jameel supports the financing efforts of microfinance institutions at all stages of development, providing loans for early-stage MFIs and guarantees for MFIs seeking to access local-currency commercial loans, as well as direct loans available in local currency. As of March 2012, Grameen-Jameel worked with 17 microfinance institutions in 9 countries in the MENA region, and reached 1,671,216 new clients through its partners.[12]

ADDITIONAL RESOURCES

- CGAP
- Grameen Foundation

10 "Microfinance Funds – 10 Years of Research and Practice," pp. 44–47.
11 "Microfinance Funds – 10 Years of Research and Practice," p. 40.
12 "Microfinance," Grameen-Jameel. http://grameen-jameel.com/microfinance/.

IMPACT INVESTMENT FUNDS

SNAPSHOT

Instrument:
Impact Investment Funds

NGO Role(s):
- Investor
- Donor
- Recipient
- Intermediary
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Crowd in new players
- Increase revenues

Feasibility – Key Factors:
- High management fees
- Fairly common structure but time-consuming to agree key features (tax, jurisdiction, governance, etc.)
- Fundraising and pipeline development can take a long time, especially for first-time fund managers

WHAT IS IT

Impact investment funds (IIFs) are vehicles specifically set up to invest in companies that generate both a social or environmental impact as well as a financial return, and in which social or commercial, private or institutional investors (with different risk/return profiles) can potentially invest.

HOW IT WORKS

Investors deploy capital into an IIF, which then invests into a diversified portfolio of enterprises that generate both a social or environmental and a financial return. Investors are paid back their principal plus a financial return based on the performance of the underlying assets. IIFs are typically managed by professional fund managers, who charge a management fee (usually a fixed percentage of assets under management (AUM)).

IIFs take on a variety of different legal forms, including both nonprofit and for-profit models, and can range from more commercially oriented funds that make debt or equity investments with the expectation of risk-adjusted market rate returns, to more socially-oriented funds making a mix of grants, subsidized loans, and equity investments typically in undercapitalized sectors in frontier markets. They also often provide pioneer funding and seed capital.

KEY PLAYERS

- **Investors –** private investors (foundations, NGOs, etc.), development agencies, and/or institutional investors (pension funds, insurance companies, mutual and investment funds, and any other large-scale investors) who invest in the IIF and become limited partners (LPs)
- **Donors –** development agencies, charities, and other philanthropic entities that provide grant capital to cover operating costs or offer first tranche losses (to crowd in commercial investors)
- **Recipients –** the social enterprises in which an IIF invests. They can be both nonprofit or for-profit (although some instruments like equity require a for-profit structure to be deployed)
- **Intermediaries –** fund managers, typically a professional firm charged with making investment decisions, conducting due diligence, and managing investments on behalf of the IIF (these actors are also referred to as the general partner (GP)); exchanges and investment platforms (to help identify investable opportunities)
- **Technical assistance providers –** advisers providing consulting and structuring services; accelerator programs (to develop social enterprises to get them investment ready)
- **Advocates/conveners –** network organizations like the Global Impact Investing Network (GIIN) that help

promote best practices, create partnerships, and increase the scale of the sector; rating and certification organizations that help verify the social and environmental performance of impact enterprises or impact funds, thereby reducing risk by providing objective certification and rating for impact investors (e.g., B Lab).[13]

NGO ROLE(S)

- **Investor –** NGOs can invest in an IIF and generate a financial return (most often on concessional terms), provided it does not violate bylaws/affect nonprofit status
- **Donor –** NGOs can provide catalytic grants to reduce risk for more commercially-oriented investors as a way of crowding them in
- **Recipient –** NGOs can be the social enterprise accepting an investment from an IIF
- **Intermediary –** NGOs can be fund managers, or general partners, of a MIF; this requires setting up the fund and raising the necessary capital to make investments
- **Provider of technical assistance –** NGOs can also work directly with entrepreneurs to build their capacity, for instance by running accelerator programs, or providing catalytic capital to get them ready to receive their first impact investment
- **Advocate/convener** – NGOs can help develop and promote best practices

MARKET SIZE/SHARE

Although aggregate data on IIFs are largely unavailable, the GIIN conducts an annual survey of impact investors. In 2017 it captured responses from 209 organizations, of which 140 (67%) identified as fund managers.[14] Of these, 121 (86% of all fund managers) identified as for-profit fund managers, while 19 identified as not-for-profit fund managers (14%). Collectively, they managed nearly US$62 billion in impact assets in 2017, or 54 percent of all impact assets recorded that year.

OBJECTIVE(S)

- Crowd in new players
- Increase revenues

PROS

- Risk diversification
- Ability to “blend” different investors with different risk/return profiles, thus attracting more funding than otherwise possible
- Flexibility – once a fund has been set up it is more flexible to operate than development or donor agencies (due to lighter management structures and more flexible regulations of such vehicles)
- Greater financial discipline (due to greater transparency and disclosure requirements, plus competition with other actors)
- Ability to deploy capital at scale, thus reaching a larger number of social enterprises
- Potentially more cost-effective than investing directly (especially for investors who do not already have the resources or specialized expertise to source and assess social enterprises in-house)

13 “From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors,” World Economic Forum, September 2013. http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

14 “Annual Impact Investor Survey 2017,” Global Impact Investing Network, May 2017. https://thegiin.org/research/publication/annualsurvey2017.

CONS

- Lack of standardization (thus can be difficult to assess performance compared to traditional funds)
- Balance between social and financial can be difficult to strike, especially with multiple investors whose interests may not always align
- Management fees (for investors) – requires certain size/deal flow to be financially viable (or will depend on subsidies)
- Lack of liquidity
- Difficult to raise capital, especially for first-time fund managers

RISKS

- Mission drift (compromising your core mission and/or values for financial gain)
- Pipeline risk (due to lack of proven, scalable social enterprises in emerging markets)
- Assets tied up for long periods of time due to lack of viable exit options (for investors)
- Not being financially sustainable/dependence on subsidies (due to high operating costs and/or lack of deal flow)

WHEN TO USE IT

Investors/LPs:

- Lack of in-house resources and/or expertise to source and assess deals (particularly if the cost of acquiring such in-house resources and/or expertise exceeds the management fee for a fund)
- Comfortable taking more hands-off or arm's-length approach to investment decisions and day-to-day management
- Strong alignment with other investors
- High likelihood of crowding in additional investment (that otherwise would not have been deployed)

Fund managers/GPs:

- Scale and flexibility are top priorities in entering the market
- Ability to raise sufficient capital in a competitive space
- Prior success in origination/sourcing investment opportunities in the given sector/geographic area(s)
- Experienced staff (in investment processes), or ability to recruit staff with such experience

WHEN NOT TO USE IT

Investors/LPs:

- Want to be more actively involved in investment decisions
- Misalignment with other investors
- Sufficient in-house capacity/expertise to make direct investments (although the benefits of risk diversification may still make fund investments a good complementary option)

Fund managers/GPs:

- Insufficient track record in sourcing deals (investing on-balance sheet or acting as a facilitator for existing funds may be a good preliminary step in building this track record)
- Lack of strong existing relationships with potential investors/LPs

M&E

A key differentiator of impact investing from other investment strategies is the commitment of the investor to measuring and reporting on the social and/or environmental performance of their investments. However, impact investors are not required to use a standard set of metrics or tools to report on their performance. Of the 209 impact investors who responded to the GIIN's annual investor survey in 2017, most (75%) reported using proprietary metrics or frameworks, qualitative information (65%), or IRIS-aligned metrics (57%).[15] Further, 32 percent of respondents indicated using standard frameworks and assessments to measure their performance.[16] Besides IRIS, tools specifically mentioned included GIIRS (the Global Impact Investing Ratings System), the Universal Standards for Social Performance Management (USSPM) for microfinance, and the Aeris measurement tool and rating agency for community development financial institutions (CDFIs). Most investors report using a combination of tools to measure their performance.

COST

Most for-profit IIFs mirror the typical private equity fund fee structure: the general partner, or fund manager, charges a flat 2 percent of total asset value as a management fee and an additional 20 percent of any profits earned, while the limited partners, or investors, receive 80 percent of the profits.

COMPLEXITY

- Fairly common structure, but figuring out all the key elements (tax, jurisdiction, governance, etc.) can be time-consuming
- Fundraising can take a long time, particularly for first-time fund managers
- Pipeline can take a long time to develop

EXAMPLE

Acumen, a nonprofit global impact investment fund, raises and invests charitable money to take bigger risks supporting small innovative companies, thereby transforming the way by which the world tackles poverty. Acumen has invested US$101 million in breakthrough innovations impacting 189 million lives and created and supported 58,000 jobs.[17]

ADDITIONAL RESOURCES

- "From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors," World Economic Forum, 2013. http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.
- "A Guide for Impact Investment Fund Managers: A Step-by-Step Resource to Creating and Managing a Private Equity Impact Fund," Global Impact Investing Network. https://thegiin.org/giin-financial-management-resources/.

15 IRIS is the catalog of generally accepted performance metrics managed by the GIIN.

16 "Annual Impact Investor Survey 2017."

17 "Innovative Finance for Development: A Snapshot of InterAction Members' IF4D activities," InterAction, 2017. https://www.interaction.org/sites/default/files/InterAction%20IF4D%20Public.pdf.

DIRECT EQUITY

SNAPSHOT

Instrument:
Direct Equity

NGO Role(s):
- Investor
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Crowd in new players
- Increase revenues
- Improve efficiency

Feasibility – Key Factors:
- Due diligence can be costly
- Some investments, especially early stage, may require large time commitment (e.g., board seat, technical assistance, etc.)

WHAT IS IT

An **equity investment** generally refers to taking an ownership interest or stake in a separate for-profit entity. In this context, we take it one step further to mean **taking an interest or stake in a socially driven business, or social enterprise.** We do not include indirect equity investments, or investments made through an externally managed fund where the NGO may be engaged as a limited partner (LP). For the latter, please refer to "impact investment funds."

HOW IT WORKS

A for-profit company (or a for-profit subsidiary of a nonprofit) divides its ownership into equal shares and sells those shares to individuals or institutions. The funds received from selling those shares can be used for start-up, growth, or working capital. Once the company reaches a certain profit threshold, investors can choose to sell their shares and reap a financial return. Prior to selling its shares, the company must undergo a valuation.

Private equity is ownership in a privately-held company whereas **public equity** is ownership in a company listed in a public market, where shareholders buy and sell shares on a public stock exchange.

Equity investors typically fund in rounds (typically comprised of **seed funding**, followed by **Series A**, **B**, **and C**), that are tied to the company's valuation, maturity level, and growth prospects, which in turn impact the types of investors likely to get involved and the reasons why the company may be seeking new capital.

KEY PLAYERS

- **Investors –** private investors (foundations, NGOs, etc.), development agencies, and/or institutional investors (pension funds, insurance companies, mutual and investment funds, and any other large-scale investors)
- **Recipients –** the (for-profit) social enterprises distributing shares in exchange for capital
- **Intermediaries –** exchanges and investment platforms (to help identify investable opportunities)
- **Technical assistance providers –** advisers providing consulting and structuring services; accelerator programs (to develop social enterprises to get them investment ready)
- **Advocates/conveners –** network organizations like the GIIN that help promote best practices, create partnerships, and increase the scale of the impact investment sector; rating and certification organizations that help verify the social and environmental performance of impact enterprises, thereby reducing risk by providing objective certification and rating for impact investors (i.e. B Lab).[18]

18 "From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors." http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

NGO ROLE(S)

- **Investor –** NGOs can make direct equity investments in for-profit companies (off its own balance sheet, or through an impact investment fund)
- **Provider of technical assistance –** examples include facilitating deal flow (for investors), and providing direct technical/financial support to entrepreneurs to get them "investment ready"
- **Advocate/convener –** examples of activities include lobbying the government to introduce policy/regulatory reforms intended to create a more conducive environment for entrepreneurs

MARKET SIZE/SHARE

From its origins in the 1970s, private equity has grown into one of the most well-known and largest asset classes in the private capital space. Between 2000 and 2017, the number of private equity firms globally has tripled, and the amount of assets under management (AUM) grew from almost US$600 billion in 2000 to over US$3 trillion in 2017 (as of December 31).[19]

The North American private equity market is by far the largest in terms of value, accounting for over 57 percent of global deal value in 2015, followed by Europe (14%).[20] According to EMPEA (the Emerging Markets Private Equity Association), the global industry association for private capital in emerging markets, just 15 percent of all global private capital (which includes private equity, private credit and private infrastructure, and real assets) raised in 2017 went to emerging markets.[21]

In 2017, the total private equity AUM dedicated specifically to impact investing or investing to generate both a financial and a social return, was just under US$22 billion, with less than 50 percent (approximately US$10 billion) focused specifically on emerging markets.[22]

OBJECTIVE(S)

- Increase revenues
- Crowd in new players
- Improve efficiency

PROS

For the investor:

- Potential for financial return
- Ability to influence management (through ownership of shares)
- Ability to grow/scale impact faster (for high-growth enterprises)

For the investee (does not apply to nonprofits):

- Access to new capital/mobilizes new investors
- Ability to grow/scale impact faster (for high-growth enterprises)
- More flexibility in how the investment is used (compared to debt or grant capital)
- Fewer constraints on cash flows (compared to debt, which requires paying interest on a regular basis)

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19 Comtois, James. "Preqin: Private equity AUM Grows 20% in 2017 to Record $3.06 Trillion," Pensions & Investments, July 24, 2018. https://www.pionline.com/article/20180724/ONLINE/180729930/preqin-private-equity-aum-grows-20-in-2017-to-record-306-trillion.

20 Heberlein, Anuar. "Private Equity Outlook 2017: Signs of Fatigue," Toptal. https://www.toptal.com/finance/private-equity-consultants/private-equity-industry.

21 "Industry Statistics Year-end 2017: Emerging Markets Private Capital Fundraising and Investment," EMPEA, February 2018. https://www.empea.org/app/uploads/2018/02/EMPEA-Industry-Statistics-YE-2017-Official-Public.pdf.

22 "2017 Annual Impact Investor Survey," Global Impact Investing Network, 2017. https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf.

CONS

For the investor:

- Legal structuring needed (to ensure that receiving financial returns does not impact NGOs' tax-exempt status)
- Lack of proven/scalable models in developing countries (thus strong prospect of little to no returns)
- Long investment periods
- Lack of viable exits

For the investee (does not apply to nonprofits):

- Requires having a for-profit spin-off or subsidiary
- Risk of ownership dilution/loss of control of the company
- If profitable, investors may demand dividends (thus less money for reinvesting in the enterprise)
- To attract investment, must have viable exit strategy (some impact sectors have fewer options than others)

RISKS

For the investor:

- Lack of investment opportunities/pipeline
- Valuation risk (especially for earlier stage enterprises or sectors with few benchmarks)
- High risk with weak prospect of returns (still a nascent market with few proven models)
- Risk of capital being tied up indefinitely (due to lack of exits)

For the investee (does not apply to nonprofits):

- Mission drift (especially if shareholders' interests are not 100 percent aligned with the NGO's mission/values)
- Valuation risk (especially for earlier stage enterprises or sectors with few benchmarks)

WHEN TO USE IT

- High growth potential (able to generate 3–10x revenues over 5 years)
- Earlier stages where cash flow is uncertain (therefore debt not accessible)
- Strong alignment between shareholders and NGO mission/values

WHEN NOT TO USE IT

- Growth trajectory is limited/uncertain
- Limited exit options (for investors)
- Disconnect between shareholders and NGO mission/values

M&E

Direct equity is one of the instruments typically associated with impact investing. As such, investors must demonstrate a commitment to measure and report on the social and/or environmental performance of their investments, though they are not required to use a standard set of metrics or tools to report on their performance. For example, of the 209 impact investors who responded to the GIIN's annual investor survey in 2017, most (75%) reported using proprietary metrics or frameworks, qualitative information (65%), or IRIS-aligned metrics (57%).[23] [24] Further, 32 percent of respondents indicated using standard frameworks and assessments to measure their performance. Besides IRIS, tools specifically mentioned included GIIRS, the Universal Standards for Social Performance Management (USSPM) for microfinance, and the Aeris measurement tool and rating agency for CDFIs. Most investors report using a combination of tools to measure their performance.

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23 "2017 Annual Impact Investor Survey," Global Impact Investing Network, 2017. https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf.

24 IRIS is the catalog of generally accepted performance metrics managed by the GIIN.

COST

- Investment due diligence costs
- Cost of managing the investment (e.g., oversight, serving on the board, providing direct support/advice)

COMPLEXITY

- Obtaining the required approvals and legal protections (for NGOs to be able to invest for a financial return)

EXAMPLE

Mercy Corps' Social Venture Fund is a nonprofit impact investment fund that employs a mix of financing instruments, including debt and equity, to create and grow scalable, self-sustaining businesses that improve people's lives. Mercy Corps pairs its on-the-ground insight into local customs and markets with a unique blend of capital and targeted business expertise.

ADDITIONAL RESOURCES

- https://impactterms.org – a library of real-world knowledge and expertise on structuring impact investments and enterprises
- https://thegiin.org – leading network organization on impact investing
- https://500.co/kiss/ – sample term sheets

CONCESSIONAL LOANS

SNAPSHOT

Instrument:
Concessional Loans

NGO Role(s):
- Investor
- Recipient
- Intermediary
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Crowd in private sector

Feasibility – Key Factors:
- Risky if there is uncertainty concerning long-term revenue and ability to pay
- Due diligence can be costly (for investors)
- Term sheet templates available but takes time to agree on terms

WHAT IS IT

Concessional loans are extended on terms substantially more generous than market loans. This concessionality can be achieved in multiple ways such as interest rates below those available on the market, longer maturities, longer grace periods, lower collateral requirements, or subordinated debt.

This section considers loans made with concessional repayment terms for income-generating activities or implementing specific development interventions in low- and middle-income countries; it does not address loans to governments.

HOW IT WORKS

Concessional loans are issued by development finance institutions and nongovernmental finance organizations. These institutions provide debt financing on concessional terms. They accept a higher risk, relative to commercial banks, in return for an expected social or environmental impact.

KEY PLAYERS

- **Investors –** lenders could be multilateral development finance institutions, nongovernmental finance organizations, bilateral organizations, private investors, or foundations
- **Recipients –** social enterprises, nonprofits
- **Intermediaries –** structurers, fund managers
- **Technical assistance providers –** advisers, consultants, incubators/accelerators
- **Advocates/conveners –** organizations like the GIIN that help promote best practices, create partnerships, and increase the scale of the impact investment sector; rating and certification organizations that help verify the social and environmental performance of impact enterprises, thereby reducing risk by providing objective certification and rating for impact investors (e.g., B Lab).[25]

NGO ROLE(S)

- **Investor**
- **Recipient**
- **Intermediary**
- **Provider of technical assistance** (e.g., through accelerator programs targeting social enterprises)
- **Advocate/convener**

25 "From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors." http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

MARKET SIZE/SHARE

According to an annual survey of global impact investors, in 2017, nearly US$40 billion, or 34 percent, of all impact investing assets under management (AUM) were allocated through private debt instruments. Although the report does not disaggregate this amount by target returns, below-market investors accounted for approximately 34 percent of the total sample and managed just 12 percent of total AUM (across all instruments). In another study that tried to determine the size of this market, concessional loans are defined as: “loans made with concessionary repayment terms to borrowers for implementing specific development interventions like green credit lines.” For the period between 2000 and 2013, the study identified six examples of such loans, valued at US$1.8 billion.[26]

OBJECTIVE(S)

- Crowd in private sector

PROS

For recipients:

- Mobilizes low-cost capital
- No impact on governance (for recipients)
- No loss of ownership
- Potential source of long-term financing

For investors:

- Relatively low risk investment

CONS

For recipients:

- Requires demonstrated positive cash flow
- Penalties for missing payments

For investors:

- Limited ability to influence management practices (for investors)
- Low interest rates/returns

RISKS

- Currency risk
- Default risk

WHEN TO USE IT

- Activities that generate regular and predictable cash flows that can be used to make interest payments
- Funding expansion, inventory, or to smooth out seasonal fluctuations in revenue

WHEN TO NOT USE IT

- Uncertainty around cash flows
- High interest rates

26 “Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes,” Dalberg Global Development Advisors, September 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.

M&E

Concessional loans are one of the instruments typically associated with impact investing. As such, investors must demonstrate a commitment to measure and report on the social and/or environmental performance of their investments, though they are not required to use a standard set of metrics or tools to report on their performance. For example, of the 209 impact investors who responded to the GIIN's annual investor survey in 2017, most (75%) reported using proprietary metrics or frameworks, qualitative information (65%), or IRIS-aligned metrics (57%).[27 28] Further, 32 percent of respondents indicated using standard frameworks and assessments to measure their performance. Besides IRIS, tools specifically mentioned included GIIRS, the Universal Standards for Social Performance Management (USSPM) for microfinance, and the Aeris measurement tool and rating agency for CDFIs. Most investors report using a combination of tools to measure their performance.

COST

- Due diligence can be costly

COMPLEXITY

- Common structure, high familiarity (both for investors and recipients), standard templates available
- Agreeing the terms – including interest rate, frequency and schedule of payments, possible penalties for late payments or default, etc. – takes time

EXAMPLE

MYC4 is an internet marketplace where investors from around the world can lend money directly to entrepreneurs who are doing business in Africa. It functions as a crowdfunding platform for concessional loans. Interested investors bid for the amount they wish to loan and the interest rate. After an auction takes place, investors with the lowest interest rates end up lending the money to the business. MYC4 aims to trigger long-term, positive social impact and create economic growth for the investor as well as the entrepreneur.

ADDITIONAL RESOURCES

- http://www.myc4.com
- https://www.usaid.gov/energy/mini-grids/financing/grants/
- https://500.co/kiss/ – sample term sheets
- "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf

27 "2017 Annual Impact Investor Survey," Global Impact Investing Network, 2017. https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf.

28 IRIS is the catalog of generally accepted performance metrics managed by the GIIN.

GUARANTEES

SNAPSHOT

Instrument:
Guarantees

NGO Role(s):
- Investor
- Donor
- Recipient
- Intermediary
- Provider of technical assistance

Objective(s):
- Crowd in private sector
- Increase revenues

Feasibility – Key Factors:
- Fairly standard structure, though agreeing terms and conditions can take significant time and resources
- Careful thought required to avoid risk of perverse incentives/market distortion
- For some donors, may be difficult to commit funds without assured payout; may require dedicated guarantee facility, which can be complex to set up

WHAT IS IT

Guarantees are like an "insurance policy" which provide a promise of loan repayments up to a specified amount in the case of default or non-performance. When guarantees are used to promote development in low-income countries, they can provide the security needed to bring on board more private risk capital.

HOW IT WORKS

An enterprise or debtor borrows money from a lender and agrees to pay the loan back over time with interest. A third-party guarantor commits to pay the lender back in case of default.

KEY PLAYERS

- **Investors –** lenders providing direct loans to recipients; can be bilateral organizations, multilateral organizations, NGOs, foundations, private investors, or corporates
- **Donors –** in this case the guarantor, who must set aside a pool of capital that is deployed (as a grant) if certain conditions are triggered; can be bilateral organizations, multilateral organizations, NGOs, foundations, private investors, or corporates
- **Recipients –** of loans; could be any number of for-profit or nonprofit entities
- **Intermediaries –** help to facilitate or manage capital flows
- **Technical assistance providers –** advisers, consultants, etc. that help set up the facility or provide contractual services
- **Advocates/conveners –** activities include getting all the parties together, generating demand, lobbying for favorable policy reforms

NGO ROLE(S)

- **Investor**
- **Donor**
- **Recipient**
- **Intermediary**
- **Provider of technical assistance**

MARKET SIZE/SHARE

One source estimates that total multilateral non-trade guarantee commitments in 2013 were US$4 billion, or about 1.5 percent of multilaterals' total development commitments. The majority of these guarantees came from the Multilateral Investment Guarantee Agency.[29]

OBJECTIVE(S)

- Crowd in private sector
- Increase revenues

PROS

- Mobilizes private capital and new players
- Lowers cost of capital
- Sharing of risk across different parties
- Common approach with pre-existing templates available
- Can be used for early- or later-stage projects

CONS

- Moral hazard: need to ensure incentives for high performance
- Difficult to structure, set right amount of guarantee, and ensure that expectations and interests of various stakeholders are aligned
- Guarantors may charge fees
- Guarantors may put in place restrictions on how loan funds can be used

RISKS

- Lowers risks for investors and recipients but guarantors risk loss of funds with no demonstrated results
- Guarantors must have high risk appetite and/or conduct significant due diligence to ensure investments are not too risky

WHEN TO USE IT

- Used across different sectors, although commonly for infrastructure projects and growth financing for enterprises
- High potential to crowd in more commercially oriented investors who otherwise would not have otherwise invested

WHEN TO NOT USE IT

- When investors assuming risk is inherent to the model (e.g., under Development Impact Bonds), or when the guarantee in any way undermines any stakeholder's role or incentives

M&E

The success of guarantees is generally measured in terms of leverage ratios, i.e., the value of additional capital they have mobilized (that otherwise would not have been deployed). However, experience to date has shown that guarantees are more likely to be successful when investors, recipients, and guarantors are aligned in their nonfinancial objectives.[30] Clearly defining, tracking, and measuring progress on a social mission is important to keeping stakeholders aligned, but is not always done systematically or in a standardized way.

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29 "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes." Dalberg, September 2014.
30 "Catalytic First Loss Capital," Global Impact Investing Network, October 2013. https://thegiin.org/assets/documents/pub/CatalyticFirstLossCapital.pdf.

COST

- Developing the contractual arrangements, terms, and amount of guarantee takes time and resources

COMPLEXITY

- Guarantees can be used to change the risk profile of an investment and attract more capital, but careful thought is required to understand how a guarantee changes incentive structures and helps a project meet its overall objectives
- Can be complicated to factor a guarantee into a loan or investment agreement and agree on the conditions under which the guarantee would be paid
- For some donors, it may be difficult to commit money that may never be paid out; often requires dedicated guarantee facility

EXAMPLE

Pledge Guarantee for Health (PGH) launched by the United Nations Health Foundation is a public-private partnership designed to increase the availability and predictability of funding from international donors for health commodities. Through a 5-year partial guarantee from the governments of Sweden and the United States, PGH is able to leverage US$100 million in credit from commercial banking partners, which, in turn, extend short-term credit to traditional donor aid recipients.

ADDITIONAL RESOURCES

- “Guarantees for Development: A Review of Multilateral Development Bank Operations,” Overseas Development Institute, 2014. https://www.odi.org/publications/9130-guarantees-development-review-multilateral-development-bank-operations.
- “Catalytic First Loss Capital,” Global Impact Investing Network, 2013. https://thegiin.org/assets/documents/pub/CatalyticFirstLossCapital.pdf.

CATALYTIC GRANTS

SNAPSHOT

Instrument:
Catalytic Grants

NGO Role(s):
- Donor
- Recipient
- Intermediary
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Crowd in private sector
- Increase revenues

Feasibility – Key Factors:
- Simple structure but high administrative burden (application, reporting, compliance)
- Typically used to fund high-risk activities (e.g., R&D)

WHAT IS IT

Catalytic grants are grants intended to **support early-stage social enterprises that serve the poor**; while these are not innovative financing instruments per se, they can **serve as a critical bridge to attracting new forms of capital later**.

HOW IT WORKS

Catalytic grants are often coupled with other forms of financing, including debt and equity, and businesses' own revenues to help social enterprises grow. Providers of catalytic grants also often provide technical assistance. This support helps promising enterprises to expand their scale, test new models, and improve their business models and operations.

KEY PLAYERS

- **Donors –** NGOs, individuals, foundations, or corporates providing catalytic grants to social enterprise
- **Recipients –** the social enterprise (nonprofit or for-profit but with a revenue generating business model)
- **Intermediaries –** fund managers, crowdfunding platforms, or other actors that help facilitate or manage capital flows but are not the direct investor or recipient.
- **Providers of technical assistance –** e.g., advisers, consultants, incubators/accelerators of social enterprises
- **Advocates/conveners –** organizations that help promote best practices, create partnerships and increase the scale of the impact investment sector; rating and certification organizations that help verify the social and environmental performance of impact enterprises, thereby reducing risk by providing objective certification and rating for impact investors (e.g., B Lab).[31]

NGO ROLE(S)

- **Donor –** providing catalytic grants to social enterprise
- **Recipient –** receiving catalytic grants from donors
- **Intermediary –** facilitating and/or managing capital flows
- **Provider of technical assistanc**e – serving as adviser, incubator, or accelerator for social enterprises
- **Advocate/convener –** promoting best practices and creating partnerships

31 "From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors." http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

MARKET SIZE/SHARE

It can be difficult to agree exactly what constitutes a "catalytic grant" to a recipient and there is no central place where information is kept about total amount deployed.

OBJECTIVE(S)

- Increase revenues
- Crowd in new players

PROS

- No need to repay grant
- Fills "Pioneer Gap"[32] for early stage start-ups
- Can pave the way for more commercially oriented investors (if used appropriately)

CONS

- Often comes with restrictions about how funds can use used
- Application and reporting processes can be burdensome
- Payment can be delayed
- Must align with donor strategic priorities, which can change from year to year

RISKS

- Market distortion/crowding out private sector if not used appropriately
- Social enterprise may use grant as a "crutch," with negative impact on financial sustainability
- Direct impact may be difficult to assess/disentangle

WHEN TO USE IT

- Activities with high degree of uncertainty of success (e.g., R&D)

WHEN TO NOT USE IT

- Activities with higher certainty of success/direct link to future cash flows

M&E

Donors typically have strict reporting requirements about how money was spent (budget line items), as well as direct project outputs (e.g., product/service developed) and outcomes (e.g., product uptake/market penetration). Tracking higher level impacts (e.g., improvement in livelihoods is less common) due to longer time horizons and attributability problems.

COST

- High administrative burdens (e.g., application and reporting procedures)

32 The "Pioneer Gap" exists in the early stages of an enterprise's growth, when it is not yet considered investable by many investors.

COMPLEXITY

- Very familiar to donors and nonprofits
- Simple to structure
- Some donors, in particular government agencies, may have high threshold for the systems, processes, and protocols that must be in place to avoid corruption and money-laundering and to ensure compliance with anti-terrorist financing laws, etc. (often too sophisticated for earlier stage enterprises)

EXAMPLE

The **Global Innovation Fund** (GIF) invests in social innovations that seek to improve the lives and opportunities of people in developing countries. It supports innovators at all stages of development, through financing in the forms of grants, loans, or equity investments. GIF awards grants to nonprofits that demonstrate a public sector or hybrid path to scale and the potential to provide a cost-effective way to solve a development challenge. It also may award grants to a for-profit applicant with a market route to scale if the for-profit can demonstrate a large social impact and that the grant would not crowd out private capital.[33]

The Mercy Corps **Social Venture Fund** (SVF) was launched in 2015 to fill a gap in the impact investing market for seed and early stage social venture start-ups. SVF is capitalized through philanthropic sources and able to take a high level of risk. It provides early-stage grant financing to build businesses and drive them towards commercial viability and follow-on investment. Investments range from US$50,000 to US$300,000. They can either be seed or early-stage financing in equity, debt, or quasi-equity forms. Investees are not required to have significant revenue traction but must define a product or service with a unique approach that can scale.

ADDITIONAL RESOURCES

- https://globalinnovation.fund
- https://www.mercycorps.org/social-venture-fund

33 For example, see: https://globalinnovation.fund/apply/steps/what-type-and-amount-of-funding-should-i-apply-for/.

BONDS

SNAPSHOT

Instrument:
Bonds

NGO Role(s):
- Investor
- Recipient
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Crowd in new players
- Increase revenues

Feasibility – Key Factors:
- Depending on the value, complexity, taxes, risk profile of the issuer, and other factors, the issuance of a bond can be very costly (millions of dollars)
- Common structure but complex and time-consuming to pull together due to high level of financial intermediation required, as well as the involvement of regulatory bodies.

WHAT IS IT

A typical bond is a debt investment in which an **investor loans money to an entity** (typically corporate or governmental) which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds can be used by companies, municipalities, states, and sovereign governments to raise money and finance a variety of projects and activities. However, in this context, **we use the term to refer to debt financing raised specifically to fund social or environmental causes**.

HOW IT WORKS

The structure, risk, and returns for bonds issued for a specific development purpose are otherwise identical to those of traditional bonds. As mentioned above, the only difference is that the capital raised through the bond is invested exclusively (either by specifying the use of the proceeds, direct project exposure, or securitization) for a specific social or environmental purpose, like clean energy, that is pre-defined. Usually, such bonds must have clear investment criteria (for selecting which projects to fund) and undergo third-party verification/certification to establish that the proceeds are funding projects that generate social or environmental benefits (in addition to financial returns, which are necessary for the issuing entity to pay back investors their principal plus interest).[34]

KEY PLAYERS

- **Investors –** individuals, companies, or institutional investors who buy bonds with the expectation of a financial return. Examples of institutional investors include endowment funds, hedge funds, insurance companies, asset managers, investment companies, investment trusts, mutual funds, pension funds, and sovereign wealth funds.
- **Recipients –** recipients include both the bond issuer (i.e., the direct recipient of the money loaned by the investors), and also any indirect recipients (i.e., any company, government agency or financial institution that develops, registers and sells a bond). In the case of bonds issued specifically to fund social or environmental causes, the indirect recipients are any companies (typically for-profit) receiving bond proceeds to tackle the social or environmental issue.
- **Intermediaries –** a financial institution serving as an underwriter to administer the issuance of the bond; creditor guarantors providing credit guarantees and credit enhancement products in secondary markets, thus modifying the risk profile of the underlying bond. A wide range of financial intermediaries offers a variety of intermediation and credit enhancement services, including raising investor capital, establishing special purpose vehicles, etc.

34 This guidance on bonds was adapted from UNDP's Financing Solutions for Sustainable Development platform. For more, see: http://www.undp.org/content/sdfinance/en/home/solutions/green-bonds.html.

- **Providers of technical assistance** – institutions responsible for verifying compliance with the standards for bonds or established credit standards.
- **Government regulators** – financial authorities responsible for regulating capital markets; they (i) examine the qualifications of underwriters as well as the securitization of credit assets and bonds' custodial arrangements; and (ii) regulate the issuance, clearing, and settlement provisions. Regulators include securities commissions and other regulatory bodies, including stock exchanges and central banks.
- **Advocates/conveners** – any organization working to build the ecosystem for a viable bond market and raising awareness around a specific development issue (for which bonds proceeds could be used).

NGO ROLE(S)

- Investor – NGOs can buy or invest in bonds, provided they can meet the conditions to maintain their nonprofit status.
- Recipient – NGOs can be a direct recipient (by issuing a bond) or an indirect recipient (by getting proceeds from a third-party issuer), provided they meet the conditions for maintaining their nonprofit status.
- Provider of technical assistance – NGOs can work with direct any number of stakeholders to build their capacity to participate in such a scheme.
- Advocate/convener – NGOs can use their convening power to push for reforms that are favorable to a commercially viable bond market and/or to ensure that a certain percentage of the proceeds go towards certain sectors/issue areas.

MARKET SIZE/SHARE

The use of bonds to raise capital to tackle social and/or environmental challenges has growth in the last decade, driven in large part by high demand from socially and environmentally-conscious investors. While the exact number of outstanding issuances is difficult to track due to the diversity of thematic areas and issuing entities (both public and private), two types of bonds have grown in popularity in recent years and show significant potential for growth: green bonds and diaspora bonds.

Green bonds, or bonds issued to generate climate or other environmental benefits, reached a record US$221 billion issuances in 2017 (an assessment using less strict criteria put the total value of outstanding issuances much higher: at about US$895 billion); global climate leaders have set a target of US$1 trillion in issuances by 2020.[35]

In a **diaspora bond**, as the name implies, bonds are issued to members of that country's diaspora to fund development needs. India and Israel have used diaspora bonds to raise billions of dollars (US$11 billion and US$32 billion, respectively).[36]

The World Bank's International Bank for Reconstruction and Development has recently launched a new series of bonds ("**sustainability bonds**") that directly link investors to the Sustainable Development Goals (SDGs).[37] Returns are linked to the performance of companies advancing global development priorities set out in the SDGs, including climate, gender, and health. Other actors are exploring similar applications, including in the refugee and peacebuilding space.

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35 Whiley, Andrew. "Climate Bonds State of the Market Report 2017: Green Bonds & Climate-aligned Universe Now Stands at $895bn: Launch Today at Climate Week NYC Event," Climate Bonds Initiative, September 18, 2017. https://www.climatebonds.net/2017/10/climate-bonds-state-market-report-2017-green-bonds-climate-aligned-universe-now-stands-895bn.

36 "Innovative Financing for Out-of-School Children and Youth," UNESCO, 2016, p. 15. http://unesdoc.unesco.org/images/0026/002600/260068e.pdf.

37 "World Bank Offers New Sustainable Growth Bonds for Investors in Switzerland," The World Bank, September 11, 2018. https://www.worldbank.org/en/news/press-release/2018/09/12/world-bank-offers-new-sustainable-growth-bonds-for-investors-in-switzerland.

OBJECTIVE(S)

- Crowd in new players
- Increase revenues

PROS

- For investors, opportunity to receive a stable financial return while generating social impact
- Ability to raise and deploy large amounts of capital for social issues—capital that would otherwise be unavailable/harder to access
- Could foster greater transparency in how proceeds are used and ensure that the social or environmental impact is reported
- Possibility of raising larger amounts of capital due to lower interest rates in exchange for social impact (e.g., granting a "patriotic discount" in the case of diaspora bonds[38])

CONS

- Underlying projects must be able to generate consistent income (unlike dividends, coupons are distributed at regular intervals, thus companies and entities seeking to issue bonds need to rely on activities that can generate sufficient cash to pay coupons)
- Minimum investment required/high running costs

RISKS

- Default (by the issuer) due to underperformance of underlying assets
- Variability in transaction costs/issuance fees (depending on the country/locale)
- Variability in the taxation of debt instruments can influence investors' decisions
- Monitoring and evaluation limitations (bonds track how proceeds are spent but not what the proceeds achieve in terms of concrete impact)
- Changes in foreign market regulations concerning capital flows (if the bond is issued abroad)

WHEN TO USE IT

- Typically best suited to large-scale projects that generate cash flows over a long investment horizon (e.g., low carbon transportation, renewable energy, etc.)
- Requires high public awareness of the social issue/salience among targeted investors

WHEN TO NOT USE IT

- Niche social issue/insufficient awareness or appetite among investors
- Lack of projects that can absorb large amounts of capital and deliver long-term, stable returns

M&E

At a minimum, the issuer should report at least annually on the investments made from the proceeds, detailing whenever possible the social or environmental benefits accrued with quantitative/qualitative indicators. However, there are no standard reporting requirements.

38 A "patriotic discount" refers to a discount provided by diaspora investors to the government of their ancestry/origin. For more, see: http://web.worldbank.org/archive/website01363/WEB/IMAGES/DIASPORA.PDF.

COST

- Depending on the value, complexity, taxes, risk profile of the issuer, and other factors, the issuance of a bond can cost anywhere from thousands of US dollars to millions

COMPLEXITY

- Very common and familiar structure for investors, but structuring can be complex and time-consuming due to the high level of financial intermediation required, as well as involvement of regulatory bodies

EXAMPLE

The World Bank manages a large portfolio of green bonds (150), mostly in middle-income countries. The World Bank has issued US$12.6 billion in green bonds in 20 currencies, including the green bonds the International Finance Corporation has issued in Peru (in the local currency) to finance renewable energy and energy efficiency projects.[39]

ADDITIONAL RESOURCES

- "What Are Green Bonds?," The World Bank. http://www.worldbank.org/en/topic/climatechange/brief/what-are-green-bonds.
- "Diaspora Bonds for Education," The World Bank. http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1257537401267/DiasporaBondsEducation.pdf.
- Kleiman, Gary. "Refugee Bonds Could Help in Venezuela's Humanitarian Catastrophe," Financial Times, May 18, 2018. https://www.ft.com/content/09ce076a-4d52-11e8-97e4-13afc22d86d4.

39 "World Bank Marks 10-Year Green Bond Anniversary with Landmark Issuance US$1.3 Billion Issuances Bring World Bank Green Bond Program to US$12.6 Billion," The World Bank, November 13, 2018. http://www.worldbank.org/en/news/press-release/2018/11/13/world-bank-marks-10-year-green-bond-anniversary-with-landmark-issuance-us-1-2-billion-issuances-bring-world-bank-green-bond-program-to-us-12-6-billion.

PERFORMANCE-BASED CONTRACTS

SNAPSHOT

Instrument:
Performance-based Contracts

NGO Role(s):
- Donor
- Recipient
- Intermediary

Objective(s):
- Improve efficiency

Feasibility – Key Factors:
- Higher than typical start-up costs to agree payment structures and measurement approach
- Typically high costs of measurement and verification to ensure confidence in results and payments made
- Extensive support and monitoring of program required, especially in early stage

WHAT IS IT

Performance-based contracts are results-oriented contracts that tie at least a portion of a contractor's payment to the achievement of specific, measurable indicators linked to outputs or outcomes.

HOW IT WORKS

Upon verification of the achievement of results, a payer disburses a payment to the contractor. Key steps are developing an agreement with clearly defined performance indicators, verifying results, and disbursing payments for pre-agreed results. There are no requirements for how payments should be used after they are rewarded. Some payers describe themselves as using performance-based contracts because they set targets and indicators but actually reimburse recipients for budgeted costs. Such mechanisms, while potentially useful for managing performance, are not considered to be performance-based.

KEY PLAYERS

- **Donors –** In this case, donors can be thought of as the "payers" under performance-based contracts, giving recipients money based on results achieved; these could be multilateral organizations, bilateral organizations, governments, foundations, NGOs, or corporates
- **Recipients –** could be NGOs, consultants, or any other project implementers
- **Evaluators –** independent verification of results is typically required
- **Intermediaries –** transactions are usually directly negotiated between donors and recipients although intermediaries may be involved in the structuring process

NGO ROLE(S)

- **Donor –** NGOs can sub-contract other organizations to implement projects and pay or partially pay them on results
- **Recipient –** NGOs are often recipients of performance-based funding
- **Intermediary –** NGOs can also help structure transactions between donors and recipients

MARKET SIZE/SHARE

It is estimated that, between 1993 and 2016, US$26.9 billion was tied to results through various results-based approaches (largely, but not only, performance-based contracts) across 78 low- and middle-income countries.[40]

40 "A Practitioner's Guide to Results-Based Financing: Getting to Impact," Instiglio and World Vision, October 2017, p. 24. https://payforsuccess.org/sites/default/files/resource-files/RBF_PractitionersGuidebook_Instiglio_18Oct2017.pdf.

OBJECTIVE(S)

- Improve efficiency

PROS

- Risk transfer (for donors) – funding disbursed only upon achievement of verifiable results
- Improves management of resources
- In principle, implementers have flexibility over inputs and approaches expected to lead to results
- NGOs have experience with this approach and templates are increasingly available
- Emphasis on measurement increases evidence base and learning

CONS

- Challenging to define outcome metrics and payment structures
- Recipient must have upfront capital available to put at risk (thus, in practice, such mechanisms only tie a small portion funding to results, with questions as to whether or not it is sufficient to actually change incentives)

RISKS

- Funders pay for programs that would have happened anyway (without the intervention), though that risk could be mitigated with rigorous impact evaluation (involving counterfactual)
- Risk of unintended consequences or gaming of results to receive funding
- May create focus on narrowly defined payable results at expense of other important aspects of project (e.g., "cherry-picking" beneficiaries to more easily reach pre-defined results)
- Risky for implementers who absorb upfront costs and do not receive full payment if results are not achieved
- Factors out of implementers' control impeding achievement of results
- Price per outcome inadequately priced (too low to incentive improved service delivery)

WHEN TO USE IT

- When there is a clear benefit in transferring risk to the implementing agency
- When desired outputs/outcomes are clear and measurable
- As a way to scale proven models efficiently/ensure quality of implementation
- When implementers have pre-financing

WHEN TO NOT USE IT

- When results are not clearly measurable and attributable to implementers
- When there is high uncertainty that interventions will lead to results (though this risk could be mitigated by conditioning smaller portion of payment on results)

M&E

Payment metrics and measurement are the backbone of any results-based approach, and typically require a significant investment of time and resources to agree in advance. Metrics range from outputs (e.g., number of people trained) to higher level impact (e.g., improvements in livelihoods); and measurement frameworks can range in terms of rigor and complexity, from simple verification of administrative data to randomized control trials (RCTs). However, given the typically low-stakes nature of performance-based contracts (compared to impact bonds), RCTs are fairly rare.

COST

- Higher than typical start-up costs to agree payment structures and measurement approach
- Typically high costs of measurement and verification to ensure confidence in results and payments made

COMPLEXITY

- More start-up time required than traditional contracts to agree on payment structures and measurement approach
- Many steps to agreeing on design: define target population, results metrics, measurement and evaluation methods, ensure data systems are in place
- Need to mitigate risks of corruption or unintended consequences
- Time for rigorous measurement and verification must be built in
- Experience shows that continuous support is required for service providers and all players in program during early stages to adapt to new systems

EXAMPLE

The **Health Results Innovation Trust Fund (HRITF)** supports results/performance-based financing approaches in the health sector to improve maternal and child health around the world. The HRITF is administered by the World Bank and supported by the Norwegian Agency for Development Cooperation (NORAD) and the UK Department for International Development (DFID). HRITF has committed US$385.6 million for 35 results-based financing programs in 29 countries. HRITF supports governments to engage in performance-based contracts with health facilities, paying them for results such as increases in household health care visits and uptake of services in remote areas, user satisfaction, and improvements in management and data systems.

ADDITIONAL RESOURCES

- RBF Health: https://www.rbfhealth.org.
- "Results Based Financing in Health (Self-paced)," The World Bank. https://olc.worldbank.org/content/results-based-financing-health-self-paced.
- Fritsche, György Bèla, Robert Soeters, and Bruno Meessen. "Performance-Based Financing Toolkit," World Bank Training, The World Bank. https://openknowledge.worldbank.org/handle/10986/17194.
- "A Practitioner's Guide to Results-Based Financing: Getting to Impact," Instiglio and World Vision, 2017. https://payforsuccess.org/sites/default/files/resource-files/RBF_PractitionersGuidebook_Instiglio_18Oct2017.pdf.
- "Funding for Results: How Governments Can Pay for Outcomes," Beeck Center for Social Impact & Innovation, Georgetown University. http://beeckcenter.georgetown.edu/wp-content/uploads/2016/06/Funding-for-Results_BeeckCenter.pdf.

SOCIAL/DEVELOPMENT IMPACT BONDS

SNAPSHOT

Instrument:
Social/Development Impact Bonds

NGO Role(s):
- Donor
- Investor
- Recipient
- Provider of technical assistance
- Intermediary

Objective(s):
- Improve efficiency/value for money
- Crowd in private sector

Feasibility – Key Factors:
- Extensive time and coordination required to structure
- Long time required to develop and adapt to new data and performance management systems
- High cost of measurement and verification
- Most suitable when there is some evidence behind an intervention but more room for experimentation or uncertainty about taking it to scale

WHAT IS IT

A **social/development impact bond** is a **contract among private investors, donors, and implementing agencies that have agreed upon a shared social outcome**. Investors fund social programs in advance, and governments (under a social impact bond (SIB)) or third-party donors (under a development impact bond (DIB)) **remunerate investors with financial returns if – and only if – evidence shows that programs achieve pre-agreed outcomes**. Impact bonds are a way to shift incentives and accountability to results, transfer performance risk to the private sector, and increase efficiency in program implementation.

HOW IT WORKS

As with any results-based contract, key steps include developing an agreement with clearly defined performance indicators and outcomes, verifying results, and disbursing payments if and when pre-agreed results are achieved. The key difference between an impact bond and other types of results-based financing contracts is that private investors – as opposed to implementing agencies or governments – put up the working capital and assume financial risks. If the program is successful in achieving outcomes, donors pay back investors their principal plus a financial return that is tied to the level of social outcomes achieved. Typically, the involvement of private investors creates incentives to improve efficiency of delivery systems, improve data systems, and adapt to program feedback and learning in real time.

KEY PLAYERS

- **Donors –** governments or donors (multilateral organizations, bilateral organizations, or foundations) that pay for outcomes
- **Investors –** social impact investors, including possibly individuals, corporates, foundations, or multilaterals
- **Recipients –** service providers who receive pre-financing to deliver social programs
- **Evaluators –** provide independent verification of results as required
- **Intermediaries –** facilitate and manage development of contracts, transfers of payments, and performance management

NGO ROLE(S)

- **Investor –** invest for a financial return
- **Donor –** pay for outcomes, or provide a first loss guarantee to crowd in commercial investors
- **Recipien**t – NGOs can be the delivery organization
- **Provider of technical assistance –** help delivery organizations become SIB/DIB-ready, provide data, implement performance management systems, etc.
- **Intermediary –** NGOs can structure the transactions

MARKET SIZE/SHARE

By the end of 2017, there were 108 impact bonds completed or in implementation globally, 32 of which were launched in 2017. Six of these were in low- or middle-income countries; the vast majority, 102, were in high-income countries. The 108 bonds were spread across 25 countries, although more than a third (42) have been contracted in the United Kingdom. DIBs have been launched in Colombia, the Democratic Republic of the Congo, India, Kenya, Mali, and Uganda. In addition to the six DIBs in implementation, there are an estimated 24 in the design phase.[41]

OBJECTIVE(S)

- Improve efficiency
- Crowd in private sector

PROS

- Directly ties funding to results
- Improves management of resources
- Leverages private sector without the need for nonprofits to change their underlying business model (i.e., no need to generate revenues)
- In principle, implementers have flexibility over inputs and approaches expected to lead to results; focus on adaptive approach responding to real-time data
- Service providers receive access to finance and do not bear financial risk
- Emphasis on measurement increases evidence base and learning

CONS

- Complex structure – extensive time and coordination required to structure, challenging to define outcome metrics and payment structures, etc. – typically requires minimum investment size (approximately US$5 million)
- Still fairly new instrument – lack of standardized templates; not as familiar to mainstream investors, donors, or nonprofits
- Concerns raised about introducing private sector role in delivery of public services

RISKS

- Donors pay for programs that would have happened anyway (without the intervention), though that risk could be mitigated with rigorous impact evaluation (involving counterfactual)
- Investors don't get paid for factors outside of their control (e.g., political instability, economic shocks, etc.)

41 Gustafsson-Wright, Emily and Izzy Boggild-Jones. "Paying for Social Outcomes: A Review of the Global Impact Bond Market in 2017," The Brookings Institution, January 17, 2018. https://www.brookings.edu/blog/education-plus-development/2018/01/17/paying-for-social-outcomes-a-review-of-the-global-impact-bond-market-in-2017/.

- Risk of unintended consequences or gaming of results to receive funding
- May create focus on narrowly defined payable results at expense of other important aspects of project (e.g., "cherry-picking" beneficiaries to more easily reach pre-defined results)
- Price per outcome inadequately priced (too low to incentivize improved service delivery)

WHEN TO USE IT

- When desired outputs/outcomes are clear and measurable
- When governments, donors, investors, and service providers can align towards achievement of a desired outcome
- Service provider has strong culture of performance management, as well as basic systems and processes in place to track outcomes
- To catalyze promising interventions; impact bonds are most suitable when there is some evidence behind an intervention but more room for experimentation or uncertainty about taking it to scale

WHEN TO NOT USE IT

- When results are not clearly measurable and attributable to implementers
- When results are either so certain that investors are taking no risk or so uncertain that the risk is too high for investors

M&E

Payment metrics and measurement are the backbone of any results-based approach, and typically require a significant investment of time and resources to agree in advance. Metrics range from outputs (e.g., number of people trained) to higher level impact (e.g., improvements in livelihoods) and measurement frameworks can range in terms of rigor and complexity, from simple verification of administrative data to randomized control trials (RCTs). However, given the typically high-stakes nature of DIBs/SIBs (compared to performance-based contracts), evaluations tend to be more rigorous.

COST

- Higher cost than other types of results-based instruments due to longer development times and higher cost of evaluation (total costs can range from half a million to over a million).

COMPLEXITY

- Typical structuring times takes 6–8 months; more start-up time required than traditional contracts to agree payment structures and measurement approach
- Multiple contracts required across different types of partners, which can be highly complex
- Time required to develop and adapt to new data and performance management systems
- Time for rigorous measurement and verification must be built in
- Need to mitigate risks of unintended consequences
- Extensive support and monitoring of program required, especially in early stage

EXAMPLE

The **Educate Girls Development Impact Bond (DIB)** is a joint project between Educate Girls (service provider), the Children's Investment Fund Foundation (CIFF) (outcomes payer), the UBS Optimus Foundation (investor), Instiglio (intermediary), and IDinsight (evaluator). The DIB aims to help improve education for 18,000 children in Rajasthan, India by linking investor returns to improvements in school enrollment and learning outcomes. The DIB also aims to create a proof of concept, showing potential donors and investors how DIBs could contribute to societal gains while also offering financial returns. In 2018, the final year of a three-year pilot project, the DIB exceeded enrollment and learning targets. UBS Optimus recouped its initial investment plus returns. The total payout is being reinvested to Educate Girls and other UBS Optimus development programs.

ADDITIONAL RESOURCES

- "Investing in Social Outcomes: Development Impact Bonds," Center for Global Development. https://www.cgdev.org/sites/default/files/investing-in-social-outcomes-development-impact-bonds.pdf.
- "A Practitioner's Guide to Results-Based Financing: Getting to Impact," Instiglio and World Vision, 2017. https://payforsuccess.org/sites/default/files/resource-files/RBF_PractitionersGuidebook_Instiglio_18Oct2017.pdf.
- Gustafsson-Wright, Emily and Izzy Boggild-Jones. "Paying for Social Outcomes: A Review of the Global Impact Bond Market in 2017," The Brookings Institution, January 17, 2018. https://www.brookings.edu/blog/education-plus-development/2018/01/17/paying-for-social-outcomes-a-review-of-the-global-impact-bond-market-in-2017/.
- "Impact Bonds in Development Countries: Early Learnings from the Field," The Brookings Institution, 2017. https://www.brookings.edu/wp-content/uploads/2017/09/impact-bonds-in-developing-countries_web.pdf.

DEBT SWAPS/BUY-DOWNS

SNAPSHOT

Instrument:
Debt Swaps/Buy-downs

NGO Role(s):
- Donor
- Intermediary
- Evaluator

Objective(s):
- Improve efficiency
- Increase revenues

Feasibility – Key Factors:
- Can be costly in terms of time and legal advice and considerations to develop agreements
- Depending on number of parties in the agreement and nature of debt, can take a long time to structure
- Long time horizon often needed between structuring of agreement and verified achievement of results

WHAT IS IT

Debt-for-development swaps (also called buy-downs or debt conversions) **occur when a developing country's debt repayment obligations are transferred or reduced based on meeting development goals.**

HOW IT WORKS

There are several types of debt swaps:

- **Debt-for-nature swap.** In exchange for debt forgiveness, a government commits to invest accrued savings in conservation and/or climate-related expenditures. Its creditor sells all or part of the outstanding debt to an NGO at a price lower than the face value. The third-party NGO is acting as the funder or donor by purchasing the debt on the secondary market. The debtor government may enact certain environmental policies or endow a government bond in the name of the NGO or conservation organization.[42]
- **Multilateral or bilateral debt swaps.** These are debt swaps between government institutions. In a bilateral swap, a creditor country forgives a portion of the public bilateral debt of a debtor nation in exchange for development, social, or environmental commitments from that country. A multilateral debt swap works the same way but involves transactions of more than two national governments.

KEY PLAYERS

- **Investors –** lender country governments
- **Donors –** NGOs, foundations, bilateral or multilateral organizations
- **Recipients –** debtor country governments
- **Intermediaries –** various structuring organizations
- **Evaluators –** independent verification of results often needed before debt is paid off

NGO ROLE(S)

- **Donor –** NGOs can take over a debtor country's debt
- **Intermediary –** structure agreement and contracts
- **Evaluator –** evaluate results

42 "Debt for Nature Swaps," United Nations Development Programme. http://www.undp.org/content/sdfinance/en/home/solutions/debt-for-nature-swaps.html.

MARKET SIZE/SHARE

According to one database, four debt swaps between 2000 and 2013 mobilized US$1.4 billion.[43] This does not include debt-for-nature swaps which, since 1989, have mobilized an additional US$1.1–US$1.5 billion.[44]

OBJECTIVE(S)

- Improve efficiency
- Increase revenues

PROS

- Mobilizes resources for development or environmental causes
- Results-based: funds are released after a developing country government takes a particular action or makes an investment concerning a development or environmental cause

CONS

- Challenging to ensure outcomes are achieved or, in case of policy outcome, if enacted policy is effective
- Challenging to determine amount of available debt
- High administrative costs of debt servicing

RISKS

- Potentially weak/ineffective monitoring systems
- Desired outcomes are not sustained after the transaction is complete
- Currency risk
- Political risks

WHEN TO USE IT

- Debtor government or institutions committed to social or environmental issues
- Lender government willing to swap/convert debt
- When third party NGO has a relationship with government

WHEN TO NOT USE IT

- Weak/ineffective monitoring systems to ensure debtor government delivers on commitment

M&E

A debt swap requires evidence of compliance with an agreement between a developing country and the original investor or lender and the investor or donor purchasing the debt. Developing country governments may commit to a policy action or financial investment in a social or environmental cause. The exact, verifiable results or terms of compliance must be agreed in the contract.

COST

- Can be costly in terms of time and legal advice and considerations to develop agreements

43 "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, September 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.

44 "World Economic and Social Survey 2012: In Search of New Development Finance," United Nations, 2012, p. viii. http://www.un.org/en/development/desa/policy/wess/wess_current/2012wess.pdf.

COMPLEXITY

- Depending on number of parties in the agreement and the nature of debt, can take a long time to structure – need to agree amount and type of debt to be converted, discount rates, exchange rates, repayment schedule, and results that trigger the debt swap
- Long time horizon often needed between structuring of agreement and verified achievement of results

EXAMPLE

Debt2Health is a bilateral debt swap involving a three-way partnership between creditors, grant-recipient countries, and a multilateral institution (currently the Global Fund to Fight AIDS, Tuberculosis and Malaria). Creditors forgo repayment of a portion of their loan to a poor country on the condition that that country, in return, invests an agreed amount in health. The investment is made through the Global Fund according to the systems and principles it regularly uses to disburse grants.

ADDITIONAL RESOURCES

- "Debt for Nature Swaps," United Nations Development Programme. http://www.undp.org/content/sdfinance/en/home/solutions/debt-for-nature-swaps.html
- "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.

CONDITIONAL CASH TRANSFERS

SNAPSHOT

Instrument:
Conditional Cash Transfers

NGO Role(s):
- Donor
- Intermediary

Objective(s):
- Improve efficiency

Feasibility – Key Factors:
- Challenging to target those who could most benefit from the program and ensure they have access to quality services
- Need to take measures to avoid corruption, cheating, or unintended consequences
- Long time to launch depending on level of political momentum and program design features; thereafter, programs are typically relatively streamlined and efficient

WHAT IS IT

Conditional cash transfers (CCTs) aim to **reduce poverty through payments from donors or governments to beneficiaries when beneficiaries fulfill certain conditions**. These conditions are typically related to beneficiaries' investments in human capital and use of services in areas such as health, nutrition, employment, and financial management.

HOW IT WORKS

Design and implementation of CCT programs involve: targeting of beneficiary population, and determining conditions for payment and payment value, timing, frequency, and duration. Once agreed conditions are met and verified – for example, children receive routine immunizations or attending school regularly – beneficiaries are eligible to receive funds directly.

KEY PLAYERS

- **Donors –** private or official donors could be program funders or co-funders. Often CCT programs are state programs funded by national or local governments. National or local governments also play a role in the delivery of services and the administration of the program
- **Recipients –** project beneficiaries
- **Intermediary –** often a trusted local NGO, supports the program administration and facilitates flow of funds
- **Other –** social service providers must verify that beneficiaries have accessed services.

NGO ROLE(S)

- **Donor –** providing their own capital
- **Intermediary –** supporting the program administration and facilitating the flow of funds

MARKET SIZE/SHARE

As of 2016, 63 countries had at least one conditional cash transfer program (up from 2 countries in 1997).[45]

45 "Cash Transfers: What Does the Evidence Say?," Overseas Development Institute, July 2016. https://www.odi.org/sites/odi.org.uk/files/resource-documents/11316.pdf.

OBJECTIVE(S)

- Improve efficiency

PROS

- Incentivizes behaviors that improve families' well-being
- Inclusive approach with shared responsibilities of beneficiaries
- Directly ties donor or government funds to results
- Improves management of resources
- Can be more cost-effective than alternative, in-kind forms of support for vulnerable populations
- Well-researched approach, with strong evidence showing improvements in access to services and some evidence showing improved outcomes

CONS

- Potential for corruption
- Social infrastructure and support services development are needed
- Implementation requires coordination with multiple stakeholders
- Challenging to define target population and include all households in need

RISKS

- Corruption
- Risk of unintended consequences/perverse incentives
- Delays or changes to programs due to changes in political leadership
- Low government capacity to deliver services or make transfer payments
- Outcomes not sustained when transfers end

WHEN TO USE IT

- Desired results are in beneficiaries' control
- When social infrastructure is in place and people in need are able to access services
- When the poor are able to access payments (e.g., through mobile money)
- Strong political buy-in and support

WHEN TO NOT USE IT

- For interventions/outcomes that are not in beneficiaries' control
- When service delivery capacity is lacking or the supply of services is interrupted
- When targeting of needy households is not possible

M&E

Numerous impact evaluations have been completed on CCT programs. There is evidence of these programs increasing the use of social services – for example, increased school enrollment and attendance, fewer drop-outs, and higher use of health services. There is less but still some evidence of positive impacts on learning, reduced child mortality, reduced incidence of diseases like diabetes and breast cancer, and increases in adult work effort and increased investment in income-generating activities.

COST

- Size of payment transfers varies widely across programs
- Cost effective overall because payments are conditional upon beneficiaries achieving some results and because CCTs are an alternative to more costly social programs
- But start-up costs of targeting and program administration are high

COMPLEXITY

- High cost in time to start-up depending on level of political momentum and program design features; thereafter, programs are typically relatively streamlined and efficient.
- Relatively simple because no contractual agreement with beneficiary; allocation of funding based on expected results needs to be determined
- Challenging to target those that could most benefit from the program and ensure they have access to quality services
- Need to ensure no corruption, cheating, or unintended consequences

EXAMPLE

First launched in 2003, **Bolsa Família** is a social welfare program of the Brazilian government that makes cash transfers to low-income families on the condition that they meet requirements such as ensuring that children attend school and are vaccinated. The program attempts to both reduce short-term poverty by direct cash transfers and fight long-term poverty by increasing human capital among the poor. Bolsa Família in Brazil reaches 26 percent of Brazil's population and has helped stimulate an expansion of conditional cash transfer programs in Latin America and around the world.

ADDITIONAL RESOURCES

- "Cash Transfers: What Does the Evidence Say?," Overseas Development Institute, 2016. https://www.odi.org/sites/odi.org.uk/files/resource-documents/11316.pdf.
- Wetzel, Deborah. "Bolsa Família: Brazil's Quiet Revolution," The World Bank, November 4, 2013. http://www.worldbank.org/en/news/opinion/2013/11/04/bolsa-familia-Brazil-quiet-revolution.
- "Conditional Cash Transfers: Reducing Present and Future Poverty," The World Bank, 2016. https://siteresources.worldbank.org/INTCCT/Resources/5757608-1234228266004/PRR-CCT_web_noembargo.pdf.

AWARDS AND PRIZES

SNAPSHOT

Instrument:
Awards and Prizes

NGO Role(s):
- Donor
- Recipient
- Intermediary

Objective(s):
- Improve efficiency

Feasibility – Key Factors:
- May be appropriate when solutions to a challenge are not known, innovation is needed, and it is possible to link payments to results
- High upfront costs, requiring recipient to have access to large unrestricted pool of capital
- Metrics and measurement can be complex/take long time to develop
- Simple structure, but long time horizon before rules and legal arrangements are in place, competitors bid, and results are achieved and measured

WHAT IS IT

Awards and prizes involve **offering a financial reward for the delivery of a development solution in a competitive selection process**. They are a type of results-based approach because prizes are not based on proposed solutions but typically on the results that the solutions deliver.

HOW IT WORKS

Funders initiate an open bid competition that awards a financial prize to the best innovation that provides a solution to a development challenge within an agreed timeframe. Competitions are designed to pay for innovations that solve specific, well-defined problems without prescribing the solution in advance or limiting the nature or number of participants.

KEY PLAYERS

- **Donors –** funding commitments can come from governments, bilateral organizations, multilateral organizations, foundations, or corporates
- **Recipients –** organizations competing for funds
- **Intermediaries –** facilitate management of processes and financial flows
- **Evaluator –** independent evaluation of results is needed

NGO ROLE(S)

- **Donor –** providing funds
- **Recipient –** competing for funds
- **Intermediary –** facilitating management of processes and financial flows

MARKET SIZE/SHARE

Awards and prizes are a relatively small share of the market for innovative finance, with an estimated US$300 million mobilized between 2000 and 2013.[46]

OBJECTIVE(S)

- Improve efficiency

PROS

- Incentivizes or accelerates discovery of new solutions to development challenges
- Stimulates competition to increase innovation and efficiency
- Donor funds only pay for successful results

CONS

- Can be challenging to agree metrics and measurement
- For recipients, requires access to unrestricted capital
- High administrative burden (application/selection and reporting)

RISKS

- For competitors, risk of not getting paid for work put in

WHEN TO USE IT

- When solutions to a challenge are not known and innovation is needed
- To accelerate the development of new approaches to solving a development challenge or reaching greater scale
- When there are many possible solutions to a challenge, and potential for a competitive pool of proposals

WHEN TO NOT USE IT

- When solutions are known
- When it is difficult to measure results reliably/objectively

M&E

Prize schemes link the full payment amount to a measurable outcome, such as the number of beneficiaries positively impacted by a development solution.

COST

- Upfront cost of product development/service delivery
- Administrative and management costs related to marketing, reviewing proposals, evaluation, administering prize

COMPLEXITY

- Relatively easy to structure but possibly long time horizon before rules and legal arrangements are in place, competitors bid, and results are achieved and measured
- Moderate operational complexity to evaluate competitors and results achieved

46 "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, September 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.

EXAMPLE

The **Haiti Mobile Money Initiative** was a US$10 million incentive fund created in partnership between the Bill and Melinda Gates Foundation and the U.S. Agency for International Development (USAID) (2010–2012) to launch mobile money services in Haiti following the 2010 earthquake. The fund provided two types of awards: a First to Market Award, and a Scaling Award for providers who achieved a certain market share/penetration.

ADDITIONAL RESOURCES

- "A Practitioner's Guide to Results-Based Financing: Getting to Impact," Instiglio and World Vision, 2017. https://payforsuccess.org/sites/default/files/resource-files/RBF_PractitionersGuidebook_Instiglio_18Oct2017.pdf.
- "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.
- "Haiti Mobile Money Initiative," USAID. https://partnerships.usaid.gov/partnership/haiti-mobile-money-initiative.

ADVANCE MARKET COMMITMENTS (AMCS)

SNAPSHOT

Instrument:
Advance Market Commitment

NGO Role(s):
- Intermediary

Objective(s):
- Improve efficiency
- Crowd in private sector

Feasibility – Key Factors:
- AMCs are suitable in very specific scenarios when incentives are needed to develop new products
- There is a high degree of time and complexity required to develop terms and agreements between different stakeholders.

WHAT IS IT

An **Advance Market Commitment** (AMC) is an agreement through which a **donor commits to subsidize the future purchase of a product that is not yet available**. Its purpose is **to accelerate the development and availability of products like vaccines**, in which pharmaceutical companies would otherwise not invest research and development due to low demand and recipient ability to pay.

HOW IT WORKS

Donors commit to fund an AMC with set specifications, including price and market size, and enter into a supply agreement with a manufacturer approved by an independent body. The manufacturer commits to supplying the product at a price affordable to developing countries in the long term. The donor funding commitment gives manufacturers incentives to develop the product and catalyzes the development of a market in developing countries.

KEY PLAYERS

- **Donors –** funding commitments can come from developing country governments, bilateral organizations, multilateral organizations, foundations, or corporates
- **Recipients –** product manufacturers develop the product and commit to supplying at an agreed price
- **Intermediaries –** fund managers and implementers are needed (e.g., in case of pneumococcal AMC, Gavi provides financial and operational support; World Bank is fund manager)
- **Government/regulatory bodies –** for a vaccine, the World Health Organization would assess prequalification requirements; an independent assessment committee would oversee process

NGO ROLE(S)

- **Intermediary –** providing financial and/or operational support

MARKET SIZE/SHARE

The Pneumococcal AMC, developed by the AMC Secretariat at Gavi and a range of international partners, remains the only AMC in practice. This mechanism deploys funding commitments of US$1.5 billion from six donors. The AMC is distinguished from other "pull mechanisms" such as prizes, which have similar features, because its key feature is the guarantee of a market to purchase goods if they are developed.

The overall global market for pneumococcal conjugate vaccines in 2015 was estimated to be US$6.5 billion, up from US$2.8 billion in 2009. Global demand is expected to grow at an average of 8 percent per year until 2025. Gavi countries account for a significant proportion of this growth.[47]

OBJECTIVE(S)

- Crowd in private sector
- Improve efficiency

PROS

- Addresses a market failure: the AMC creates incentives for private investment to develop and market specific vaccines
- Lowers vaccine prices to make them available in developing countries
- Stimulates competition among firms to drive up quality of product and ensure competitive market
- Clear roles and benefits for public and private partners (direct impact on saving lives; potential profitability)

CONS

- Complicated to structure: multiple stakeholders and a lot of time required
- Challenging to develop independent, transparent financial management, and procurement systems
- High R&D cost
- Challenging to determine appropriate size of incentive and pricing, particularly in a situation of uncertain demand
- Challenging to secure long-term forward commitments from donors

RISKS

- Uncertain market demand
- New technologies and shifting costs
- High upfront funding commitment over a long term
- Lack of transparency

WHEN TO USE IT

- To incentivize development of a new product
- When products are in an early stage and need more R&D
- When the challenge impeding progress is that producers do not know whether a market for their product exists
- Particularly applicable to investments in drug development and agricultural products

WHEN TO NOT USE IT

- When it is not possible to secure a long-term donor funding commitment that allows sufficient time for research and development

47 "The Advance Market Commitment Pilot for Pneumococcal Vaccines: Outcomes and Impact Evaluation," The Boston Consulting Group, 2015. https://www.gavi.org/results/evaluations/pneumococcal-amc-outcomes-and-impact-evaluation/.

M&E

AMCs are evaluated based on the social value resulting from a new market that has been created.

An evaluation of the Pneumococcal AMC was conducted in 2015 by The Boston Consulting Group. Overall, this evaluation demonstrated positive outcomes and the feasibility of implementing an AMC.

Positive results were measured in terms of:

- Averted deaths due to increased vaccine uptake
- Growth in low-income country market for vaccines

However little impact was observed in:

- Acceleration of R&D outcomes (e.g., acceleration of development timelines for new manufacturers that will bring down vaccine outcomes over time).

COST

- Product manufacturers must invest in costs of R&D
- Investors or donors must make large upfront, long-term funding commitments
- High cost requirement for time and legal procedures to develop terms and contracts between all stakeholders

COMPLEXITY

- Extensive time required to align all stakeholders and develop terms for AMC
- Long-term nature of agreements in context of uncertain future market demand makes pricing and delivery a challenge
- Complex independent, transparent financial management and procurement systems are needed
- High legal complexity in developing contracts between funders, manufacturers, developing country governments, and intermediaries

EXAMPLE

The **Pneumococcal AMC** initiative of Gavi (the Vaccine Alliance) with a combined US$1.5 billion contribution from Italy, the United Kingdom, Canada, the Russian Federation, Norway, and the Bill & Melinda Gates Foundation, makes effective and affordable pneumococcal vaccines available for children in 50 Gavi-eligible developing countries. It is estimated that the pilot can prevent more than 1.5 million childhood deaths by 2020. Development of the financial mechanism began in 2005 and it was launched in 2007.

ADDITIONAL RESOURCES

- "Pneumococcal AMC," Gavi, the Vaccine Alliance. https://www.gavi.org/funding/pneumococcal-amc/.
- "The Advance Market Commitment Pilot for Pneumococcal Vaccines: Outcomes and Impact Evaluation," Boston Consulting Group, 2015. https://www.gavi.org/results/evaluations/pneumococcal-amc-outcomes-and-impact-evaluation/.

INSURANCE SCHEMES

SNAPSHOT

Instrument:
Insurance Schemes

NGO Role(s):
- Recipient
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Improve efficiency
- Crowd in new players
- Increase revenues

Feasibility – Key Factors:
- Costs and overall feasibility highly context- and issue-specific
- Requires high degree of specialized skills to be able to assess and price risks in sectors and geographies that are largely new and unfamiliar to most traditional investors
- High degree of risk involved

WHAT IS IT

Insurance schemes are a **form of risk management primarily used to reduce any substantial losses or gains** suffered by an individual or an organization. In development, insurance schemes are widely used to increase the resilience of individuals, companies, and public entities to external shocks and reduce their future expenditures in case of a disaster.[48]

HOW IT WORKS

At its most basic level, insurance commits an individual or entity to pay a fixed amount at regular intervals (premium) into a common fund (the scheme), from which money is retrieved (pay-out) to compensate for losses arising from a predefined event (coverage). The pay-out helps to moderate the financial impact of external shocks, so that the livelihood and business of the insured are not jeopardized by the occurrence of an event.

An insurance scheme is "**direct**" or "**traditional**" when the insured entity — an individual or a company — signs a contract with the insurance provider (i.e., without intermediation). These are typical insurance products offered by private companies, in which the insured party receives a pay-out directly from the insurer (e.g., a farmer from an insurance company) upon the occurrence of an event (e.g., a drought). The periodical payment of an insurance premium is required.

The insurance scheme is "**indirect**" or "**mutual/cooperative**" when the contractual arrangement between the insured entity and the insurer is intermediated by a third party. The intermediary can be a government (e.g., through regional risk insurance pools) or an institution that has negotiated insurance cover for its clients (e.g., credit unions, microfinance institutions, savings clubs, etc.). Pooling schemes often offer better terms. For developing countries, the establishment of regional risk facilities (e.g., Caribbean Catastrophic Risk Insurance Facility) is a relatively recent phenomenon. Countries that become members can receive pay-outs to be invested in things like public rehabilitation programs (public buildings and assets like roads, maintaining police forces, keeping ministries running following a major catastrophe).

48 This guidance on insurance schemes was adapted from UNDP's Financing Solutions for Sustainable Development platform. For more, see: http://www.undp.org/content/sdfinance/en/home/solutions/disaster-risk-insurance.html.

KEY PLAYERS

- **Investors –** insurance providers (e.g., banks, credit unions, development finance institutions) that offer insurance solutions to the consumer market and re-insurance companies (e.g., Re-Swiss, Munich Reinsurance Company) that offer financial products to the insurers themselves; they take on risk and must make a pay-out in case of a covered loss.
- **Recipients –** the "insured party," which includes individuals, households, and companies receiving the insurance pay-out after the occurrence of a certain event. In the case of direct approaches, individuals or companies pay a premium and receive a pay-out when the insurance agreement is triggered. In the case of an indirect approach, the premium is paid by or through a third party.
- **Government/regulators –** other than being the insurer of last resort, governments can promote (and incentivize) public and private insurance schemes. They are also responsible for providing the legal framework and oversight over the insurance industry.
- **Providers of technical assistance –** provide technical assistance and official development assistance to raise awareness for and implement disaster-related insurance schemes.

NGO ROLE(S)

- **Recipient –** NGOs can be an insured party that receives a pay-out in case a covered loss occurs
- **Provider of technical assistance –** NGOs can work with insurance companies to make available risk data, help promote awareness in society, innovate, build capacity, and work with target populations to design and/or implement risk reduction measures to avoid large compensation claims (thus ensuring a more sustainable insurance market)
- **Advocate/convener –** NGOs can work with policymakers to raise awareness of risk and the benefits of insurance among target populations (e.g., householders, farmers, etc.)

MARKET SIZE/SHARE

One could roughly assess the monetary impact of any given insurance scheme by calculating the pay-outs allocated to insured entities affected by covered losses and the ratio between the premium and the amount of insured losses. However, this would underestimate the scheme's total value, as it would not include cost-savings resulting from investments in mitigation, benefits of immediate financial relief, etc.

While there are no known studies tracking the total monetary value of insurance schemes across developing countries, one can look at pay-outs related to disaster risk insurance, which is becoming increasingly popular in the development context, for illustrative purposes. A few notable examples are profiled below:

- The Caribbean Catastrophe Risk Insurance Facility was designed to address hurricane and earthquake risk in the Caribbean. After the 2010 earthquake in Haiti, the facility paid US$8 million to the government within two weeks of the disaster, providing emergency liquidity. Since 2007, the facility has approved eight pay-outs totalling US$38 million to eight member governments.
- In 2015, the African Risk Capacity paid out US$26 million to Senegal, Mauritania, and Niger against extreme droughts for an annual premium of US$930,000 which is paid through a USAID grant. The insurance contract can trigger a maximum pay-out of about US$7 million in the case of very severe droughts. In addition to pay-outs, it has been shown that for each US$1 of insurance pay-out under the scheme, US$4.40 of international aid can be foregone as a result of cost efficiency.
- The Rural Resilience Initiative is a risk management approach that helps rural communities become more resilient to weather variability in Africa. In 2012, the facility released pay-outs to Ethiopian farmers of US$322,772 as a result of drought conditions. Farmers pay the premium with their labor through the Insurance-for-Assets scheme.

For reference, insurers paid out about US$27 billion for natural disaster claims in 2015 across all countries, mostly developed.

OBJECTIVE(S)

- Improve efficiency (e.g., smooth out cash flows)
- Raise revenue (in the case of a covered loss)
- Crowd in new players (i.e., insurance companies)

PROS

- Provide liquidity/smooth out impact of external shocks, to ensure livelihoods, reconstruction, etc.
- The certainty and stability created by such schemes can create incentives for investment in prevention/resilience, thus leading to better outcomes down the line
- Pooling of risk, thus decreasing overall costs of participation (than would otherwise be possible)

CONS

- Insured must be willing and able to pay premiums regularly, an unrealistic expectation among the most vulnerable who are most in need of such insurance schemes
- Requires reliable data on risks and vulnerability, often lacking in developing countries
- Costly to set up
- Insufficient on its own to prevent loss of life, assets, livelihoods, etc. (needs to be complemented with other measures)

RISKS

- Access to reliable data
- Cultural norms (which could impact behavior/enrollment)
- Adverse selection
- Moral hazard
- Insufficient stream of premium income at scale (thus financially unsustainable)

WHEN TO USE IT

- Availability of/access to reliable data
- Willing and able payers of premiums

WHEN TO NOT USE IT

- Lack of reliable data
- Lack of willing/able premium payers

M&E

Highly variable (depends on the scheme).

COST

- High start-up costs

COMPLEXITY

- Difficulties in raising initial capital
- Lack of reliable data, unfamiliar risks to traditional investors

EXAMPLE

African governments pay a premium to join **African Risk Capacity**, a continent-wide pooled risk mechanism which has also been supported by development partners. When rainfall in a participating country drops below a certain threshold, this triggers a speedy pay-out—within 2–4 weeks of the end of the rainfall season—allowing the government to start taking action almost immediately to protect and assist its citizens.

HUGinsure, the world's first social impact insurance firm, is a joint venture between D. Capital Partners and Hollard Insurance South Africa. HUGinsure uses risk management and mitigation principles to increase the ability of funders to fund projects where risk is unknown or exceptionally high. At the same time, social enterprises can insure themselves against shocks, such as delayed government payments.

ADDITIONAL RESOURCES

- "Catastrophe Risk Financing in Developing Countries: Principles for Public Intervention," The World Bank, 2009. http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/CATRISKbook.pdf.
- "Climate Risk Insurance for the Poor & Vulnerable: How to Effectively Implement the Pro-Poor Focus of Insuresilience," Munich Climate Risk Insurance Initiative, 2016. http://www.climate-insurance.org/fileadmin/mcii/documents/MCII_2016_CRI_for_the_Poor_and_Vulnerable_full_study_lo-res.pdf.
- "Principles for Sustainable Insurance," United Nations. http://www.unepfi.org/psi/.
- "Disaster Risk Finance Across the Globe," The World Bank, January 13, 2016. https://www.youtube.com/watch?v=VtvQaJx71E0.
- "Disaster Risk Insurance," United Nations Development Programme. http://www.undp.org/content/sdfinance/en/home/solutions/disaster-risk-insurance.html.

INNOVATIVE TAXES

SNAPSHOT

Instrument:
Innovative Taxes

NGO Role(s):
- Advocate/convener
- Provider of technical assistance
- Recipient

Objective(s):
- Increase revenues

Feasibility – Key Factors:
- Moderate complexity to ensure consistent collection of funds, regulation, and allocation to recipients
- Reliance on government commitments and regulatory processes presents some risk to sustainability of funding

WHAT IS IT

Innovative taxes are specific taxes imposed by governments **to raise funding for a specific development challenge**. These initiatives generate new public revenue streams for development from the private sector.

HOW IT WORKS

A country or group of countries voluntarily agree to implement domestic taxes on a product or service and allocate funding raised to an NGO or international organization that supports a cause such as global health.

KEY PLAYERS

- **Donors –** governments, which must enact taxes; direct costs are often borne by businesses but passed on to consumers
- **Recipients –** organizations that receive funds raised by tax revenues for a social cause
- **Regulatory bodies –** such as ministries of finance or tax administration authorities must ensure enforcement and regulation
- **Providers of technical assistance –** may help to design tax schemes
- **Advocates/conveners –** may work to secure support for tax scheme

NGO ROLE(S)

- **Advocate/convener –** securing support for tax schemes with policymakers and/or the public
- **Provider of technical assistance –** advising on and designing tax schemes
- **Recipient –** receiving funds to work toward a social cause

MARKET SIZE/SHARE

Six examples of innovative tax schemes for development identified between 2000 and 2013, totalling US$2.4 billion.[49]

OBJECTIVE(S)

- Increase revenues

49 "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.

PROS

- Generates revenues
- Predictable revenue source
- Increases public awareness of issues
- Wide range of applicability across sectors

CONS

- Reliance on government processes and commitments to issue

RISKS

- Political risks
- Corruption/misuse of funds
- Unintended consequences (e.g., consumers switch to a substitute product to avoid paying tax, tax evasion)

WHEN TO USE IT

- Large financing gap for the social issue
- Broad public awareness and support for the social issue and proposed tax (e.g., cigarettes)
- Strong governance structures in place to avoid corruption, fraud, and waste
- Desired results are tangible and within reach (preferably with strong evidence base for what works)

WHEN TO NOT USE IT

- When additional financing will not solve a development challenge
- When the public/government is not committed to the social issue
- Tax difficult to agree and/or administer

M&E

- Volume of funds mobilized
- Lack of standard monitoring framework to track societal outcomes/impact (varies by issue/tax)

COST

- Administration and collection of tax
- Cost of monitoring and governance/coordination

COMPLEXITY

- Depends on issue area and level of political commitment
- Complex to launch but relatively simple once set up and running

EXAMPLE

In 1997, Costa Rica enacted a **tax on carbon pollution**, set at 3.5 percent of the market value of fossil fuels. The revenue raised from the tax goes into a national forest fund which pays indigenous communities for protecting the forests around them.

ADDITIONAL RESOURCES

- "Earmarked Tobacco Taxes: Lessons Learnt from Nine Countries," World Health Organization, 2016. http://apps.who.int/iris/bitstream/handle/10665/206007/9789241510424_eng.pdf;jsessionid=7ED3A1441A1E18FB333CCA94A17A0C6C?sequence=1.
- "The Taxation of Natural Resources: Principles and Policy Issues," The World Bank, 1993. http://documents.worldbank.org/curated/en/974521468739320152/pdf/multi0page.pdf.
- Parry, Ian, Eliza Lis Dirk Heine, and Shanjun Li. "Getting Energy Prices Right: From Principle to Practice," International Monetary Fund, 2014. https://www.elibrary.imf.org/view/IMF071/21171-9781484388570/21171-9781484388570/21171-9781484388570.xml?rskey=kHyJS5&result=1&highlight=true&redirect=true&redirect=true.

CROWDFUNDING

SNAPSHOT

Instrument:
Crowdfunding

NGO Role(s):
- Investor
- Donor
- Recipient
- Provider of technical assistance

Objective(s):
- Increase revenues
- Crowd in new players

Feasibility – Key Factors:
- Simple to structure but developing marketing and communication campaign can take significant time and resources to develop and execute successfully

WHAT IS IT

Crowdfunding is the practice of **funding a project or venture by raising monetary contributions from a large number of people** and leveraging their networks for greater reach and exposure. Crowdfunding typically comes in four types: donations-based, rewards-based, lending-based, or equity-based, and **helps finance projects that are too innovative or risky for traditional financing**. Crowdfunding emerged from innovation in technologies that made it possible for businesses, NGOs, and individuals to secure funding with no or limited intermediation.[50]

HOW IT WORKS

- **Donations-based** – the crowdfunder transfers funds to an individual, NGO, or business without expecting any return.
- **Rewards-based** – the crowdfunder transfers funds with the expectation of a reward, which may be in the form of a token gift or an early exclusive release of a product or service.
- **Lending-based** – the crowdfunder lends money to individuals or companies in return for interest.
- **Equity-based** – the crowdfunder purchases equity in a company.

KEY PLAYERS

- **Investor** (the crowdfunder) – provides equity or debt capital (in expectation of a financial return). Individuals make most of the market, but private and public institutions can invest and/or donate as well.
- **Donor** (the crowdfunder) – provides grant capital. Otherwise same as above.
- **Recipient** – the person or entity seeking funds for a product, project, or initiative. They can encompass a broad range of actors, including private companies, NGOs, social enterprises, startups, and individuals.
- **Intermediaries** – online platforms that connect the crowdfunders with the beneficiary or investee. They charge commissions for participation and/or interest/dividends. Platforms can perform a wide range of services, including financial due diligence, contracting, etc.
- **Providers of technical assistance** – platforms can also contract out certain services to a third-party provider, including financial due diligence and measurement and tracking of outcomes (financial, social, environmental).

50 This guidance on crowdfunding was adapted from UNDP's Financing Solutions for Sustainable Development platform. For more, see: http://www.undp.org/content/sdfinance/en/home/solutions/template-fiche12.html.

NGO ROLE(S)

- **Investor –** can act as the crowdfunder in any capacity
- **Recipient –** can be on the receiving end of grant or debt capital
- **Provider of technical assistance –** examples of activities include facilitating access to crowdfunding by providing knowledge, skills, and capacity building for direct beneficiary populations

MARKET SIZE/SHARE

Crowdfunding has grown substantially from US$1 billion in 2011 to US$34 billion in 2015, making it comparable to venture capital, which invests an average of US$30 billion per year. The World Bank estimates that crowdfunding will surpass US$100 billion by 2025.[51]

Lending-based activity (US$25 billion) makes up most of the current market, followed by donations (US$2.9 billion), rewards (US$2.7 billion), and equity (US$2.5 billion). However, the distribution differs in developing countries, where most crowdfunding is donation-based (43%), followed by lending (38%), equity (11%), and reward (11%).

Crowdfunders invest mostly in business and entrepreneurship (40%), social causes (20%), films and performing arts (12%), and real estate (6%). In addition, specialized platforms have emerged targeting subsectors such as agriculture, retail, food, and housing and services.[52]

OBJECTIVE(S)

- Increase revenues
- Crowd in new players

PROS

- Highly scalable, with potential to tap into diaspora and remittances market
- Can attract funding for projects that are otherwise too innovative or risky for traditional donors or investors (i.e., by pooling risk)
- Through more direct supporter engagement, allows beneficiaries/investees to test/validate ideas before approaching traditional donors/investors
- Democratization of start-up financing (traditional donors/investors often have "blind spots" so funding does not always flow to where it can have the greatest impact)
- Cost-effective, as crowdfunding platforms can help both crowdfunders and beneficiaries/investees navigate complex foreign legal frameworks that would otherwise prevent them from investing in/being able to receive funds from abroad

CONS

- Designing an effective communication strategy and crowdfunding campaign can take time, resources, and expertise
- Commissioning costs
- High competition
- Unpredictable funding flows
- Presumes high internet/mobile technology penetration rates (can be difficult in more remote/underserved areas)
- Lack of standards in monitoring impact and project results/lack of transparency into project results after required amount has been mobilized

51 "Crowdfunding's Potential for the Developing World," The World Bank, 2013. http://www.infodev.org/infodev-files/wb_crowdfundingreport-v12.pdf.

52 "Crowdfunding," United Nations Development Programme. http://www.undp.org/content/sdfinance/en/home/solutions/template-fiche12.html.

RISKS

- Cybersecurity
- Fraud
- Collapse of platforms (due to malpractice)
- Changes in regulatory frameworks, including tax provisions
- Reputational

WHEN TO USE IT

- Innovative program/initiative that is too risky for traditional investment
- Potential to reach/appeal to a wide audience, especially overseas/at a global scale (e.g., diaspora)
- Implementing organization has experience implementing effective marketing/communication campaigns

WHEN TO NOT USE IT

- Service/product appeals to niche market
- Able to raise similar levels of funding from traditional donors/investors

M&E

One of the criticisms of crowdfunding is the lack of transparency into project results after the required amount has been mobilized, and general lack of standards in monitoring and reporting project outcomes/impact.

Most crowdfunding platforms measure success by tracking outputs, while some measure higher level outcomes as well, namely:

- Total amount raised
- Number of projects/initiatives launched
- Number of jobs created/turnover rate
- Increase in profits
- Number/percentage of crowdfunders who contribute in non-financial ways (e.g., giving feedback on the product/initiative, volunteering their time, etc.)
- Financial leverage ratio (total amount matched by institutions or traditional donors/total crowdfunded from individuals)

COST

- Platform fees – 3%–8% of the total amount raised depending on the platform.
- Equity (additional) fees – equity investees are often subject to additional fees such as accounting fees, legal and securities costs, shareholder services, and reporting requirements. In the United States, these costs can range from US$10,000 to US$40,000.
- Marketing – these include communication, information technology (IT), design, and video production. Successful campaigns are often supported by well-designed marketing strategies and professional services providers, including professional photographers, videographers, and marketing consultants or freelancers (which can range from several hundred to several thousands of dollars).
- Project specific costs – highly variable, from a few thousand to hundreds of thousands.
- Time requirements – highly dependent on the scale of the project, investees' team, outsourcing strategy, and the type of project crowdfunded.

COMPLEXITY

- Simple to structure/set up, but developing marketing and communication campaign can take significant time and resources to develop and execute successfully

EXAMPLE

- JustGiving (donation-based)
- Kickstarter (rewards-based)
- Indiegogo (rewards-based)
- GoFundMe (donation-based)
- Kiva (lending-based)
- AngelList (equity-based)

ADDITIONAL RESOURCES

- "Crowding Funding's Potential for the Developing World," The World Bank, 2013. http://www.infodev.org/infodev-files/wb_crowdfundingreport-v12.pdf.
- "Crowdfunding Field Guide," Indiegogo. https://learn.indiegogo.com/marketing-crowdfunding-field-guide-a/.
- Steinberg, Scott. "The Crowdfunding Bible: How to Raise Money for Any Startup, Video Game, or Project," READ.ME, 2012. http://www.crowdfundingguides.com/The%20Crowdfunding%20Bible.pdf.
- "Crowdfunding," United Nations Development Programme. http://www.undp.org/content/sdfinance/en/home/solutions/template-fiche12.html.

VOLUNTARY CONTRIBUTIONS

SNAPSHOT

Instrument:
Voluntary Contributions

NGO Role(s):
- Donor
- Recipient
- Provider of technical assistance
- Advocate/convener

Objective(s):
- Increase revenues
- Crowd in new players

Feasibility – Key Factors:
- Relatively simple way to mobilize resources although funding flows are unpredictable
- High initial costs to start up and determine communications strategy

WHAT IS IT

Voluntary contributions are a **part of consumer purchases that usually take the form of donations**. Typically, these are private sector contributions (most often from individual citizens) facilitated or channelled by public authorities. They have the benefit of engaging a wider base of people into international development and humanitarian causes.

HOW IT WORKS

Voluntary contributions can take several possible forms, including:

- **Corporate or government matching programs –** Governments can encourage voluntary contributions from private corporations or individuals by setting up programs that promise to match any contributions made. For example, the Canadian government's Pakistan Relief Fund in 2010 raised US$47 million in citizen contributions. Matching programs can also be set up by corporates to encourage individual contributions.
- **Corporate donations –** Companies may voluntarily tie a percentage of their profits to global challenges.
- **Voluntary solidarity contributions –** Consumers are given the option to make a small additional contribution when they make a purchase that is then donated to a cause. For example, travelers can make a small voluntary contribution every time they purchase travel services with the contribution going towards global health causes. This is different from a tax in that it is not compulsory.

KEY PLAYERS

- **Donors –** provide capital on a voluntary basis and do not expect financial returns
- **Recipients –** the person or entity seeking funds for a product, project, or initiative. They can encompass a broad range of actors, including private companies, NGOs, social enterprises, startups, and individuals.
- **Intermediaries –** governments or other entities can manage and facilitate the flow of funds
- **Providers of technical assistance –** platforms for voluntary contributions can also contract out certain services to a third-party provider, including financial due diligence, measurement, and tracking of outcomes (financial, social, and environmental)
- **Advocates/conveners –** NGOs may provide knowledge about issue areas or beneficiary populations and build up support for voluntary contributions

NGO ROLE(S)

- **Donor –** providing own capital
- **Recipient –** receiving funds for a product, project, or initiative

- **Provider of technical assistance** – providing financial due diligence, measurement, and outcomes tracking
- **Advocate/convener** – providing knowledge about issue areas or beneficiary populations and building up support for voluntary contributions

MARKET SIZE/SHARE

Schemes can vary in size and there is no available source of information that provides aggregate numbers for the amounts mobilized through voluntary donations.

OBJECTIVE(S)

- Increase revenues
- Crowd in new players

PROS

- Resource mobilization
- Raising awareness of issues and attracting new donors
- Scalable, with potential to tap into diaspora and remittances market

CONS

- Unpredictable funding flows
- High start-up costs
- Costs required to determine effective communications strategy
- Funding for a specific issue may only be provided in the short term
- Relies on internet/technology for people to learn about contribution platform and make donations – more difficult in more remote/underserved areas
- Lack of standards in monitoring impact and project results/lack of transparency into project results after required amount has been mobilized

RISKS

- Cybersecurity if platforms are internet-based
- Changes in government leadership or regulatory frameworks
- Short-term funding

WHEN TO USE IT

- When funds need to be mobilized quickly
- To supplement funds provided by governments or other donors
- Potential to reach/appeal to a wide audience, especially overseas/at a global scale (e.g., diaspora)
- Experience implementing effective marketing/communication campaigns

WHEN TO NOT USE IT

- Service/product appeals to niche market

M&E

As with crowdfunding instruments, there is likely to be lack of transparency in project results after the required amount has been mobilized, and general lack of standards in monitoring and reporting project outcomes/impact.

COST

- Costs to determine communications and funding mobilization strategy
- High costs for starting-up and administering

COMPLEXITY

- Costs to starting up platform for collecting and disbursing funds
- Communications strategy and advertising are important and will have costs in terms of time and finances
- Unpredictable funding flows

EXAMPLE

Product Red was founded in 2006 by the singer Bono and Bobby Shriver to provide a sustained flow of funds from the private sector to the Global Fund to Fight AIDS, Tuberculosis and Malaria, for support of HIV/AIDS programs in Africa, while also raising awareness of the issue. Product Red is a brand licensed to several private companies, each of which creates a product with the Product Red logo and donates a portion of the profits made from selling that product to the Global Fund. As of late 2017, Product Red has generated more than US$500 million to the Global Fund.[53]

ADDITIONAL RESOURCES

- "World Economic and Social Survey 2012: In Search of New Development Finance," United Nations, 2012. http://www.un.org/en/development/desa/policy/wess/wess_current/2012wess.pdf.
- "Innovative Financing for Development: Scalable Business Models that Produce Economic, Social and Environmental Outcomes," Dalberg Global Development Advisors, 2014. https://www.citigroup.com/citi/foundation/pdf/innovative_financing_for_development.pdf.
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IV. Case Studies

BRINGING VENTURE CAPITAL TO DEVELOPMENT (MERCY CORPS SOCIAL VENTURE FUND)

SUMMARY	
NGO Name	Mercy Corps Social Venture Fund (SVF)
NGO Role	Intermediary/Fund Manager
Instrument Type	Impact Investment Fund
Transaction Size	US$50,000–US$300,000 in equity or convertible debt instruments (overall fund size undisclosed)
Target Sector/Geography/ Population	Seed-stage for-profit ventures in the areas of financial inclusion, agriculture, last-mile distribution, and youth employment in Colombia, Kenya, Indonesia, Nigeria, Tanzania, and Uganda.
Target/Expected Impact	Seeks impact on underserved populations, in significant numbers and in meaningful ways. Seeking nexus of reach, breadth, and depth of impact. Each investment opportunity has its own theory-of-change and tailored impact metrics.
Current Status	• Launched in late 2015 • 13 investments made as of October 2018 (totaling US$1.65 million) • SVF has no end date to its investment holding period

THE DEVELOPMENT CHALLENGE

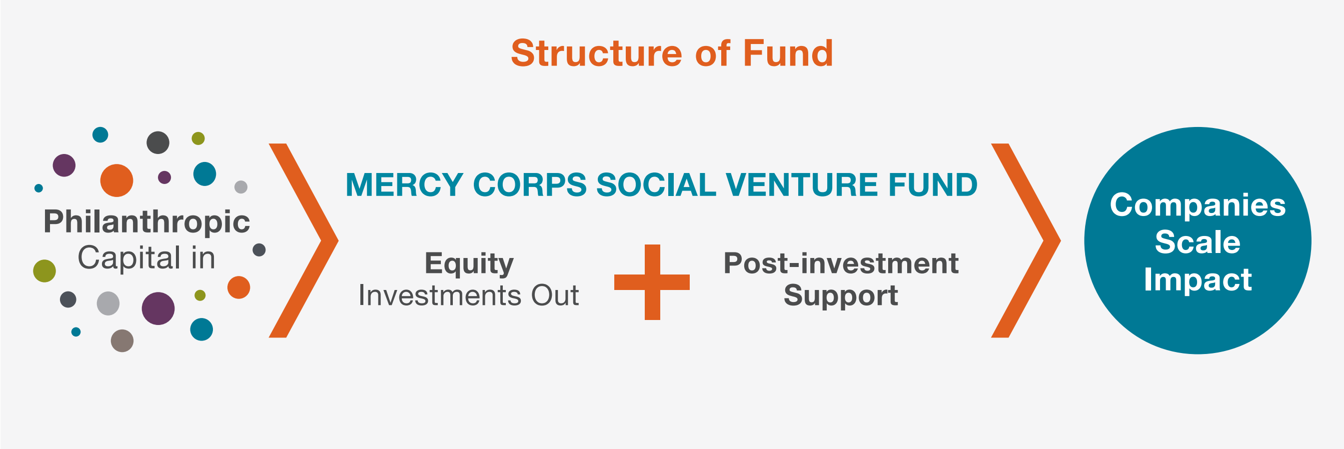
The traditional grant-based model of funding international development is limiting. It rarely promotes the flexibility and experimentation required to test new models that could sustainably deliver social benefit to millions of people in the developing world. Social enterprises are pioneering new models for solving social problems, but grant funding is often not the optimal form of capital to support such businesses as they seek to scale up their impact. Furthermore, many investors, even those who care about impact, choose either to avoid early-stage companies or to invest at a later stage when the execution risk is lower or when the risks are better understood. Only a small subset of impact investing funds is willing to take on the high risks and low-to-mid single digit annual returns that come with investing in early-stage companies in frontier markets.

THE INNOVATIVE FINANCE SOLUTION

In 2014, building on a multiyear track record of both creating and supporting social enterprises, Mercy Corps decided to further its engagement with social entrepreneurs by launching the Social Venture Fund (SVF), a seed and early stage impact investment fund. Initially, the fund was focused on leveraging the entrepreneurial spirit of the Mercy Corps staff by providing early stage financing and hands-on support to test their ideas in the marketplace and help turn the more promising concepts into commercial businesses. While this approach generated a number of innovative and potentially viable business ideas, it was challenging to implement and ultimately not scalable. At the same time, Mercy Corps had identified many early-stage enterprises, external to Mercy Corps, that improve people's lives and that were aligned with Mercy Corps' mission but had difficulty accessing capital to strengthen their business models and expand their operations.

In 2015, Mercy Corps shifted the focus of the SVF to address this early-stage financing gap (referred to as the "Pioneer Gap") by making investments of up to US$300,000 in seed and early-stage social ventures that have the potential to positively impact millions. Generally, investors and private funds do not make investments of this size because transaction costs for each deal can be quite high and the risks of investing at such an early stage are significant. Mercy Corps is able to overcome these barriers by raising philanthropic funds that it then uses to make equity or convertible debt investments in social ventures (Figure 14).

Figure 14. SVF operational flowchart



Source: Mercy Corps.

HOW IT WORKS

SVF invests in businesses working in agriculture, financial services, last-mile distribution, and youth and female employment in Colombia, Indonesia, Kenya, Nigeria, Tanzania, and Uganda. Investments range from US$50,000 to US$300,000 in equity or convertible debt instruments. Prospective portfolio companies need not have significant revenue traction but should have a defined product or service with a unique approach that can scale.

The Social Venture Fund had made 13 investments as of October 2018. In one such investment, Mercy Corps invested in Vasham, a social enterprise that leverages a closed-loop business model to provide Indonesian smallholder farmers with the financing, expertise, income security, and market linkages they need to achieve significantly better standards of living. Vasham aggregates and provides a bundle of services to smallholder farmers growing maize. Those services include input and working capital loans, farmer advisory through mobile channels and field officers, and market linkages at an above-market price premium via its off-take partner. Vasham aims to serve over 200,000 farmers across Indonesia by 2020.

With confidence in Vasham's leadership, model, and impact thesis, SVF formalized the partnership in March 2016, investing $250,000 for a minority stake in the company in a $2.5 million investment round led by Patamar Capital (formerly Unitus Impact Fund). Mercy Corps maintains an observer seat on Vasham's board of directors and redemption rights to ensure Vasham maintains its core social mission. Through the due diligence process, Mercy Corps and Vasham identified many areas of potential collaboration and mutual value added. During the investment due diligence phase, Vasham signaled that it wanted to work with Mercy Corps to tackle certain core business model issues, like weather risk mitigation and expansion to new regions.

NGO ROLE AND VALUE-ADDED

Mercy Corps leverages the expertise and networks of its local field offices to identify potential investment opportunities, conduct due diligence, and provide post-investment support to companies. Mercy Corps works on the ground in more than 40 developing countries, and its country teams have special insight into local behaviors, systems, and attitudes. When that local knowledge is combined with a global understanding of development, technology, and business, Mercy Corps is able to identify social enterprise opportunities that address the market gaps it observes. It also leverages the expertise and networks of its staff and local partners to improve the chances of success for the businesses in which it invests.

STRUCTURING STEPS

To launch the Social Venture Fund, the Ventures team developed and implemented a strategy to align venture investment with Mercy Corps' impact goals that included the following steps:

- Hiring in new staff with the required skill sets (rather than training existing staff to do this work)
- Executive and board support were crucial, as was the ability to raise sufficient capital to build a portfolio of 10 or more investments.
- With internal and external counsel, Mercy Corps established a separate legal entity (SLE) to deploy investment capital and a framework to align investment with its mission.
- Mercy Corps determined its ability to legally comply with requirements of the target countries.
- A board of directors and governance structure was established for the SLE.
- The Mercy Corps financial team established processes for financial compliance.
- Clear investment criteria and due diligence and approval processes were determined, including establishing an investment committee.
- The team developed an initial pipeline of potential investment opportunities.
- The team worked closely with Mercy Corps country leadership to ensure strategic alignment.

MONITORING, EVALUATION, AND RESULTS

The SVF believes that by identifying high-potential startups and providing them with the right capital, support, and partnerships, they can overcome barriers to growth and design more effective models that will improve the livelihoods of underserved populations at scale. The SVF strives to be an impact anchor for its investees, to assess impact throughout the investment cycle, and to align its work with industry standards for measuring impact. It works with the ventures in its portfolio to better define their route to impact and impact hypotheses, hone their customer value propositions, and create impact metrics that matter and impact management processes to track them.

Mercy Corps' impact framework for SVF looks at three different impact dimensions: reach, breadth, and depth. SVF seeks to have impact on underserved populations (reach), in significant numbers (breadth), and in meaningful ways (depth). While SVF investing targets the aforementioned impact themes, it does not have a set of pre-determined impact metrics that each company needs to fit into. Each investment opportunity has its own theory-of-change and tailored impact metrics—a "made-to-order" approach.

As of June 2018, the SVF portfolio companies had reached approximately 1.5 million customers. Among other impact metrics, the companies in the portfolio had facilitated over 20,000 employment opportunities, provided access to insurance for over 600,000 farmers, and sold over 430,000 beneficial products in "last-mile" communities. The SVF has mapped all of its investments to the Sustainable Development Goals (SDGs) and has found that companies in its portfolio are collectively contributing to 13 of the 17 SDGs.

In addition to tracking impact metrics, SVF tracks several financial metrics across all of the investments in its portfolio and considers the amount of follow-on funding raised by these companies as an indicator of success. In terms of proof points for the Social Venture Fund as an investment vehicle, it achieved a milestone in late 2018 with its first successful exit from a portfolio company, and a second profitable exit is imminent.

KEY BENEFITS

By providing early-stage capital and tailored support, the SVF aims to help social entrepreneurs validate and scale up their ventures to improve the livelihoods of millions of people. With a global footprint of nearly 5,000 staff across more than 40 countries, innovative programming, and deep technical expertise, Mercy Corps is a valuable asset and partner to social entrepreneurs.

After it invests, the SVF is high-touch. Its post-investment support focuses on helping entrepreneurs develop their business models, hone their product or service, and de-risk their impact. While common challenges exist, each enterprise is unique and the SVF tailors its approach to fit: acting as a consultant, sounding board, partnership creator, active board member, and impact anchor. It also forges catalytic partnerships within Mercy Corps' global network, connections that help ventures in its portfolio gain credibility and trust in communities, attract customers, professionalize faster, and scale smarter.

KEY CHALLENGES

A few of the major challenges faced by the SVF team include:

- **Opening up Mercy Corps' global platform to investees:** SVF investees have benefited from Mercy Corps' support in developing partnerships with large financial institutions, mobile network operators, local and multinational corporations, and governments; from tapping into its programs and domain expertise in financial services, agriculture, and youth training and employment; and from leveraging its connections to local stakeholders and resources. However, creating these meaningful connections takes time and is not inevitable. The SVF team has found that connections with large, stand-alone, private foundation-funded programs are easiest; they are, by nature, the most flexible and adaptive. Yet bilateral donors (the resources behind the vast majority of international NGO programming) are increasingly realizing the importance of innovative financing and adaptive management in program design and execution.
- **Implementing an inherently different approach than the typical international NGO business model:** International NGOs have a very defined business model: access funding from bilateral and multilateral sources, individual donors, corporations, and other institutions; implement programming according to agreed-upon action plans; and report back to stakeholders. This model typically has a different risk tolerance, fundraising system, timeline (a 5-year program is considered long-term), and reporting/M&E expectations than impact investing. Impact investing inherently carries significant risks, and failures are likely along the way. The investment lifecycle can last 10–12 years or longer in the impact space. The source of funds will very likely be a completely different audience, the members of which may or may not require a return on their capital. Moreover, success and financial returns are not assured.
- **Finding effective, scalable ways to capture and share learning:** One of the reasons that Mercy Corps created the SVF is to learn in-depth about: (i) new solutions that could be widely applicable across many of the fragile places where Mercy Corps works; and (ii) how to change the ways in which it operates. While each of its investments has a learning agenda tied to it and the SVF team tries to disseminate these lessons as widely as possible, it has yet to institutionalize systems to capture and share learnings. One of the most effective things the SVF has done in this regard is to have strategic team members occupy the SVF's board observer seats in some ventures. For instance, its Indonesia Country Director sits on the Vasham board, an arrangement which has greatly benefitted both parties. These high-touch interactions are the most valuable, but the least scalable.

LESSONS LEARNED

Mercy Corps has learned some very valuable lessons that should be useful to others starting their own fund journey.

- **Traction is key. Just get started!:** Like any new fund manager, investors (and donors) want to see the fund manager's track record. Many funds start and manage their lifecycle by building a pipeline, making a few test investments to refine their thesis, and then starting more substantive fundraising. The SVF team believes this approach (as opposed to doing it all at once) helps to improve one's chances of successful future fundraising, not to mention providing an invaluable opportunity to learn and refine one's investment thesis along the way.
- **Secure a foundational partner:** This is a funder (not a staff member) that essentially seeds the fund and covers the cost to get everything rolling (structure, thesis, pipeline development, fundraising). From the SVF team's perspective, this could be the international NGO itself—showing it has skin in the game and is 100 percent invested in the long-term success of the fund.
- **Ensure entrepreneurs are your North Star:** The SVF devised its due diligence processes with the entrepreneur in mind. It developed a gated process with several major decision points that allow it to get to a "yes" or (more often) a "no" much more quickly, and has the ability to complete deals in 8–12 weeks on average. It attempts to run an efficient process to respect the time demands of busy entrepreneurs and to make the process as painless as possible.
- **Use your "boots on the ground":** Many NGOs have deep local connections through their staff and their organizational networks. Such local expertise and contacts are helpful in building an investment pipeline, making deals, and providing post-investment support to ventures.
- **Align expectations on post-investment support:** The SVF team notes that it is important not to over-promise when it comes to support that an investment team can provide to companies in which it has invested. The due diligence process can be used to make sure that the entrepreneur and the investment fund are on the same page in terms of priority needs for support and targets to achieve after the investment is made.

MERCY CORPS

Mercy Corps empowers people to survive through crisis, build better lives, and transform their communities for good. Mercy Corps brings its experience in developing field-based programming in over 40 countries to its Social Venture Fund's work of investing in high-impact startups. Learn more at www.mercycorps.org.

SEYCHELLES DEBT CONVERSION FOR A RESILIENT FUTURE (NATUREVEST)[54]

SUMMARY	
NGO Name	NatureVest, the conservation investing unit of The Nature Conservancy (TNC)
NGO Role	Intermediary
Instrument Type	Debt Conversion
Transaction Size	US$21.6 million total, comprising: • US$5 million grant funding • US$15.2 million loan capital • US$1.4 million discount on US$21.6 million sovereign debt
Target Sector/Geography/ Population	Marine conservation and climate adaptation in the Seychelles
Target/Expected Impact	• Increase protection for Seychelles waters from less than 1 percent to more than 30 percent of the country's Exclusive Economic Zone (EEZ) • Support the creation of the second largest Marine Protected Area (MPA) in the West Indian Ocean • Provide a permanent funding stream for ongoing climate adaptation and marine conservation activities
Current Status	Debt conversion closed Feb 2016, providing $281K/year in grants for on-the-ground conservation, and $151K/year to capitalize an endowment. Repayment period ends in 2036.

THE DEVELOPMENT CHALLENGE

The Seychelles is a developing nation of 115 small islands off the coast of East Africa. The country is 99 percent ocean, and tourism and fishing are major parts of the economy. As a result, the people and economy of the Seychelles are vulnerable to the threats of climate change. Already, more severe storms and rising sea levels are battering coastal areas that attract tourists, warmer ocean temperatures are diminishing fish stocks, and increasing ocean acidity from rising carbon levels is destroying coral reefs that buffer the force of storms and provide vital habitat for numerous marine species. However, similar to other small island and coastal nations, the Seychelles faces high levels of sovereign debt and lacks funding for important environmental development priorities.

THE INNOVATIVE FINANCE SOLUTION

NatureVest, the conservation investing unit of The Nature Conservancy (TNC), structured a groundbreaking debt conversion for marine conservation and climate adaptation with the Seychelles government. TNC created the Seychelles Conservation and Climate Adaptation Trust to raise grant and loan capital for the debt conversion. In exchange, the Seychelles government committed to improved policies and increased investment around marine conservation and climate adaptation.

While debt conversion instruments are complex and context-specific, debt conversion represents a potentially high-impact model for small island and coastal nations that face high levels of sovereign debt and lack funding for important environmental and development priorities. NatureVest works with countries facing such challenges to structure debt conversions that will support ecosystem-based adaptation strategies and improve fisheries and marine management.

54 This case study is adapted and updated from a 2017 case study developed by Convergence, a global network for blended finance. It can be accessed by following this link: https://www.convergence.finance/knowledge/3p1S3pSTVKQYYC2ecwaeiK/view.

HOW IT WORKS

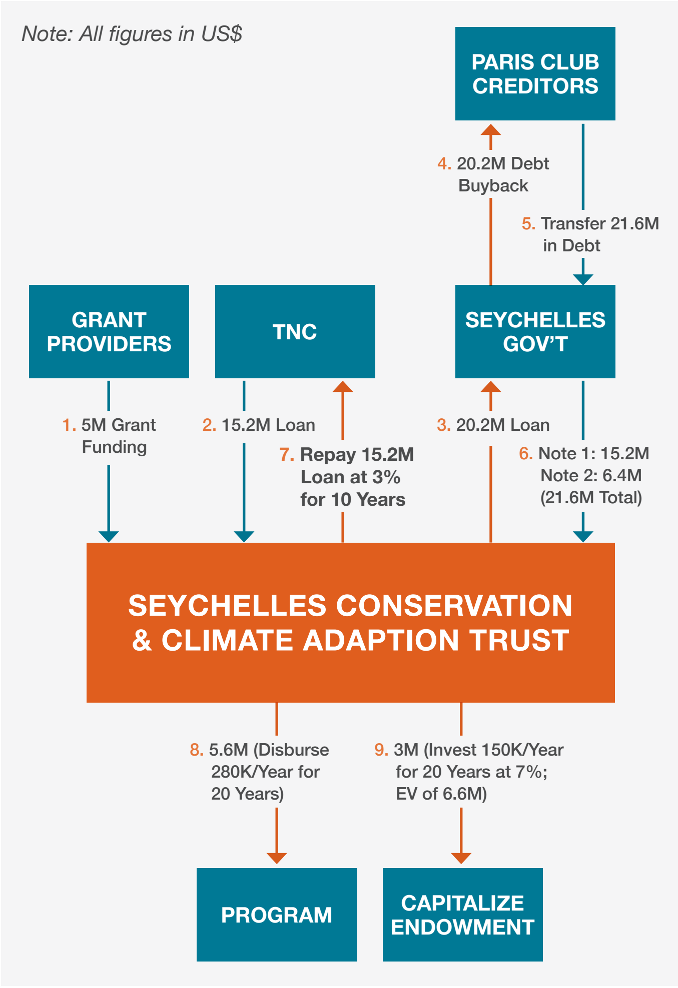
In a typical debt conversion, TNC raises a mixture of grants and repayable loans for a new in-country nonprofit trust. The trust uses its capital to extend a loan to a government that has a high debt burden and faces the imminent threat of climate change. The government purchases its debt from creditors and then repays the trust on more favorable terms (e.g., over a longer period and at a lower interest rate). The trust uses the debt payments from the government to: (1) repay the initial capital raised; (2) fund ongoing conservation programming; and (3) capitalize an endowment to fund conservation in perpetuity. In exchange for restructuring its debt obligation on more favorable terms, the government commits to improved policy and the deal creates increased investment in conservation (e.g., creating marine protected areas and no-take zones).

In the Seychelles transaction, TNC created the Seychelles Conservation and Climate Adaptation Trust (SeyCCAT) to raise grant and loan capital for the debt conversion, and, in exchange, the Seychelles government committed to improved policies and increased investment in marine conservation and climate adaptation. The trust raised US$5 million in grant capital and US$15.2 million in loan capital (US$20.2 million total) to extend a specific-purpose loan to the Seychelles government to purchase US$21.6 million of its sovereign debt (at a discount of US$1.4 million). The debt conversion effectively redirects the Seychelles' debt payments from official creditors (Belgium, France, Italy, and the United Kingdom (under the Paris Club)) to the newly created local trust, and restructures debt payments to more favorable terms (i.e., longer term and partial conversion to local currency). The trust will use the Seychelles' debt payments to: (1) repay the initial capital raised; (2) disburse US$280,000 per year over 20 years in local currency for marine conservation and climate adaptation activities; and (3) invest US$150,000 per year over 20 years in endowment to fund future programming. Figure 15 illustrates the transaction structure, including the sequence of funding flows between different stakeholders.

NGO ROLE AND VALUE-ADDED

To mitigate the effects of climate change on the Seychelles, NatureVest worked with the Seychelles government on the groundbreaking debt conversion for marine conservation and climate adaptation. NatureVest played the role of intermediary, undertaking all structuring and fundraising, with pro bono legal support from Ropes & Gray and advisory support from White Oak Advisory. NatureVest was able to leverage the technical expertise and global platform of the TNC. For nearly 30 years, the Conservancy has worked with governments, communities, and others across the globe to protect, restore, and conserve threatened marine ecosystems. More recently, the Conservancy has established itself as a world leader in debt-for-nature conversions, based on a unique combination of scientific, management, and financial expertise. TNC has completed 11 Tropical Forest Conservation Act (TFCA) debt conversions since 2001, with a face value of over US$191 million, resulting in over US$240 million of new funding for forest conservation. Through these transactions, the Conservancy leveraged approximately US$17 for every US$1 of donor gift—significantly more than most conservation projects of this scale. TNC has 4,000 employees operating in 72 countries around the world, with a commitment to work locally in a stakeholder-driven process, guided by science.

Figure 15. Seychelles/TNC debt conversion structure



Source: The Nature Conservancy.
Note: GOV'T = government; K = 1,000; M = million.

STRUCTURING STEPS

The high-level steps in the process of structuring the debt conversion included:

- Establishing a local trust fund or nonprofit entity to lend the Seychelles funds to purchase sovereign debt, receive debt payments, and fund programming;
- Fundraising for the repayable loan and non-repayable grant capital for debt buyback;
- Working with the Government of Seychelles to identify eligible sovereign debt to purchase and secure commitments from the Seychelles to improve policy and increase investment in the specific development area; and
- Via the Paris Club, identifying and reaching agreement with creditors willing to sell debt owed by the Seychelles and purchase debt as financed through SeyCCAT.

MONITORING, EVALUATION, AND RESULTS

Because of the Seychelles policy and investment commitments, as well as the trust programming activity, the following conservation impact is expected:

- **Marine Protected Areas (MPAs):** The Seychelles will increase its MPAs from 1 percent to 30 percent of its territorial waters—an area of roughly 400,000 square kilometers, equal to the size of Germany. The increase is expected to be complete by the end of 2020, with the first phase increase to 15 percent completed in early 2018.
- **No-take fishing areas:** Half of the new marine protected areas—approximately 200,000 square kilometers—will be classified as a “no-take” zone to help protect important tuna feeding grounds, which will increase fish stocks and improve the Seychelles’ tuna industry.
- **Coastal protection:** The Seychelles will restore coral reefs and mangroves, which will buffer sea level rise and the force of increasing, severe storms. It will also develop and reform coastal zone management, fisheries, and marine policy and regulatory protection to cope with climate change.
- **Permanent trust fund:** The trust fund will manage the perpetual endowment to fund marine conservation and climate adaptation activities in addition to enforcing the terms of the debt restructuring agreement. The trust will also be responsible for distributing the proceeds of the debt conversion annually, through a transparent process, to government and other NGOs.

KEY BENEFITS

The US$5 million of grant capital blended with impact capital will create nearly US$12.6 million of funding for conservation, comprising US$6 million in cash flow for projects and additional funds to capitalize an endowment with an ending value estimated at US$6.6 million. Moreover, the SeyCCAT structure has become a platform for future financial products, paving the way for the Seychelles to subsequently launch the world’s first Blue Bond: US$15 million to support sustainable fisheries and marine projects, managed by the Development Bank of Seychelles (DBS) and SeyCCAT. Proceeds will support expansion of the MPAs to 30 percent of the EEZ. In February 2018, the Seychelles formally established two new MPAs covering 210,753 square kilometers—making up 15 percent of the Seychelles’ EEZ. Five of the 15 percent is designated with the highest level of biodiversity protection.

The Seychelles is just one of many small island and coastal nations that are highly threatened by the effects of climate change but lack the funding to adequately manage their marine resources. The Seychelles debt conversion served as a pilot for similar models in small island developing states. TNC is now expanding the model to the Caribbean and to other Indian Ocean islands; it is also exploring opportunities to coastal countries in Africa.

KEY CHALLENGES

Timing is everything. The transaction itself was launched later than originally planned, in part due to the grant fundraising process as well as attempting to secure government commitments during an election year. In addition, as the deal planning moved forward, the government was also successful in implementing a reform program backed by the International Monetary Fund. While this was good for the country overall, it did reduce the discount on the repurchased debt, meaning that there could have been more funding, upwards of US$17 million, available for conservation had the transaction closed earlier.

LESSONS LEARNED

The Seychelles debt conversion for marine conservation and climate adaptation represents one model for small island and coastal nations to restructure sovereign debt while supporting conservation and climate adaptation goals. Similar debt conversions in the future should incorporate the following considerations:

- **Debt conversions are complex and require several preconditions for success:** The complex process of structuring the Seychelles debt conversion took approximately four years and required extensive negotiations with multiple stakeholders. Further, the Seychelles presented the ideal pre-conditions for a debt conversion: a government interested in promoting marine conservation and climate, and official creditors willing to sell debt owed by the Seychelles.
- **The complexity and high transaction costs of the structure can be justified by the outsized investment and policy commitments from the participating government:** While funding for programming as a direct result of the debt conversion may be relatively small (approximately US$6 million in program funding and another US$3 million in contributions to the endowment), the investment and policy commitments from the Seychelles government in exchange for the debt conversion will result in significant additional funding flows for marine conservation and climate adaptation activities.
- **Early funding commitments can have a large impact on pushing a debt conversion forward:** An early commitment from one foundation of US$1 million played an important role in demonstrating to the Seychelles government that there was real funder interest in the debt conversion.
- **Expectations around total transaction size should be carefully managed:** The initial debt conversion target of US$80 million was announced early in the structuring process, before official creditors made firm commitments. This estimate set expectations of a larger transaction than the US$21.6 million transaction that was ultimately agreed upon.
- **Securing buy-in at the right levels was key:** Ministries of environment (or equivalent government entities) typically strongly support solutions like this, but the NatureVest team found that gaining support from the Seychelles Ministry of Finance was critical to pushing this forward. Showing the transaction's potential as a multifaceted financial solution for both fiscal concerns and economic needs was a key to success.
- **Debt conversions could be explored for other development areas:** Although the Seychelles debt conversion focused on marine conservation and climate adaptation, practitioners could explore using this approach for other development areas.

THE NATURE CONSERVANCY

The Nature Conservancy is a global conservation organization dedicated to conserving the lands and waters on which all life depends. Guided by science, TNC creates innovative, on-the-ground solutions to the world's toughest challenges so that nature and people can thrive together. TNC is tackling climate change, conserving lands, waters and oceans at an unprecedented scale, providing food and water sustainably and helping make cities more sustainable. Working in 72 countries, TNC uses a collaborative approach that engages local communities, governments, the private sector, and other partners. To learn more, visit www.nature.org or follow @nature_press on Twitter.

NATUREVEST

NatureVest is the conservation investing unit of The Nature Conservancy. While philanthropy and public funding have long been essential to conserving our natural resources, the massive scale of today's environmental challenges requires additional sources of financing. NatureVest's mission is to engage private capital to rapidly scale critical conservation work around the world by creating investment opportunities in a wide variety of sectors that deliver environmental results and financial returns for investors.

A DEVELOPMENT IMPACT BOND TO SUPPORT RESILIENCE IN REFUGEE HOST COMMUNITIES (NEAR EAST FOUNDATION, KOIS)

SUMMARY	
NGO Name	Near East Foundation
NGO Role	Recipient
Instrument Type	Development Impact Bond
Transaction Size	Program budget: US$14,935,000 million over 3.5 years
Target Sector/Geography/ Population	Improved livelihoods for Syrian refugees and vulnerable host populations in Jordan and Lebanon
Target/Expected Impact	6,555 aspiring entrepreneurs and 240 local medium and small microenterprises
Current Status	Structuring complete; actively seeking funders; estimated launch in 2019

THE DEVELOPMENT CHALLENGE

Over the past seven years, five million people have fled Syria, desperate to escape violence. Three neighboring countries—Jordan, Lebanon, and Turkey—host more than 80 percent of all Syrian refugees worldwide. The majority (90 percent) of Syrian refugees live in urban and often impoverished communities where competition for jobs and housing has driven wages down and the cost of living up. While the prospect of mass returns is unlikely in the near to medium term, the strain of an expanding refugee population in neighboring urban communities is affecting all aspects of societal, economic, and political norms.

As a result of these circumstances, refugees and their host communities often find themselves forced to adopt increasingly risky coping strategies that amplify their vulnerability and render it even more difficult to rise above their current situation. Moreover, the crisis fuels civil tension and puts downward pressure on host countries already-fragile economies, furthering conditions for potential unrest, local conflicts, and continued reliance on humanitarian assistance. A focus on sustainable livelihoods can create new business, wealth, and jobs for refugees and local populations, and also contribute to more dynamic and stable economies. However, traditional grant-based models of funding often lack the flexibility and multiyear commitments required to effectively implement long-term, large-scale livelihoods and resilience programs. Piloting outcome-driven, multiyear funding models could ultimately be a more effective way to implement livelihoods programs in rapidly changing contexts.

THE INNOVATIVE FINANCE SOLUTION

The Development Impact Bond (DIB) is a variation of the social impact bond model that provides new sources of financing to achieve improved social outcomes in the context of developing countries. When focused on livelihoods and job integration, DIBs can offer a solution to shift from emergency relief to long-term, large-scale resilience programs. A DIB does this by channeling multiyear funding from traditional funders and nontraditional investors to highly effective implementing partners to deliver pre-agreed livelihoods outcomes.

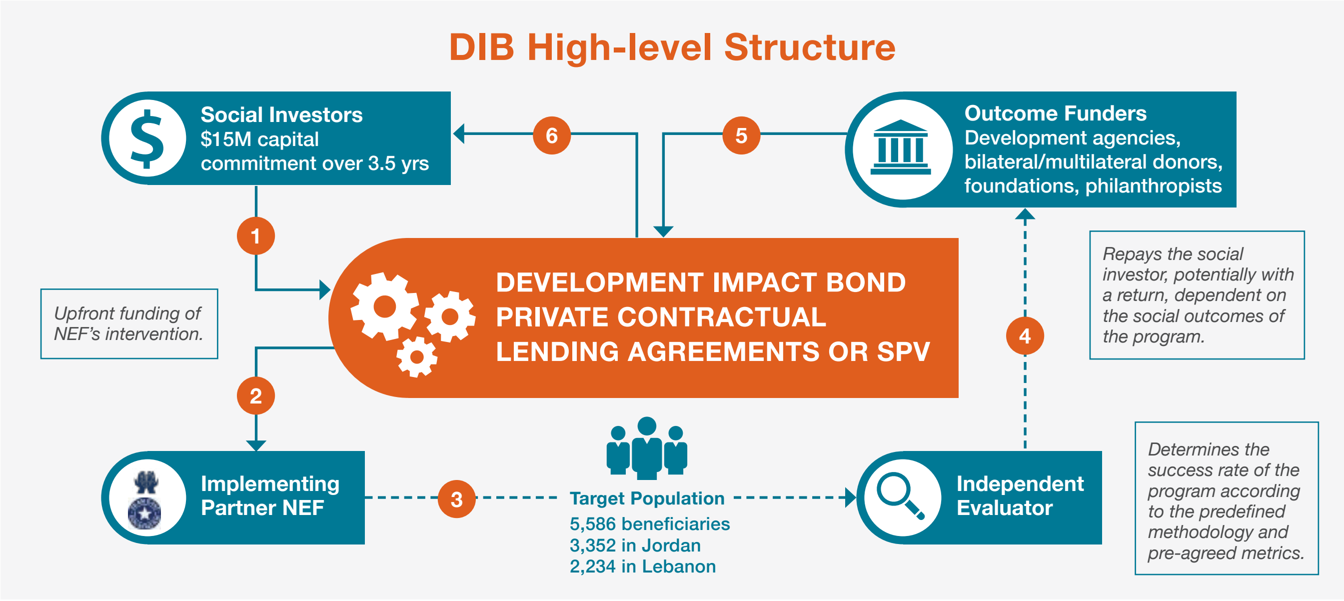
HOW IT WORKS

In the DIB, social investors will deploy roughly US$15M in working capital to the Near East Foundation (NEF) to deliver evidence-based livelihoods programs to Syrian refugees and vulnerable locals (mostly female) in Jordan and Lebanon over 3.5 years. Outcome funders will repay social investors, contingent on NEF's capacity to achieve a minimum threshold for two outcome metrics: (1) the percentage of businesses that are active

10 months after the creation of the business; and (2) the level of increase in household basic consumption two years after business creation. Results will be assessed by an independent third-party evaluator. The first metric (business creation) will be assessed using a pre-post treatment-only survey, whereas the second metric (household consumption) will be assessed using a rigorous quasi-experimental design. Thresholds are set using a combination of NEF's historical track record and comparable programs internationally.

Social investors will receive additional progressive payments (up to a pre-determined maximum) beyond the principal invested, if NEF exceeds the thresholds set for the two outcome metrics. While investors can assume a guaranteed return on capital (up to 50 percent) and an internal rate of return (IRR) tied to successful outcomes, it is important to note that the DIB is designed to support "value for money." This means that the cost of the program will not outweigh the expected social and economic return of the program.

Figure 16. DIB high-level structure



Source: Near East Foundation and KOIS
Note: DIB = development impact bond; SPV = special purpose vehicle.

NGO ROLE AND VALUE-ADDED

NEF will be the lead implementing partner for the first tranche of the DIB, its primary objective being to improve Syrian refugees' and host communities' access to quality and dignified livelihoods opportunities in both Jordan and Lebanon. NEF will achieve this by: (1) supporting small business creation and medium and small microenterprises expansion; (2) soft and life skills training, expanded social/economic networks, and support activities to address specific barriers to economic participation; and (3) building the capacities of local structures/civil society to deliver social and economic inclusion programming through training, support, and participation in multi-actor public-private dialogue.

Through the DIB, NEF will target urban and peri-urban regions that are among the most vulnerable cadasters, located in regions in Jordan and Lebanon that experience higher than national average rates of food insecurity, poverty, indebtedness, seasonal employment, unemployment, and prevalence of single-headed households in addition to hosting a large number of the most vulnerable refugees. NEF's program prioritizes women, female-headed households, and young females and males who are most impacted by identity-related protection risks.

The DIB builds on evidence and primary data generated through NEF's ongoing work in both Jordan and Lebanon, where it has employed a comparable model over the past 10 years. While NEF is an international NGO, its global operations are based on a model that engages national staff and empowers NEF country teams to feed into technical, programmatic, and operational decisions for local activities. This approach gives NEF the character of a local organization with the advantage of access to management systems and program support typical of a larger international organization. This emphasis on almost entirely local staffing, in and near target communities, is key to NEF's success in gaining community confidence in all the areas in which it works.

STRUCTURING STEPS

NEF underwent a rigorous vetting process, led by KOIS, an impact investing firm leading the feasibility, structuring, and fundraising efforts, to be selected as the main implementing partner for the DIB. After a seven-month feasibility and vetting process, a highly collaborative eight-month structuring process began, with significant involvement and contribution from NEF. The structuring stage involved defining the operational model, agreeing payment metrics and measurement framework, building the budget and financial model, and establishing legal and governance plans, sometimes with the support of external experts. NEF and KOIS are now in the fundraising stage, working to secure outcome funding and private investment. The whole process—from initial conversations to completion of the structuring—took approximately 2.5 years and required significant time and resources from both NEF and KOIS.

MONITORING, EVALUATION, AND RESULTS

Over 3.5 years across five locations in Jordan and Lebanon NEF aims to:

- engage a total of 6,555 aspiring entrepreneurs in business development processes (75 percent women, 50 percent refugees);
- provide business financing and coaching for 5,586 entrepreneurs and rapid vocational training/one-to-one mentorship for 2,793 entrepreneurs; and,
- expand 240 local medium and small microenterprises, and establish and/or upgrade 8 community-based livelihood centers, 223 support and business networks, and 16 local socio-economic innovation initiatives.

In addition to the two key trigger outcome metrics—(1) the percentage of businesses active 10 months after their creation; and, (2) the level of increase in household basic consumption two years after business creation—the DIB will assess the impact of other outcome goals of interest that are embedded in NEF's theory of change, including: women's agency and bargaining power in the household, women's self-confidence, and household savings. The evaluation will also include key assumptions and program implementation fidelity to support learning and adaptation for NEF and more broadly for other actors focused on economic development with a livelihoods lens.

In addition to advancing NEF's programs, the DIB will generate much needed evidence to promote further support for livelihoods interventions. At present, available outcomes data for livelihoods programs, especially those focused on refugees and similarly vulnerable communities, are limited and not well funded. Through its role in the DIB, NEF will be in a position to contribute to further evidence for livelihoods programs in refugee contexts.

KEY BENEFITS

The DIB presents an opportunity to expand and strengthen the impact of NEF's livelihoods work through improved data measurement, reliable multiyear funding, and an opportunity to drive innovation through its programs. Traditional grantmaking is often not able to support the kind of long-term and large-scale livelihoods programs needed to affect meaningful change, due to the associated risks involved. This makes it difficult for NGOs working in this space to demonstrate the impact of livelihoods programs and to have a transformative impact in communities in need of these services, especially in refugee and emergency relief contexts. The DIB, however, seeks to address donor concerns around risk while also providing meaningful support to NGOs, including:

- **New sources of capital:** The innovative model of the DIB encourages traditional and less traditional sources of capital, including funding from governments, traditional grant-makers, private sector institutions, and venture philanthropy. Participation in a DIB mechanism could have the potential to position an organization more competitively to secure less traditional funding.
- **Access to longer-term, predictable funding:** The DIB is designed with a 3.5-year implementation work plan. To support this, sufficient capital is secured from the outset, which allows NGOs to focus on implementation and achieving outcomes without the burden of reapplying for additional funding part way through the program to ensure its continuance.

- **Greater flexibility to adapt programs along the way:** The DIB's outcome-driven approach allows NGOs to be more responsive and adapt their interventions to the variable environment often found in refugee or emergency contexts. An outcome-driven mechanism also allows greater innovation to be tested and learning to be documented through independent data collection and evaluation.
- **Greater focus on learning:** The DIB requires monitoring and learning data to be collected through both the delivery partner and an independent third-party evaluator. This approach improves the quality, rigorousness, and independence of data measurement while also building evidence on the effectiveness of livelihoods interventions with an aim to over time reduce risks and costs for future livelihoods programs.

KEY CHALLENGES

Since the DIB structure is an emerging funding mechanism, it comes with a steep learning curve and associated challenges.

- **Making the case internally:** When embarking on a DIB, there are many moving pieces and the final outcome is not always known. This is counterintuitive to how NGOs typically assess funding opportunities and can thus make it difficult to make the case internally, especially in light of the significant time and resources required to pursue it.
- **Maintaining focus and momentum amidst ongoing programs:** The DIB has required significant time and resources from the multiple teams across NEF, including programs, operations, compliance, legal, monitoring and evaluation, etc., which is necessary in the structuring phase but sometimes difficult to accommodate amidst ongoing programs.
- **Ensuring programs stay relevant in light of constantly changing contexts:** This DIB was designed to respond to an ongoing humanitarian crisis with rapidly changing contexts. When the structuring of an impact bond has the potential to take up to two years, there is a risk that the DIB's design elements will become outdated. Further, a DIB that covers multiple geographies offers another challenge when agreeing on a single method for measuring and pricing, in addition to monitoring the contexts and regulatory environments across multiple countries. To circumvent this challenge, it is important to continually assess the DIB's design during the structuring phase to ensure it remains relevant. NEF had ongoing livelihoods programs in both Jordan and Lebanon which allowed NEF to ensure the DIB was adapted as needed.
- **Overcoming language barriers:** The DIB provides an opportunity to bridge the public and private sectors but with that comes the challenge of blending the acumen of both the finance and NGO sectors. This includes layering a finance and humanitarian lens onto the programmatic approach, monitoring and evaluation, and even fundraising. In addition to this, there is a vocabulary that needs to be learned and understood from both the public and private perspective, ushering in a need for clear communication and collaboration between all parties involved in the structuring of the DIB.
- **Considering complexities of a multi-country approach:** Where possible, focusing the geography of any intervention, especially one that responds to humanitarian crises, is important to consider. Multi-country approaches for a single DIB mechanism can be challenging in terms of agreeing on a single method for measuring and pricing across multiple contexts.

LESSONS LEARNED

Since the development impact bond is in the final stages of structuring, it has yet to be operationalized. As such, the key takeaways from this experience focus on the structuring phase, including:

- **Delivery partners should be equipped with strong evidence about their programs:** Elements of the DIB including outcome metrics and payment triggers heavily rely on the track record and tested ability of a delivery partner to deliver successful outcomes. It is impossible to entirely de-risk interventions that focus on livelihoods in emergency contexts, but seeking out delivery partners who offer a proven model of success will strengthen the DIB's ability to attract social investors and outcome funders and achieve its desired objectives.
- **A pipeline of prospective outcome funders and social investors should be identified early in the structuring process and recruitment should begin as early as possible:** Funder recruitment in any context, let alone for a model like a DIB, is often a lengthy process. Given that a DIB aims to respond to needed social outcomes that directly impact people in need on the ground, program implementation should happen as soon as it can, and this is contingent on committed outcome funders and social investors.
- **Having an internal legal expert is very beneficial:** Given the legal and governance complexities surrounding an innovative funding mechanism like the DIB, an NGO that has an in-house staff member who has expertise and can advise on legal and compliance matters is a major benefit.
- **Be aware of the time and resource commitment required during the structuring phase:** It is our hope that our learning in this space will contribute to streamlining this process for other NGOs looking to participate in similar DIBs in the future.

NEAR EAST FOUNDATION

The Near East Foundation is an international development organization that works to build inclusive, prosperous, and sustainable societies in the Middle East, Caucasus, and Africa by providing vulnerable and disenfranchised people with skills, training, and resources to fully engage and prosper in their own communities and economies. NEF field staff—almost all of whom are from the countries in which they work—partner with local organizations to find grassroots solutions to development challenges. (www.neareast.org)

KOIS

KOIS is an international impact investment firm that works on structuring innovative financing instruments to address societal problems. KOIS has structured the second social impact bond in continental Europe (to improve the employment rate of migrant youth through mentoring in Belgium), and worked with the International Committee of the Red Cross (ICRC) on structuring the first and largest humanitarian impact bond for building and managing physical rehabilitation centers in conflict and post-conflict zones. (www.koisinvest.com)

V. Lessons Learned and Recommendations

InterAction's survey to its members showed that the adoption of innovative finance among NGOs has been slow—only 40 percent of survey respondents were actively implementing or piloting an innovative finance initiative—but that interest in doing more and learning more about innovative finance is high.

This report has built on the survey research previously conducted to provide concrete tools that NGOs can use as they explore their options for participating in IF4D. These tools include a guide of various IF4D instruments and case study examples. InterAction's goal is to continue to increase its members' understanding of IF4D approaches and expand the resources available to help them test, design, implement, and evaluate these approaches effectively. This will contribute to the global evidence base for IF4D and strengthen the efficiency and quality of international development and humanitarian programs.

Challenges and opportunities for NGOs

In this report, InterAction has presented research from: (1) a survey of members' experiences with IF4D; (2) studies into the details of how different IF4D instruments work; and (3) case studies from NGOs with more involvement in IF4D to share more details about their experience. Across these three elements, patterns have emerged related to the biggest challenges and opportunities facing NGOs that are interested in IF4D.

Some of the most salient challenges confronting NGOs engaged in, or looking to engage in, IF4D are:

- **Informational barriers** about the features and objectives of different IF4D approaches, and how to implement them;
- **Insufficient internal capacity** to engage in IF4D, including insufficient staff and resources, as well as limited skills and expertise; and
- **Burdens placed on NGOs by the time requirements and complexity of innovative approaches**, including the staff, financial resources, and specialized expertise required; the need for external partner engagement; the rigor of impact measurement and evaluation; and operational, legal, and regulatory complexities.

Innovative financing approaches often rely on clearly defined metrics and rigorous evaluation, strong and adaptive performance management systems, and aligned expectations and clear contractual arrangements between multiple stakeholders. The systems required are often very different from traditional ways NGOs operate. With a menu of new approaches to choose from, it is often a challenge for NGOs with limited resources to even understand potentially suitable instruments, let alone successfully design and implement them. NGOs have expressed a strong need for more information and support to implement IF4D.

Some of the most salient opportunities for NGOs are:

- **Potential to increase revenues, crowd in private sector partners, and increase efficiency and value for money**. These are three of the core benefits of IF4D and core motivations cited by NGOs, although they do not all apply to all instruments. The research has revealed a need for NGOs to understand the objectives of an instrument before they invest in it.
- **Potential and need to learn from others' experiences.** NGOs cited an interest in connecting with other NGOs to share best practices, which could help to avoid a need to re-invent the wheel and to accelerate the adoption of IF4D approaches. Sharing existing implementation examples shows NGOs how their peers were able to overcome challenges with IF4D instruments and may help them to avoid pitfalls.
- **Potential to improve development outcomes through more effective market for IF4D**. As NGOs test IF4D approaches, learn, adapt, and share their experiences, understanding of these approaches will improve, time and administrative burdens will decrease as internal capacity improves, and these approaches will become more standard options in the development toolkit. Examples of these instruments in practice have demonstrated positive results, with evidence of programs achieving their aims to attract finance, leverage the expertise of new partners, and improve efficiency. As IF4D approaches are more commonly used, their benefits can have a wider reach.

Recommendations

FOR NGOs

- **Develop an IF4D strategy.** Strengthening an organization's engagement in IF4D, whether it is an active player or just starting out, requires clear objectives and a roadmap. A detailed strategy should include a review of:
  - Instruments the organization has used in the past, for what purpose, and with what results (for implementing organizations)
  - Why the organization wants to enter the market in the first place (for non-implementing organizations)
  - The larger ecosystem of players, both public and private, around the social problems the organization is trying to solve
  - Specific innovative finance instruments that are potentially well suited for the organization
  - Possible programs or priority issues for the organization in which these instruments could be applied
  - Role(s) the organization would play
  - Partners the organization would need
  - Strengths the organization would bring to the table
  - Areas where the organization may need to develop its capacity to be able to effectively implement the instrument
  - Risks associated with instruments an organization is considering implementing
  - Costs associated—in money, time, and human resources
  - Pitfalls, successes, and lessons from others' experiences with similar instruments or roles
  - Remaining gaps and questions that the organization has
  - Actions the organization will take with targets and a timeline
- **Be willing to experiment, learn, and adapt**. IF4D is an emerging field that is rapidly evolving with new approaches being proposed and piloted. There are few established solutions. NGOs should test out new approaches, understand how to fail, fail quickly, adapt and learn, and treat the costs as an investment.
- **Dedicate resources**. For a strategy to have "teeth," it must be appropriately resourced. InterAction's research has shown that NGO knowledge and experience with IF4D is limited and developing new approaches imposes cost and time burdens on teams. NGOs should devote adequate resources to implementing their IF4D strategy, including resources for capacity building, piloting new initiatives, and building the evidence base.
- **Dedicating resources should include appointing an IF4D point person or team.** The research has also shown that even among the most seasoned players in the IF4D space, IF4D-related activities are often conducted in an ad-hoc way and rarely coordinated across the organization.
- **Connect with peers and share lessons**. As InterAction learned in its survey and follow-up interviews, NGOs have the most to learn from each other, and welcome collaborative approaches. Thus, it is important to connect with peers to form partnerships and communities of practice (e.g., around specific issue areas, sectors, geographies, or instruments), and to generate and share lessons from both failures and successes at every point in the project cycle, from early development to exit. NGOs should be actively engaged in documenting their experiences and lessons to be shared, and where possible, to share templates of frameworks or tools that can help other NGOs to learn and accelerate progress.

FOR INTERMEDIARIES, ALLIANCES, AND COALITIONS

- **Convene and connect**. InterAction and other alliances can support sector development in three areas.
  - *Improving access to information*: InterAction's working group/task force architecture can be tailored and utilized to promote the periodical convening of IF4D stakeholders and support their needs for information and collaboration.
  - *Facilitating partnerships:* Alliances can respond to NGOs' biggest stated need, helping to connect with funders or investors by serving as a central source to facilitate these partnerships.
  - *Coordinating to improve capacity:* InterAction and other similarly placed groups can help coordinate with select alliances that could help NGOs to improve their internal capacity to engage in IF4D. Coordination with alliances, such as the Aspen Network of Development Entrepreneurs (ANDE), Humentum, and others, would widen NGOs' potential networks of IF4D partners.

- **Develop and deliver learning tools.** Barriers to NGO engagement in IF4D range from the basics to the complex operational aspects of implementation. Alliances such as InterAction can help IF4D partners develop case study examples and frameworks, and can facilitate sharing of these learning tools.
- **Catalogue and disseminate knowledge or share who is doing what and where.** Members reported that there would be value in InterAction using a resource, such as an online platform or database, to provide current catalogued information. This resource could include information on who is using what instruments and where; the different M&E tools required for various instruments; and case study examples. As interest and experience with IF4D grow, it could eventually be integrated with visual tools such as the InterAction NGO Aid Map. The survey could also be updated and shared periodically, which would provide evidence on how NGO engagement with IF4D is changing time over time. Additional research themes could be jointly decided by InterAction, its membership, and key partners.

FOR DONORS/INVESTORS

- **Support the entry of international NGOs into the IF4D market.** Donors can support the knowledge-sharing and development of learning tools needed to grow NGOs' participation in this market. This role is critical given the constraints NGOs face regarding staff, expertise, and resources. This support can include:
  - Covering upfront costs for the design/feasibility/scoping work associated with developing a specific instrument. There are higher risks associated with innovation, and donors such as foundations are well-positioned to "buy-down" that risk.
  - Building the accessible evidence base by funding more rigorous public evaluations of IF4D activities.
  - Supporting alliances to convene knowledge-sharing opportunities.
  - Supporting NGOs and alliances in the development and sharing of learning tools such as sample frameworks and case studies.
  - Playing other connecting/convening roles across sectors, such as connecting NGOs with other donors or investors that may want to participate in IF4D implementation.

InterAction
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