INVESTMENT CLIMATE REFORM FACILITY

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DFI INSIGHTS

INVESTING IN CHANGE: GETTING STARTED ON SOCIAL IMPACT BONDS

THE BASICS

Social Impact Bonds (SIBs) are a type of Results-Based Financing, a financing mechanism where capital provision is linked to the delivery of pre-agreed and verified results.

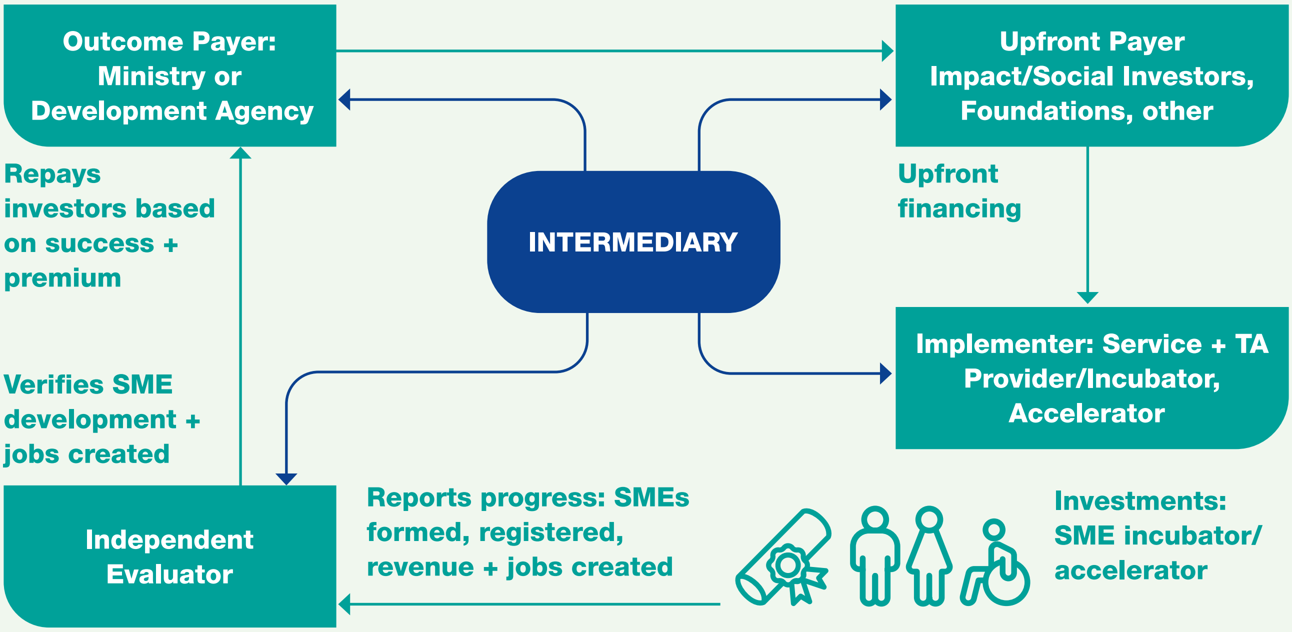
In the case of social impact bonds, a public-private-partnership is established between a government or development agency and private investors, usually residing in different countries. The public entity (**outcome payer**) is interested in achieving positive societal outcomes (e.g. poverty reduction, zero hunger, increase of biodiversity); however, instead of financing a project upfront, they find an investor (**upfront payer**), usually a philanthropic or corporate foundation, willing to make the investment and receive payment afterwards.

These two parties agree on the results to be achieved and their timeline, the monitoring and evaluation process, and the repayment conditions. The project is put in place by an implementer or **service provider** and monitored by an **independent evaluator** chosen by the two parties. An **intermediary** usually facilitates these processes by helping to find interested investors and defining the contract terms. **If the project does not achieve the intended results, the investor is not paid.**

Social impact bonds are particularly useful when a focus on outcomes is likely to generate better results compared to projects where results can be reliably measured and attributed, and where projects need upfront capital. The term social impact bond is sometimes used interchangeably with development impact bonds: the main difference between them is that the first are financed by a government, whereas the latter may be financed by other types of entities, such as foundations or development agencies.

Implemented by

EXAMPLE OF A SOCIAL IMPACT BOND STRUCTURE



WHY ARE SOCIAL IMPACT BONDS INTERESTING FOR DEVELOPMENT FINANCE INSTITUTIONS?

For Development Finance Institutions (DFIs), SIB mechanisms offer several potential benefits:

- SIBs allow projects to get **upfront liquidity**: implementers (for example NGOs) can thus focus on the project activities rather than fundraising.
- Tying the repayment to the results obtained can help **focus all actors on the outcomes** of the project. On the one hand, this gives the implementer more freedom to try out new approaches, as long as the results are achieved. On the other hand, importance is given to monitoring and evaluation at all stages of the project.

In SIB structures, DFIs can be upfront or outcome payers. Benefits for DFIs as outcome payers include:

- SIBs **mobilise private capital**, fostering cooperation between different actors interested in one social topic, potentially contributing to a more consistent impact in that field.
- The outcome payer **only pays for successful projects:** this transfers the risk of wasting money on failing projects to the private sector and is especially important when the outcome payer needs to be transparent and account for how the money is used, e.g. a government or government-owned entity using taxpayers' money.

In the case of DFIs as upfront payers:

- **Investors can be compensated for the risk they take in providing upfront financing**, while also sustaining projects with a positive social impact. This can be interesting to investors because of their **profit mandate** as well as a potential interest in highlighting **impact-oriented investments**.

While bringing advantages, SIBs are also complex mechanisms that require time and expertise to ensure all the parties involved are committed and the intended outcomes are achieved.

IMPLEMENTING SOCIAL IMPACT BONDS IN YOUR DFI

Before your DFI embarks on such a journey, you should:

- **Consider the policy and regulatory framework.** SIB engagements usually involve parties in different countries, so it is important to check the overall legal and political landscape of the agreement. In some countries, governments encourage SIBs through a smooth regulatory environment or tax relief for investing in social impact mechanisms, whereas in others, the legal framework might be missing or unfavourable. For example, the amount of money that can be invested may be limited or complex public procurement rules may apply.
- **Assess the outcome payer's capacities.** The outcome payer needs to have sufficient secured funding to provide payment and to take care of the administrative work connected to the repayment schedule (e.g. expenditure planning, reserving the budget, timely disbursements). If your DFI is the outcome payer, make sure to thoroughly assess your capacities; if your DFI is the upfront payer, gather enough information on the outcome payer to understand its processes and effectiveness.
- **Analyse the social issue** and possible solutions. It is crucial to understand the social issue that your DFI aims to solve through an SIB: what are the target groups and what solutions are feasible and impactful? What timeframe is needed to see results? Especially consider if you can define realistic, measurable outcomes. Usually, this is covered in a feasibility study.
- **Assess the capacities of the service provider.** The implementer needs to be able to fulfil the objectives according to schedule and track results as needed for the M&E mechanism put in place.
- **Assess the availability of investors.** An SIB mechanism only works if there are investors that have enough funds to invest, understand the specificities of such a project, and are motivated to take part in it.
- **Assess the attractiveness of the SIB for the investors.** Connected to the point above, SIBs are only successful if they are attractive to investors. This means there needs to be a proven model, reliable implementers and outcome payers, as well as achievable targets and an interesting return.

If this initial analysis demonstrates that an SIB is feasible and can bear good results, your DFI can move ahead.

In case your DFI is planning to be an outcome payer, you will focus on raising capital from investors and finding service providers. Investors might want to mitigate the risk they cover, for example by integrating a guarantee, optimising the interest rate, or securing an agreement to be repaid a certain amount of the investment regardless of the outcomes.

Both as an outcome and upfront payer, your DFI will need to negotiate the terms of your engagement with the other parties –especially regarding the M&E process and repayment schedule – and formalise these agreements in binding contracts.

A sound, shared M&E structure is key. In a system where funding and repayment are based on successful outcomes, it is crucial to reach an agreement on what "success" means. Also consider that projects may be designed with reduced risk to ensure favourable outcomes, e.g. by exclusively involving target groups deemed likely to succeed. However, this approach can be detrimental as it may overlook those who require the measures the most and may thus fail to provide a genuine proof of concept regarding the programme's success. Ensure that the project identifies and involves diverse groups, including those who may face greater challenges or barriers, and is based on comprehensive data collection and rigorous evaluation methods to transparently assess the impact of the program.

KEY QUESTIONS AND IMPLEMENTATION STRATEGIES

- **Are SIBs feasible in the current regulatory framework and is your DFI allowed/ eligible to act as outcome or upfront payer in an SIB agreement?**

- **How do Social Impact Bonds fit into your DFI's mandate and vision?** This is important to clarify what your role can be (outcome or upfront payer) and communicate effectively on this effort internally.

- **How can SIBs help solve the identified issue and what solutions are feasible and impactful?**

- **What are realistic, measurable outcomes for this issue?** This is key to ensure the success of the project.

- **Are there market signals for the need of an SIB, e.g. strong interest from government, potential investors, and service providers?** What risks do they face and how can they be mitigated?

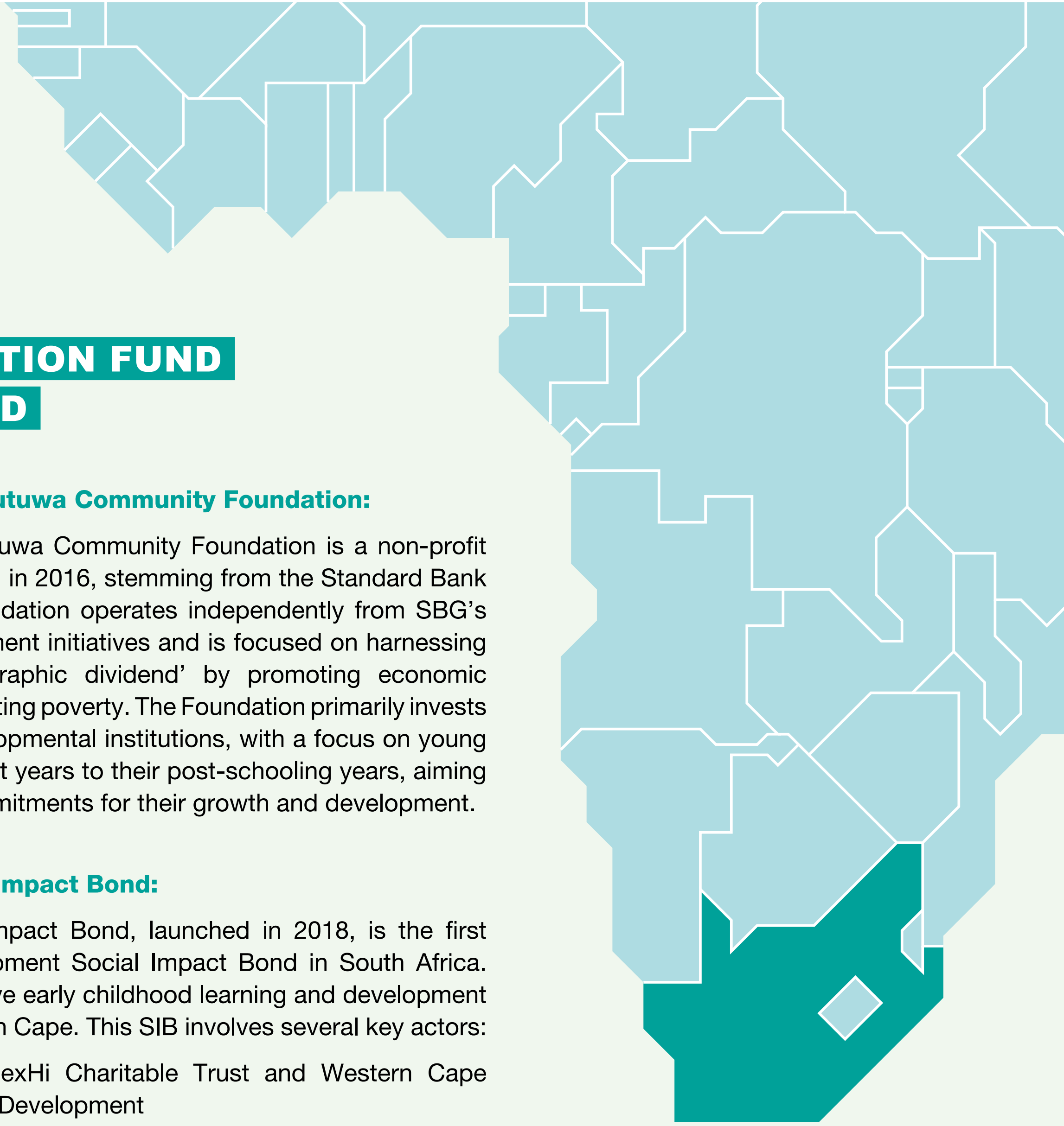
- **Consider each stakeholder's situation.** Do all stakeholders trust each other and are they committed to the mechanism? What are the risks of breaking commitment?

- **What is the outcome payer's capacity to provide payment and manage the administrative work connected to the repayment schedule?**

- **Are the implementers knowledgeable and familiar with local contexts, do they have successful experience in project implementation and are they highly regarded by investors and outcome payers?**

- **What priorities should you keep in mind when negotiating the terms of your engagement with the other parties, especially regarding the M&E process and repayment schedule?**

- **Do you have the capacity to fulfil the objectives according to the decided schedule and track results as needed for the M&E mechanism?**



DEEP DIVE: THE INNOVATION FUND IMPACT BOND

The Standard Bank Tutuwa Community Foundation:

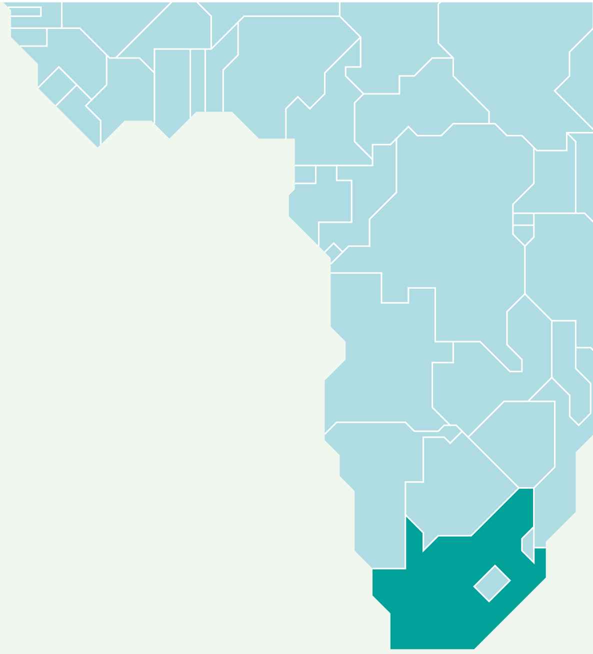
The Standard Bank Tutuwa Community Foundation is a non-profit organisation established in 2016, stemming from the Standard Bank Group (SBG). The Foundation operates independently from SBG's corporate social investment initiatives and is focused on harnessing South Africa's 'demographic dividend' by promoting economic development and alleviating poverty. The Foundation primarily invests in projects run by developmental institutions, with a focus on young people from their earliest years to their post-schooling years, aiming to make long-term commitments for their growth and development.

The Innovation Fund Impact Bond:

The Innovation Fund Impact Bond, launched in 2018, is the first early childhood development Social Impact Bond in South Africa. Its objective is to improve early childhood learning and development outcomes in the Western Cape. This SIB involves several key actors:

- Outcome payers: ApexHi Charitable Trust and Western Cape Department of Social Development
- Intermediaries: Mothers2mothers, Social Finance UK, The Bertha Centre, Volta Capital
- Upfront payers: Futuregrowth Asset Management, LGT Venture Philanthropy, The Standard Bank Tutuwa Community Foundation

The actors were highly committed and demonstrated flexibility to overcome challenges throughout the process. Outcome payers provided additional capital outside of the contract to accommodate an extended ramp-up period. The outcome targets were adjusted to reflect the delayed launch, while institutional investors stayed engaged despite altered deal-terms. Intermediaries also contributed by investing extra time and resources beyond their budgets to guarantee a successful transaction.



The Innovation Fund Impact Bond attracted investment from various sources, amounting to a total of 1.04M USD. The terms of the investment include a defined period during which outcomes are to be achieved and verified by an independent evaluator. The following steps were taken to establish the fund:

- 2015: scoping and feasibility studies were completed, and design options shared. The funding by the Department of Social Development was secured.
- 2016: an intermediary was selected, and the donor outcomes funding were secured. Investors were identified and the project specifications published.
- 2017: the implementer and auditor were selected.

Results:

The Intellidex final evaluation report (2021) revealed that the Innovation Fund impact bond had successfully delivered above-market returns during its operation, with investors earning on average 14% annually. In terms of social returns, the bond reached 4,000 preschool-aged children and their caregivers, exceeding the target number by double. However, while the Early Learning Outcome Measure targets were missed, improvements in early learning outcomes were still achieved. Although these performance gains did not significantly impact investor returns due to limited linkage with outcome payments, they demonstrate progress in the quality of delivered services. The high degree of flexibility and compromise exhibited throughout the collaborative process further underscores the potential for successful future endeavours in this domain.

You can read more on the challenges and enablers of the Innovation Fund Impact Bond here.

FURTHER READINGS

- Brookings Institution Global Impact Bond Database, accessed 4 March 2024
- Ghana education project outcomes, accessed 7 March 2024
- Impact bonds in developing countries: Early Learnings from the Field, (Brookings, 2017)
- Understanding social impact bonds (Galitopoulou and Noya for OECD, 2016)
- World's first development impact bond for education shows successful achievement of outcomes in its final year (Brookings, 2018)

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The ICR Facility supports public and private stakeholders in African, Caribbean and Pacific (ACP) countries in creating a more conducive, sustainable and inclusive business environment and investment climate.

ANY QUESTIONS? Contact us

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