A review of impact-linked finance: does incentivising impact work?

INVESTING FOR GOOD

Acknowledgements

The co-authors of this report by **Investing for Good** are Dr. Leonora Buckland, Geoff Burnand, and Man-Ling Ho.

Investing for Good was established in 2004 and is a leading intermediary in the impact investing market, responsible for a number of market-first innovations and with a long track record of supporting social purpose organisations and impact investors. Its two principal areas of focus are the structuring of bond, note and blended capital debt funds for social purpose and impact management services including impact frameworks, reporting, training and impact audit.

The **Esmée Fairbairn Foundation** is one of the largest independent grant-makers in the UK with a strategy focussed on working collaboratively to improve the natural world, secure a fairer future, and strengthen the bonds in communities in the UK. They adopt an 'impact-first' approach towards social investment and they actively support new innovative financial models with the aim of establishing greater collective impact.

We would like to thank all those who have so generously contributed their time and insights through the interview and survey process, who are all listed in Appendix A. We feel it is important to give a special acknowledgement to Bjoern Struewer from Roots of Impact who has been an example of collaboration and support whilst not seeking to influence the outcome of the report.

Finally, we wanted to show our real gratitude for the confidence and trust that **Esmée Fairbairn Foundation** has shown in us and in the research and we hope that it is of use for the field.

Esmée Fairbairn FOUNDATION

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Executive Summary

About the study

This study was commissioned by **Esmée Fairbairn Foundation** with a view to understanding more about impact-linked finance globally and exploring its implementation in the UK social/impact investment market. This study has an investor focus, although it is recognised that a next step would be to develop more understanding of the demand from investees for this tool.

The research consisted of a global review complemented by a UK review (with over 30 qualitative interviews and a UK investor survey with 33 respondents.) Please see Appendix A for a list of survey respondents and interviewees. Whilst the number of interviews and sample size of the survey is too limited to generate hard conclusions, it certainly provides interesting directional insights for an emergent field. Its value lies primarily in bringing together disparate and fragmented practices and voices on impact-linked finance in a neutral way.

Context, boundaries and definitions

Impact-linked finance draws on a **rich history of investors innovating with different financial tools to incentivise impact amongst delivery organisations** as well as the evolving field of outcomes-based financing. Moreover, there is a strong context which is propelling such ideas forwards within impact investment, including investors increasingly tying fund-level compensation to impact as well as experimentation with ways to bake impact more clearly into financial agreements. The standardisation of impact management frameworks and growing emphasis on impact data is also making impact-linked finance more possible. Finally, there is the growth of what we see as parallel markets, such as sustainability-linked loans.

The key market-builder **Roots of Impact**, has created the following definition for impact-linked finance – *'the linking of financial rewards for market-based organisations to the achievements of positive social outcomes.'* They underline three key design principles: i) incentives go to the value creator; ii) a focus on outcomes (rather than outputs); and iii) impact additionality meaning that the financial rewards should drive the organisations to deliver additional outcomes that would not have happened without these incentives. Roots of Impact has primarily envisaged impact-linked finance as a subset of blended finance and for use in that context, where it can achieve both impact and financial additionality.

Boundaries of impact-linked finance with outcomes-based financing are somewhat blurred. Throughout the study, **Investing for Good** has used the definition of impact-linked finance as, *'the linking of financial incentives to social purpose organisations to the achievement of social performance targets.'* Key to understanding it is that it should be a more flexible and less costly and complex tool compared to social and development impact bonds. In addition, impact bonds primarily are used to finance activities that do not have an income stream, whereas impact-linked finance is typically used for organisations and interventions that do have an earned income. In practice, there have been very different applications of impact-linked finance with some that are straightforward but others that become more complex with multiple stakeholders and start to look more like 'traditional' outcomes-based financing. The modular nature of impact-linked finance may be why little consensus has been reached on its exact boundaries and meaning.

Impact-linked finance can be used across different asset classes. To date the most common form of impact-linked finance is arguably impact-linked loans, however cash incentives are also common due to a number of Social Impact Incentive (SIINC) transactions pioneered by Roots of Impact. Impact-linked finance has also been used alongside quasi-equity financing and in equity buybacks.

Impact-linked finance transactions vary in type and complexity as the table opposite **(Figure 1)** illustrates.

Promise of impact-linked finance

There is considerable energy and enthusiasm for impact-linked finance amongst the impact investing community, notably from existing practitioners (and not just the market-builders themselves). Primarily, it is seen as useful for alignment of incentives between investor and investee and re-focusing the relationship, conversation and reporting around impact rather than financial returns. It can also be a strategic tool in helping to guard against mission-drift amongst investees as well as to increase impact transparency and incentivise better impact management. It has been used in

	Low Complexity	Medium Complexity	High Complexity
Type of instrument	Impact-linked loan (Debt)	Cash incentive (SIINC)	Social Success Note (Debt)
Brief Description	Impact investing fund, ***Beneficial Returns,*** provides impact-linked loans to social enterprises in developing countries, whereby the final repayment is forgiven based on achievement of pre-agreed impact targets	Outcome payer Swiss Agency for Development and Cooperation and IDB Lab (DFI for Latin America and the Caribbean) provided up to $1m of outcome payments to ***Root Capital*** a non-profit social investment fund that grows rural prosperity in poor, environmentally vulnerable places by lending capital, delivering training and strengthening market connections for small and growing agricultural businesses. This cash incentive was based on Root Capital making up to 40 new loans to high-impact, but less profitable segments of its market	The Investor, the ***UBS Optimus Foundation*** provided ***Impact Water,*** with a $500,000 working capital loan, so that it could continue to sell, install and maintain water filtration systems to schools in Uganda. ***Rockefeller Foundation*** will provide an Outcome Payment of $200,000 split between the Investor (UBS Optimus) and the social business (Impact Water) if impact targets are met. ***Yunus Social Business*** will manage monitoring and evaluation throughout the 5-year term
Number and type of stakeholders	Investor and investee	Outcome payer, intermediary/ verification agent, investee	Investor, outcome payer, intermediary/verification agent, investee
Output or outcome data	Output data pre-agreed with investee	Output data (based on strong link to outcomes).	Output data
Verification of data	None	Light verification	Significant verification

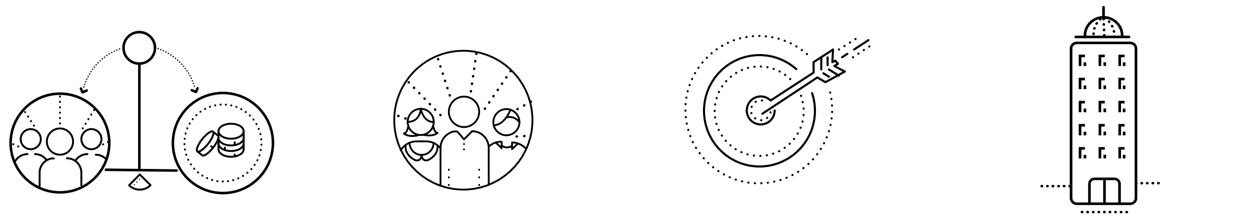
Figure 1: *Illustrative examples of impact-linked finance transactions by complexity*

particular to incentivise a focus on customer segments or business models which would be less possible given typical financial return constraints faced by investees. It is also perceived by investors to provide good value for money, since they can know what impact they are getting for each $ of subsidy they provide.

There are sceptics who question whether incentives are needed and there are also implementation concerns. These are primarily related to the setting of impact targets as well as the price subsidy which can distort markets. Getting the cost and transaction complexity down over time is considered a key criterion for its greater traction and use. For practitioners, the tool's risks and potential downsides identified can be managed through discipline and rigour in the investee selection and price setting process and also by making sure that impact-linked finance transactions are co-created between investor and investee, with in-built flexibility to come back and renegotiate as the situation evolves. It is this element of being a dynamic, flexible tool that most excites practitioners.

The table opposite in **Figure 2** is a summary of the key players on the investor side as well as the specific case studies that are included in this report

In terms of track record, there is not enough evidence yet to build the case for the impact and financial additionality of impact-linked finance transactions. Partly this is related to the lack of transparency from the diverse set of practitioners about the transaction performance, but it is primarily driven by the market still being in its infancy, whereby full track record data is not yet available.



	Development finance Institutions and donors	Non-profits/Trusts/ Foundations	Impact investing funds	Mainstream capital and financial institutions
Summary	• Key drivers of field to date • Motivated by transparency around development outcomes impact-linked finance provides • Use tool mostly in blended finance • Scale/transaction size is a barrier and managing risk	• Key providers of catalytic capital • Hope to leverage mainstream investment • Helps philanthropic capital to move away from input mindset • Some barriers to adoption	• Directly reward impact • Protect against mission drift • Generate impact transparency	• Incentivise corporate sustainability
Research Case studies	• Swiss Agency for Development and Cooperation through SIINCs and impact-linked loans (Pg. 34) • IDB Lab through SIINCs • IDB Invest through blended finance facility (Pg. 33)	• UBS Optimus Foundation (Pg. 27) • Rockefeller Foundation • Esmée Fairbairn Foundation (Pg. 61)	• IIG (Pg. 29) • Camco-REPP (Pg. 30) • Nesta Cultural Impact Development Fund (Pg. 60)	• BNP Paribas (Pg. 37) • Social Capital Partners (Pg.41) • HCT Group (Pg.59)

Figure 2: *Key impact-linked finance actors on the supply side.*[4]

Global impact-linked finance landscape: who is doing what, where, and how

Impact-linked finance is a nascent, early-stage concept. It involves many different actors from across the impact investing community. The majority of experimentation has happened in the developing country context and there has been particular application in the renewable energy and gender and diversity sectors, although a wide variety of sectors have been covered.

On the supply side, to date philanthropic capital (trusts, foundations and non-profit investors) have provided some of the concessional, catalytic capital and demonstration examples. Benefits for trusts and foundations include good value for money, helping to bring mainstream investors into impact investment and moving from an input-based grants mentality.

Impact-linked finance is a tool which is very suitable for trusts and foundations experimenting along the spectrum of capital, since it implicitly recognises some trade-off between financial and social returns. However, the transactions to date have often been demonstration projects and it is unclear how far and fast foundations want to scale up this practice. There is a concern that there is not much catalytic capital about (either in the form of outcome payment in blended finance transactions or for impact investments willing to take lower financial returns for improved impact), and that many foundations which invest for impact out of their endowments might find the idea of an impact-link overly complex. Moreover, the fear of high transactions costs and real regulatory barriers (for example using grant funds to finance social enterprises) can be off-putting.

Development finance institutions (DFIs) and development agencies such as IDB, the Swiss Development Corporation, USAID, IFC are also critical actors in impact-linked finance and the key to its scaling. Just a small share of the approximately $150bn USD official development assistance budget would unlock the market. The rigorous pricing and risk assessment practices of the DFIs have much to teach impact-linked finance practitioners about how to approach such transactions. Many DFIs have used this tool with large-scale corporates and financial institutions as well as smaller, younger enterprises and social enterprises. For DFIs, impact-linked finance provides security and transparency around development outcomes and significant market-level impacts can be created through small amounts of price subsidy via an impact-link. Limited scale and track record of impact-linked finance to date could affect how far this tool might move from the margins to the centre of DFI strategies, yet there is growing awareness among DFIs that linking incentives to impact can be used across the entire spectrum of finance provided by DFIs.

Impact investing funds have been less active in this area, which primarily relates to financial hurdle constraints on their capital. Although one of the original motivations for impact-linked finance is to crowd in private capital the question remains as to how far impact-linked structures are appealing to mainstream finance investors. Many observers are unconvinced that impact-linked finance will be adopted by institutional capital due to it being considered concessional, esoteric and niche.

On the demand side, social enterprises are the primary investees for impact-linked finance. Unfortunately, this study did not contain in-depth research about demand although it is clear that the alignment with investors on impact can be very appealing for some investees, as well as the lower cost of capital and the ability to reach segments of the population they would not normally be able to due to financial sustainability constraints. Impact-linked finance seems to make most sense for more mature social purpose organisations, since they can become involved in the co-creation of these transactions as equal partners and have strong existing impact data. There is certainly a level of risk that needs to be borne by investees which they have to be comfortable around. Corporates have received impact-linked finance - it could be in the future they are strong candidates for impact-linked finance to keep their focus on impact. Whereas social enterprises might need impact-linked finance to lower financing cost to better fulfil their mission, corporates need incentives to target specific impact topics/areas.

Key Insights and Learnings from Global Review

Whilst there is no clear track record for impact-linked finance, practitioners did share some useful insights and learnings from their experiences to date. In terms of pipeline and navigating the demand for impact-linked finance, whilst there does need to be some education and familiarisation in the market related to impact-linked finance, many entrepreneurs and senior managers intuitively and instinctively understand that it is a tool that can reduce the cost of capital and allow them to amplify their impact and fundraising possibilities.

How practitioners decide how and when to implement this tool is not standardised and at the moment seems haphazard, partly related to the stage of the market. There appears to be more 'push' from investors than 'pull' from investees through open calls and active pipeline development, although the 'demand' side does respond positively. Concerns from those who have not yet experimented with the tool about how complex it might be to understand could be misguided, particularly for more mature social purpose organisations.

There are also **significant learnings about the setting, negotiation and verification of impact targets as well as the pricing of the incentive.** Again, rigour varies widely in the field as does the size of the incentive offered. However, most impact-linked loans have offered quite a significant pricing incentive for impact targets being reached (often 2%-4% reduction on the original interest rate for targets reached). Some practitioners are using pricing tension and negotiating tactics to explore the maximum amount of impact that they can get from each dollar of subsidy, also attempting to use benchmarks to price impact and ensure that pricing does not become market distorting. Others are more informal in their approach concerning pricing, impact-setting and impact verification, perhaps settling on a few key output targets for investees and trusting self-reporting.

A key question is how to create fair, stretch impact targets as well as what level of verification is required of these impact targets. If the targets are being easily reached, is this a good use of the incentive? If the investor relies on investee self-reporting, is that acceptable? Verification requires additional layers of cost (through external, independent verification and more stakeholders around the table). Are output indicators sufficient or are outcome targets (which are ultimately more costly) indispensable – they also give the investee more freedom about how they reach these targets?

These are all interesting trade-offs and design challenges facing practitioners of impact-linked finance – as yet there is no existing playbook (although Roots of Impact is working on an open platform on impact-linked finance). The case studies in the research indicate a range of possible approaches and perspectives. There is also a recognition amongst practitioners that one of the advantages of the impact-linked finance tool must be that it is dynamic, there are possibilities to re-price and re-negotiate impact targets given a constantly evolving market, and relatively light-touch. There is a tightrope that practitioners are walking between creating a tool that meets these intentions about not creating unwieldly, costly structures but is also rigorous enough to preserve trust and confidence among investors.

UK investor awareness and appetite for impact-linked finance

Amongst the limited sample of UK investors interviewed and surveyed for the study, there is a fairly high awareness of impact-linked finance as a concept, although some differing interpretations about the exact definition. Over 50% of those surveyed had explored or are currently exploring impact-linked finance opportunities and the interviews uncovered that many leading UK social investors had thought about an impact-link and how it could be structured into funds and transactions before 'impact-linked finance' became a term. The relatively mature and sophisticated UK social and impact investment market in relation to outcomes-based financing means that investors intuitively understand and have often experienced or participated in such types of financing. Some of the concerns related to social impact bonds, in particular how the instrument started to come before the need, also make UK investors wary about the latest vogue financial innovation which may not respond to investee demand.

Over 60% of those surveyed identified a need for impact-linked finance in the UK and are primarily attracted to the alignment of incentives as well as the impact transparency that global practitioners alluded to. As in the global review, there were many and varied concerns raised about its implementation, primarily related to the availability of concessional capital to make the trade-off in return for 'buying' impact, concerns about the cost and viability of impact target setting and verification (with impact additionality hard to ascertain) as well as the reticence about adding further complexity for investees when they are already struggling with more conventional social and impact investment termsheets.

Interviewees were relatively neutral about which social/environmental sectors might be most appropriate for further exploration in the UK of impact-linked finance. There is an acknowledgement that sectors where outcome measurement is clearer and more advanced could be frontrunners (such as energy, employment or housing) but that even in these sectors, there are considerable challenges in terms of setting material impact targets which do not create perverse incentives.

The key barrier to potential implementation in the UK identified through the investor survey is the lack of knowledge and experience of impact-linked finance in the UK. Other challenges identified were weak existing impact management practices amongst investees, lack of investor capacity and resource to manage impact-linked finance transactions and a lack of track record of impact-linked finance in the UK.

UK case studies to date

Whilst it is evident that there are barriers to be overcome, impact-linked finance has started to be implemented in the UK, solving different problems for different types of investors/investees.

There are three case studies featured in the report - In the case of **HCT Group**, a community transport operator in the UK, which received a £10m impact-linked loan from a range of impact-first as well as mainstream investors, **Nesta Cultural Impact Development Fund** which is using impact-linked loans to both incentivise outcomes as well as targeting changes in impact management at investee level and **Esmée Fairbairn Foundation** which is testing the impact-linked finance concept in an impact-linked loan to investee Hubbub to run a Climate Emergency Campaign in Manchester.

Conclusion and recommendations

Impact-linked finance is a versatile and flexible tool – an idea that can be applied to different sectors and market problems. It is this versatility that makes it interesting and a site for further exploration and experimentation. Whilst one of the original objectives of the study was to develop term sheets that could be shared as examples for investors, it soon became apparent that the market may not yet be ready or at the stage for codification and standardisation. Instead, the focus needs to be on further building a track record which will help to prove more concretely the philosophical arguments for impact-linked finance. As one UK survey respondent suggested, *'we need evidence of impact generated relative to the cost of implementation.'*

The case studies illustrate that it has been used amongst early stage as well as mature enterprises, for corporates as well as social enterprises, in sectors where impact management is harder and less widespread (primarily to incentivise this culture) as well as in sectors where measurement is easier, more standardised and benchmarked. This versatility is an advantage, but also potentially a barrier to scaling. Whilst there is this wide range of experimentation, it could be helpful for practitioners to build some framing around which contexts (social issues, investees) deliver the most value. Many interviewees felt that it is primarily a tool for larger-scale, more mature social purpose organisations in sectors with the best prospects of relatively standardised impact measurements which will not create significant additional cost to the investee or investor.

As this study demonstrates, there is strong potential for impact-linked finance in the UK. In the context of an acknowledged need to improve the structure and functioning of the social and impact investment market, to bring in more mainstream capital and to encourage greater catalytic funding from trusts and foundations, impact-linked finance could be a way of developing a more impact-oriented dialogue and transaction between investors and investee. This could help to potentially unblocking the some of the structural inadequacies of the market and to develop more products that really inhabit and 'own' the spectrum of capital as well as to encourage impact management in the sector.

In the key next step globally and in particular in the UK is to understand the demand-side of the equation. A strong recommendation from practitioners is to keep the framing and language as simple and jargon-free as possible for entrepreneurs, but there needs to be further investigation as to how far investees feel that this type of tool will help them to achieve a deeper impact.

It is clear that the idea is just beginning to really develop traction over the last few years and a concerted effort, of which this study hopes to help, is required to bring all the fragmented initiatives, learnings and activities together to determine whether this is a tool that can help investors better support their investees and ultimately the communities they serve (through financial and impact additionalities) and, if so, how it might be scaled. For impact-linked finance to be more broadly accepted and experimented with, there needs to be a crystal clear understanding about what problem it is seeking to solve and evidence that it is actually solving this problem.

Global Review of Impact-Linked Finance

Introduction

B.1.

Why the study?

This study was commissioned by **Esmée Fairbairn Foundation** in the UK with a view to understanding more about impact-linked finance globally and to exploring its implementation in the UK social investment market. Whilst there are some existing articles and reports on impact-linked finance, **Investing for Good** believed there was a need for a more holistic and current perspective on this potentially innovative tool, bringing together the varied and fragmented experiences of different players and actors to explore key learnings, insights and adaptability to new contexts such as the UK.

Research questions and study methodology

The research was split into two parts:

(A) A global review of impact-linked finance
This consisted of a literature and desk review of impact-linked finance as well as parallel markets (such as sustainability-linked loans, social and development impact bonds). This was followed by 16 semi-structured one-hour qualitative interviews with academics and key field practitioners identified through the literature review as well as existing contacts. The interviews were transcribed and a thematic analysis conducted to explore key insights.

The research questions guiding this global review were:

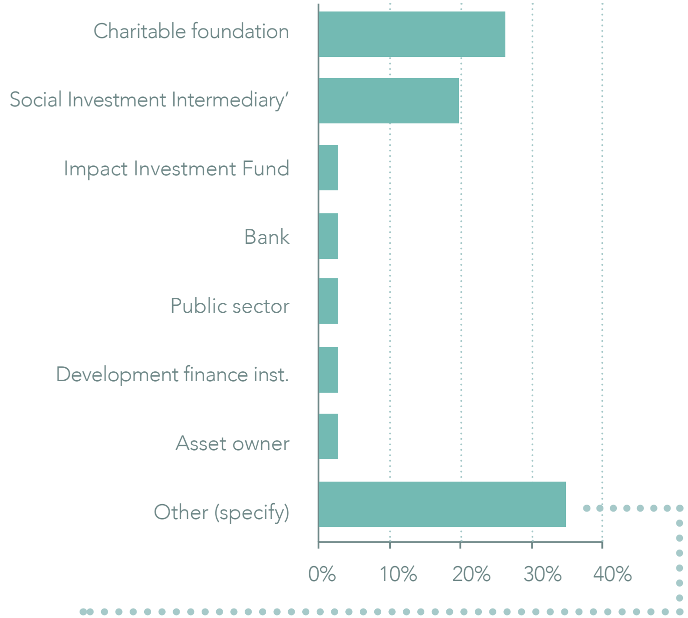
- How can impact-linked be defined?
- Who are the current actors and what are key international case studies?
- What are the perceived benefits for different stakeholders?
- What are the barriers and challenges for implementation?
- What can impact-linked finance learn from the recent development of other innovative financing models (SIBs/DIBs etc.)?

(B) An exploration of potential for adaptability for the UK market
This consisted of an investor survey with ten questions sent to over 100 UK social and impact investors, identified through Investing for Good's existing network, intermediary networks such as the SIIG[1] as well as the list of those involved in the UK Social Investment Taskforce. There were 33 complete responses to the survey, primarily from impact-first investors (charitable foundations and social investment intermediaries). See **Figure 3** opposite for a detailed breakdown of responses by stakeholder group. There was minimal representation from mainstream finance. The survey was followed up by 13 semi-structured expert and investor interviews. The interviews were recorded, transcribed and insights developed using thematic analysis.

The research questions guiding the UK market landscaping were:

- What is the awareness of impact-linked finance amongst social and impact investors?
- What is the appetite for impact-linked finance?
- Are there any case studies of impact-linked finance in the UK?
- Are there certain sectors or segments of the market where impact-linked finance might work best?
- What are the prospects for UK implementation of impact-linked finance?

The sample size of the survey is insufficient to draw conclusions about the key questions and there is a response bias towards those already interested and involved in outcomes-based financing and to a lesser extent impact-linked finance. Whilst there are these methodological limitations to the study, given the limited data to date on impact-linked finance, the survey is an interesting first step and complemented by the qualitative interviews it gives us some directional insights into how far impact-linked finance might be appropriate within the UK context. Please see Appendix A for a full list of survey respondents and interviewees.



1. Ecosystem builder
2 Charity
3. Sole trader
4. Independent non-profit institute
5. Investment crowdfunding platform
6. Social impact investment wholesaler
7. Social impact investment intermediary + impact investment fund
8. Advisory firm/consultancy
9. NDPB
10. Research + consulting
11. Researcher
12. Development financed incubator

Figure 3: *Breakdown of UK Survey Respondents by Type of Organisation*

What is impact-linked finance?

What do we mean by impact-linked finance?

The impact-linked finance market is still in its infancy and thus the boundaries and meanings of the term are somewhat undefined and contested. There is no consensus definition although one of the key practitioners and market-builders, Roots of Impact, is aiming to move towards a set of agreed design principles outlined in the **Figure 4**. opposite, with the core three principles defined as: a) incentives go to the value creator (rather than, for example in Social Impact Bonds where incentives tend to go to the investor); b) a focus on outcomes (rather than outputs) and; c) impact additionality meaning that the financial rewards of these instruments should drive the organisations to deliver additional outcomes that would not have happened without these incentives.

Since impact-linked finance has primarily been publicly championed and written about within a blended finance context, the design principles put forward by Roots of Impact build on well-known concepts in this field, such as financial additionality which translates into the idea of crowding in private sector finance. Impact-linked finance is perceived as a way of bridging the gap between the supply and demand of capital for social enterprises. Additional private sector investment for social purpose organisations is blended with public or philanthropic funds. In some impact-linked finance transactions, there is an outcome payer in addition to the impact investor who provides the upfront risk capital and there are impact-linked finance funds and transactions where there are junior and senior tranches of debt.

B.2.

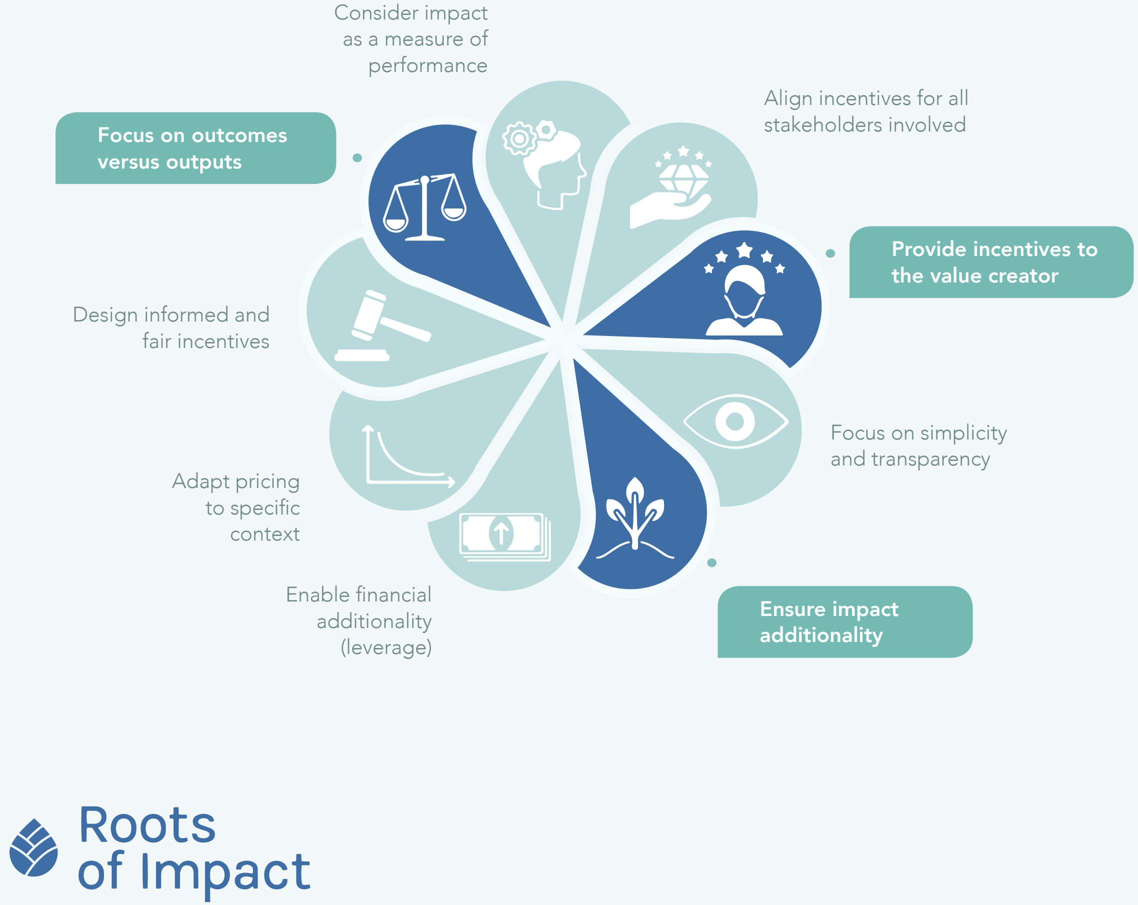


Figure 4: *Roots of Impact Suggested Design Principles for Impact-Linked Finance*[2]

Organisation's Planned Work		Organisation's Intended Results		
Inputs	**Activities**	**Outputs**	**Outcomes**	**Impact**
Resources (capital, human), invested in the activity	**Concrete actions of the organisation**	Tangible products from the activity	Changes, benefits, learnings, effects resulting from the activity	Attributions of an organisation's activities to broader & longer-term outcomes
$, number of people etc.	**Development & implementation of programs, building new infrastructures etc.**	Number of people reached, items sold, etc.	Effects on target population e.g. increased level of education, increased employment	Take account of actions of others (alternative programs), unintended consequences
EUR 50,000 invested, 5 people working on project	**Land bought, school designed and built**	New school built etc.	Places occupied by	New students with acces to education

Source: Key Definitions in Impact Measurement, EVPA Guide, 2012

Figure 5. *Impact logic chain*[3]

Throughout the study, Investing for Good has used the definition of impact-linked finance as:'The linking of financial incentives to social purpose organisations to the achievement of social performance targets.'

The key elements of the definition that we believe are central are:

- A set of agreed impact goals/metrics is agreed between investor and investee
- The social value creator i.e. the delivery organisation is financially rewarded for achieving these pre-agreed impact targets/metrics
- There is an agreed framework for verification of impact targets/ metrics

Beyond these key elements of impact-linked finance, there are several additional elements which are still contested:

- Definition of 'impact' and how far impact goals/metrics need to be set at output or outcome level. **Figure 5** opposite shows the impact logic chain and example of outputs versus outcomes which provide commonly used language around impact. Outcome metrics might be philosophically ideal, but could be hard to implement, in particular potentially requiring expensive impact management systems and verification processes.
- *The additionality of the finance:* how far the impact-linked finance should help crowd in additional private capital. This speaks to whether impact-linked finance is primarily a blended finance proposition or also to be used in bilateral investor-investee impact-linked transactions where no additional private capital is raised tied to the transaction.

The need for more clarity and a degree of quality control around what counts as impact-linked finance is important. For Bjoern Struewer from Roots of Impact, design principles matter, *'We just have to find a pragmatic, efficient and effective way to make every single transaction better than without any design principles, without thinking about certain quality criteria'.*[4] However other practitioners would like to keep impact-linked finance as a big tent, by not imposing too many conditions.

	Low Complexity	Medium Complexity	High Complexity
Type of instrument	Impact-linked loan (Debt)	Cash incentive (SIINC)	Social Success Note (Debt)
Brief Description	Impact investing fund, ***Beneficial Returns,*** provides impact-linked loans to social enterprises in developing countries, whereby the final repayment is forgiven based on achievement of pre-agreed impact targets	Outcome payer Swiss Agency for Development and Cooperation and IDB Lab (DFI for Latin America and the Caribbean) provided up to $1m of outcome payments to ***Root Capital*** a non-profit social investment fund that grows rural prosperity in poor, environmentally vulnerable places by lending capital, delivering training and strengthening market connections for small and growing agricultural businesses. This cash incentive was based on Root Capital making up to 40 new loans to high-impact, but less profitable segments of its market.	The Investor, the ***UBS Optimus Foundation*** provided ***Impact Water,*** with a $500,000 working capital loan, so that it could continue to sell, install and maintain water filtration systems to schools in Uganda. ***Rockefeller Foundation*** will provide an Outcome Payment of $200,000 split between the Investor (UBS Optimus) and the social business (Impact Water) if impact targets are met. ***Yunus Social Business*** will manage monitoring and evaluation throughout the 5-year term.
Number and type of stakeholders	Investor and investee	Outcome payer, intermediary/ verification agent, investee	Investor, outcome payer, intermediary/verification agent, investee
Output or outcome data	Output data pre-agreed with investee	Output data (based on strong link to outcomes).	Output data
Verification of data	None	Light verification	Significant verification

Figure 6: *Illustrative examples of impact-linked finance transactions by complexity*

In order to describe and define impact-linked finance, perhaps the best way is by introducing a few practical examples. Our research has illustrated that there is a range of complexity to impact-linked finance. The table in **Figure 6** describes a few light complexity, medium complexity and high complexity examples, to make more concrete the concept of impact-linked finance. Complexity is not driven so much by the financial instrument itself but rather criteria such as whether impact targets are output or outcome level, external verification and also the number of stakeholders involved in the transaction.

How is impact-linked finance different from outcomes-based finance?

Impact-linked finance may be considered a subset of outcome-based finance. There could be a certain level of confusion about whether impact-linked finance includes, for example, Social Impact Bonds (SIBs) and Development Impact Bonds (DIBs). Whilst deriving inspiration and learning from SIBs and DIBs, impact-linked finance is a different concept since it does not normally include the commissioning/public sector as a player; the financial value of the impact achieved tends to go directly to the social purpose organisation and the demand side is normally either NGOs, charities or social enterprises with a clear revenue stream in scaling phase (rather than a non-profit intervention).

Sometimes the boundaries between different forms of outcome-based finance can be blurred: for example, in certain social impact bond or outcomes funds, the financial value associated with impact achieved does flow to the service organisation as well as to the investor. In addition, NGOs and social enterprises with revenue streams can also participate in social impact bonds. **In essence, impact-linked finance is a similar tool applied to a slightly different set of circumstances, and most crucially seeks to reduce the level of complexity and number of stakeholders involved in transactions.**

The table in **Figure 7** opposite describes some key, common differences between SIBs/DIBs and impact-linked finance, although there are exceptions to these differences.[5]

> **Karim Harji,** *'With SIBs, in my opinion, the instrument has become the solution… rather than what I think it was originally designed to facilitate. Impact-linked finance is not trying to over-engineer or complicate the contractual and instrumental aspects. I think it is more responsive to who is at the table, and flexible to the extent you are trying to work together to generate a range of different solutions in challenging contexts, where you often have limited information and resources.'* [6]

One of the key benefits of impact-linked finance as compared to other outcomes-based finance is that it seeks to be a lower-cost, more agile and efficient tool. It thus responds to the criticisms of structures that the transaction costs can be too high. However, whilst some interviewees saw impact-linked finance as the next generation of SIBs/DIBs, absorbing and learning their lessons, they are ultimately **complementary models that can be used in different contexts and for different types of investees.** In addition, as the SIBs/DIBs are constantly evolving, the boundaries between these type of outcome-based finance tools and impact-linked finance also evolves.

	SIBs/DIBs	Impact-linked finance
Context	Primarily government/Non-profit intervention (typically not enterprise)	Primarily social enterprises, charities or NGOs in scaling phase with sustainable revenue model for debt repayment (can also be enterprises and corporates)
Theory of change	To de-risk innovative service delivery models; to achieve proof of concept and cost savings	To provide cheaper capital to high impact enterprises; to reward effective solutions to a given problem
Risk-bearer	Investors bear the financial and impact risk – often "all or nothing"	Financial and impact risks primarily borne by the investee; impact risk to investor is mitigated via price-impact link
Recipient of 'financial reward'	Most commonly investor for being the risk-bearer (although in some cases upside also goes to investee)	Investee for creating social value and for bearing risk – arguably a better alignment of interest
Role of outcome payer	Outcome payer is a third party (i.e. not the investor); responsible for the full cost of intervention plus investor return	Outcome payer may be the investor or a third party, responsible for marginal payments or financial incentive linked to the impact targets
Investee control	There may be less flexibility and autonomy in service delivery, given SIBs/DIBs contracts tend to be rigid and investors (as the primary risk-bearer) may have greater influence over intervention delivery	Investees generally have greater autonomy and are free to change approach throughout the contract terms as long as the impact target is achieved
Cost & Complexity	Multi-stakeholder, more lengthy and costly to set up and manage	May be two-party as in traditional loan arrangment, or multi-stakeholder if additional parties (e.g. outcome payer, M&E) are involved, although the contract is generally leaner and less prescriptive than SIBs/DIBs The reduced complexity and cost in setting up arguably allows participation of small/medium sized organisations

Figure 7: *Key general differences between SIBs/DIB's and impact-linked finance*

Impact-linked finance across asset classes

Impact-linked finance is a general term which encompasses different types of products/structures and can be used across asset classes. To date, the most common form of impact-linked finance is arguably *impact-linked loans*, where the financial incentive is tied to impact targets in the form of interest rate adjustment. *Cash incentives* are also common and form the basis of a number of Social Impact Incentives (SIINC) transactions, this is where 'bonus' payments are triggered at the achievement of pre-defined impact targets. Impact-linked finance has also been used alongside quasi-equity financing, where debt can be repaid in the form of revenue share or operating profit which better aligns investor return with the borrower's ability to pay back.

Aside from the use of cash, financial incentives can be embedded in an impact-linked transaction in myriad other ways. *Tranching* is where capital is released in tranches pending on the achievement of impact milestones, while *vesting* is the release of share ownership. Alternatively, upon achievement of impact milestones, the investor may allow *equity buybacks*, where the ownership can be sold back to the entrepreneur.

In fact, impact-linked finance is best conceptualised as a feature that could be flexibly embedded in various products/structures. The 'modular' nature of impact-linked finance may be why little consensus has been reached on its exact boundaries and meaning.

The promise of impact-linked finance

During our research, we heard a range of reasons as to why impact-linked finance could be a promising financial tool for the impact investment market. Each interviewee, often representing a different perspective or part of the impact investing value chain, articulated in quite different ways what was most exciting about it. The breadth and range of overarching rationale or meaning attributed to impact-linked finance illustrates that there is still a lot of fluidity and sense-making associated with it and **there is not a particularly strong convergence about exactly why it is needed and, in particular, what value it will bring to the impact investing market.**

Why it might be necessary

For impact-linked finance to be more broadly accepted and experimented with, **there needs to be a clear understanding about what problem it is seeking to solve i.e. the why?** Financial innovation should respond to real market need. Amongst interviewees for this study, there are different ideas as to what the purpose of impact-linked finance is, although some agreement at a more philosophical / high-level about what it is trying to achieve. There is a sense from interviewees that impact-linked finance can be a guardian for the 'impact' of 'impact investment', helping to protect against the risk that the broad tent of impact investment risks impact dilution. There is a fear that the market faces 'impact wash', where impact is claimed without necessarily being achieved. Clearly incentivising impact (of which impact-linked finance is one method) is a means of putting impact front and centre and making it a key feature of impact finance transactions.

Thus, impact-linked finance has a role in spurring and catalysing the market in a positive direction, **to properly account for, prioritise and focus on this impact side of the equation**. There is a cost to creating social value which should be properly recognised and rewarded.

Chris West, Sumerian Partners, *'Isn't this weird that all the impact that organisations are generating is essentially an externality. It is a free good. It really worries me in that social entrepreneurs are not being rewarded in any sense for what they do. Anything that tries to capture and price and value an externality, I think is really important, just as it is on the environmental side.'* [7]

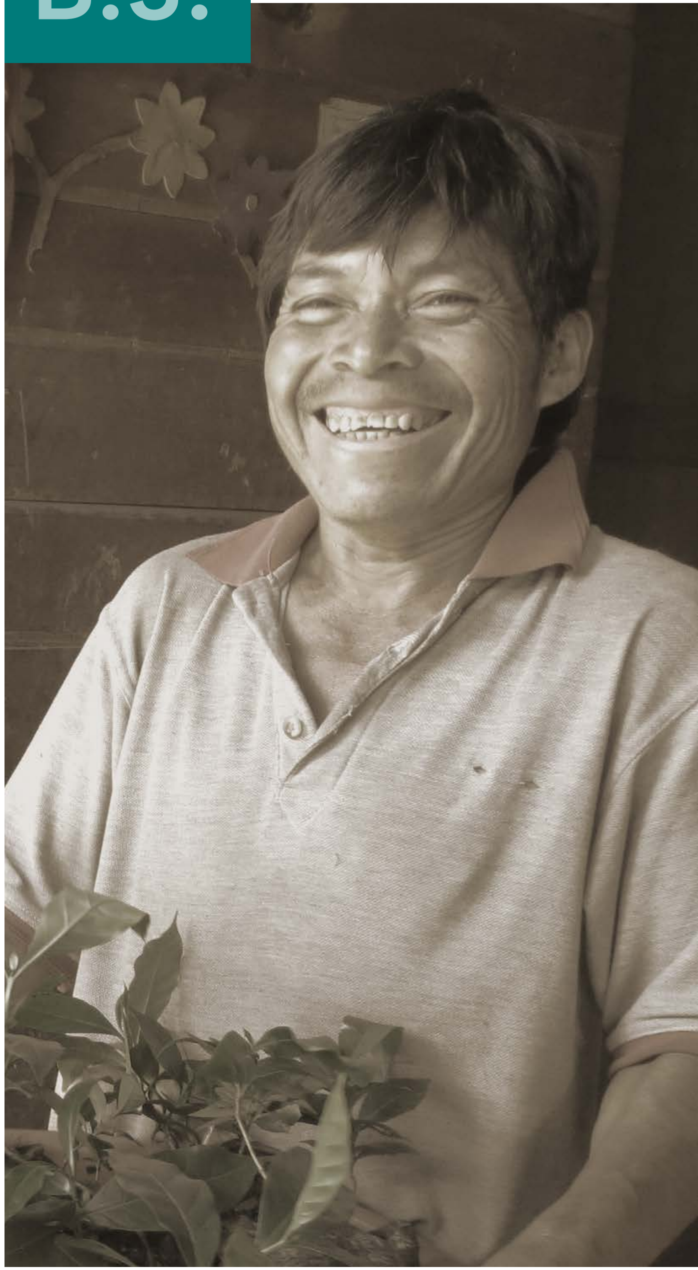
From a blended finance perspective, impact-linked finance is another tool to help bridge the gap between the demand for capital and the supply of capital. More often than not, markets remain imperfect and do not translate the whole value created for society into returns created for investors.[8] For high-impact social entrepreneurs to attract commercial sources of capital, they may need to change or a shift in business model towards more profitable segments of the market – something that is not attractive from an impact point of view.[9] Impact investing is often considered an obvious solution for social entrepreneurs, but a majority of impact investing funds (over 80%) seek to generate financial returns at market rate or close to market rate similar to traditional investment. **Beyond guarantees and first-loss slices, arguably an impact-link is a more efficient use of subsidy (by the DFI or catalytic capital seeking to support the enterprise) and significantly improves the risk-return profile for mainstream/commercial investors to come into the transaction.**

What is the value of impact-linked finance?

Practitioners described a range of different benefits of impact-linked finance, which are somewhat dependent on the perspective of the stakeholder as well as the type of market need which impact-linked finance is responding to:

- **Alignment of incentives and focusing on impact:** this is about showing in a concrete and contractual way that both investor and investee are focusing on and value impact and that performance is judged on both social and financial returns. This impact target-setting process allows and facilitates this strong and necessary conversation about impact and brings the central focus of the transaction and monitoring of the investment again and again back to impact.

B.3.



Lorenzo Bernasconi, formerly Rockefeller Foundation, *'It is an underdeveloped area of finding ways of aligning incentives between investor and borrower or investee such that the cost of capital to the investee allows them to maximise impact.'* [10]

- **Impact transparency/ impact management tool:** it remains a frustration for many that there is still weak impact reporting and transparency in impact investing both among investees and investors. Like social impact bonds, which have long been recognised as to some degree a monitoring and evaluation tool, impact-linked finance catalyses and spurs on stronger impact management procedures, often (but not always) including third-party verification. At the minimum, investors need to work with investees to improve their output monitoring capability, ideally with evidenced link to outcomes or outcome data itself. For some (particularly in the UK), the major purpose of impact-linked finance is to encourage stronger impact management practice.

Seva Phillips, Nesta, *'From our experience, it encourages more in-depth thinking around impact evaluation and target setting, certainly for the investor and possibly for the investee.'* [11]

Anna Kanze, Grassroots Capital, *'I think it is important as an impact investor to really measure the impact part of it. We spend a lot of time proving that you can make financial returns and building that case, but not as much time on the impact side. And so then you are just an investor, not really an impact investor.'* [12]

- **Moving from input/output mentality to an outcome mindset:** there is a recognition amongst interviewees that investors and investees need to reflect and engage with impact beyond inputs and outputs, to really understand the change that their capital and activities are having on the lives of those they are seeking to serve and potentially how far they are contributing to that. Within the impact investing sector, much impact measurement is still at the output indicator level (for example IRIS indicators are often output-oriented), but there is momentum in pushing the sector towards a more outcome-oriented perspective. However, opinions can be mixed on the value of this (i.e. whether it is desirable and/or achievable).

Katie Naeve, Root Capital, *'I think impact-linked finance can shift the mindset of funders and implementers in focusing on results as opposed to inputs.'* [13]

- **Allowing social enterprises to target less profitable/harder-to-reach segments and protecting against mission drift:** in practice many of the cases in which impact-linked finance has been used include a focus for relatively mature enterprises to focus on less profitable segments where impact might actually be the greatest, so their financial return pressure does not get in the way of them achieving their mission. This could, for example, relate to a health intervention focusing more on customers from lower socio-economic groups with less ability to pay or for lenders to target less profitable, higher-risk but high-impact segments. The impact-link can also help to lock the mission into the enterprise, although how sustainable this is when the impact-linked finance comes to an end is uncertain.

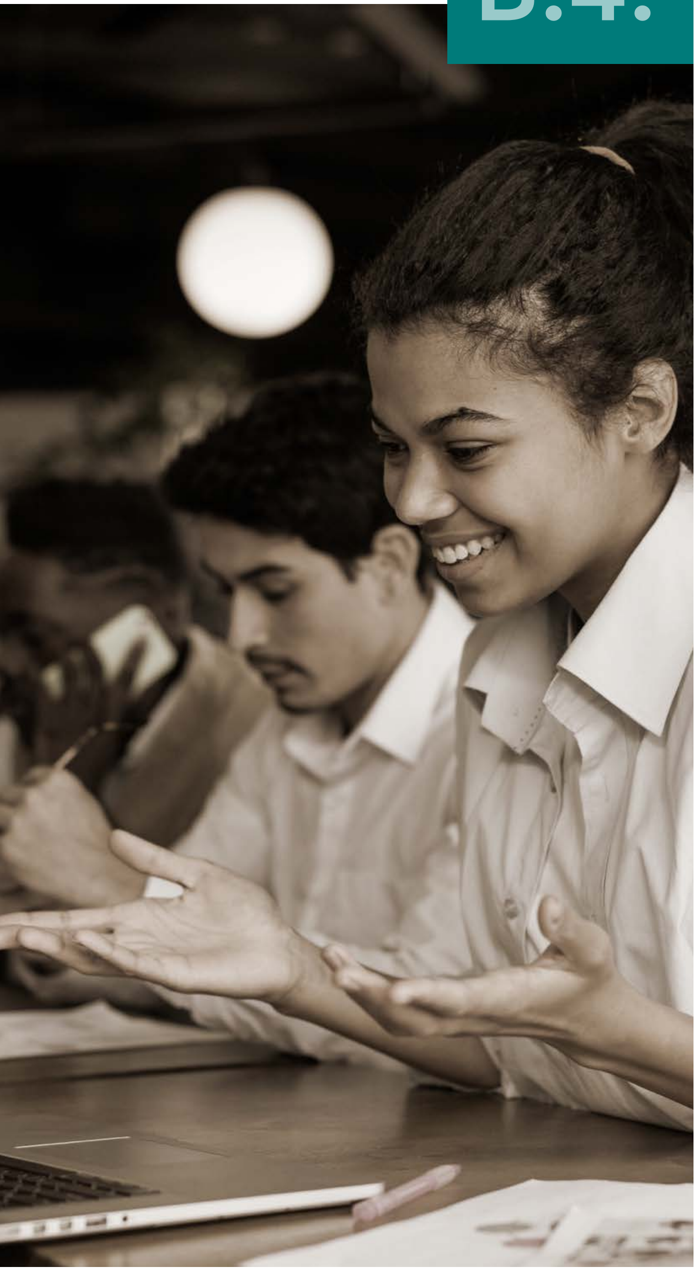
Risks and healthy scepticism

Interviewees mentioned several **risks** of impact-linked finance, notably:

- **Whether incentives are actually required to increase impact:** many impact investing practitioners state that they already screen for impact when selecting investees - since founders are normally committed to impact, it is unclear how far additional incentives are required. The use of incentives potentially comes down to the type of investee.
- **Unintended consequences of incentives:** there is significant literature that financial incentives do alter time allocation between financial returns and impact returns, but there can be widespread gaming of the system (which DFIs have discovered in target setting), and incentives may even diminish the intrinsic motivations which often drive social entrepreneurs.[14] Another unintended consequence is potentially to discourage innovation and creativity, essential attributes of social enterprises, particularly if impact targets are narrowly or wrongly set.
- **Sustainability of impact achieved by incentives:** there is a question as to whether impact-linked incentives can create long-term behaviour change within the social enterprise or even market-level change.
- **The risk of market distortion** through lower cost of concessional capital crowding out private sector capital.

Such risks can potentially be managed by making impact-linked finance transactions more flexible so that if impact targets are not appropriate, they can be revised and to use impact-linked finance in a carefully thought-out way to subsidise market development or social enterprises only in the short-term (rather than the medium or long-term).

Beyond managing risks connected to the setting and implementation of impact incentives, there is a degree of scepticism in the market, particularly amongst those who have not yet used the tool, related to how significant, necessary and appropriate this financial innovation is given the state of the impact investment and impact management.



B.4.

The context for impact-linked finance

Impact-linked finance is also distinct but connected to other trends described in more detail below such as the growth of impact carry within impact investing fund management as well as the increasing work to reflect and embed impact more clearly within impact investing contracting. These indicate that there are a variety of methods impact investment practitioners to bake 'impact' into transactions, of which impact-linked finance is one approach amongst many others.

- **Impact carry:** Increasingly impact investors are attempting to tie a portion of General Partner (GP) compensation to social and environmental performance[15]. An impact-based incentive structure can be designed to penalise low impact by reducing compensation and/or reward outstanding impact by increasing compensation. However, the overall percentage of impact investors doing this is relatively low (recently estimated at around 1%) and there is still scepticism about the method for calculating such impact carry. In Europe, impact carry is more established driven by the policy of the Social Impact Accelerator (SIA) of the European Investment Fund which is a public-private partnership to address the need for equity finance to support social enterprises (€243m fund combining resources from the EIB group as well as external investors including Credit Cooperatif, Deutsche Bank, SITRA and the Bulgarian Development Bank).[16]

  To measure social impact, EIF developed a framework for quantifying and reporting on impact metrics throughout the investment chain. Social impact funds financed by SIA are asked to define between 1 and 5 social impact indicators per portfolio company and set pre-investment quantifiable objectives for each of the indicators. The fund manager is held accountable for the social performance of its portfolio companies and this performance affects the distribution of carried interest to the management team. The utility and efficacy of impact carry as a tool is mixed according to commentators.

- **Embedding impact within legal contracts:** over the last decade impact loan agreements have become increasingly performance oriented. Early impact loan agreements were indistinguishable from commercial ones but nowadays they often embed impact consideration or explicitly incorporate impact performance requirements into the contract. Most innovation in contracting for impact has happened at the level of direct investment. The microfinance sector, for example, has been using performance-based agreements for many years.[17]

Another important context and precondition for impact-linked finance is a level of standardisation and data related to impact management. At the heart of impact-linked finance is the ability to rigorously and proportionately measure impact translating into an ability to actually 'price' impact. Issues that have dogged impact investment for some time and which have impeded the development of secondary market for social equity is the lack of a standardised impact management framework with agreed and comparable outcome indicators.

There is, however, progress with a convergence of frameworks driven by collaborative, multi-stakeholder initiatives such as the Impact Management Project. To some extent the journey of impact-linked finance is intimately connected to the impact management journey for the entire impact investing industry: the more standardised, accurate and cost-effective impact management becomes, the greater the chance that impact-linked finance has of becoming conventional practice. Big data initiatives to collect meaningful output and outcome data at scale, such as 60 Decibels[18], provide optimism that it will become increasingly possible to measure impact in a cost-effective, proportionate way in contrast to the complex, bespoke and time-consuming impact measurement procedures that have accompanied outcomes-based financing.

Finally, **the growth of sustainability-linked loans is a parallel and interesting trend.** The Loan Market Association defines sustainability-linked loans to be *"any types of loan instruments and/or contingent facilities which incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives"*[19]; although sustainability-linked loans have also been used in the context of incentivising social performance targets (see BNP Paribas mini case study). In that sense, sustainability-linked loans are conceptually indistinguishable from impact-linked finance, but here we argue for a distinction based on how the tools are used *in practice*.

Sustainability-linked loans are primarily used by mainstream corporates looking to transition towards a more sustainable strategy, whereas impact-linked finance is ideally used by social purpose organisations looking to scale operation and impact. More contentiously, sustainability-linked loans are also associated with more modest price impact (relative to loan size) and less ambitious social and/or environmental targets, focusing on the output (as opposed to outcome) level.

A notable example has come from Enel, an Italian energy group, which issued the world's first sustainability-linked bonds in 2019. More recently, they issued a six-year €1 billion sustainability-linked loan facility where the loan margin is linked to the company's renewable energy capacity. A step-up or step-down of the loan margin may be applied depending on if Enel reached their sustainability performance target (SPT) of 60% by the last day of 2022. As of 30th June 2020, Enel's renewable energy capacity stood at 51.9%. The 'ambitiousness' of the SPT is debatable because as early as November 2018, Enel has predicted 62% of their energy will be emission-free by 2021.

The rise of sustainability-linked loan in recent years signals potential willingness of mainstream investors to forego their returns (even if by a small amount) in exchange of the impact targets being met. For this reason, we did not include sustainability-linked bonds in our discussion, as they are typically characterised by a one-way pricing mechanism where the missing of performance targets would result in financial penalty (i.e. coupon step-up); they are thus conceptually even more distinct from impact-linked finance.

As per **Figure 8**, sustainability-linked loans have been gaining popularity.

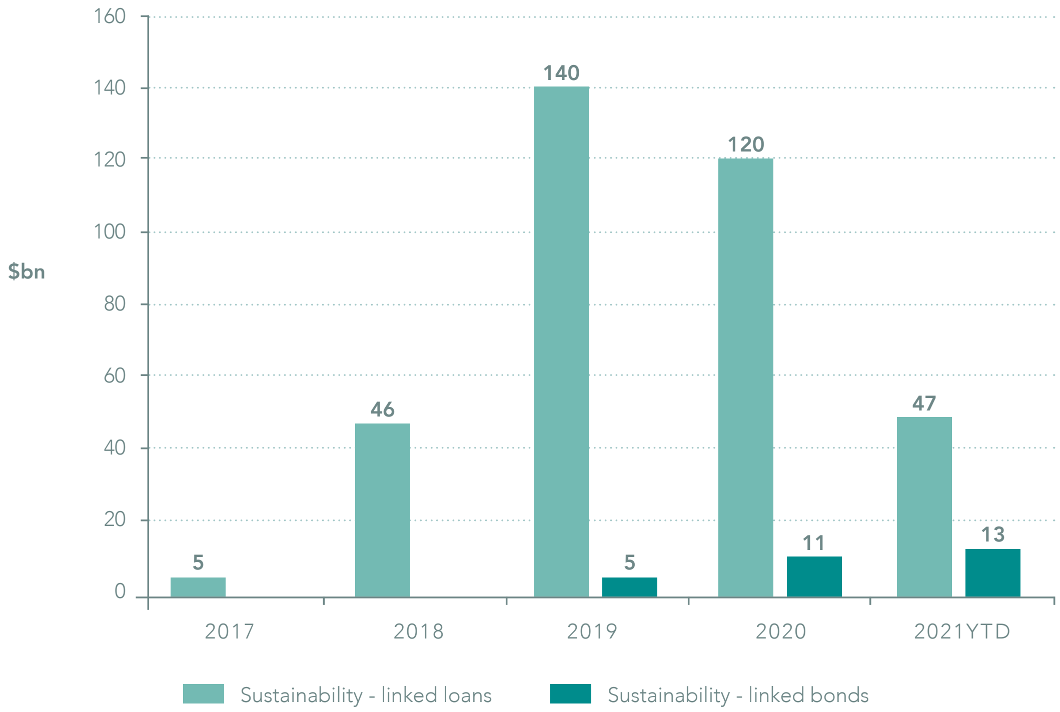


Figure 8. *Global issuance of loans and bonds linked to sustainability performances target (Bloomberg)*

The state of the market and who is doing what in impact-linked finance globally

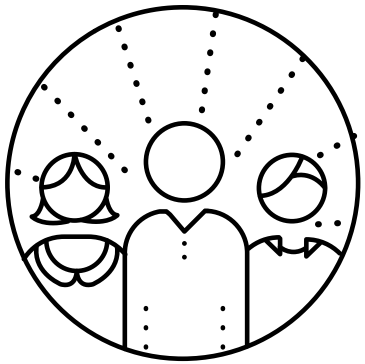
B.5.

State of the market

Interviewees are in agreement that impact-linked finance is a concept rather than an actual market. Activities are fragmented and dispersed, with pockets of innovation, exploration and experimentation but limited awareness among the broader impact investing community. Many interviewees who are part of global or regional impact investing networks had not heard of the term. Practitioners describe the market as 'nascent', 'at the beginning', even 'chaotic' and far away from standardised methodologies, impact metrics or term sheets. There are different actors engaging in pilot tests or small-scale transactions but limited large-scale impact-linked finance facilities.

In practice social and impact investors have been playing with different financing tools and attempting to include impact links for decades, although these have often been under-the-radar and unacknowledged. Roots of Impact and others are attempting to bring more formalisation, consistency and standard market practices to impact-linked finance and it is likely that there will be more tracking of the market in the future.

Sietse Wouters, UBS Optimus Foundation, *'It is the challenge with blended finance to find those parties that are willing to fund first loss and to frame that in the right way. When you frame the leverage in the right way, you frame that you are enabling something much bigger. In the end the pool of investment is potentially huge, but you need to find someone who puts up the first loss or the high-risk component. That is a difficult one.'* [20]



Non-profits/Trusts/
Foundations

Supply: key actors and case studies

Philanthropic capital - trusts, foundations and non-profit investors

They can provide the concessional/catalytic capital to make impact-linked finance work (as few investors may tolerate lower returns in exchange for impact). Impact-linked finance could be a complementary tool to grants and this group may have the type of risk capital which is necessary.

In particular, trusts and foundations are essential within blended finance impact-linked structures as outcome payers or to take on the junior tranche of investment. There is still a question of how appealing this role is for them, even if the additionality (in terms of impact and private sector investment) is high.

There are some 'forward-thinking' foundations engaging across the spectrum of capital who are experimenting with impact-linked finance, such as UBS Optimus Foundation (see mini case study on next page), Rockefeller Foundation,[21] Michael and Susan Dell Foundation[22] and the Global Innovation Fund.[23] These are the pioneers which are engaged in financial innovation related to impact investment. The majority of these transactions have been impact-linked loans. Global Innovation Fund uses impact milestones in their deal tranching to split their investment into tranches based on the achievement of pre-agreed impact goals as well as using impact milestones to price their capital. On the equity side, UBS Optimus Foundation is considering earn backs, where through impact the founders can earn back some equity.

Chris West, Sumerian Partners, *'I always direct my aspirations towards trusts and foundations because I think they have, unlike investors, more ability to look at different instruments of which impact-linked financing fits in.'* [24]

For other trusts and foundations who are starting to engage in impact investing as well as grant-making, impact-linked finance might be a complex proposition which falls between what are different practices, cultures and mindsets related to the grant and investment pots. Although impact-linked finance is a tool which perhaps works best between return of principal and what is termed as market-rate risk-adjusted returns, it could be hard to convince either the grant side to use their subsidy in a more impact-linked finance way (for both regulatory and attitudinal reasons) or the investment side (either out of the endowment or even PRI funds) to consider a tool which carries with it uncertainty, variability and does not conform to habitual investment decision-making. For those trusts and foundations currently working and experimenting in the spectrum of capital in impact investing, impact-linked finance is a clearer and more suitable proposition.

Aunnie Patton Power, Intelligent Impact, *'If we are thinking specifically about foundations, getting them to think about impact investing has been one big shift and now suddenly we are asking them to not just think about doing deals but doing deals with impact milestones and metrics.'* [25]

However, for foundations that have experimented with impact-linked finance, there are several key benefits specific to them as actors:

- Moving foundations **from an input-based grants mentality to an output and outcomes-based mentality;**
- Making the most of their funds: for foundations, impact-linked finance is **good value for money.** Foundations and trusts only pay for actual impact achieved;
- Experimenting with hybrid finance propositions along the spectrum of finance;
- When used in a blended finance structure, **this has led to significant financial additionality** and has brought more mainstream investors into transactions.

As more foundations experiment with the tool and as sophistication increases around impact investing and the possibilities across the spectrum of capital, impact-linked finance could become an increasingly well-used tool.

Mini case study - philanthropic capital

UBS Optimus foundation[26]

About UBS Optimus Foundation: Funded on an annual basis by clients, UBS and staff, UBS Optimus Foundation has been involved in social finance in addition to its grant-making for over five years. It has played a key role in results-based funding, for example as the investor in the Educate Girls development impact bond in India.

Impact-linked transactions and experiences to date:

- UBS Optimus Foundation first became involved in impact-linked finance through the Social Success Note (SSN) in 2018, where Rockefeller Foundation is the outcome payer for Impact Water in Kenya and UBS Optimus Foundation is the investor. The foundation likes this structure and would be happy to continue to do those if there are willing outcome funders.
- It is too early to talk about the track record of the Social Success Note (the evaluation will be over five years 2018-2023), given this is a pilot, the costs of intermediation accompanying the structure is relatively high, which is expected to reduce the potential for scaling up this model.
- Encouraged by what the foundation sees as the benefits of impact-linked finance, it has experimented more recently with less complex structures, including two direct impact-linked loans to investees in Africa which are not intermediated, where impact targets are based on output data and do not require external verification.

Motivation for becoming involved in impact-linked finance:

- Sietse Wouters, '*We see there is a lot of interest from our donors to engage in programs where there is not always the belief that grants will work for everything.*'
- UBS Optimus Foundation believes one of the key advantages of this approach is transparency and flexibility, where there is a continued focus on programmes and problem-solving and partners can always come back to the negotiating table

Investee example

- Type: A 3-year, $400k USD impact-linked loan was provided to Hewatel, an oxygen provider in Kenya
- Impact targets: two key output metrics were defined which the foundation evidenced to greater outcomes: oxygen volumes going to more distant clinics and clinics using oxygen for the first time
- Terms: The investee will pay between 1%-7% interest dependent on the impact achieved

Impact investors/funds

Impact investment funds might become involved in impact-linked finance, but rarely drive them. Interviewees felt that whilst impact investors may be concerned about impact metrics, they are generally not at a particularly sophisticated level when it comes to impact management. Whilst there is certainly greater perceived interest in finding better fund management structures that more clearly integrate impact, the impact investor community is still relatively sceptical about the rigour of impact measurement and management that would for example underlie incentivising impact among fund managers (through impact carry) or to their investees (through impact-linked finance). There has been significant work amongst the impact investing community to find a way of properly incorporating impact into due diligence and decision-making across so that it has the same value and rigour as financial metrics and this could be a precursor to more widespread use of impact-linked finance.

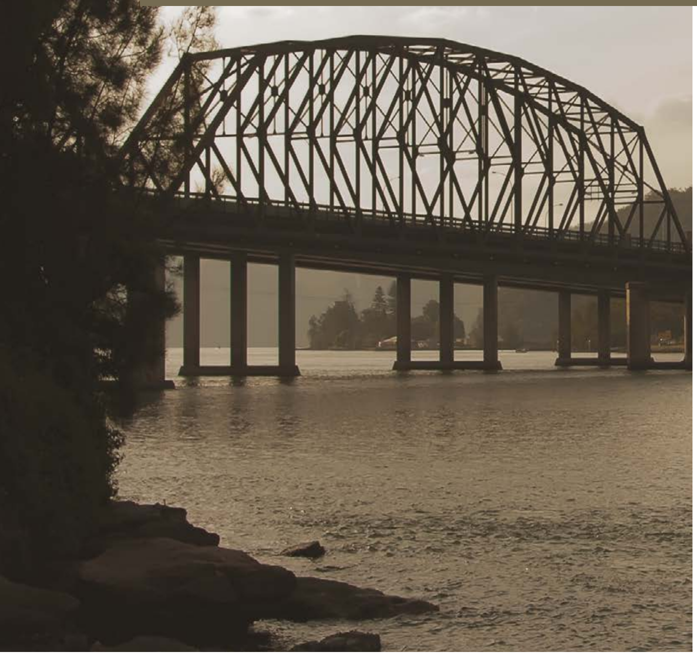
Impact investors who are considering or have participated in impact-linked finance transactions tend to be strongly impact-first[27] and often do not have the financial returns hurdle constraints that many impact investors are operating with. An example is Beneficial Returns, an impact investment fund that provides capital asset financing to leading social enterprises that eliminate poverty and protect the natural environment in Latin America and South-East Asia. It has provided seven impact-linked loans to social entrepreneurs that support a few key impact metrics which, if achieve, result in forgiving the final loan payment. Another impact investor that has conducted feasibility studies into using impact-linked finance within the context of microfinance is Grassroots Capital, although this has not been implemented yet.

The case studies below illustrate there is early activity from impact-first investors related to impact-linked finance. However, the majority of impact investing funds have not moved into concrete activities in terms of incentivising impact. Rather, the majority rely on the intrinsic motivations of investees.

Mini case study - impact investing fund

IIG (Australia) develops BOLD product[28]

About IIG: a leading Australian impact investment funds manager set up in 2013. As of March 31st 2020, IIG had more than $650m in assets under management



Motivation

BOLD aims to meet a gap in the market, *'since it financially incentivises (enterprises) to keep delivering their social or environmental benefits. Other types of finance, like traditional venture funding, or a loan from a standard finance company, can drag a purpose-driven founder away from their mission.'* [29]

Impact-linked transactions and experiences to date:

- IIG has developed a product called BOLD (Beneficial Outcomes-Linked Debt) which provides financial incentives for companies creating positive change.
- The BOLD loan scheme is also backed by Tripple, the Community Impact Foundation, the Disability Impact Fund and the Snow Foundation.

Investee example:

- **Type:** The first impact-linked loan of $600,000 was made in to Xceptional, an IT recruitment firm for people with neurodiverse conditions such as autism.
- **Impact metrics:** an output indicator (number of jobs) as well as an outcome indicator (the wellbeing of those in jobs). Of particular interest to note is that there is a floor agreed for impact (minimum impact level), and each unit of impact is assigned a $ value.
- **Pricing and returns:** the loan, according to IIG, will result in an investor return of between 5% and 15%, The base case for the loan repayment is 4–4.5 years and the maximum terms of the loan is 10 years.

Return Amount Formula:
A= (B x C) – D
Return Amount: A
This is the amount of money the investors can receive back from their investment

Principal Amount: B
The amount of money that the investors loaned the company

Multiplier: C
This is decided by a commercial negotiation, and is one of the variables that defines the maximum return amount

Impact Adjustment Amount: D
This is a variable, expressed in dollars, based on the degree of impact, that reduces the maximum return amount. The calculation and inputs for this are below. This is the incentive mechanism: Depending on the amount of impact (D) the loan amount is reduced

Impact Adjustment Formula:
D = (E – F) x G
Impact Metric: E
This is a crucial metric. It is a number to represent the chosen positive impact. It is extremely important to design a metrics that measures the outcome the parties are trying to achieve. In this case, it's people placed in jobs, who are also happy with their role.

Minimum Impact Level: F
This is the impact baseline. The BOLD incentivises impact above the threshold.

Impact Value: G
This is an amount in dollars ascribed to each instance of impact.

Figure 9. Key mechanisms of BOLD Contract

Mini case study - impact investing fund

On gender-lens result base financial incentives by Camco manager of the-REPP

About Camco & REPP: Camco Clean Energy (Camco) is a fund management company and the investment manager of the Renewable Energy Performance Platform (REPP), which is supported by £148 million funding from the UK's International Climate Finance. REPP is working to stimulate the development of a vibrant, networked and viable market for small and distributed renewable energy projects in African countries. To date, REPP has committed £37 million across 27 investments.

Impact-linked transactions and experiences to date:

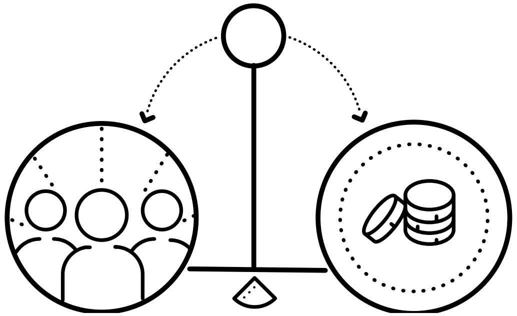
- REPP adopted a gender mainstreaming policy in August 2019, which encourages its investee companies to promote gender mainstreaming by analysing the gender equality situation within the company, country of operation and target sector, and establishing a gender action plan by identifying gender performance indicators and sex-disaggregated targets against an established baseline.
- There are broadly similar gender impact targets that will be agreed across investees. These will, for example, touch on the following areas: increased female labour work force; increased number of women in management roles; upskilling of female employees; promotion of female entrepreneurship; provision of access to credit; female access to infrastructure; and gender mainstreaming in public participation processes.[30]
- REPP is trialling result based financial incentives with companies that have taken sufficient, verifiable action to reach their gender action plan targets.
- Investees are enthusiastic to participate, with nearly all investees having expressed interest to implement the gender mainstreaming policy. Only one investee so far has a plan in place, but this is expected to grow as gender action plans are finalised.
- REPP's investors and Board are supportive of this initiative, since they are able to see the business case for gender diversity in the medium and long-term.

Motivation for using impact-linked finance:

Laura Lahti, Impact Manager, Camco, said: *'There is considerable evidence and broad international agreement that advancing gender equality works towards reducing poverty, supports inclusive growth and it is particularly crucial to addressing the climate change and energy challenge. However, the renewable energy sector and the energy sector as a whole remain very male-dominated. We recognise this gap in the market and have taken steps to address it by actively promoting increased diversity not only in our investees but also at the project level to ensure fair and sustainable project implementation.'*

Investee example:

- Virunga Power Holdings Limited's gender journey started in October 2019 when the company identified its gender baseline based on the UN Global Women's Empowerment Principles Gender Gap Analysis Tool. The baseline and draft gender action plan (GAP) were reviewed by REPP to ensure specific and measurable indicators, actions and targets. The GAP was finalised in July 2020 and contains 57 actions and targets in three main areas: corporate; project construction and operation; and community. As REPP's investment manager, Camco monitors the implementation of the gender action plan through annual investee reviews.



Development finance Institutions and donors

Development finance institutions and agencies

Development finance institutions could be key players in this market and many are already experimenting in this area. There are pockets of activity specifically within a blended finance context as illustrated below in the case studies of IDB Invest through its blended finance facility and the Swiss Agency for Development and Cooperation with IDB Lab and SIINCs. There is interest from DFIs in SIBs/DIBs and impact-linked finance, principally as a way of getting greater transparency and focus on development outcomes .

For DFIs, this transparency and incentivisation has been somewhat overlooked in their investments as compared to their grants where impact measurement and targets are arguably more advanced. In addition, DFIs are starting to develop and implement sophisticated and well-resourced impact management frameworks that often go beyond the level of measuring impact at transaction-level to measuring systemic and market impacts.

Principle 1: Anchor blended finance use to a development rationale

Principle 2: Design blended finance to increase the mobilisation of commercial finance

Principle 3: Tailor blended finance to local context

Principle 4: Focus on effective partnering for blended finance

Principle 5: Monitor blended finance for transparency and results

Figure 10. *OCED Blended finance principles.*[31]

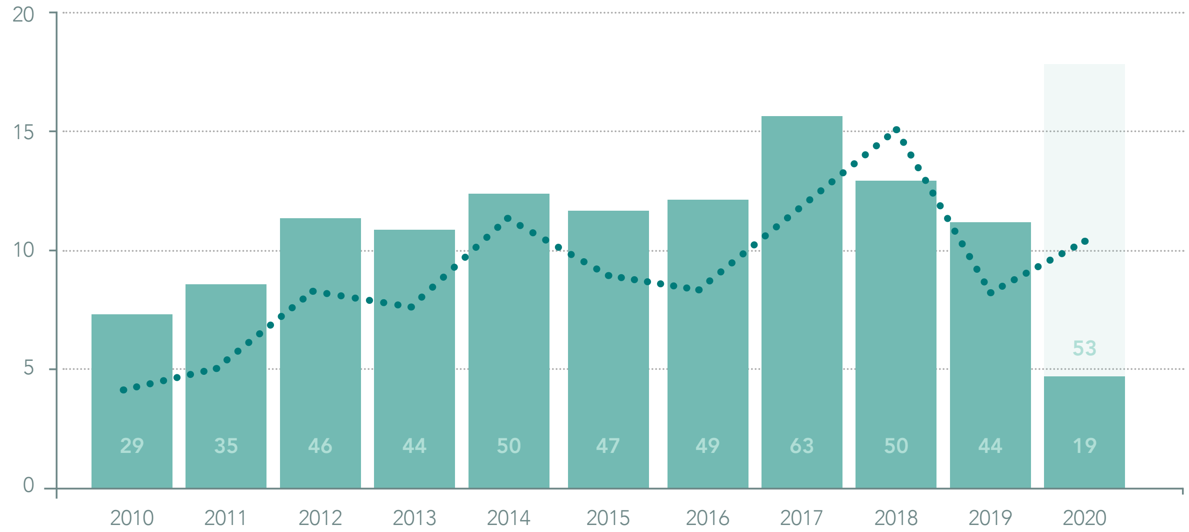


Figure 11. *Blended finance market transaction counts from 2010-2020* [32]

Impact-linked finance has particular relevance for DFIs within the realm of blended finance. The OECD's blended finance principles underline how far DFIs and other public sector actors are being encouraged to explicitly set impact targets and metrics and track them in a transparent way. In the recent guidance on these blended finance principles, impact incentivisation is mentioned as a tool that can be used to achieve this aim (within the context of Principle 1). As DFIs grow their use of blended finance, it is likely they will increasingly explore impact-linked finance.

For Roots of Impact who have been working with different DFIs and development agencies; impact-linked finance is a way of directly linking rewards to the achievements of development outcomes as shown in **Figure 12** below.[33]

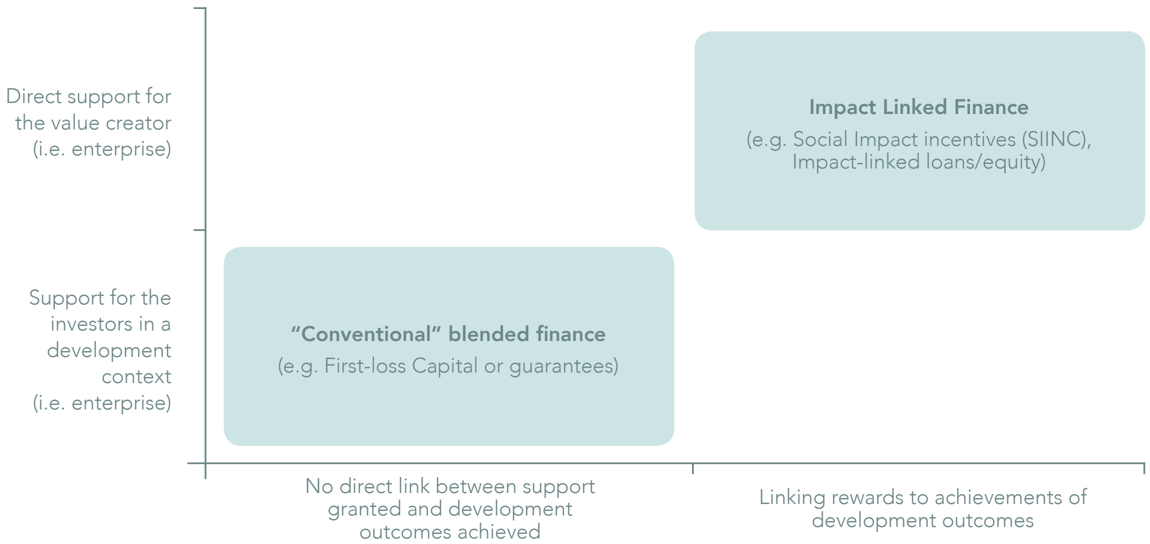


Figure 12. *Positioning of impact-linked finance and 'conventional' blended finance*

Mini case study - DFIs

IDB Invest uses impact-linked finance tool within blended finance facility[34]

About: IDB Invest is the private sector arm of the Inter-American Development Bank group. It aims to be the partner of choice for the private sector in Latin America and the Caribbean. It finances projects to advance clean energy, modernize agriculture, strengthen transportation systems and expand access to financing.

Impact-linked tools, transactions and experiences to date:

- IDB Invest has used impact-linked finance in over half of its $800m blended finance facility in the gender and energy sectors, focused on large financial institutions and corporates which generate ripple effects in the market and can create wider behavioural changes.
- The blended finance team has identified impact-linked finance as a tool that appears to work for specific types of market failures such as market inertia, information failure and competitiveness issues.
- Pricing incentives are used as a short-term subsidy to accelerate market development (particularly in the case of climate mitigation) or to address the issue of inertia (particularly in the case of gender, diversity and inclusion).
- For IDB Invest if it is able to identify the low-hanging fruit in terms of market failures, it doesn't take a huge amount of subsidy to jumpstart the market.
- IDB Invest has developed specific impact target-setting and pricing strategies, which involve assessing the opportunity cost of the incentive, conducting a 'price discovery' exercise and evaluating the market distortion created. In this way the benefits of using the incentive are balanced against the risks, in particular the risk of crowding out private capital.

Motivation

For Matthieu Pegon, *'The whole point of outcome-based financing or impact-linked financing is that it creates a better alignment of incentive between the recipient of the incentive and the provider.'*

Investee example[35]:

IDB Invest structured and subscribed to the world's first gender-focused social bond issued by Colombian bank Davivienda, which will be used to finance the growth of its women-led SME portfolio (WSMEs) and the purchase of social interest houses by women in Colombia. The growth of WSMEs is linked to a $300,000 bonus payment (to be issued over a period of five years in the amount of $60,000 with progress assessed annually) based on the expansion of the WSME portfolio.

Mini case study - DFIs

Social Impact Incentives (SIINC) co-created by Roots of Impact and the Swiss Agency for Development and Cooperation (SDC)

Impact-linked tools, transactions and experiences to date:

- Roots of Impact first developed the Social Impact Incentives (SIINC) model in partnership with IDB, the Swiss Agency for Development and Cooperation (SDC), Ashoka and New Ventures in 2016
- The SIINC was designed with the view to combine impact bonds with a market-based mechanism. As in an impact bond arrangement, a typical SIINC transaction is focused on outcomes and normally involves three actors: the social enterprise, the outcome payer, and the investor. The key distinction is that in a SIINC, the outcome payer pays the premium directly to the social enterprise based on its social performance, as opposed to the investor as in a SIB or DIB. This approach is thought to align interest of all parties involved, since impact is maximised using the outcome payer's fund and the investor is able to achieve both social and financial return. More importantly, the social enterprise is rewarded with cheaper capital to scale operations having proven its solution to be effective, and in turn, is placed in a more attractive position to leverage further capital from impact investors.
- As of January 2021, 6 SIINCs have been completed, 13 are in preparation, and 37 are in the pipeline, covering geographical regions including Latin American, Asia, Africa and the Middle East. The SIINC model is sector agnostic, although previous transactions have touched on the themes of health (e.g. Clínicas del Azúcar), employability (e.g. Inka Moss), and affordable clean energy (e.g. Village Infrastructure Angel, EnDev); SIINCs in development will address themes such as agriculture, WASH and financial inclusion.
- In theory, the basic mechanics of SIINC is compatible with both growth-stage social enterprise and large corporates, although it may be used to achieve different goals. In the former scenario, a SIINC transaction can increase the marginal income to align with the costs of impact delivery, thus improving the income bottom line. In the latter scenario, the SIINC could encourage a commercially successful and impact-conscious business to address underserved (and less lucrative) markets to deepen its impact, thus improving the impact bottom line.
- In 2020, Roots of Impact in collaboration with Kaya Impacto SDC, VIWALA, Open Road Impact Fund, Ashoka, New Ventures, LeFilConsulting developed the COVID-19 impact-linked emergency loans based on the SIINC model, with SDC as the outcome payer. This aims to provide social enterprises with a loan of between $85,000 and $350,000 for up to 3 years, with agreement of partial loan forgiveness upon demonstration of impact.

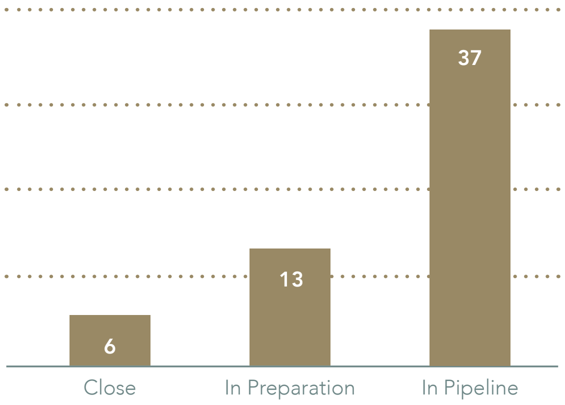


Figure 11. Number of SIINC transactions to date

More about SIINCs

Investee example: Clínicas del Azúcar

Social enterprise Clínicas del Azúcar provides affordable and specialised diabetes care in Mexico through a network of retail-type health clinics. Clínicas del Azúcar's model is particularly effective in addressing the unmet medical need. After just six years of operation, they became the largest private provider of specialised diabetes care addressing more than 50,000 patients, offering the treatment at 40% of the average price with 95% of their patients able to experience specialised treatment for the first time in their lives.

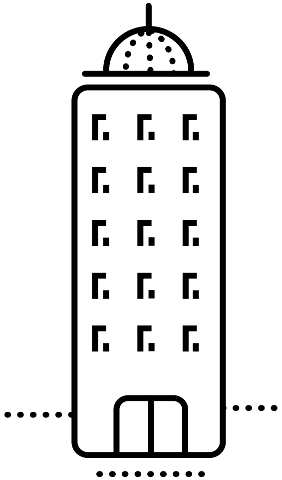
In 2017, Roots of Impact – in partnership with IDB Lab, the SDC, Ashoka and New Ventures – structured the first ever SIINC to allow Clínicas del Azúcar to scale their operations and impact. By leaveraging a total of $275k in SIINC payments, Clinicas del Azúcar was able to raise a further $1.5 million through equity from impact investors. To ensure Clínicas del Azúcar was able to continue scaling their operation while serving clients at the bottom of the pyramid (BoP), the incentive was structured such that the premiums were linked to the ratio of BoP clients and the treatment effectiveness for BoP clients.

The company achieved well above their social outcome's targets over the agreed 2.5 years and received their maximum in impact-linked payments ahead of schedule. In all, both the equity financing and impact-linked payments has enabled Clinicas del Azúcar to significantly expand its services while growing the percentage of low-income patients from 32% to 37%.

A 2020 report prepared by an independent researcher[36] confirmed Clínicas del Azúcar's BoP proportion to have increased by 6% as a result of the SIINC (causal effect), and this did not influence their ability to attract non-BoP patients. More importantly, the report showed that treatment effectiveness has been maintained; on average, patient HbA1C level reduced by 2 points and the effect was observed even 24 months after treatment.

The evaluation concluded that a conservative estimate is that, by year 5, there will be more than 4,000 additional BOP patients per annum. Cumulatively, this will result in 10,000 additional BOP patients in that year. In 2019 Clínicas del Azúcar managed to raise an additional $6 million in funding from the International Finance Corporation (IFC), the Inter-American Development Bank (IDB) and other investors, which will help the company scale to 100 clinics in the next few years.

CASE STUDY



Mainstream capital and financial institutions

Mainstream capital/finance

One of the original motivations for impact-linked finance is to crowd in private capital, particularly within blended finance structures. A key question is how far such tools and structures are appealing and attractive to more mainstream, commercial investors and financial institutions. On the one hand the growth of sustainability-linked loans appears to signal that commercial investors are willing to make small basis point interest rate reductions in return for impact, although the jury is out on whether this is a marketing exercise. The key argument for commercial investors is that the focus on sustainability reduces risk.

Some observers who have been involved in impact-linked finance, are very optimistic about the interest of mainstream capital in such products (particularly blended finance), allowing them to reach scale and more systemic change. Others remain unconvinced that this tool will look and feel familiar enough for mainstream investors, with the variability and complexity around impact targets potentially too esoteric and niche.

It is interesting to note that there are mainstream players experimenting with this tool and to understand their motivations and experiences, as per the mini case study of BNP Paribas below.

Mini case study

BNP Paribas

About BNP Paribas: is the European Union's leading bank and key player in international banking. BNP Paribas has a presence in 68 countries, with more than 193,000 employees including nearly 148,000 in Europe and Euro 44.3bn of revenues in 2020. International Finance Review recently awarded BNP Paribas 'Bank of the Year for Sustainable Finance', highlighting the Bank's leading role in supporting clients as they address critical environmental and social challenges.

Tools, transactions and experiences to date:

- BNP Paribas' first experience with sustainability-linked loans (previously termed the positive incentive loans) was in February 2018, where they acted as the sustainable coordinator of a banking pool that issued a €2 billion revolving credit facility for Danone, a French multinational food company. A discount or premium was applied to the margin (reviewed every 12 months), depending on Danone's average ESG score and B Corp Certification.
- BNP Paribas has issued sustainability-linked loans that embed employability targets (e.g. L&Q – see investee example below), education targets (e.g. Pearson – the number of people educated), biodiversity metrics (e.g. UPM – a net positive impact on biodiversity in the company's forests in Finland), sustainability targets (e.g. Solvay – greenhouse gas reduction) and the more conventional ESG scores (e.g. Thames Water – GRESB infrastructure score). More recent SLLs include for Tesco which became one of the first UK reatilers in January 2021 to establish an SLL.
- The sustainable finance market is evolving rapidly, and Delphine Queniart, Global Head of Sustainable Finance And Solutions at BNP Paribas Global Markets noted, "a noticeable progression is that innovation in sustainable capital markets is extending beyond the bond market into other solutions such as convertible sustainability-linked instruments"
- BNP Paribas sees sustainability-linked loans (and bonds) as important tools for catalysing the 'climate transition' and has been actively involved in the drafting of the Sustainability Linked Loan Principles, which were designed to be 'non-prescriptive' given the immaturity of the market. It has also been active in various coalitions for impact, especially in the road to COP26.
- Despite the ongoing economic and social impacts of the Covid-19, BNP Paribas sees that social bond issuances are booming both in volume and in percentage of the total sustainable supply.

Social housing sustainability linked loan example

- London & Quadrant (L&Q) is a UK-based charitable housing association with a core focus of providing social housing at below market rents for people on low income.
- In 2018, BNP Paribas issued a five-year £100 million credit facility for L&Q.
- The interest rate of the loan was linked to the output of L&Q's Independent Lives Programme, such that BNP Paribas would apply an undisclosed discount on the margin if L&Q succeeds in getting at least 600 residents back into work in the first year; with the target increasing by 25 residents in subsequent years.
- The pricing terms were such that L&Q may face a premium if it did not reach these targets. The loans also allowed for environmental key performance indicators to be added later in the life of the facility, supplementing the existing interest rate discount available to L&Q.
- While the proceeds of the loan can be used for general corporate purposes, L&Q intends to reinvest any savings achieved on the margin into social and community projects.
- This was the first sustainability-linked loan in the UK housing association sector. BNP Paribas has since issued sustainability-linked loans to other UK housing associations including Optivo in 2019 and Clarion in 2020 with similar impact metrics.

Demand: key actors and case studies

Social enterprises

The most common recipient of impact-linked finance are social enterprises. A key question is how far social entrepreneurs need impact-linked finance and how much demand there is for it. At the moment, it does seem to be more 'push' than 'pull', where investors are approaching or stimulating the market with this product offering. However, as an indicator of demand, where open calls have been used to generate demand there has been a very positive response. For example, in 2020 Roots of Impact and Aqua for All launched the programme 'Social Impact Incentives for Water, Sanitation and Hygiene'. In the first call for applications, 140 organisations from 33 countries applied from across Asia, Sub-Saharan Africa and the MENA region.

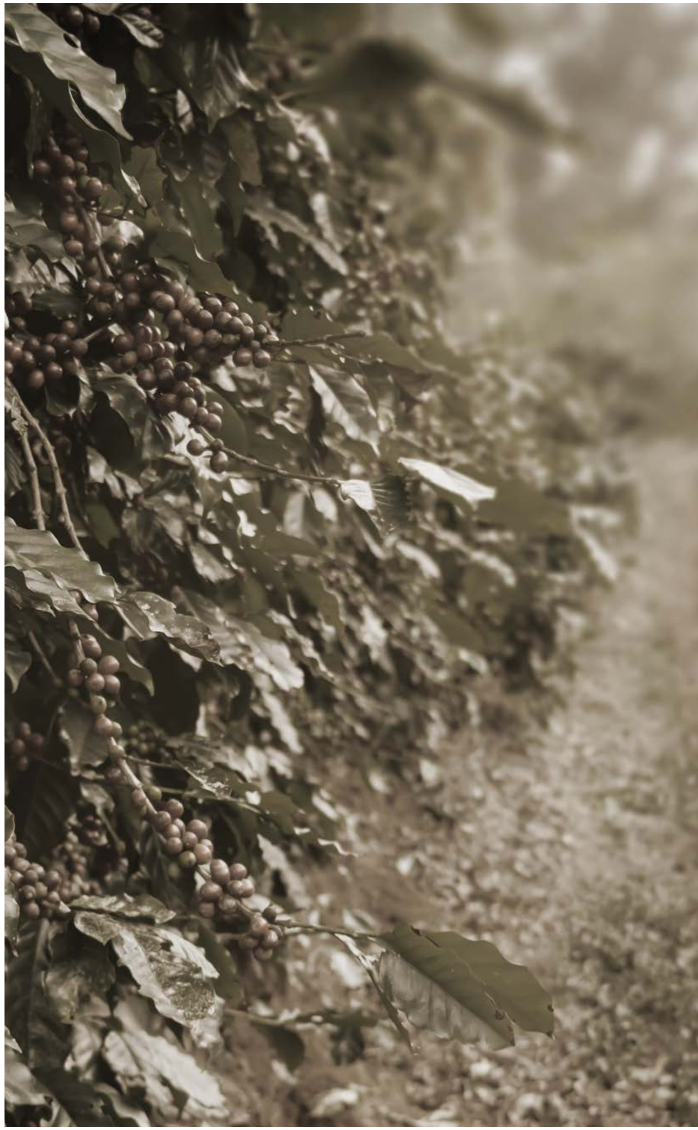
For those who have worked on impact-linked finance transactions, it appears to be the case that some entrepreneurs get it and understand quickly how this tool can help them and their business. For example, one entrepreneur Greg Krupa CEO of Novulis, discussing a potential SIINC transaction is quoted as saying, 'thanks for motivating us to grow faster and scale smarter.' For others it might appear over-complex and require significant education. Often there needs to be strong capacity-building and technical assistance that will sit alongside the impact-linked finance to support the social business/SME in achieving some of the targets.

Priscilla Bioardi, '*We need to find entrepreneurs that are open-minded, because it's a learning process, it's a lot of work. There is a lot of convincing that you need to do for the social entrepreneurs that this is an advantage for them. They will always try to get a grant and if they can't maybe equity, and then maybe these kinds of structures because there are strings attached, and requests, and requirements or at least this is their perception.*' [37]

Whilst there is the obvious and clear attraction of cheaper finance if social entrepreneurs reach impact goals, as well as the possibility of raising additional finance through blended finance structures, entrepreneurs are being asked to take on a level of risk related to achieving impact which they may not be comfortable with. There might also be concerns amongst social businesses of the consequences of accepting concessional capital for follow-on fundraising.

NGOs with earned revenue streams

Impact-linked finance can be used for NGOs with revenue streams since most NGOs are allowed to take on debt. The case study below is of Root Capital which is a non-profit lender. Roots of Impact is currently preparing a transaction with a non-profit organisation as part of the Water, Sanitation and Hygiene programme mentioned above. The major issue with NGOs and non-profits is that they can typically be quite risk averse and so it may be harder to structure impact-linked finance transactions with them.



Mini case study: social enterprises

Root Capital[38]

About Root Capital: founded in 1999 by Willy Foote, Root Capital works in Latin America, sub-Saharan Africa, and Southeast Asia. It supplies agricultural businesses with financial capital and training to help them grow. It has worked with more than 700 clients, representing 1.3 million farmers and their families.

Katie Naeve, *'I like that it incentivses us to have a greater impact. Rather than funding our activities, it funds us to focus on outcomes. I like that the support is directly targeted to the data. It is based on numbers. It is based on Root Capital's own experience. And it's based on impact criteria that all parties agree upon.'*

Impact-linked transaction and experience:

- Root Capital was the recipient of the third SIINC structure which incentivised them to reach down market to make loans that would otherwise be unprofitable for them. For Katie Naeve, *'It really allowed us to double down on lending for early stage businesses for which the costs to serve would otherwise be prohibitive.'*
- Root Capital received cash incentives of $1,000,000 (approximately $25,000 per loan for up to 40 loans) over a three-year period
- Impact criteria were that the loans needed to be a) high additionality (the borrower could not access the loan on the same terms from anyone else) or medium additionality (the borrower could only access the loan on the same terms from a social lender); and, b) loan sizes that do not produce loan revenues that offset the cost to make and service the loan i.e. below $500,000. There was also a criterion for c) number of loans for new clients as well as a bonus payment for d) lending to gender inclusive businesses (additional $1,000 per loan).
- These impact criteria were developed in partnership with Roots of Impact, the intermediary who put the transaction together and validated the data, as well as the funders of the project IDB Lab and Swiss Agency for Development, and Cooperation. IDB Lab also provided $550,000 to Root Capital to provide complementary technical support to agri-businesses.
- The nearly three dozen agri-businesses supported by the Root Capital loans went on to generate almost $50 million in revenue. They paid $41 million directly to smallholder farmers in Colombia, Costa Rica, Guatemala, Honduras, Mexico, Nicaragua and Peru. Already four of those businesses have been able to access new loans from other sources and 56% have grown their annual revenues, at an average growth rate of 41%.
- Based on the success of the first SIINC, Root Capital will now leverage an additional $750,000 in SIINC outcome payments to deploy roughly $6million in loans to 25 early-stage businesses in Latin America.

Corporates

Impact-linked finance has been used by impact investors in partnership with the public sector to stimulate public good outcomes in the private sector. The case study on IDB Invest illustrated how this DFI used impact-linked finance in particularly to incentivise large corporates around gender, diversity and inclusion dimensions. Moreover, as corporates become more interested in demonstrating sustainability, but perhaps require greater incentivisation to do so than social entrepreneurs where impact is often embedded in their DNA / business model, impact-linked finance could be a very useful tool. Indeed, it could be that the use of impact-linked finance for corporates is a major growth area. Rockefeller Foundation sees great potential here and has been approached by different corporates and banks to consider impact-linked finance options. An example was that Rockefeller Foundation was considering participating in a partnership with a multinational dairy producer in Africa which loses a significant amount of revenue due to malaria. At the same time there is a big trend among philanthropists for malaria prevention. Impact-linked finance could be a way of co-ordinating these efforts, whereby the corporate would experience increased revenue from the NGOs malaria prevention work and this could be incentivised and quantified. As the world moves to increasing recognition of the interconnection of challenges and the need for partnership across sectors, tools that can align incentives across different partners will become more important and useful.

Over a decade ago, Canada's pioneering social finance organisation, Social Capital Partners, worked on developing at scale impact-linked finance programmes to improve employability outcomes for vulnerable/disadvantaged groups (such as homeless, social assistance recipients, previously incarcerated people, single mothers, high-school drop-outs) alongside the public and mainstream finance/corporate sectors as is illustrated in the case study below.

Lorenzo Bernasconi, formerly Rockefeller Foundation,
'There is always excitement when you are able to align core, strategic goals of corporates with what non-profits or philanthropic actors are good at for example in securing and strengthening the resilience of supply chains. There is a lot of opportunity there if we think about it in creative ways.' [39]

Mini case study - corporate

Social Capital Partners Canada[40]

About Social Capital Partners: founded as a non-profit organisation in 2001, Social Capital Partners (SCP) is dedicated to discovering and testing ways in which market-based solutions can address systemic societal challenges, with a particular focus on generating positive employment outcomes. SCPs unique model – acting as an incubator of ideas, testing and funding their implementation, and supporting others to scale solutions that work – has evolved significantly since its inception.

Impact-linked transactions and experiences

- From 2001-2006 SCP identified and funded a portfolio of social enterprises across Canada that targeted specific populations groups with barriers to employment. It deployed a combination of funding – grants, loans, and equity – together with support for measurement (social return on investment), using a venture philanthropy approach.
- Acknowledging the limitations of this model in terms of scalability – each business required a significant investment of resources, time, and patience – SCP tested how they could instead find ways of embedding a deliberate "social outcomes" lens into already scalable business models, which led them to consider working with established private sector franchises that could provide good jobs and career pathways.
- The Community Employment Loan Programme (CELP) was established in 2006 to facilitate access to subordinated debt financing for small business owners (franchisees) who committed to hiring disadvantaged workers via community agencies and employment service providers.
- The terms of the CELP loans were linked directly to employment results - for every employee hired from one of its community partners, the interest rate on the loan decreased. These were codified into loan agreements that set out a schedule of business and hiring growth over the term of the loan; for example, rates could drop from 8% at inception to up to 5% if the business met its anticipated growth and recruitment targets over a 3 or 5-year period.
- While the primary data points for interest rate adjustments were recruitment numbers as well as retention – an employee had to stay for at least 3 months to be counted, and interest rates were adjusted quarterly – other data points were tracked in an excel model to understand how employers were supporting career pathways e.g. training investments, shifts in roles or responsibilities, and qualitative insights from employers on employee performance.
- These results were discussed with individual franchisees regularly and shared in aggregate with the entire franchise on an annual basis to provide recognition for outstanding performers.
- While the loan had a positive incentive in terms of the interest rate savings, employers frequently noted that the most significant benefits were the efficiency in the hiring and matching process.
- SCP also instituted conditions that mitigated behaviours that were not consistent with the principles of CELP e.g. if there was evidence that franchisees were not making an effort to hire and retain from disadvantaged communities, SCP had the ability to recall the loan or activate a penalty clause that increased interest rates: *'we had the carrot of reductions in rates to make this happen, but we've also got the stick to call your loan if you don't do this well.'*
- Starting out in automotive finance where it was very successful, SCP moved to home healthcare franchises.

Scaling Up

- In 2014, RBC Generator, the investment arm of RBC's Social Finance initiative purchased $250,000 of SCP's Community Loan portfolio and added an additional commitment of $450,000
- Due to the success of the impact-linked finance programme, SCP started to raise its ambition levels to creating systems-wide change, from the way government supports disadvantaged workers to how community and hiring agencies work.
- SCP partnered with the public sector, commercial banks and corporate unions to scale small impact-linked business loans for entrepreneurs in a programme called 'rate drop rebate' tied to these entrepreneurs working with agencies helping more vulnerable people get back to work.
- Whilst a potential multi-sectoral partnership approach to scale, there were some barriers to the programme's success, such as the high costs of running the programme with a national network across multiple industries and the education requirements of the commercial banks and credit unions. In particular, the customer-centric focus of the initial CELP programme, where employers were seen as the customer (rather than the candidate), was not maintained as the programme was managed by the public sector without SCP as intermediaries.

Geographies and sectors where impact-linked finance has been used

Impact-linked finance is currently primarily used within a developing world context, by DFIs and catalytic funders. One of the key objectives of the research is to understand how far impact-linked finance might be suitable in the developed world context (specifically in the UK). There are no specific barriers to use in the developed world context that have been identified, indeed there could be advantages for example less currency risk and low-interest rate environments.

Moreover, domestic impact investors might potentially be more willing to trade-off on financial returns if they feel that they are able to touch and see impact generated. There are cases of use by domestic impact investors (such as the BOLD investment by Australian IIG and the employment-related impact-linked loans pioneered by Social Capital Partners in Canada). In the UK more recently several examples of impact-linked finance have emerged driven by pioneering foundations such as Esmée Fairbairn Foundation and Nesta Cultural Impact Development Fund.

Why the focus to date on developing markets? There appears to be more exploration and experimentation in the developing world due to a combination of factors: greater interest among catalytic foundations/impact investors in the developing world; stronger use and experience of blended finance structures in these markets; the supporting role of development agencies; lower cost of impact verification and transactions. There have also been important intermediaries, such as Roots of Impact, who have primarily focused on market building and educating in emerging economies.

To date, impact-linked finance has been somewhat sector agnostic, with evidence of use in employability, education, access to water, health, energy, gender and agriculture. Are there criteria to determine the appropriateness of certain sectors for impact-linked finance? Stronger standardisation and comparability of impact measures in certain sectors (such as energy where the price of carbon is benchmarked) could facilitate impact-linked finance approaches. In addition, the maturity and sophistication of investees is important, where social businesses or NGOs with a stronger track record, data analysis and a clearer understanding of what impact is possible will be more willing to take on the impact risk inherent in this tool and can potentially be better and more equal partners in transactions.

Please see **Figure 13** below for examples of impact-linked tran-sactions by sector

Track record

There is limited track record to date for impact-linked finance, in particular: how far the incentives generated impact additionality and financial additionality, what percentages of impact targets are hit and thus what type of cost of capital reductions investees are experiencing, and the path of social enterprises after the impact-linked finance (in particular, the sustainability of the impact approach that has been incentivised). This lack of track record acts as a barrier to impact-linked finance's growth.

	Case study	Impact targets
Agriculture	Through the **Global Innovation Fund**, Nigeria-based social enterprise **Babban Gona** received impact-linked debt funding to sustainably improve the lives of smallholder farmers through an innovative agricultural franchise model that includes the provision of end-to-end farming services; for example, members receive credit, training, agricultural inputs, marketing support and other key services	Undisclosed
Arts/Culture	**Nesta's Cultural Impact Development Fund** (CIDF) offers impact-linked loan or quasi-equity funding to arts and cultural organisations looking to improve social outcomes and achieve financial resilience. So far, CIDF has provided impact-linked funding to four organisations: **InHouse Records, IRIE! dance theatre, Pop Up Projects and Saffron Hall**	*Depends on the individual organisation (undisclosed)*
Education	As part of a pilot initiative, the **Michael and Susan Dell Foundation** provided impact-linked loans to two school financing companies **– the Indian School Financing Compnay** and **Varthana –** which were dedicated to transforming affordable private schools in India	Improvement in students' test score by 5-10 points after two years of loan term (relative to baseline measured at the start of loan term)
Employability	**IIG** issued its first impact-linked loan to **Xceptional** – a platform focused on connecting job seekers on the Autism spectrum with companies requiring tech talent	The number of individuals on the spectrum placed in suitable jobs resulting in meaningful improvement in life (validated by a wellbeing survey)
Energy	**Roots of Impact,** in partnership with **IDB Lab, the SDC, Ashoka, New Ventures,** developed a SIINC-based cash incentives scheme for **Village Infrastructure Angel (VIA)**, a social enterprise that provides poor communities worldwide access to affordable, renewable energy. VIA was looking to scale its operation in Honduras and to promote wider adoption of solar-powered community mills. Given agro-milling is traditionally a male-centric business, the SIINC payments were triggered by impact metrics linked to female empowerment; these included lease contracts signed with female agents, time saved in manual labour for women, and additional economic value created for the communities as measured through hand-made goods in lieu of payment for the solar-powered mill.	(1) Lease contracts signed with female micro-entrepreneurs (2) Number of hours of manual labour saved by women (which is an indirect measure of how effective the mill operation is) (3) Goods provided in lieu of payment for the solar-powered mill; this would encourage women in the local communities to convert time saved from mills to producing more locally crafted goods
Gender	**IDB Invest** structured and subscribed to the world's first gender-focused social bond issued by Colombian bank **Davivienda,** which will be used to finance the growth of its women-led SME portfolio (WSMEs) and the purchase of social interest houses by women in Colombia. The growth of WSMEs is linked to a $300,000 bonus payment (to be issued over a period of five years in the amount of $60,000 with progress assessed annually)	The expansion of WSMEs portfolio from 20% to 27% (~6,500 loans)
Health	A SIINC transaction was arranged to provide **Clínicas del Azúcar** with cash incentives to scale its operation while addressing underserved market. Clínica del Azúcar is a network of health clinics in Mexico that provides specialised diabetes care that are affordable and accessible to all	(1) The ratio of bottom of pyramid (BoP) clients across the health clinics (2) Treatment effectiveness for BoP clients, as measured by HbA1C level
Water	**Yunus Social Business** and the **Rockefellar Foundation** co-developed the Social Success Notes (SSN), which reduces the cost of debt funding for high impact social enterprises and rewards risk-bearing impact investors through the involvement of an outcome payer. The first SSN was structured for Impact Water, a social enterprise that installs water purification systems in Uganda. The achievement of pre-determined impact target will see the bonus payment provided by the Rockefeller Foundation (the outcome payer) split between Impact Water (the investee) and **UBS Optimus Foundation** (the investor).	Installation of 3,600 water purification systems over 5 years

Figure 13. *Examples of Impact-Linked Finance by Sector/Issue*

B.6.

Key learnings from impact-linked finance practice to date

Whilst there is limited track record, there are certainly some very interesting findings and insights from practitioners about a range of key dimensions of impact-linked finance which will be treated in turn: developing pipeline; deciding impact targets and verification and pricing the impact incentive.

Pipeline

Roots of Impact, which has most experience of implementing impact-linked finance has operated a more 'traditional' approach to finding appropriate investees, mostly through open calls where its partners, such as IDB and IDB Lab have strong local networks and outreach capability. For those not using open calls, such as UBS Optimus Foundation, sourcing pipeline can be challenging – this happens through conferences, webinars and incubators/ accelerators. As investors and intermediaries start to understand and develop impact-linked finance transaction capabilities, this could help pipeline to emerge.

Whilst each investor will have their own criteria for assessing pipeline, it is useful to understand the approach of Roots of Impact and SIINCs. They state the following selection criteria for potential impact-linked finance investees as important:

- Strong evidence of positive impact on disadvantaged target groups
- High scalability and mid-term potential for commercial self-sustainability or public contracting
- Direct and measurable outcomes (trackable and attributable to solutions)
- Market failure: deepening of impact and targeting highest impact areas e.g. serving very low income groups or more rural areas, may (initially) lead to higher risk and lower profitability

Setting impact targets

For practitioners, setting impact targets is an art, rather than a science, and requires a strong understanding of impact management, the investee and their historic impact track record, as well as an openness as an investor to work with the investee and their beneficiaries on what impact targets might be most meaningful for them, rather than imposing them 'from above'.

Apart from in the energy sector, where there are greater universal impact targets such as tons of CO_2 saved, each investee will most likely have impact targets that are more specifically relevant to them. Impact target standardisation which might be useful for investors to measure the relative impact of different interventions is often not meaningful for individual investees with different business models and impact intentionality.

Matthew Grimes, Cambridge Judge Business School, *'I think the question of what are fair targets starts moving organisations towards more customised proxies that are related to the specific organisation and less standardised across organisations.'*[41]

The complexity of setting impact targets also depends on how sophisticated the investee is in terms of their understanding of the impact they are creating or would like to create and how far they have strong impact measurement systems in place to measure and validate this.

Rachel Bass, GIIN, *'If you think about having a financial incentive linked to some type of performance target, then you need to be able to set a quantitative time-bound performance target that is both achievable and aspirational. You'll need to have some background evidence around what level of impact performance is appropriate to target within a given strategy to then inform broad targets and guide more discrete milestones. There is currently a significant knowledge gap around what typical performance might look like and how it varies among different strategies.'*[42]

- **Output or outcome:** the majority of impact-linked finance practitioners are using output rather than outcome targets. This is based on the trade-off related to the cost to measure outcomes (normally significantly greater) as well as the complexity of contribution and the longer-term nature of achieving outcomes. Best practice when using output targets is to have strong evidence that these outputs generate outcomes (either primary or secondary evidence).

  In some cases, investees do not yet have a strong impact thesis and measurement system and it is a case of working with them to develop these. Although the use of output targets is more common in impact-linked finance for pragmatic and cost reasons, outcome targets potentially are more liberating for the investee who is given relative freedom as to how to achieve the outcomes, reducing problems of rigidity and lack of innovation associated with fixed targets. Indeed, with outcomes the onus is on the enterprise to produce strategies which are in line with their plans, with greater flexibility in determining how best to generate the desired results.

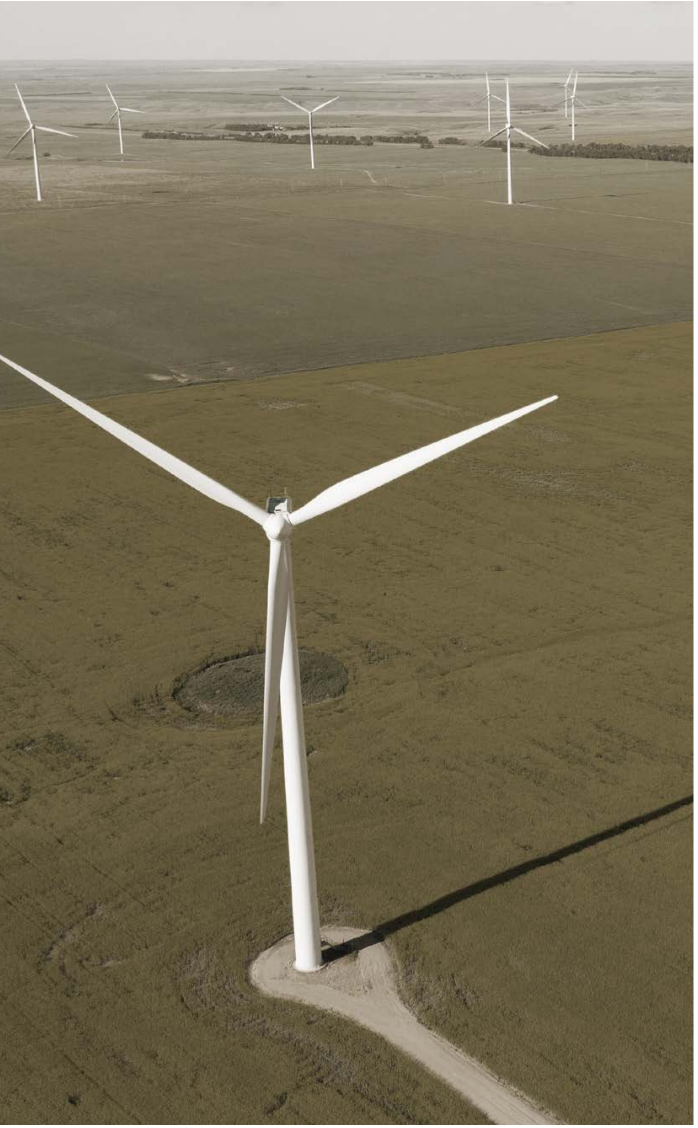
Aunnie Patton Power, Intelligent Impact, *'I would say to be very careful about doing outcomes from a timing perspective, depending on how long your capital is. Because it makes the transaction a lot more complex in terms of measurement. I think the way to try this is around simpler outputs that are easier to measure and easy to agree on, perhaps with more mature businesses that have a good idea of what they are going to be able to achieve and their ability to negotiate.'* [43]

- **Setting fair, but 'stretch' targets which are relevant to investees and their stakeholders:** in the impact-linked finance transactions to date we have covered, there are elements of negotiation in the setting of impact targets between investor/ intermediary and investee. Many practitioners like to make this a very open, transparent process where different voices are included and power dynamics are paid attention to in this target-setting process.

- **Dynamic impact targets:** a key element of impact-linked finance transactions has been their flexibility and that investors can and have come back to the table to renegotiate impact targets as the external context evolves. Covid has been a case in point in terms of making initial impact targets redundant.

Lorenzo Bernasconi, formerly Rockefeller Foundation,
'One of the big issues that you have is making sure that you ex post facto have the right kinds of impact targets. (In the Social Success Note)… we were caught out by the technology risk and it turns out that there was a different approach to providing the impact that we had hoped for and the company we backed was not using the new technology. So they had to fundamentally change their business model, whereby the impact outcomes we identified seemed a bit less relevant.' [44]

- **Systemic impact:** the impact management field is still in development in terms of creating impact evaluation structures that go beyond the level of transaction and are able to ascertain how far wider market failures have been addressed or systemic impact achieved.



Pricing Impact

Since impact-linked finance deals are fragmented and there isn't a clear best practice, most practitioners have created their own ways of pricing impact, some more rigorous than others. If the concept and practice was more mature, impact pricing could be understood and established through repeated auctions, however, this is not currently a possibility (apart from in carbon pricing sector) and is unlikely to be the case for some time for other social and environmental impacts.

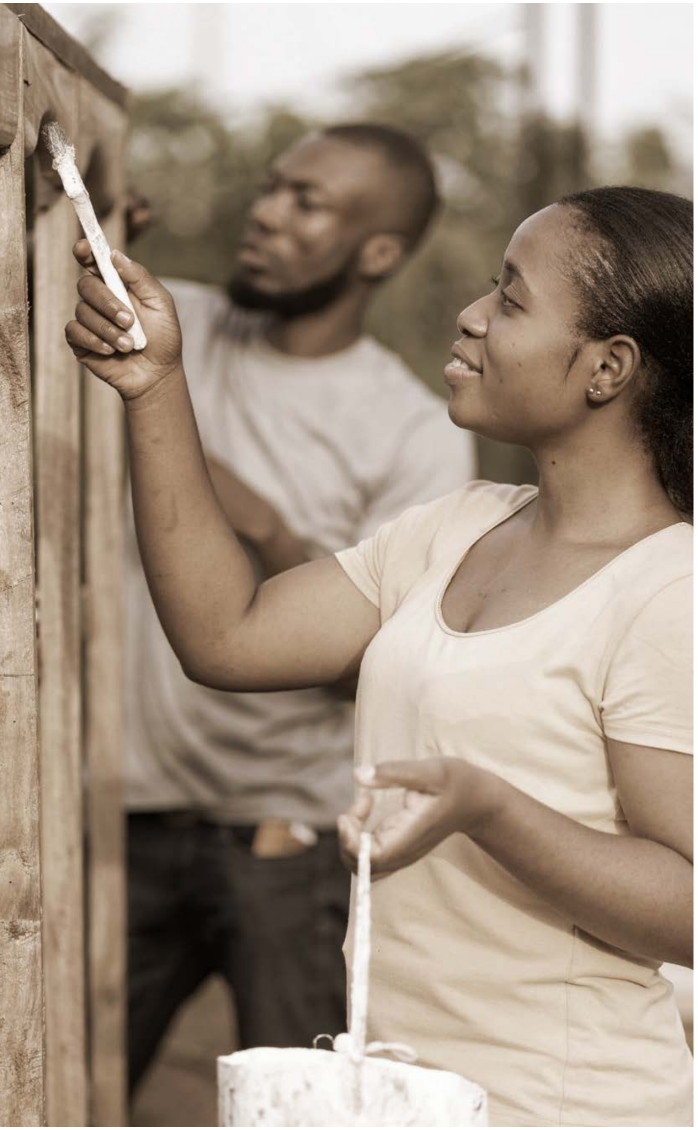
IDB Invest **is perhaps the best example of creating a strong process for pricing impact.** Their mandate is clarifying: to obtain as much impact for every dollar of incentive. To this end, they try to size the incentive relative to the impact it is getting as well as the overall market failures the transaction is trying to address. There are three important steps to their process:

- **Understanding the opportunity cost of the incentive:** this is the impact you are getting in exchange for that pricing reduction. So, in the case of carbon, how much of a grant equivalent is being extended in exchange for a reduction of a ton of CO_2? For this, there are market benchmarks and IDB Invest tends to take the lowest possible benchmark, *'typically when we work in climate, we are looking at an opportunity cost that is below two dollars per tonne of Co2.'* For gender, the incentive is measured against the impact at the fund level of, for example, the number of women-owned SMEs who get access to finance or access to the market.
- **Conducting a price discovery exercise:** understanding the opportunity cost will give a $ amount floor and a cap. Between that is the price discovery exercise. IDB Invest has created its own internal price tension, given that the market is not able to create it through auctioning. Although the price discovery exercise is primarily based on the impact of that given transaction, IDB Invest always remembers that it is about the bigger picture and the market.

Matthieu Pegon, IDB Invest, *'You need to have in place within the institution that is extending the incentive a governance that allows for one team to be playing the role of the common good and limiting the amount of subsidy that goes to the market and other teams that are going to be representing the interests of our clients.'* [45]

- **Assessing the market distortion created:** the incentive is translatable into a reduction of basis points of interest rate. IDB Invest believes that since commercial players are willing to finance against impact with between five basis points to 20 basis points in financing, any pricing reduction that is within that range is within market practice. Anything that goes beyond that needs to be justified in terms of why the market is being distorted in that particular instance.

Current impact-linked finance practitioners are using a one-way pricing mechanism whereby the cost of capital is reduced where pre-defined impact is achieve. It is only with sustainability-linked loans where the cost of capital is increased as a penalty if impact targets are not reached.



Deal Structuring and Negotiation

One of the advantages of impact-linked finance transactions could be that they are lower-cost, lighter-touch and more flexible than other forms of outcomes-based financing.

Katie Naeve, Root Capital, *'we selected impact criteria based on the impact we aimed to achieve through the project: filling financing gaps for early stage businesses so they can generate impact in their communities. We agreed on those impact criteria. And then there is a simple outcome payment structure associated with the costs of reaching those criteria. It's not to say that there weren't any administrative costs and the approach also requires a budget for impact verification. But one thing that I really like about this model is that it is simpler than some other models. It is based up on a small number of simple criteria that are both directly linked to costs and impact.'* [46]

However, some transactions have been more time-heavy and costlier than others. Key variables influencing the time taken and level of negotiation required are:

- **Number of stakeholders around the negotiating table:** for more complex structures, with multiple stakeholders, the complexity goes up and the need for intermediation increases. This is often the case with blended finance structures.
- **Level of trust:** most practitioners commented that in theory, impact-linked finance transactions can be very low-cost. We have seen this, in particular, with bilateral deals between impact investors and their investees. For Sietse Wouters from UBS Optimus Foundation, *'Distrust leads to additional conditions being put on and additional metrics identified to cover perceived risks.'*

Karim Harji, *"Social Impact Bonds were pitched as something that would give all parties a "win" if you figured it out contractually. What we have seen is that it is difficult to predict outcomes precisely in advance, to price or contract them properly, and to design with asymmetric or limited information, especially in changing contexts. And the real costs of time, legal, verification etc. are significant.'* [47]

Impact Verification

Many practitioners have used external, independent impact verification to accompany the impact-linked finance transaction. One question is whether these relatively heavy ex-ante and ex-post evaluation structures are a break on the scalability of impact-linked finance. There is a balance here between verification and transaction costs. Other practitioners have relied on the investees themselves producing verifiable data, with on-sight visits and the potential to audit and check a possibility to ensure rigor and accuracy of impact data provided. However, this light-touch approach to verification (relying on investee self-reporting) raises some questions and concerns.

Key principles here include: impact transparency (between investor and investee), selecting simple, easy-to-measure metrics which are meaningful for the investee, and ensuring sufficient rigour so that there are no question marks over the reliability of the impact data.

For Sietse Wouters, UBS Optimus Foundation, *'Verification is the key - we need to find the right way of doing it. If you can do that in a cost-effective,e.g. using digital tools to do that, sturing the impact-linked transaction is lot more straightforward.'* [48]

B.7.

Future of impact-linked finance globally

Whilst a fragmented and nascent market, current practitioners are very positive about its potential. The scalability and growth of impact-linked finance will depend on a variety of factors:

- More experimentation and exploration across different sectors, geographies and types of investees;
- Stronger track record of impact and financial additionality;
- Better evidence of demand from investees;
- Actors with deep pockets adopting this tool (particularly development finance institutions);
- Scaling up of transaction sizes;
- Reduction in complexity of transaction and lower intermediation/ impact verification costs;
- Improved sophistication of impact management amongst investees;
- More impact investors with flexibility on their returns or their own cost of capital to be able to offer variable/discounted rates for greater impact;
- Catalytic capital (trusts, foundations) ready to jumpstart this market and fund provide demonstration projects;
- Greater interest from mainstream finance for this type of tool.

Many of these inter-linked factors are unknown and unpredictable and others, such as the development of impact management are long-term propositions. In that sense, the journey for impact-linked finance to scale could be long, arduous and uncertain. There are many learnings from the development of parallel markets, such as the social impact bond market, which has evolved to respond to earlier critiques.

In fact, sub-sectors such as off-grid energy may have already reached this inflexion point. The World Bank – the single largest financer of mini grids – has published detailed cost benchmarks for mini grid installation in various regions, which has been used to inform pricing in performance-based grants / subsidies.[49]

It is no surprise that the energy sector is the first to reach the impact standardisation milestone. The sector is unique in that the outcome of interest scales more or less linearly with the output, which allows straightforward quantification (and pricing) of impact. In sectors where the outputs are loosely coupled with the outcomes (e.g. health, education), it may be possible to start the standardisation process by identifying quantifiable metrics that can act as reliable proxies for the outcome of interest. Conversely, we should also recognise that full standardisation may never be reached in certain sectors (e.g. arts/culture), where the metrics for each transaction may be highly idiosyncratic and the outputs are largely dissociable from outcomes. Here standardisation poses the greatest risk of compromising the meaningfulness of the impact measure.

Even without standardised pricing of impact, it is still possible to create impact-linked financial incentives. For example, impact-linked tranching is where payment is released in tranches based on the achievement of pre-determined impact milestones. This structure was recently used by Power Africa to incentivise electrification of rural healthcare facilities in sub-Saharan Africa.

Another important market development that has already arrived is the move beyond individual impact-linked finance transactions towards larger-scale outcomes fund structures which responds to the problem of under-sized, bespoke transactions.

Roots of Impact is currently developing specific outcomes funds and impact-linked finance facilities in off-grid energy, gender-inclusive Fintech and WASH. Such outcome funds and facilities offer the benefits of scale effects and sector-specific knowledge and data, which will help in the design challenge of setting and pricing incentives. The case studies below illustrate these emerging trends'

Mini case study

Off-grid impact-linked tranching

Through the United States Agency for International Development (USAID) – recently distributed $2.6 million in grants across nine solar energy companies; the goal was to provide reliable, affordable off-grid energy to 288 healthcare facilities across nine countries in sub-Saharan Africa.

Impact-linked finance transactions and experience

Power Africa – through the United States Agency for International Development (USAID) – recently distributed $2.6 million in grants across nine solar energy companies; the goal was to provide reliable, affordable off-grid energy to 288 healthcare facilities across nine countries in sub-Saharan Africa. One of the grants – with impact-linked tranching embedded – has been awarded to Havenhill Synergy, a clean tech utility company committed to improving energy access in rural and urban Nigeria. The grant will provide Havenhill Synergy with the capital to electrify 21 healthcare facilities in Oyo State, Nigeria using energy-as-a-service model. The newly installed systems would supply reliable power across the day, as opposed to an average 4 hours per day of intermittent power received from the national grid. Here grant payments are linked to the achievement of pre-agreed impact milestones, which typically include the following:

- Contractual agreements to enable project delivery
- Procurement planning and equipment purchasing
- Project installations (may be split out into multiple milestones)
- Progress report (may have multiple across a project)
- Project close out report and impact data collection

One challenge with the use of impact-linked tranching is that it limits the grantee's access to upfront capital and the ability to purchase inventory at economies of scale. To overcome this, Havenhill Synergy secured a competitively-priced loan (8% interest rate) from Charm Impact – a peer-to-peer impact investing platform that fundraise for early-stage entrepreneurs furthering the energy transition. This provided Havenhill Synergy with the upfront capital and negotiating power with its supplier, which ultimately allows them to maximise profits.

Further insights and reflections

Impact-linked tranching enforces market-based mechanism by awarding grants to high impact social enterprises with a track record of delivery. Like other impact-linked structures, it also ensures impact maximisation using the outcome payer's funds. Finally, by leveraging the grant, impact investors also face a different (arguably lower) risk profile, where the risk of customer repayment is shifted to service delivery, resulting in a form of blended finance where the grant-maker is driving the impact additionality through the impact targets, with the mechanism creating further financial additionality by making the investment more attractive for an impact investor.

Gavriel Landau, Charm Impact, *'What's really interesting is we're seeing grants not getting the effect they need to. We see companies that keep just running for grants rather than running for creating good business. [...] A sustainable, profitable business, that is the precursor to real impact. It is the difference between electrifying one hundred people in one community to electrifying one hundred communities. And to do that we need to be promoting sustainable businesses.'*[50]

Mini case study

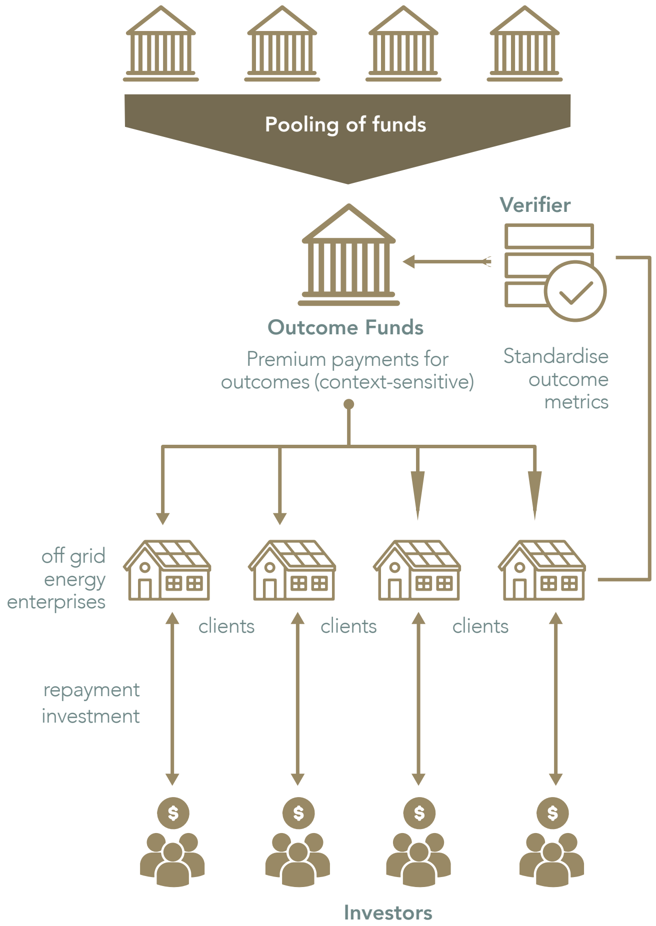
Off-grid impact-linked outcomes fund

Roots of Impact with support from the Swiss Development Corporation and Acumen designed a $USD 20-30m outcomes fund using impact-linked finance instruments to catalyse over $USD 100m investment in off-grid clean energy in sub-Saharan Africa. While KfW Development Bank on behalf of BMZ will allocate initial funding and take a leading role in the implementation, Switzerland and Austria intend to contribute in 2021 in order to scale up the 'Smart Outcomes Fund.'

The fund's ultimate objective is to establish appropriate incentives to reward entrepreneurs and subsequent investors who push the boundaries of pro-poor, off-grid energy supply. The core premise of this outcomes fund is to track social outcomes for the customers these companies are trying to reach, using these outcomes as a basis for payments to the companies serving them. In this way, the fund ensures that organisations are rewarded for the quality of results they produce for their customers rather than, for example, the number of customers that they serve only.

The fund design implies using smart survey methodologies such as Lean Data to provide the necessary customer feedback. Enterprises for funding shall be selected based on: additionality, impact scalability, impact enterprise model, management team, business sustainability and customer service. Impact scoring resulting in payments will be based on Acumen's Lean Data based on the number of customers reached, the income groups of the customers (inclusivity ratio) and the household welfare change which measures quality of life changes, amount being spent on energy etc.

Interestingly, there is also a context co-efficient included which evaluates the ease or difficulty of enterprises operating in a given market, to ensure that there is an even playing field across different contexts and geographies. The fund allows for a type of iterative learning around the setting and pricing of impact incentives in the off-grid energy sector, since as more data is collected and a growing track record generated, the accuracy of the impact target setting process will improve.



LEAN DATA

Figure 14. Representation of off-grid energy outcomes fund [51]

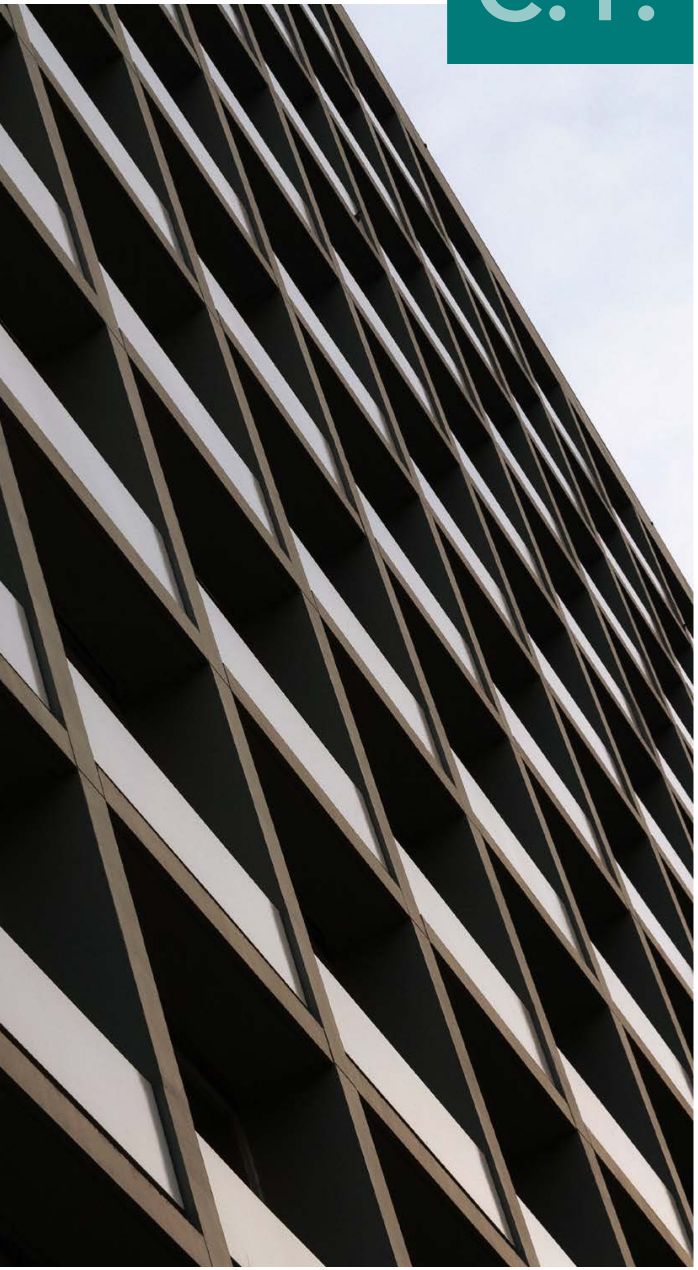
Moving forward

Having identified the potential but also the challenges for the development of impact-linked finance such as lack of experience, knowledge, data and capacity constraints, Roots of Impact is also engaging in other important market-building activities to counter some of these such as:

- An open platform to facilitate collaboration between practitioners and train organisations on how to design such transactions, whilst making sure that key principles are preserved;
- An Impact-linked finance fund which will act as a future hub and platform for impact-linked finance programmes, facilities and knowledge dissemination.

If the forces of all those engaging in impact-linked finance transactions are combined, with the market becoming less fragmented and practitioners coming together to exchange their learning and to help others seeking to experiment and explore, there is a possibility that impact-linked finance can become a better-known concept, encompassing a broad and growing set of actors, operating within different fields of development finance, blended finance, domestic impact investing and even commercial finance and corporate sustainability.

Review of Impact-Linked Finance in the UK

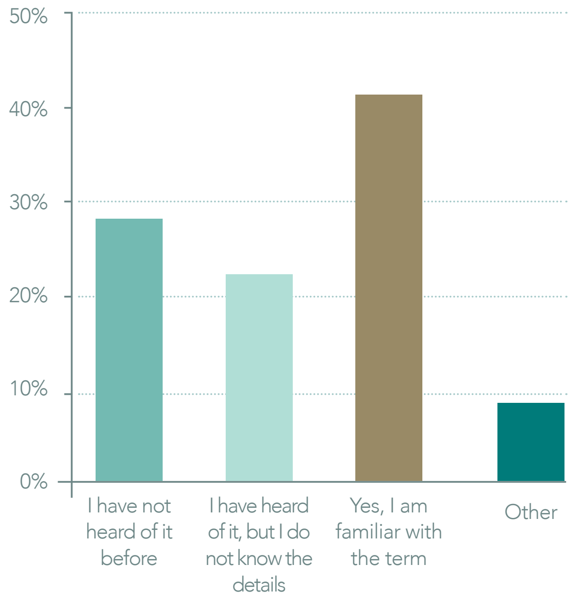


C.1.

Awareness and appetite for impact-linked finance in the UK among investors

There **is a surprising level of awareness of the general concept of impact-linked finance** amongst UK investors surveyed as shown in **Figure 15** below with over 40% of respondents already familiar with the term and over 50% currently involved in or actively exploring impact-linked finance opportunities. This could reflect survey bias (respondents tend to be those already interested in the concept) as well as the overlap between the concept of impact-linked finance and general outcomes-based finance. When survey respondents were asked to indicate what they understood by impact-linked finance, the terminology was quite broad, and could for example include outcomes-based financing in general of which the UK has been a market leader. In this sense, there is significant work needed to tease out where impact-linked finance fits in within this broader outcomes-based financing market and potentially to clarify how far this is a different product concept or simply a similar idea adapted to a different market/context. It is **likely that the relatively mature and sophisticated UK market in relation to outcomes-based financing will enable swifter awareness and potentially adoption of this parallel concept.**

Seva Phillips, Nesta, *'If the use of impact-linked finance can lead to more rigorous and in-depth thinking around social impact evaluation, and if this can lead to better evidence of impact causality on the part of the investee as well as greater impact itself, then it is surely a desirable thing.'* [52]



1. I don't know if I would have used that specific term but I'm familiar with the concept.
2. I was not aware of the term per se, but we have a loan in our portfolio that uses this mechanism
3. As you say, I don't think this is a defined term, however, I'm familiar with such structures both in development finance and commercial finance

Figure 15. *Responses to Investing for Good survey October 2020. Question: before this survey, were you familiar with the term 'impact-linked finance'?*

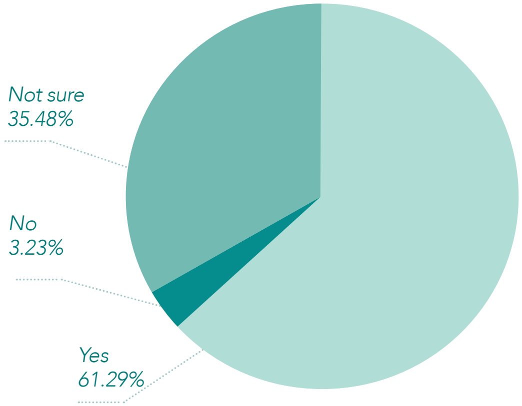


Figure 16. *Responses to Investing for Good investor survey October 2020. Question: is there a need for impact-linked finance in the UK?*

There is clear enthusiasm for the idea of impact-linked finance with over 60% identifying a need for impact-linked finance in the UK as per **Figure 16** above.

The appetite of UK investors relates to how impact-linked finance can focus the investor and investee's mind on impact as shown in **Figure 16** above where over x% responded that it helps to align investor/funder and investee around the importance of impact. In our interviews, we heard that an impact-linked finance approach is 'the purer form of impact investing' since there is a pure link between outcome and payment of money. For some investors who believe that there is a trade-off between financial and social return, paying for impact (which is not sufficiently recognised and rewarded because of externalities) is fair and appropriate.

> **Denise Holle, JRF,** *'It does force you to be more explicit on impact and transparent on whether your investments are delivering impact or not.'* [53]

> **Danyal Sattar, Big Issue Invest,** *'If we want impacts, we are going to have to pay for it. If the market doesn't capture the externalities involved, if we want those, we have to pay for them, which is the logic of saying some investors have to take a discount to make this work.'* [54]

Moreover, investors perceive it could improve the investor and investee transparency around impact and believe that the product could be particularly suitable for enterprises that are not able to generate market-rate returns.

Those who did not see such a strong need are not convinced that impact-driven organisations need incentives and feel that it is unclear whether there would be sufficient investee demand.

Whilst philosophically there is generally a strong commitment and openness to the idea amongst interviewees and survey respondents, there were many and varied concerns raised about its implementation. These included:

- **Concerns about the practicality of *setting meaningful and material impact targets,* as well as the *potential gaming of the system related to incentives, impact target rigidity*** (and direct experience of problems in social impact bonds related to impact targets). Even in sectors such as housing, which at first sight might be more amenable to outcomes-based targets, it was felt that impact targets could create unhelpful pressure to, for example, move beneficiaries quickly out of supported accommodation when they are not ready. Investors describe how investees are often resistant to more quantitative targets as well as how there might be a tendency to create impact targets which focus on easy and quick impact creation rather than long-lasting, sustainable changes.

> **Jess Daggers, Flip Finance,** *'I specialise in impact measurement, and understand the challenges of defining useful metrics that remain useful over time. So there are challenges over setting up deals like this in a way that creates the right incentives.'* [55]

- **A sense that the *complexity* might be very off-putting** both to investees (especially early-stage, less mature companies) as well as more mainstream investors;
- **Scepticism of whether there is *sufficient capital*** willing to make a financial trade-off in return for 'buying' impact, either from catalytic investors such as trusts or foundations or from mainstream finance. In the UK, education of the mainstream finance about impact investment has deliberately tried to overcome investor concerns about concessionality and this type of impact-linked finance structure could be problematic.
- **Investees in general are not developed enough in their impact management approaches** (particularly in venture investing). Impact-linked finance without direct financial and non-financial support, and possibly incentives, to encourage the development of impact measurement systems could be a negative for the sector.´

> **Melissa Wong, Nesta,** *'One of the key challenges is that you are asking investees to do a level of reporting that they may not necessarily have been used to doing, but you are not providing any additional resource besides as a critical friend'* [56]

The lack of knowledge and experience of impact-linked finance amongst UK investors is also acknowledged to be a major barrier (as illustrated by Figure y below), although this could be managed through awareness-raising, capacity-building and simple exploration and experimentation. Amongst the social investment community interviewed, there is a strong demand for more information and examples of impact-linked finance.

Some who are already using the tool (as will be explained in the next part of the report) are very positive about their experience and feel that it does have strong potential. For example, for Ben Smith, Esmée Fairbairn Foundation, *'our use of impact-linked finance has yielded strong results and we will continue to use and evolve our practice in a bid to make it more effective. For it to be most successful, we've seen a need to co-design the instrument and outcomes with investees.'* However, others are more wary and may not consider using it again.

> **Hermina Popa, SASC,** *'Where it works well is where the service delivery organisation has a good relationship with the entity who pays for outcomes – there is an element of co-creation, with a focus on the quality of the intervention. There is flexibility in re-defining the outcomes to reflect lessons from the intervention, in real time, in real life.'* [57]

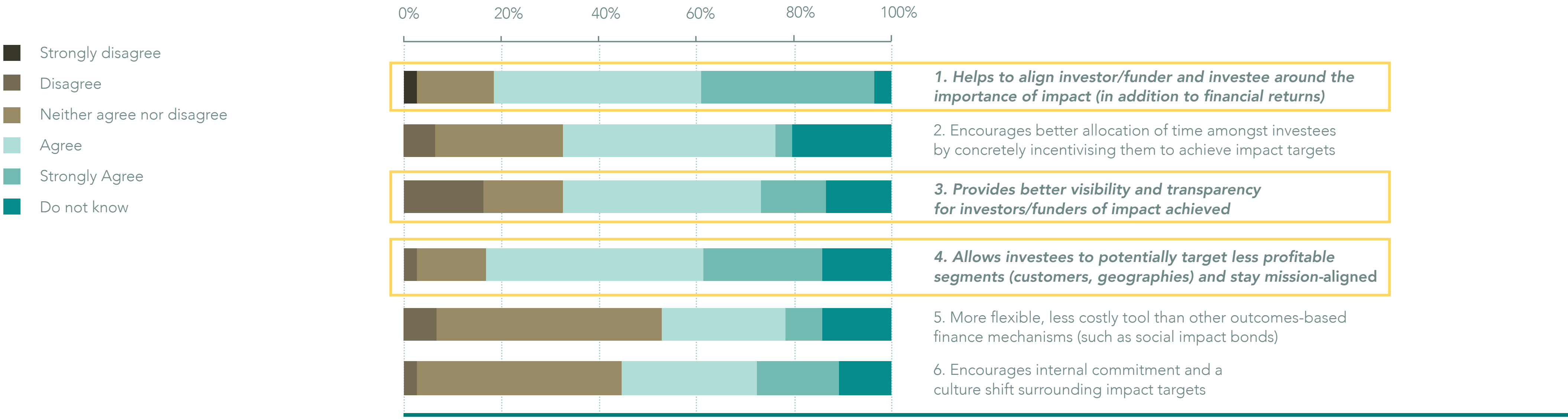


Figure 16: *Survey responses: below are outlined some benefits of impact-linked finance. Please rate how far you agree with these.*

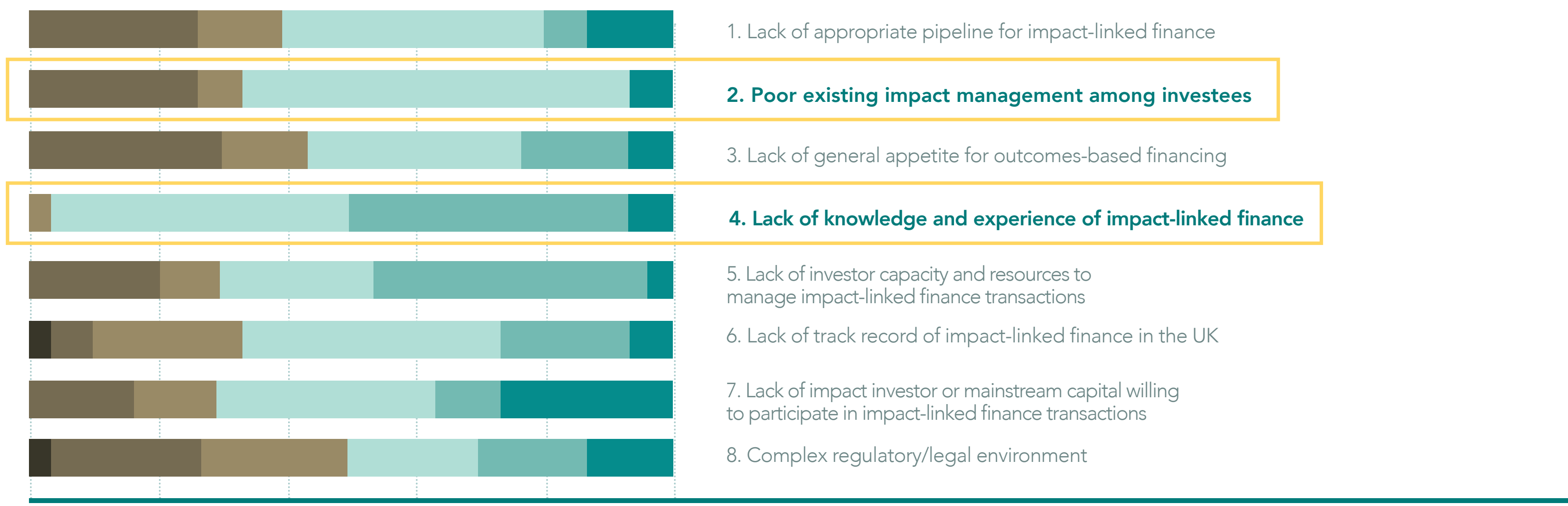


Figure 17: *In the UK, what do you see as the key current or potential challenges for the development of impact-linked finance*

C.2.

Context for impact-linked finance in the UK

The UK has a certain market specificity which needs to be acknowledged and taken into account when considering the appropriateness and adaptability of impact-linked finance to the UK context.

Ben Smith, Esmée Fairbairn Foundation, *"There is a lack of impact-linked finance in the UK. I believe partially because of the added complexity and cost involved in structuring and monitoring, and the lack of widely available flexible wholesale finance.'* [58]

Outcomes-based financing experience:

The UK has been a market leader in outcomes-based financing. Notably, UK launched the world's first ever SIB in 2010 to reduce reoffending by short-term offenders in Peterborough prison; the transaction was led by UK-based intermediary Social Finance. Since then, SIBs have grown in popularity across high-income countries, including the US, Australia and countries in Western Europe, where they have been developed primarily to tackle employability and social welfare issues. Despite the rise in SIBs/DIBs worldwide, UK alone still accounts for over 40% of the social impact bonds issued between 2010-2020.[59]

Given the UK investors' familiarity with SIBs, there was healthy skepticisms among interviewees and survey respondents that the challenges faced by SIB may be generalised to impact-linked finance. For exmaple, the linking of social outcomes and financial incentive may increase the risk of perverse incentive and 'gaming' of the system. Furthermore, the adoption of SIBs has been slow relative to the initial hype around the instrument, which may be driven in part by the lack of a dominant design. A study found the majority of SIBs are only partially or marginally compliant with a so-called SIB prototype.[60]

It is also our experience that there is substantial idiosyncrasy in the design of impact-linked finance transactions; more importantly, there appears to be little consensus around the purpose of impact-linked finance, which has an implication on the convergence towards 'best practices'. The challenge in standardising impact pricing may also limit the growth of impact-linked finance. Nonetheless, the prominence of SIBs suggest the UK may be uniquely suited to the experimentation of impact-linked finance, with organisations such as the Big Society Capital acting as the social finance wholesaler and a history of the UK government providing (direct or indirect) subsidies for SIBs.[61] For example, in 2017, Big Issue Invest launched the Outcomes Investment Fund embedding an impact-linked finance mechanism.

Dan Gregory, Common Capital, *'As the story of Social Impact Bonds warns us, dreaming up a new financial mechanism may attract some short-term enthusiasm but will soon encounter numerous, entirely predictable challenges that could have been foreseen if the idea had been approached with a larger dose of humility in the first case.'* [62]

History of financial innovation, interest/activity in impact-linked finance and growing use of impact carry

Although fragmented and not at scale, various interviewees we spoke to described how they had experimented in the past with different ideas drawing on the concept of impact link some years ago. However, these never developed traction, mainly because they were seen as too complex particularly in the market-building phase. Catalytic funders, for example, felt that it could just be less work to provide an up-front grant in addition to a loan to a social enterprise, rather than to forgive the loan at the back end for impact achieved. Interviewees acknowledged that time had passed and that it could be a more promising time to being such discussions again, as the market had matured.

In recent years, there has been a growth in the use of impact carry (particularly driven by the European Investment Bank). For the funds which are subject to impact carry, there is a natural evolution towards impact-linked finance. However, the fund managers experience of managing impact related to carry has been quite complex and costly.

Yvonne Gale, NEL Fund Managers Ltd, *'Over several funds we have become increasingly comfortable with the trend towards having our contracts linked with impact to the extent that we now classify ourselves as an impact investment fund manager focusing on socio-economic change, we see impact-linked finance as a natural evolution.'* [63]

Constraints and context in the structure of the social capital market:

- A focus on early-stage impact venture with relatively few, large-scale, mature social enterprises. There was a key question as to whether deals, for example, below £500k could be appropriate for impact-linked finance (due to the transaction costs).
- Constraints faced by social/impact investment funds which feel unable to make significant financial return/social return trade-offs due to the financial hurdles they need to meet. Social investors we interviewed did not feel that impact-linked finance would be possible for them unless their own cost of capital was adjusted.
- Strong desire from investees for patient, flexible (and cheaper) capital: UK social/impact investors acknowledged that the possibility of cheaper capital would of course be extremely welcome to investees, although particularly now with so many pressures facing social enterprises related to Covid, investees may not be so willing to take on the additional risk that impact-linked finance could be perceived to bring. The UK social investment market has acknowledged a need for more patient, flexible capital although it is unclear whether this type of capital combined with an impact-link could be a powerful and suitable proposition for the market.
- A strong wholesaler in Big Society Capital with significant market power
- Limited catalytic capital and some frustration at the weak role of foundations to date in catalysing the impact investment market

C.3.

UK Case studies

While many UK investors we surveyed or interviewed have participated in impact-linked finance transactions, there was substantial variation in their experience with the tool. Of particular interest is the lack of agreement on the perceived purpose of impact-linked finance. As we demonstrate below with three UK-based case studies (with various degrees of success), impact-linked finance appears to solve different problems for different types of investor/investee. This suggests impact-linked finance may be a versatile tool and can be used creatively to incentivise a wide range of behaviours.

Impact-linked finance can take inspiration from the relative success of **match trading**, which has shown the power of incentives and also that small-scale social enterprises are willing to accept such incentive structures (although in this case the incentives related to increased trading income by social enterprises).

Match trading – created by the School for Social Entrepreneurs – is a type of grant-funding that provides pound-for-pound matching for an increase in trading income. At its core, match trading stems from the idea that social purpose organisations are fundamentally impact-driven and would thus benefit more from incentive to achieve financial sustainability. Initial pilots of the match funding programme proved to be successful. Data from 173 organisations suggests over just one year, the match-trading recipients (143 organisations) increased their averaged trading income by 64%, while recipients in the control group (30 organisations receiving a traditional grant) increased their trading income by just 21%. The match-trading recipients also increased their ratio of income from trading from 58% to 69%. Overall, the pilot programme demonstrated that match trading increased the averaged trading income of its recipients by 2.5 times relative to traditional grant. To date, the match trading programme has benefitted over 500 social purpose organisations.[64]

Mini Case Study

HCT Group

Impact-linked tools/transaction

In 2015, ClearlySo helped raise £10 million in growth capital for HCT Group – a leading community transport operator in the UK – from a range of impact-first and mainstream investors, including Big Issue Invest, Triodos, FSE Group, Social and Sustainable Capital, City of London Corporation, Esmée Fairbairn Foundation, The Phone Co-op and HSBC. The loan was structured to include a senior tranche with a fixed 6% interest rate, and a more expensive junior tranche with variable interest rate, which may step down in 0.5% increment from 9% every year depending on the achievement of pre-determined social impact targets.[65]

Outcome and insights

- Given the scale of HCT Group's operation and the size of the investment deals they are typically involved in, the pricing change is arguably modest and the potential financial gain (or loss) is unlikely to have a significant effect on HCT Group's operation.
- There were doubts on whether such modest pricing change may incentivise additional impact, and HCT group has previously missed the annual impact target. On the other hand, significant pricing changes would have deterred participation of mainstream investors. In cases where modest pricing is used either due to conversation of the investee and/or the investor, impact-linked finance could still function as a 'signalling tool' (as in the case of sustainability-linked loans/bonds). For example, the significance of the impact-linked transaction could be communicated internally to incentivise changes at the operational level and to enable different kinds of dialogue with the stakeholders.
- For large enterprises like the HCT Group operating both a commercial and a charitable arm, the use of impact-linked finance could highlight the work of its impact division and to attract different kinds of investors. Conversely, impact-linked finance offers social investors the opportunity to scrutinise impact targets of large enterprises and hold them accountable.

CASE STUDY

Mini Case Study

Nesta Cultural Impact Development Fund (CIDF)

Impact-linked tools/transaction [66]

- Nesta launched the Cultural Impact Development Fund (CIDF) in 2018 where they would provide loans and/or quasi-equity funding of between £25,000 to £150,000 to arts and cultural organisations looking to scale their impact operation and achieve financial sustainability. So far, the portfolio includes four organisations – InHouse Records, IRIE! dance theatre, Pop Up Projects and Saffron Hall – where the starting interest rate varied from 5.5% to 8.5%.
- Impact incentive is embedded in loans with a minimum repayment period of three years (up to a maximum of five years), where meeting 50% or 100% of the target leads to a 0.2% or 0.45% reduction in interest rate, respectively.
- The impact targets are assessed annually and the interest rate reduction is cumulative across repayment period, such that organisations could achieve a maximum reduction of 1.8% by year five if 100% of the targets are met consistently. There is also an opportunity to renegotiate the impact targets halfway through the repayment period.

Outcome and insights

- An interesting element of the CDIF is that the interest rate is linked (equally) to both outcome and impact management targets. To our knowledge, this is the first impact-linked transaction that considers impact management target, as opposed to just outcome (or output) targets.
- The rationale of this is two-fold. Firstly, it encourages a culture of M&E and evidence-based learning within the organisation. Secondly, it empowers the investee by giving back a sense of control, since the achievement of outcome targets may depend on external factors while the meeting of impact management targets is primarily dependent on how the organisation chooses to allocate time and resources.
- To the surprise of the investor, data from the first year data suggests all of the investees have met or exceeded the outcome targets, while only one of them achieved the impact management target. This was likely because with staff on furlough (due to the COVID-19 pandemic), the organisations prioritised service delivery over improving M&E capabilities.
- It is worth noting that some investees applied for the CDIF without prior knowledge and experience in M&E, which posed significant challenge to the initial setting of impact management and outcome targets. Yet the tool has proved successful so far in encouraging better M&E practices in investee organisations.
- So while impact-linked finance is often thought to be more compatible with mature sectors, where impact can be robustly quantified and priced, there is an argument for using it in more nascent organisations at least as a tool for incentivising M&E.

Mini Case Study

Esmée Fairbairn Foundation and Hubbub

Impact-linked tools/transaction

In June 2020, Esmée Fairbairn Foundation agreed a £250,000 impact-linked finance investment into Hubbub – who develop creative campaigns to inspire a greener living – to run a Climate Emergency Campaign in Manchester. The interest rate is 4% per annum but reduces to 2% upon evidence that the Climate Emergency Campaign is adopted by one other Local Authority. The unsecured loan is repayable by bullet on maturity.

The impact-linked loan will subsidise the cost of the one-year campaign, during which Hubbub will create a range of different initiatives, addressing key targets within the council's overall strategy in partnership with the council, businesses and local community groups.

This will include boosting active travel, reducing food waste, cutting energy use in homes, greening the city and promoting more healthy diets. Hubbub will raise the fund for repayment by encouraging 25 businesses to each invest £10,000.

This transaction follows a previously proven model initiated in Leeds in 2018, in which 26 businesses gave £10,000 to trial new approaches to high street recycling, which successfully increased high street recycling by the public in Leeds threefold. Based on the initial success, the council has taken over the campaign and the companies involved have continued their investment, enabling the approach to be spread to Swansea, Edinburgh and Dublin with three more areas to follow in 2020.

The Leeds campaign aimed to improve recycling only and did not require a loan, while the challenge with the Manchester initiative is that it involves multiple themes (e.g. air pollution, food waste reduction, urban greening) and will require more complex branding). The role of Esmée Fairbairn Foundation was thus to underwrite the cost of the campaign before they have been proven to be successful.

Outcome and insights

- The rationale of this transaction is similar to that of a SIINC model, which aims to scale a proven model and reward high impact social enterprises. Although the innovation here is the idea that instead of growing and scaling the operation of a single organisation, it may be possible to spread 'best practices' across multiple organisations.
- In this case, the success of Hubbub is defined not only by the implementation of the campaigns in one region, but whether their approach would be successful enough to be adopted by other local authorities. A common concern with impact-linked finance is that it may incentivise behavioural change only during the loan term; this transaction shows that it is possible to set impact metrics indicative of long-term behavioural change.

C.4.

Next steps for experimenting with impact-linked finance in the UK

The case studies above, as well as the general context outlined earlier, suggest that the **UK could be an interesting developed market to explore more fully the power and potential of impact-linked finance.** Over 60% of survey respondents said that they were willing to experiment with impact-linked finance in the UK.

Clearly there is an acknowledged need to improve the structure and functioning of the social and impact investment market, to bring in more mainstream capital and to encourage greater catalytic funding from trusts and foundations. Impact-linked finance could be a way of developing a more impact-oriented dialogue and transaction between investors and investee, potentially unblocking the some of the structural inadequacies of the market and developing more products that really inhabit and 'own' the spectrum of capital as well as encourage impact management in the sector. This could be through blended finance structures, for example, where impact-linked finance can generate the financial additionality of attracting mainstream investors.

A **key next step needs to be to understand the demand-side of the equation.** Interviewees and survey respondents acknowledged this as critical for building their confidence and belief in it really responding to a market need and helping enterprises achieve their impact potential.

Beyond this, there were various recommendations for how to take this further, with some believing that the UK needs to continue with a few small-scale impact-linked finance transactions, to test the waters, just slightly modifying existing loan structures and covenants. Others recommended a more careful, concerted approach perhaps in collaboration with Big Society Capital to experiment more widely and at a larger scale.

A strong recommendation was that the **language needs to be kept as simple as possible** and the product as familiar as possible. Already many enterprises struggle with the financial machinery of social investment and there is a clear concern that investees might find the impact-link hard to understand and digest. In order to attract mainstream investors, if that is possible, the product needs to fit into their product sensibilities, which is perhaps being facilitated by the growth of sustainability-linked lending.

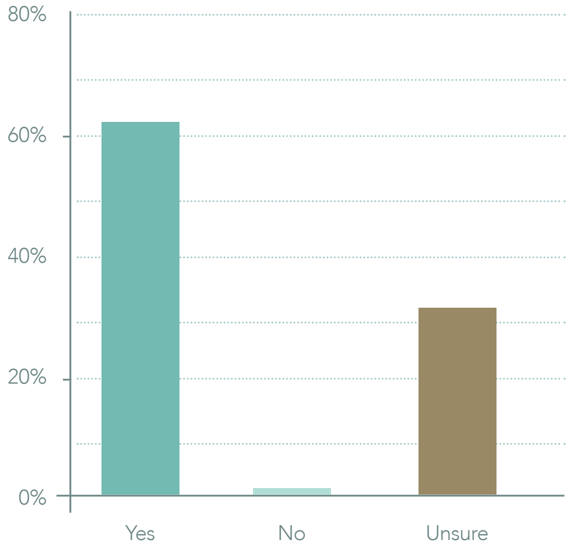


Figure 17: *Survey response to question – are you willing to experiment with impact-linked finance in the UK*

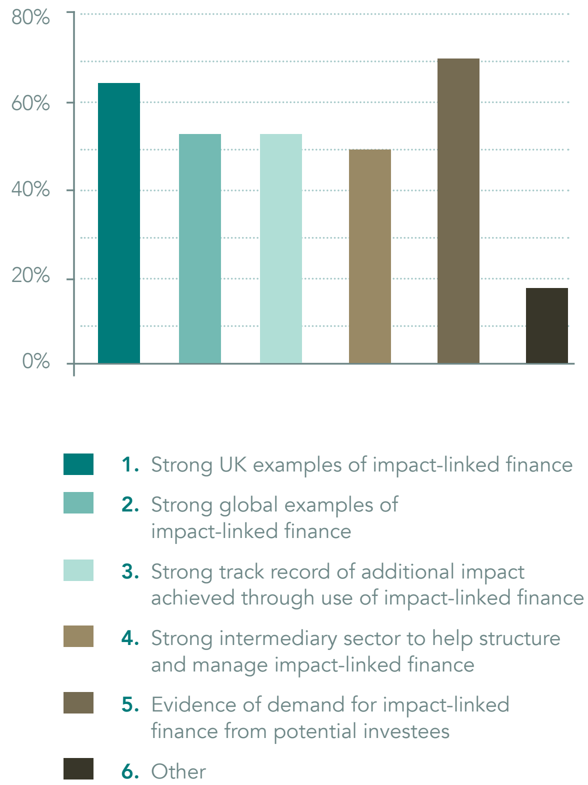


Figure 18: *: What might be most useful in helping you to explore impact-linked finance*

Global Interviewees

Global Interviewees		
CAMCO	Laura Lahti	Impact Manager
Charm Impact	Gavriel Landau	Co-founder & CEO
Independent Consultant	Charles Bleehen	Consultant On Development Policy and Finance
GIIN	Rachel Bass	Research Senior Manager
	Pete Murphy	Market Building Manager
	Katherine Zafiris	Senior Associate Market Building
Global Innovation Fund	Ginny Reyes	Deputy General Counsel
	Jocelyn Cheng	Senior Investment Director
Grassroots Capital	Anna Kanze	Managing Director
IDB Invest	Matthieu Pegon	Head of Blended Finance
	Stephanie Oueda	Head of Gender and Diversity
Intelligent Impact	Aunnie Patton Power	Academic/Practitioner
OECD	Priscilla Bioardi	Policy Analyst in Private Finance for Sustainable Development
Oxford Saïd Business School	Karim Harji	Academic/Practitioner
Rockefeller Foundation (formerly)	Lorenzo Bernasconi	Managing Director (formerly)
Root Capital	Katie Naeve	Director of Impact and Partnerships
Social Capital Partners	Bill Young	Founder & CEO
Roots of Impact	Bjoern Struewer	Founder & CEO
Sumerian Partners	Chris West	Partner & Co-founder
UBS Optimus Foundation	Sietse Wouters	Program Director of Innovative Finance
Cambridge Judge Business School	Matthew Grimes	Academic Researcher

UK Interviewees

UK Interviewees		
Big Issue Invest	Danyal Sattar	CEO
Big Society Capital	Camilla Parke	Investment Director
BNP Paribas	Laetitia Girolami-Boyer	Director in Sustainable Finance
Education Outcomes Fund	Alasdair Maclay	Chief Strategy Officer
Esmée Fairbairn Foundation	Ben Smith	Head of Social Investment
Impact Investing Institute	Bella Landymore	Policy Director
Joseph Rowntree Foundation	Denise Holle	Head of Social Investment
Key Fund	Matt Smith	CEO
NESTA	Melissa Wong	Impact Manager for CIDF
	Seva Phillips	Head of Arts & Culture Finance
Resonance	Simon Chisholm	Chief Investment Officer
School for Social Entrepreneurs	Graeme English	Strategic Projects Manager
Social and Sustainable Capital	Hermina Popa	Portfolio Director
UnLtd	David Bartram	Director of Delivery and Investment

Survey Respondents

Survey Respondents		
Allia C&C	Phil Caroe	Director Deal Execution
Baillie Gifford	Rosie Rankin	Director of Clients Department
Bank of America Merrill Lynch	Andrea Sullivan	Head of International Environment, Social & Governance
Barrow Cadbury Trust	Mark O'Kelly	Director of Finance and Administration
Bedfordshire and Luton Community Foundation	Hannan Ali	Grants & Programmes Manager
Big Issue Invest	Danyal Sattar	CEO
Big Society Capital	Joanna Heywood	Relationships Director
BNP Paribas	Laetitia Girolami-Boyer	Director in Sustainable Finance
Bristol and Bath Regional Capital	Edward Rowberry	CEO
CAF Venturesome	Joanne Wedderspoon	Development Manager
Cazenove Capital	Lyn Tomlinson	Head of Impact and Philanthropy
City Bridge Trust	Tim Wilson	Funding Director & Social Investment Fund Manager
City of London Corporation	Hannah Davey	Social Investment Fund Associate
Freelance	Simon Evill	Impact Investment Advisor
Common Capital	Dan Gregory	Director of International and Sustainable Development
Education Outcomes Fund	Alasdair Maclay	Chief Strategy Officer

Esmée Fairbairn Foundation	Ben Smith	Head of Social Investment
Ethex	Lisa Ashford	CEO & Director
Flip Finance	Jess Daggers	Academic/Practitioner
Government Inclusive Economy Unit	Vanessa Morphet	Head of Social Impact Investment
Impact Investing Institute	Bella Landymore	Policy Director
Joseph Rowntree Foundation	Denise Holle	Head of Social Investment
	Jonathan Levy	Investment Portfolio Manager
Key Fund	Matt Smith	CEO
NEL Fund Managers	Yvonne Gale	CEO
NESTA	Seva Phillips	Head of Arts & Culture Finance
Partnership for Forests	Ramona Liberoff	Senior Advisor
Resonance	Simon Chisholm	Chief Investment Officer
School for Social Entrepreneurs	Graeme English	Strategic Projects Manager
Social and Sustainable Capital	Hermina Popa	Portfolio Director
The Good Economy	Sarah Forster	CEO & Co-Founder
The National Lottery Community Fund	Samantha Magne	Policy & Learning Manager
Ufi VocTech Trust	Joe Ludlow	Impact Investment Director
UnLtd	David Bartram	Director of Delivery and Investment

Footnotes

1 The Social Impact Investors Group (SIIG) exists to support Foundations interested in starting or currently undertaking social investment https://www.acf.org.uk/networksandevents/siig/

2 https://ilf-fund.org/impact-linked-finance/

3 EVPA, 2012

4 Qualitative interview with Bjoern Struewer, Founder and CEO, Roots of Impact, 28th July 2020´

5 Roots of Impact (2020) 'Impact-Linked Finance (ILF) Information package and "state of play"

6 Qualitative interview with Karim Harji, Associate Fellow, Oxford Saïd Business School, 4th August 2020

7 Qualitative interview with Chris West, Partner and Co-founder, Sumerian Partners, 28th July 2020

8 Felix Oldenburg, Bjoern Struewer, Full spectrum finance: how philanthropy discovers impact beyond donations and investments. Philanthropy Impact Magazine: 11, Spring 2016

9 Alexander Baic, Bjoern Struewer, Wolfgang Doerner, Brad Henderson, Max Maennig, Leopold Kammerer, Patricia Baffioni, and Benedicte Montgomery, January 2019, Accelerating Impact-Linked Finance

10 Qualitative interview with Lorenzo Bernasconi, at the time Managing Director, Rockefeller Foundation, 25th August 2020

11 Survey response, 'Impact-linked finance – UK investors', October 22nd 2020

12 Anna Kanze, Managing Director, Grassroots Capital, 26th September 2020

13 Qualitative interview with Katie Naeve, Director of Impact and Partnerships, Root Capital, 24th August 2020

14 Qualitative interview with Dr. Matthew Grimes, Cambridge Judge Business School, 28th July 2020

15 GIIN, 2011, 'Impact-based structures: aligning fund manager compensation with social and environmental performance'

16 https://www.eif.org/what_we_do/equity/sia/index.htm

17 D. Burand (2017), 'Contracting for impact: embedding social and environmental goals into loan agreements'

18 60 Decibels spun out of Acumen to create a new social enterprise to bring Lean Data to the world. The Lean Data approach turns customer voice into high-value insights that help businesses maximize their impact. 60 Decibels has a network of 120+ trained Lean Data(SM) researchers in 30+ countries who speak directly to customers to understand their lived experience. By combining voice, SMS, and other technologies to collect data remotely with proprietary survey tools, 60 Decibels helps clients listen more effectively and benchmark their social performance against their peers,

19 Loan Market Association (2019) 'Sustainability Linked Loan Principles'

20 Qualitative interview with Sietse Wouters, Director, Social Finance, UBS Optimus Foundation, 25th September 2020

21 For more information on the Social Success Note, see Social Success Note Flyer 2018 https://www.yunussb.com/blog/launched-innovative-new-financing-solution-social-success-note

22 For more information on the Michael and Susan Dell Foundation impact-linked loans see: Rahil Rangwala, 'A New Impact Investing Model for Education', SSIR, Jan 2018, https://ssir.org/articles/entry/a_new_impact_investing_model_for_education

23 https://www.globalinnovation.fund/combining-investment-money-with-grants-how-does-gif-use-blended-finance/

24 Qualitative interview with Chris West, Partner and Co-founder, Sumerian Partners, 28th July 2020

25 Qualitative interview with Aunnie Patton Power, Founder, Intelligent Impact, 29th July 2020

26 Qualitative interview with Sietse Wouters, Director, Social Finance, UBS Optimus Foundation, 25th September 2020

27 Impact-first is a term focused on investors who are deploying their capital primarily to have an impact and whose financial return goals are more modest, such as capital preservation or a sub-market return.

28 IIG, The Bold Contract, http://www.impact-group.com.au/wp-content/uploads/2019/11/IIG-BOLD-Contract-Explainer.pdf

29 https://probonoaustralia.com.au/news/2019/12/bold-new-way-to-invest-for-social-change/

30 REPP, Gender Mainstreaming Policy

31 OECD/DAC BlendedFinance Principle Guidance Notes,

32 Figure taken from Convergence Finance (https://www.convergence.finance/blended-finance/2020)

33 Source: Roots of Impact

34 Content taken from qualitative interview with Matthieu Pegon, Head of Blended Finance and Stephanie Oueda, Head of Gender and Diversity, IDB Invest

35 For more examples of where IDB Invest has used financial incentives to advance gender equality, see, C2F, IDB Invest, 'For equality we make the difference. Financial incentives to close the gender gap' (2018),

36 The report was prepared by Ari Bronsoler, a PhD candidate in Economics from M.I.T.

37 Qualitative interview with Priscilla Bioardi, Policy Analyst, OECD, 7th September 2020

38 Content for this case study is taken from various sources. Qualitative interview with Katie Naeve, Director of Impact and Partnerships, Root Capital, 24th August 2020; https://rootcapital.org/about-us/; https://impactalpha.com/a-little-incentive-goes-a-long-way-to-change-lending-for-small-farmers-in-latin-america/

39 Qualitative interview with Lorenzo Bernasconi, former Managing Director, Rockefeller Foundation, 25th August 2020

40 Source for data includes: https://www.socialcapitalpartners.ca/our-journey; qualitative interview with Karim Harji, Saïd Business School, University of Oxford (formerly worked at Social Capital Partners during the Community Loan Programme), 4th August 2020 and qualitative interview with Bill Young, Social Capital Partners; https://www.corporateknights.com/channels/workplace/competitive-disadvantage-13535999/; http://www.rbc.com/newsroom/news/2014/20140317-rbc-social-finance.html

41 Qualitative interview with Matthew Grimes, Associate Professor, Cambridge Judge Business School, 28th July 2020

42 Qualitative interview with Rachel Bass, Pete Murphy, Katharine Zafiris, GIIN, August 2020

43 Qualitative interview with Aunnie Patton Power, Intelligent Impact, 29th July 2020

44 Qualitative interview with Lorenzo Bernasconi, former Managing Director, Rockefeller Foundation, 25th August 2020

45 Qualitative interview with Katie Naeve, Director of Impact and Partnerships, Root Capital, 24th August 2020

46 Qualitative interview with Sietse Wouters, Director, Social Finance, UBS Optimus Foundation, 25th September 2020

47 Energy Sector Management Assistance Program, 2019, 'Mini Grids for Half a Billion People : Market Outlook and Handbook for Decision Makers'

48 Qualitative interview with Gavriel Landau, Co-founder and CEO, Charm Impact, 19th February 2021

49 Roots of Impact, Acumen, Swiss Development Finance Corporation, 'Blueprint for an outcomes fund in off-grid clean energy,

50 Survey response, Wednesday October 21, 2020

51 Qualitative interview with Denise Holle, Head of Social Investment, Joseph Rowntree Foundation, 11th November 2020,

52 Qualitative interview with Danyal Sattar, CEO, Big Issue Invest, 11th November 2020

53 Survey response, Thursday October 22, 2020

54 Qualitative interview with Melissa Wong, Impact Manager for CDIF and Seva Phillips, Head of Arts and Culture Finance, Nesta, 20th November, 2020

55 Qualitative interview with Hermina Popa, Portfolio Director, Social and Sustainable Capital, 12th October 2020

56 Survey response, Tuesday October 20th 2020

57 Data taken from the Government Outcomes Lab Project Database

58 Arena et al. (2016) Social Impact Bonds: Blockbuster or Flash in a Pan?

59 Centre for Public Impact (2017) Social Impact Bonds: An Overview of the Global Market for Commissioners and Policymakers

60 Survey response, October 21st, 2020

61 Survey response, October 22nd, 2020

62 Evaluation summary for the 2015/16 pilot programme, published by the School of Social Entrepreneurs

63 Qualitative interview with Hermina Popa, Portfolio Director, Social and Sustainable Capital, 2020

64 Qualitative interview with Melissa Wong, Impact Manager for CDIF and Seva Phillips, Head of Arts and Culture Finance, Nesta, 2020

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Glossary of terms

Development finance institution (DFI): Development Finance Institutions (DFIs) are specialised development organisations that are usually majority owned by national governments. DFIs invest in private sector projects in low and middle-income countries to promote job creation and sustainable economic growth. They apply stringent investment criteria aimed at safeguarding financial sustainability, transparency, and environmental and social accountability

Development Impact Bond (DIB): finance development programmes with money from private investors who earn a return if the programme is successful, paid by a third-party donor. The outcomes to be measured are agreed upon at the outset and independently verified.

Impact: the effects (positive or negative) experienced by people or the planet as a result of one or more activities.

Impact investing: refers to investments "made into companies, organizations, and funds with the intention to generate a measurable, beneficial social or environmental impactalongside a financial return"

Impact additionality: the extent to which desirable outcomes would have occurred without the intervention (the 'counterfactual')

Financial additionality: additionality is the particular support the investor brings to an investment project which is not available from commercial sources of finance

Outcomes: intermediate changes that contribute to impact

Outputs: the direct results from an organisation or project's activities

Social Impact Bond (SIB): social impact bonds provide investment to address social problems and look to fund preventative interventions. They link financial success to the delivery of measured social outcomes. If the social outcome improves, the outcome payor repays the investors for their initial investment plus a return for the financial risks they took.