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Accelerating Impact-Linked Finance

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Accelerating Impact-Linked Finance

Alexander Baic, Bjoern Struewer, Wolfgang Doerner, Brad Henderson, Max Maennig, Leopold Kammerer, Patrizia Baffioni, and Benedicte Montgomery

January 2019

FOREWORD BOSTON CONSULTING GROUP

Alexander Baic
Associate Director
BCG Munich

Boston Consulting Group has a long tradition of engaging in social impact work. We foster long-term relationships with our global social impact partners including the World Food Programme, Save the Children, the Bill & Melinda Gates Foundation, Yunus Social Business, WWF, and Teach For All. For our corporate clients, we incorporate social impact as an integral part of their business strategies, enabling them to unleash their potential and deliver innovative solutions to global societal challenges. We are deeply committed to using our talents and resources to address topics that have an impact on some of the most underprivileged in society. Moreover, we are driving major initiatives on a broad spectrum of issues across the public, private, and social sectors, closely aligned with the United Nation's Sustainable Development Goals (SDGs).

Examining the current status of the SDGs, it seems that the traditional use of development funds is not satisfactory in tackling the world's most pressing issues. While official development assistance (ODA) and philanthropic flows have increased continuously in absolute terms, there remains an enormous financing gap for accomplishing the SDGs.[1] In order to close this funding gap and to reach the most disadvantaged and underserved globally, development institutions have recognized that amplifying private sector participation is urgently required.

Although social impact enterprises typically create positive externalities, their valuable impact is often neither priced nor compensated adequately. In many cases that means social enterprises exhibit an unattractive risk-return profile, which makes funding through traditional channels extremely challenging. Organizations that work with public funders, philanthropists, and impact investors argue for alternative and innovative funding mechanisms that create incentives for effective change. This aims at leveraging scarce resources and preventing market distortions and inefficient usage of donor money. In this regard, impact-linked finance is a promising solution that directly links financial rewards for market-based organizations to achieving positive social outcomes.

We hope to raise awareness for impact-linked financing models and programs where public and philanthropic funds mobilize additional private sector investments. Impact-linked finance has the potential to fund social enterprises or even other market actors that are positively contributing to the achievement of the SDGs. Despite its achievements thus far, impact-linked finance is still in its infancy, so it remains to be seen whether impact-linked finance is successful at scale and whether it's more suitable for leveraging private sector investments than existing instruments in terms of costs and benefits. We believe that impact-linked finance can accelerate and scale by building a clear identity, engaging in knowledge dissemination and capacity building, sector-specific pooling, and facilitating cooperation, as well as by leveraging technology systematically over time.

FOREWORD ROOTS OF IMPACT

Upon entering the impact economy a few years ago and working with hundreds of entrepreneurs, I wondered how to fix the mismatch between the needs of high-impact organizations and the realities of the capital markets. If these high-impact organizations truly want to scale significantly and manage to attract commercial sources of capital, they might risk leaving behind the people who need their solutions most. I felt the urgent need for a simple solution to address the root causes of this pattern.

Bjoern Struewer
Founder & CEO
Roots of Impact

Impact investing is often considered an obvious solution for financing systems changing ideas but typically seeks to generate financial returns at market rate or close to market rate similar to traditional investment. Considering that, blended finance acknowledges the current realities of the market: Compelling, risk-adjusted investor returns are needed to continuously attract large amounts of investment. So, if we are to push the limits of market-based solutions, do we have to positively incentivize private sector participation with financial rewards? In a word, yes. The idea is simple, but all too often blended finance structures are quite investor-centric and anything but easy. The obvious question is, "What should a fair deal for all stakeholders look like?"

- What is the right level of incentive to produce the desired results?
- How can market distortion be avoided?
- How can win-win-win-win situations between donors, investors, enterprises, and end customers be created?

Just as important is how to make the value creator central in these agreements. I strongly believe that rewards have to be directed first and foremost to the player who is most central in the value creation process. The incentive levels have to be appropriate to be effective and unlock their full potential. And of course, they should be targeted at the intended positive impact.

Linking incentives to results is considered to be more effective than solely reducing risk to leverage private finance for development.[2] In fact, what's more natural than linking rewards directly to positive impact and providing them directly to the enterprise creating it? This is how we came to Social Impact Incentives (SIINC), which are already generating positive results. Developed by Roots of Impact and the Swiss Agency for Development and Cooperation (SDC) and implemented in several transactions since 2017 in partnership with the Inter-American Development Bank, SIINC has proven to be a straightforward and powerful catalytic instrument.

But there are many more areas for application. Rewards for positive impact can be built into financing instruments across the board, so that it can expand its scope significantly. I believe that impact-linked finance as introduced here is a highly effective way of "scaling what works" at the intersection of blended finance, impact investing, and results-based finance. However, it has to be implemented in an effective and professional way and follow some basic principles to deliver on its promise. It deserves and needs its own practice, and everyone is invited to join the growing community of practitioners working on this simple idea: Make generating more impact a business choice that pays off for everyone.

AT A GLANCE

The United Nations Sustainable Development Goals (SDGs) set ambitious targets for achieving a more prosperous and sustainable future for all. At current levels of investment, however, existing resources have to be leveraged substantially to attract private capital at scale and to overcome the funding gap of $2–3 trillion per year that the SDGs currently face.[1] In this context, impact-linked finance is a promising solution.

The following report defines the concept of impact-linked finance and juxtaposes it with blended finance, impact investing, and results-based finance. It covers current constraints that stakeholders may face and develops a clear roadmap to accelerate and scale impact-linked finance. The concept has the potential to mobilize additional private sector investments, as it directly links financial rewards for market-based impact organizations (or organizations with great impact potential) to the achievement of positive social outcomes, thereby improving the risk-return profile. Although manageable, impact-linked finance has to address constraints around experience, knowledge, regulation, attractiveness, capacity, and data to unlock its full potential.

We propose a five-step roadmap to address these constraints. We believe this to be a multiyear journey that has just begun and involves many players, partnerships, and collaboration. The endorsed roadmap covers actions from raising awareness and showcasing proof of concept to identity building, establishing standards, and capacity building as well as the introduction of sector-specific pooling and systematic application of technology. The implementation of such will unlock the full potential of impact-linked finance.

EVEN THOUGH NUMEROUS ENTERPRISES create positive externalities, the impact they generate for social or environmental outcomes is often not fully compensated. While financial incentives for optimizing positive externalities nudge organizations to increase their impact, they simultaneously attract further investments to these enterprises. In this context, impact-linked finance does not necessarily focus on enterprises that are commercially less attractive—it simply enables and incentivizes market-based enterprises to accelerate and deepen their impact.

By definition, impact-linked finance refers to financial solutions for market-based organizations that directly link financial rewards to the achievement of positive social outcomes.[3] The following provides an outline:

Impact-linked finance incentivizes market-based enterprises to accelerate and deepen their positive impact

- Market-based organizations describe enterprises that have a revenue stream (i.e., paying customers) and follow market principles (they do not need to be profitable and may rely on alternative sources of funding such as grants and donations). Impact-linked finance was originally applied to primarily market-based social or impact enterprises. However, experience has shown that it can very much be applied to other market-based organizations as well, ranging from typical social or impact enterprises to include traditional enterprises with great potential for positive impact.

- The notion of directly linking financial rewards refers to the fact that financial rewards are directed to the primary value creator (i.e., directly to social enterprises as opposed to the investor in most pay-for-success schemes).

- Financial rewards can take several forms, ranging from straightforward incentive payments (most common) to preferential financing terms like reduced interest rates or reduced repayment obligations for the enterprise, which are all related to achieving positive outcomes.

- Impact-linked finance is based on creating outcomes (as opposed to outputs) and measuring them or proxies thereof wherever feasible, useful, and economically viable as triggers for determining the level of financial rewards to be disbursed. Outputs strongly differ from outcomes, as the latter typically refer to the effect of a specific activity or service on a group of targeted beneficiaries. For example, the amount of children receiving after-school support may correspond to outputs, while outcomes may relate to the specific reduction in dropout rates due to a particular intervention.

Impact-linked finance incorporates a strong focus on additionality in the sense that financial rewards should facilitate the enterprise in delivering additional outcomes

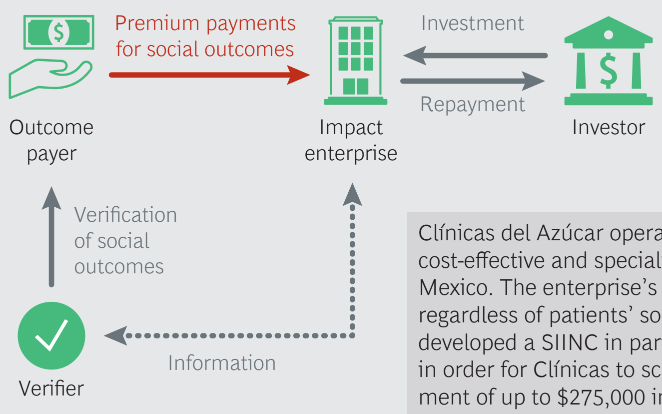
Moreover, impact-linked finance incorporates a strong focus on additionality in the sense that financial rewards should facilitate the enterprise in delivering additional outcomes. This contrasts with paying for effects that would have happened without financial incentives. For instance, some market-based organizations are able to scale even without using impact-linked finance. By applying impact-linked finance, the incentive structure needs to be set up in a way to create additional impact. This is in-line with the ultimate goal to accelerate positive impact and to contribute to the achievement of the SDGs. We believe that impact-linked finance can do it most effectively by avoiding windfall profits, preventing market distortion, nudging high-impact performance, and creating additionality.

Impact-linked finance comprises solutions that take many different forms and shapes. The Social Impact Incentives (SIINC) transaction with Clínicas del Azúcar as described in exhibit 1 serves as one example of an already existing impact-linked finance solution.

Impact-linked finance has multifaceted intersections with blended finance, impact investing, and results-based finance but differentiates itself starkly from pay-for-success mechanisms like impact bonds (see exhibit 2). Impact-linked finance can be summarized in the following four points:

- It follows the blended finance approach, as it aims to mobilize (additional) private sector investment for organizations, projects, or initiatives with significant potential for creating positive impact, with private sector investments blended with public or philanthropic funds.

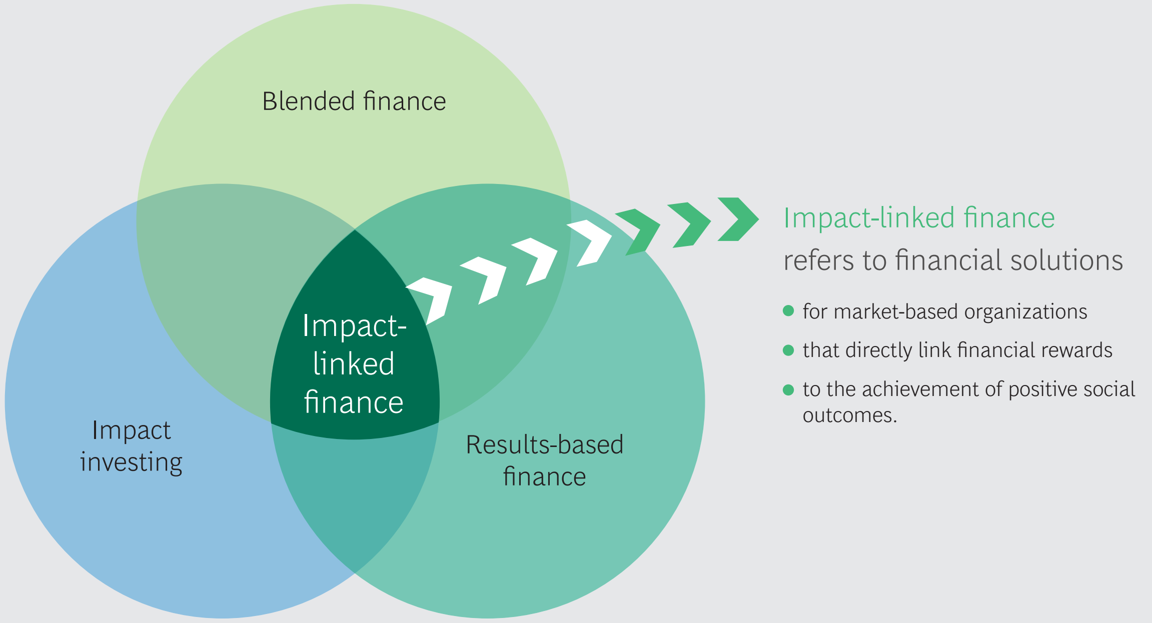
EXHIBIT 1 | Clínicas del Azúcar as a successful impact-linked finance example



Clínicas del Azúcar operates a network of "one-stop shops" offering high-quality, cost-effective and specialized health-care services to treat and prevent diabetes in Mexico. The enterprise's vision is to give every Mexican access to this service, regardless of patients' socio-economic backgrounds. In 2017, Roots of Impact developed a SIINC in partnership with the SDC, IDB, Ashoka, and New Ventures in order for Clínicas to scale up operations and impact. With a SIINC commitment of up to $275,000 in total over a period of 2.5 years, the company was able to raise $1.5 million in growth capital (equity) from impact investors. The ongoing SIINC premiums are based on proven social outcomes, which are then disbursed in addition to Clínicas' regular revenues by the outcome payer SDC. The SIINC set out an incentive structure to make sure the effectiveness of treatment for base of the pyramid clients (BoP) was improved, and the ratio of BoP clients was increased. Initial results have shown a rise in the ratio of BoP across the organization (up from 31% to 36%), and that the level of effectiveness of treatment was enhanced (measured as HbA1c level). This triggered outcome payments totaling $134,000 so far after the first year.

Note: All denominations in US dollars.

Exhibit 2 | Definition and positioning of impact-linked finance



- It overlaps with impact investing, as it enables investors to target financial returns while creating positive impact. Linking financial rewards to impact allows for stabilized and risk-adjusted impact investments if impact performance is in-line with expectations.

- It shares some of the characteristics of traditional results-based finance approaches, as financial rewards are tied to generated results. However, impact-linked finance puts a more explicit emphasis on actual outcomes for the beneficiaries and on mobilizing private sector capital than traditional results-based-finance.

- It is designed to financially reward and scale market-based organizations, while exhibiting a simple structure. Due to its principles, impact-linked finance is different from pay-for-success approaches such as social impact bonds, development impact bonds, and other outcome-based contracts, as these structures primarily focus on financing public services and non-market-based interventions, necessitating more complex contractual frameworks.

With its interdisciplinary positioning, impact-linked finance has the potential to gain an increasing share of the growing markets for blended finance, impact investing, and results-based finance. Noticeably, blended finance is a promising approach for leveraging private sector capital for development impact and contributing to achieving the SDGs.[4] In fact, blended finance has already "mobilized over $126 billion in capital towards sustainable development [...] to date."[5] Simultaneously, impact investing has gained significant momentum, doubling in total assets under management from $114 billion in 2016 to almost $230 billion in 2017.[6] Within developmental financing schemes, results-based finance is progressively considered to be a crucial part of effective aid-delivery solutions, with more than $25 billion in development spending tied to results over the past decade.[7]

While official development assistance (ODA) has expanded steadily over the past five years by around 4.6% p.a. to approximately $147 billion in 2017,[8] the relationship of ODA to gross national income has remained relatively constant at around 0.3%[9] in the world's major donor countries.[10] A significant part of ODA has increasingly been allocated to innovative financial instruments, with a strong trend towards leveraging additional private sector capital, holistically attempting to create more value for the money. But even looking beyond funding mechanisms for market-based companies, it becomes evident that the pace is accelerating.

Impact-linked finance has characteristics of all the concepts mentioned above. However, impact-linked finance differentiates from other pay-for-success schemes in the sense that it focuses on market-based enterprises, functions with simple contractual structures, and disburses incentives directly to the enterprises driving positive social outcomes. In fact, impact-linked finance aligns incentives (regarding impact and return) on an enterprise level (value creator) and makes high-impact opportunities investible. Hence, impact-linked finance has the potential to not only assume some of the popularity of existing pay-for-success structures but to grow noticeably in-line with or above overall market trends.

Impact-linked finance has the potential to grow noticeably in-line or above overall market trends

We recognize that there are many efforts and transactions among blended finance, results-based finance, and impact investing today that have pioneered and already included some of the elements that comprise impact-linked finance. With the inception of a new term, impact-linked finance emphasizes the importance of existing efforts and certain transactions. It aims at effectively linking elements thereof to build a clear and strong identity and to further drive the development and scale of this field. Based on actual outcomes achieved, impact-linked finance ensures that market-based organizations are directly rewarded for creating additional impact.

In order to understand the dynamics that drive impact-linked finance, and to design strategies to accelerate and scale the concept, it is vital to understand the stakeholders involved and what their needs and positions are. As illustrated in exhibit 3 below, we have organized the multiple stakeholders into four groups.

- Capital providers: They provide investment or public/philanthropic capital to market-based enterprises with the goal of achieving attractive financial returns (e.g., traditional investors), generating financial returns while also achieving impact (e.g., impact investors) or to primarily achieve additional positive impact (e.g., public funders or development agencies such as the Swiss Agency for Development and Cooperation).

- Capital facilitators: They design transactions, manage capital flows, or verify the impact linked to capital flows (e.g., intermediaries or advisory firms such as Roots of Impact). Their role in impact-linked finance is manifold as enabler, professional services provider, and market builder.

Exhibit 3 | Key stakeholder groups

Provide capital	Facilitate capital	Receive capital	Further
Public funders/dev. agencies Philanthropists Impact investors Classical investors	Advisory firms Impact verifiers Intermediaries	Impact enterprises (market-based) Enterprises with impact potential Hybrid organizations[1]	Academia NGO

[1] Hybrid organizations refer to those enterprises consisting of a "traditional" as well as a "social" or "charitable" arm.

- Capital receivers: They include market-based enterprises and receive both investment capital and incentives to deliver financial returns and to create impact (e.g., impact enterprises such as Clínicas del Azúcar or enterprises with impact potential). The transactions are designed to enable these enterprises to scale and deepen their positive impact.

- Further: This group includes entities in academia or NGOs, for instance.

In the following, we look at the positions of the different stakeholder groups and the potential constraints that these groups may face when engaging in impact-linked finance Only by addressing and solving these can impact-linked finance unlock its full potential.

From the perspective of the stakeholders, we found that most of the constraints that impact-linked finance potentially faces can be organized into six key categories around which we have structured our analysis. We take into account that each stakeholder group and individual institution has unique and specific needs. Therefore, our analysis recognizes that constraints may apply differently across the stakeholder spectrum.

- Experience: As the term impact-linked finance is not yet established, it is obvious that the stakeholders are not yet fully aware of its characteristics. Outcome payers may be risk-averse to exploring innovative ways of funding impact, while traditional investors may be reserved to partner up with public or philanthropic funders. After all, impact- linked finance needs to prove that it can be more successful and effective in comparison with existing solutions (such as blended finance instruments that are not linked to outcomes) in terms of delivering impact and attractive risk-return profiles. Limited (academic) research has been done to date in the overlapping fields of blended finance, impact investing, and results-based finance and the optimization of financial incentives to be provided (i.e., not too low to leave impact potential untapped, and not too high in order to avoid market distortion or perceived waste of public or donor money).

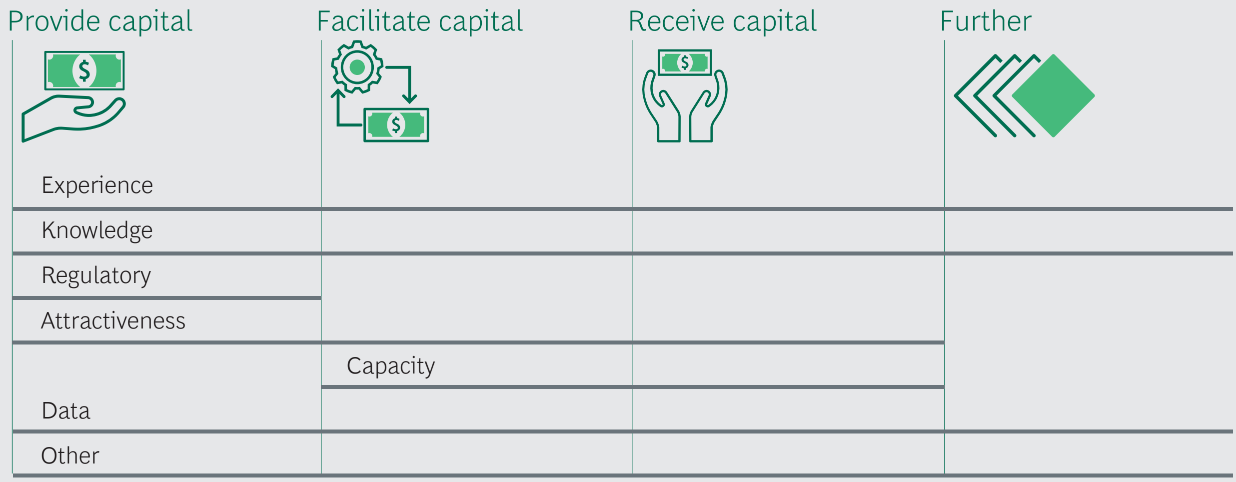
- Knowledge: We recognize that impact-linked finance needs a change in mind-set regarding results orientation and accountability. The stakeholders need a solid understanding of the concept, processes, available solutions, and implementation practices. The lack of commonly agreed upon principles and guidelines for implementation potentially limits the development of impact-linked finance, as the shift of focus from outputs to outcomes and the provision of financial rewards directly to market-based impact creators may be unfamiliar for some stakeholders.

- Regulatory: Providers of capital for impact-linked finance need to pay particular attention to external and internal regulation surrounding the concept. Currently, some established impact finance solutions have a positive tax effect, like charitable donations. Depending on the legal entity and setup chosen by the capital providers, it may be easier or more difficult to leverage innovative impact finance solutions. Especially for foundations, the focus of impact-linked finance on market-based enterprises may come with challenges in some geographies; for example, in the case of foundations wanting to provide grant-based rewards to market-based enterprises in developed countries (due to the primarily indirect charitable focus). Development or public actors might be more flexible in how to use their funding, especially as the financial rewards in impact-linked finance are directly linked to the envisioned results.

- Attractiveness: Impact-linked finance solutions need to be attractive for all stakeholders. Generally, for outcome payers this means delivering additional impact, and for impact investors this means an investment characterized by an appropriate risk-return profile. But it doesn't stop there: the returns have to be achieved efficiently. This requires that transaction costs (such as in planning and structuring the deal as well as in measuring the impact) are kept to an acceptable level, and deals need to be structured and closed within a reasonable time frame. As not all (impact) enterprises are suited for additional investment from an investor perspective and not all show promising potential for additional impact, there might be too few attractive (impact) enterprises available for impact-linked finance currently. For enterprises, an attractive impact-linked finance solution needs to serve their funding needs as well as their commercial and impact generation models. As impact enterprises typically do not have excess resources, they should not be overburdened with additional tasks. This gives rise to further constraints such as the question of who should invest the resources to monitor impact.

- Capacity: When impact-linked finance is seen as attractive, other constraints in accelerating and scaling may relate to (resource) capacity restrictions, mainly on the side of capital facilitators and receivers. This includes limited resources with expertise on how to plan and structure impact-linked finance deals as well as a lack of capacity to (rapidly) expand and scale business operations—both on a management and operational level.

EXHIBIT 4 | Categories of constraints apply differently to the stakeholder groups



- Data: Specific financial and impact-related data needs to be available. Financial data regarding potential impact-linked finance enterprises is relevant for investors and outcome payers to be able to analyze the underlying business model and its viability. Further, impact-related data needs to be available for impact investors, outcome funders, capital facilitators and enterprises to be able to define, measure, and analyze the impact targets and how they're achieved. This relevant data needs to be made available in an economic and timely manner.

While certainly not exhaustive, we feel that a sound understanding of these potential constraints is the critical first step to address them. All these potential challenges are manageable and can be met with various approaches over time. In the following chapter, we develop an action-oriented roadmap to accelerate and scale impact-linked finance.

FINDINGS FROM OTHER SOCIAL INNOVATIONS

There are important social innovations that have managed to scale and create an impact on a systems level, globally. Inclusive finance and Fairtrade have generated mixed opinions, but key insights can be drawn from their evolution and applied to impact-linked finance. Specifically, those two concepts can serve as illustrative examples of potential methods to scale and accelerate social innovations.

Inclusive finance

Microfinance, later expanded to inclusive finance, evolved from early government-financed rural agriculture schemes in India and lending groups pioneered by the nonprofit sector in Bangladesh to being operated commercially on a global scale today. Even though early initiatives were largely backed by government support and blended with public funds, the biggest push in inclusive finance today is commercially driven. In 2017, the global loan portfolio exceeded $114 billion serving a total of 139 million customers, growing by approximately 16% p.a. in loans and 6% p.a. in customers.[11] The following represents potential insights for impact-linked finance:

- Strive for pooling of funds to access new classes of institutional investors and ensure gains in efficiency, as microfinance investment funds have benefited from structured finance vehicles to approach a broader base of institutional capital globally.[12]
- Define and incorporate principles to define the scope of the social innovation and safeguard ethical considerations, such as in developing countries, as the international community has recognized and formulated principles for microfinance at the G8 summit in 2004, or as the Social Performance Task Force defined a joint vision of responsible inclusive finance.[13]
- Leverage technology thoroughly over time to broaden product offering, drive down transaction costs, and widen customer base, as peer-to-peer e-platforms (like Kiva) and mobile banking platforms (such as Safaricom's M-Pesa) have emerged long after the initial microfinance concept was born.[14]

Fairtrade

Fairtrade certification provides financial incentives for agricultural exporters that are following social and environmental standards. In 2017, Fairtrade's certified network amounted to almost 1,600 producer organizations in 75 countries worldwide, increasing roughly by 13% in certified producers since 2016.[15] The following represent potential insights for impact-linked finance:

- Introduce premiums and access to non financial resources (e.g., networks, expertise) for social and environmental good practices to achieve economic and financial sustainability, as certified farmers have received an above-market rate for the product by conforming to the Fairtrade norms, and as Fairtrade producer networks have organized training events. The Fairtrade premiums (amounting to approx. €178 million in 2017) and the access to non-financial resources led to higher levels of commercial viability for certified producers.[16]
- Leverage partnerships to drive awareness, visibility, and minimum standards, as Fairtrade has reached out to strengthen its ties with public and private organizations such as the Food and Agriculture Organization of the United Nations (FAO) and Mediaplanet. Having launched the 2018 World Food Day campaign together, the joint media outreach will last several months.[17]

We believe impact-linked finance will be able to address the various stakeholder positions and potential constraints. This will not only make the concept more tangible and well known, but also deliver on its promise of additional impact and contribution towards the achievement of the SDGs. To this end, we have created an action-oriented roadmap to accelerate and scale impact-linked finance comprised of five key levers to be applied over time.

Showcase proof of concept and engage further stakeholders

Knowledge
Experience
Regulatory

This report is pioneering the definition of the concept and approach of impact-linked finance. The critical first step will be to raise awareness of the concept for the various stakeholders, especially impact investors, outcome funders, and impact enterprises. Included in this has to be tangible proof that impact-linked finance is working successfully and generating the envisioned results. SIINC (Social Impact Incentives) has been implemented in four different transactions so far. Please see exhibit 1 for details on the case study of Clínicas del Azúcar that successfully applied SIINC under the impact-linked finance umbrella. As a logical next step, impact-linked finance will have to prove that it is more effective than other solutions and under what conditions that's the case. We encourage stakeholders to try new ways and learn more about the successes of impact-linked finance and how it can support their goals. In addition to finding partners and building a community to create future impact-linked finance solutions, impact-linked finance needs to find an academic home that can drive independent research and involve further stakeholders. An academic initiative can contribute to building the field and creating an evidence base. It can also drive educational programs to disseminate knowledge and build skills for its application.

We encourage stakeholder to try new ways and learn more about the successes of impact-linked finance

Design simple, powerful solutions and introduce sector-specific pooling

Attractiveness
Experience
Capacity

There are already impact-linked finance solutions on the market (please see exhibit 1 for more details on the first SIINC transaction). There is also a pipeline of further impact-linked finance transactions that need to attract new (co)funders and (co)investors. A focused, sector-specific approach holds huge potential to drive down transaction costs and create synergies. Building on the concept of sector-specific approaches, the next step should be starting outcome funds where donors (and potentially investors) pool their resources and target predefined impact objectives along the SDGs. These strategic outcome funds can enable demand for impact-linked finance and stimulate a market for impact. Together with Acumen and SDC, Roots of Impact has already published its Blueprint for an Outcomes Fund in Off-Grid Clean Energy and, with partners, has already launched a project focusing on vocational skill development in Latin America. We see additional interesting applications in other fields such as financial inclusion (in particular with fintechs), water and sanitation, and education. Finally, these initiatives should provide solid proof of concept at scale and thus contribute to effectively tackling large-scale development challenges. Over time, development of powerful impact-linked finance solutions will involve creating a family of impact-linked finance instruments, covering all kinds of financial solutions (debt-based, equity-based, or mezzanine). Examples include impact-linked guarantees, impact-linked shares, impact-linked notes, impact-linked convertible notes or impact-linked revenue-share agreements. A wide range of possibilities can be imagined and rewards for positive impact can be built into financing instruments across the board. Some of the models highlighted above are described in the report *Blueprint for an Outcomes Fund in Off-Grid Clean Energy*.[18]

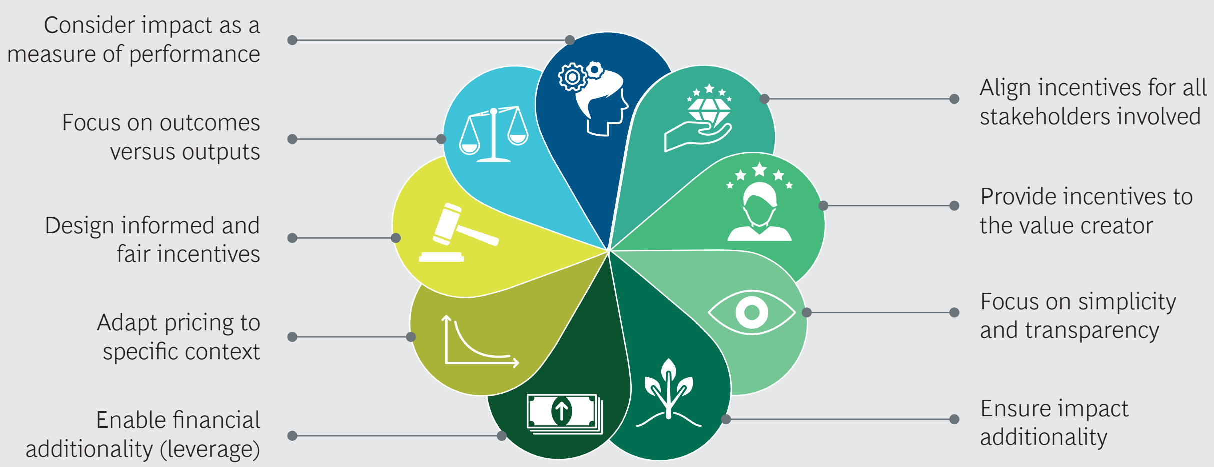
Knowledge Attractiveness

Build identity and establish open standards for practice

To date, there are no commonly defined and agreed-upon standards and principles regarding impact-linked finance. To rectify the situation, introduce design principles and quality standards. This is in order to define the applicability of the concept; guide and simplify the implementation of impact-linked finance solutions; enable broad replication; ensure effectiveness; and prevent dilution. Roots of Impact has already drafted initial design principles that should be validated and augmented over time (exhibit 5). Importantly, the design principles should be further developed by a consortium of relevant stakeholders including academic institutions among others. These principles should be considered when designing impact-linked finance transactions in addition to other relevant standards and principles such as the OECD DAC Blended Finance Principles.

These design principles were formulated in order to promote the most effective use of impact-linked finance models and transactions. It represents a springboard for broader involvement of practitioners, experts, academics, and other stakeholders who are invited to advance the principles. As an example, the principle "consider impact as a measure of performance" should express that incentives have to be relative (e.g., rewarding every percentage point of higher penetration of bottom-of-the-pyramid [BoP] customers) rather than rewarding the achievement of fixed targets or milestones (e.g., a target of 20,000 BoP customers is achieved) to stimulate the creation of additional impact and increased performance. Another example is "enable financial additionality," which highlights that incentives should have a link to investment and enable the leveraging and scaling of resources (e.g., $5 of private investment raised for every $1 incentive payment provided). This does not mean that more financial leverage is always better. Leverage has to be appropriate for the context, since financial resources in impact-linked finance are primarily a means for creating developmental additionality.

Exhibit 5 | Design principles for impact-linked finance



Engage in knowledge dissemination and capacity building

In order to pool the latest knowledge, make best practices and practical implementation guidelines available, and engage more stakeholders, an open knowledge platform is of vital importance. This platform, hosted by a consortium of practitioners, academics, and experts should continuously serve the growing community of stakeholders in impact-linked finance. Education programs for practitioners, in particular public funders and providers of concessional capital, could build on and leverage the platform. Incubation programs for capital facilitators who want to engage in structuring impact-linked finance transactions and for enterprises who want to participate in such solutions can build the capacity for an accelerated application. Moreover, based on impact-linked finance transactions in similar sectors, templates could be created to guide the future application of impact-linked finance in these sectors and standardize its implementation.

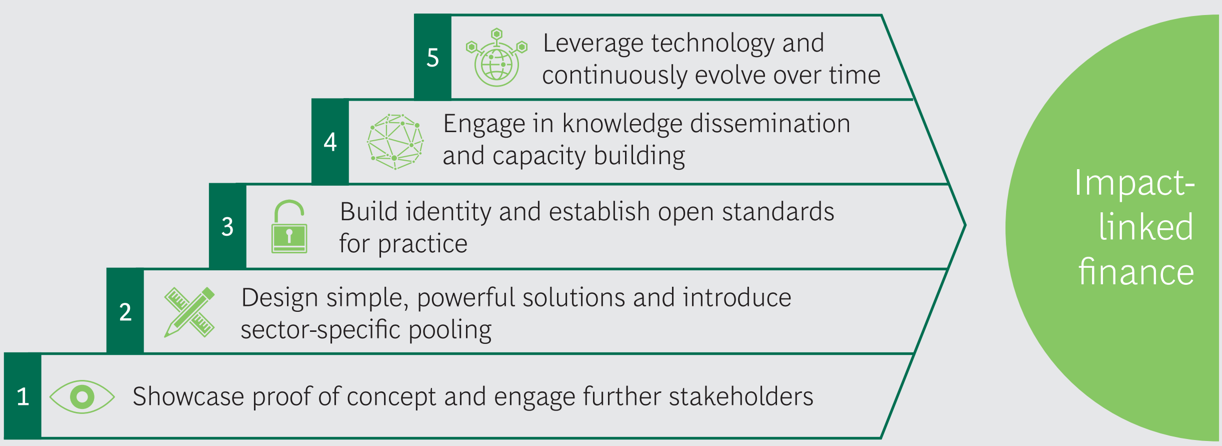
Knowledge
Capacity

Leverage technology and continuously evolve over time

Apply further levers such as technology systematically over time to reduce costs and increase transaction speed. Furthermore, incorporate existing best practices for impact measurement and verification such as Acumen's Lean Data. As impact-linked finance becomes more established, the role of technology will become more central over time. This will include remote sensors and Internet of Things for impact data generation, data verification with blockchain, an impact-linked finance engine with smart contracts and impact warrants, the use of machine learning for outcomes identification, and pricing. In particular, technology can help to create and enable a market and price discovery for impact. The possibilities are vast, and with focused efforts technology can be adapted to the specific needs of impact-linked finance to the benefit of all stakeholders. As this roadmap is being implemented and feedback is received by additional stakeholders, these learnings should be incorporated to continuously improve the concept, enhance quality, and push for more efficiency in various solutions.

Attractiveness
Experience
Data

Exhibit 6 | Five-step roadmap to accelerate and scale impact-linked finance



By implementing the proposed five-step roadmap, we believe that impact-linked finance will be able to accelerate and scale, thereby nudging organizations to deliver additional positive social outcomes. In order to advance impact-linked finance applications and to design the way forward, all stakeholders are called to action. We especially encourage:

- Traditional and impact investors to be curious and get involved in the current pipeline of impact-linked finance transactions, providing leverage to public or philanthropic funding to scale the impact

- Public funders and providers of concessional capital to explore new ways in financing their impact goals and use their resources, networks, and platforms to support the impact-linked finance concept both through funding and in terms of awareness

- Social and impact enterprises to raise awareness within their current investment community, learn about the benefits impact-linked finance has to offer and explore the use of impact-linked finance instruments in their future endeavors

- Academia to engage in independent research to establish best practices, challenge the impact-linked finance principles, drive educational programs to disseminate knowledge, and build skills for the implementation of impact-linked finance

There is enormous potential to leverage and combine efforts and resources to achieve social impact at scale. By doing so, impact-linked finance will actively contribute to the achievement of the Sustainable Development Goals and help close the funding gap of $2–3 trillion per year.

We encourage you to connect with us, as we are eager to hear from you, exchange thoughts and ideas, and further shape impact-linked finance together.

Notes

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18. This project will be implemented by a partnership of SDC, IDB, Roots of Impact and New Ventures with support from Ashoka. Further information can be found: Roots of Impact. 2018. Blueprint for an Outcomes Fund in Off-Grid Clean Energy – Pushing the Boundaries of High Impact Businesses with Next Generation Results-Based Finance. Frankfurt a.M..

About the Authors

Alexander Baic (Boston Consulting Group, baic.alexander@bcg.com)

Bjoern Struewer (Roots of Impact, bstruewer@roots-of-impact.org)

Wolfgang Doerner (Boston Consulting Group, doerner.wolfgang@bcg.com)

Brad Henderson (Boston Consulting Group - BCG Henderson Institute, henderson.brad@bcg.com)

Max Maennig (Boston Consulting Group, maennig.max@bcg.com)

Leopold Kammerer (Boston Consulting Group, kammerer.leopold@bcg.com)

Patrizia Baffioni (Roots of Impact, pbaffioni@roots-of-impact.org)

Benedicte Montgomery (Boston Consulting Group, montgomery.benedicte@bcg.com)

Acknowledgments

We would like to thank everyone that has contributed to this report, especially those that have invested their time for an expert interview. Notably, we would like to thank Dr. Peter Beez, Dr. Guido Beltrani, and Dr. Lars Stein (Swiss Agency for Development and Cooperation), Gabriela Gandel (Impact Hub), Karl H. Richter (EngagedX), Richard Ambrose (Pomona Impact), and Karim Harji (University of Oxford, Saïd Business School).

For Further Contact

If you would like to discuss this report, please contact one of the authors.

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