Impact Investment seeks to address financial repression and inequality in access to capital and is a growing financial investment approach that is being applied across all asset classes. This approach promotes a move away from aid reliance to investment by accessing funds in traditional capital markets. Impact investments are made with the intention of generating positive and measurable social and environmental impact alongside a financial return. In addition, innovative finance constitutes the various creative ways that capital flows and funds can be leveraged and channeled to amplify impact.

Given their link to social returns, impact investments are synonymous with capital provision to address the global challenges outlined in the Sustainable Development Goals (SDGs), in sectors such as sustainable agriculture, renewable energy, conservation, microfinance housing, healthcare and education.

There is a strong business case today for the SDGs where steady financial returns are being realised alongside real and sustained social impact. The financing gap to achieve the SDGs is estimated to be $2.6 trillion. Traditional funding sources cannot keep pace and close this gap so financial markets have evolved to fill this financial void. Capital market flows are being encouraged to restructure towards capital structure designs that compliment the more nuanced metrics of social impact projects. In return, social projects are relooking at both their project (programme design) and capital structure elements (revenue models) in order to sufficiently satisfy the return and reporting expectations of this new class of investors.
KEY QUESTIONS TO CONSIDER

1. Can impact investments generate measurable social and/or environmental impact alongside a real financial return?
2. Are impact investments truly providing financial access for social and environmental focused businesses?
3. Are the appropriate financial products and capital structures being used?
4. What are the latest innovative financial models that can be applied?
5. How can impact investing help us accelerate social solutions to the market through finance for scale?
6. How can social and investment practitioners design financial solutions that will attract and crowd in capital in order to generate positive returns?

THE CHALLENGES OF IMPACT INVESTMENT

Intentional design and management of impact investment funds seeks to address these two main challenges:

CHALLENGE 1: Impact investment models that generate social returns apply outcomes-based finance. In these revenue models, the social business gets paid for the social impact outcomes that are derived as benefit from the programme. But these projects are typically both labour and material intensive so the resulting transaction costs are high. How do socially and environmentally focused businesses cover these costs? How can projects be structured accordingly and who pays the transaction cost?

CHALLENGE 2: What finance is needed at what stage of growth? Which financial tools introduced at which project stage can help to build consistent models that can leverage impact at different stages in the project?

6 KEY CONSIDERATIONS FOR IMPACT INVESTORS

CONSIDERATION 1: The importance of linking impact investment to traditional capital markets
The required investment to fund social impact projects sits in the capital markets and it is these markets that will help us bridge the gaps towards a more sustainable future. A key focus of this work is to legitimately leverage funds for impact investment by linking and aligning the basic principles of impact investment to the traditional capital markets.

CONSIDERATION 2: The importance of matching investors to investments by creating a viable pipeline
It is important that the field of impact investment continues to identify and support a pipeline of investable projects that can be showcased and matched to investors in order to create the type of change at scale that is needed.

CONSIDERATION 3: The importance of technical assistance and leveraged grants
If linked to a viable development model, then official development assistance (ODA) and Technical Assistance (TA) can effectively support impact investments to sufficiently address every gap in each stage of a social project’s development process.

CONSIDERATION 4: The importance of transparency for financial inclusion
Impact investment works to champion a new form of transaction for social good; one that is built on trust and transparency rather than solely relying on legal complexity. Increased transparency is critical to inclusion and real economic growth with full participation from all sectors of society.

CONSIDERATION 5: The importance of creating an increasing returns model of economic growth
The main macroeconomic growth models associated with impact investments are the more recent, nuanced theories that support the notion that equality spurs economic growth and argue against the idea that growth requires a trade-off between the two. It is important to understand these and other macroeconomic growth models in order to apply a more anticipatory and proactive approach to project design for financing growth.

CONSIDERATION 6: The importance of capital structures and blended finance
Blended finance is a financing approach comprised of a mix of concessional (soft) loans and market-rate financial sources. This finance is provided to high-impact projects that would not attract funding on strictly commercial terms because the risks are considered too high or the returns are either unproven or do not commensurate with the level of risk.

“With impact investing and innovative finance we are looking to increase the pie. We want to bake new cakes not just re-divide existing cakes.”

Professor Glenn Yago
This Toolkit is a basic guide for designing a social impact project that is aligned to and can channel impact investment funds, including explanations of the capital tools available and how to manage project financial risk.

When applying financial innovation like impact investing to your programme design, distinguish between the 3 P’s of innovative finance:

- **PRODUCT** e.g. new financial products for low income market
- **PROCESS** e.g. a new and improved water sanitation delivery system
- **PROGRAMME DEVELOPMENT** e.g. project staff are supported with improved modes of transport to deliver services in the community

**TOOLS FOR BUILDING CAPITAL STACKS**

There are a variety of capital tools (assets) at one’s disposal in impact investing and each comes with its own risk allowance.

**Examples of these capital tools include:**

**BELOW-MARKET-RATE TOOLS**
- Grants
- Recoverable grants
- Guarantees / credit enhancement
- Below-market loans
  - Revolving loan funds
  - Gap financing
  - First-loss loans
  - Community development venture capital

**MARKET-RATE TOOLS**
- Cash (deposits)
- Loans
  - Senior
  - Subordinated
  - Guarantees
  - Loan funds
  - Line of credit
- Fixed income
  - Bonds
  - Bond funds
  - Asset-backed securities

**ALIGNING PROJECT STRUCTURE WITH CAPITAL STRUCTURE**

The 5 stages of project development are each associated with different financial needs and each comes with its own investment risk nature.

Typically, the type of finance appropriate to each stage in the project evolution can be summarised as follows:

<table>
<thead>
<tr>
<th>GRANTS</th>
<th>EQUITY</th>
<th>IMPACT LOANS</th>
<th>CREDIT SUPPORT</th>
<th>MARKET LOANS</th>
<th>CAPITAL MARKETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recoverable Design Grants</td>
<td>Equity</td>
<td>Subordinated Loans</td>
<td>Guarantees</td>
<td>Bank Loans</td>
<td>Bonds</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>Impact Equity</td>
<td>Participating/Performance Loans</td>
<td>Insurance</td>
<td>Loan Syndications</td>
<td>Pooled Bonds</td>
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<tr>
<td>Convertible Loans</td>
<td>Development Impact Bonds</td>
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</table>

**DESIGN** ➔ **DEVELOPMENT** ➔ **IMPLEMENTATION** ➔ **OPERATIONS** ➔ **GROWTH**
**KEY QUESTIONS: PROJECT STRUCTURE DESIGN**
When designing a project’s desired outcomes, these are the key questions to consider with its financial feasibility in mind:

- What is the market?
- What is the impact?
- Who owns the project?
- How is the project managed?
- What are we building?
- How much does it cost?

**KEY QUESTIONS: CAPITAL STRUCTURE DESIGN**
When designing the capital structure or revenue models for a project, these are the key questions to consider:

- What are the sources of revenue?
- Who pays? Who is the customer?
- What happens if they do not pay?
- What are the financial returns to each investor?
- How is the project sustained?

**MANAGING PROJECT RISK IN FINANCIAL MODELING**
A key impact investing principle is that different investors have a different risk tolerance, according to their investment mandates. Impact investments target a range of returns from below market to market rate, depending on the strategic goals of the investor. Different financial assets are available to accommodate various forms of risk and mitigate against it.

Note: Two options are available when managing risk:
1. Reduce the probability of bad outcomes
2. Offset the impact of bad outcomes (through an insurance policy)

**5 AVAILABLE FINANCIAL TOOLS OR INSURANCES FOR RISK MITIGATION:**

1. **CURRENCY SWAP:** An agreement in which two parties exchange the principal amount of a loan and the interest in one currency for the principal and interest in another currency.

2. **FUTURES MARKET:** Favourable for use in agriculture when looking to reduce risk by exposure to market price volatility.

3. **CALL & PUT OPTIONS:** A call option gives the holder the right to buy a stock and a put option gives the holder the right to sell a stock. A way to increase cost efficiency and has the potential to deliver higher investment returns.

4. **CATASTROPHE BONDS:** Risk-linked securities that transfer a specified, negotiated set of risks from the project to the investors.

5. **DIVERSIFICATION:** Allocating capital in a variety of ways to reduce exposure to any one particular asset or risk element.

**KEY CONSIDERATIONS FOR PROJECT IMPLEMENTATION PLAN**

1. **PROJECT:** What is the project proposing to do?
2. **OPPORTUNITY:** What need is it meeting? Who is interested in the success of this project? Who are the stakeholders?
3. **TEAM:** Who is doing it? What is their experience, expertise, roles?
4. **MARKET:** Who is the customer? What are the marketing channels to reach the customer?
5. **COSTS:** How much does it cost to build? To operate?
6. **CAPITAL STRUCTURE:** How will it be financed? By whom and under what terms and conditions? What are the returns to each investor?
7. **PLAN:** What is the workplan and milestones?
8. **RISKS:** What are the risks and how will the risks be mitigated?
9. **OUTCOMES:** What are the outcomes and how will they be measured?
A PRACTICAL EXAMPLE

CASE STUDY: SMALLHOLDER FARMERS AND ALFATOXIN ERADICATION

Problem: Sub-Saharan Africa is plagued by Aflatoxin, a pervasive toxin which contaminates maize and other crops. Humans and livestock that eat infected crops are at risk of liver disease and reduced immune function. Aflatoxin crop contamination results in almost half-billion dollar trade losses in Africa every year. Successful eradication of this toxin would smooth asset and income shocks and enable farmers to generate higher, less volatile incomes, maintain valuable assets and increase crop productivity and profitability. Aflasafe™ is a biocontrol product that can drastically reduce Aflatoxin in maize and groundnut yields.

Solution Options: A range of financing options were available to incentivise Aflasafe™ adoption by smallholder farmers (these different financing options have varied impact on the value-chain and programme design):

OPTION 1: Purchase Aflasafe™ directly and distribute to smallholder farmers for free or at highly subsidised rates included in other input bundles

Pros: Easiest way to clearly incentivise manufacturing
Cons: Distribution and verification is difficult with no monetary incentive for farmer; free product distorts the market

OPTION 2: Pay for performance which requires fields to be surveyed; farmers are rewarded for either prevalence of Aflasafe™ strains or reduction in overall Aflatoxin contamination.

Pros: Successful adoption is rewarded; behaviour is incentivised, and subsidy is truly aligned with the ultimate social objective.
Cons: Baseline and result surveys are costly and added complexity of sourcing a contractor partner to facilitate this option.

OPTION 3: Buy Aflatoxin-free agricultural products thus creating a ‘premium’ value-chain

Pros: Creates new commodity category of Aflatoxin-free maize with price premium; introduces Aflatoxin testing at many points of the value chain.
Cons: More complex coordination of additional players and requires careful navigation of maize purchasing subsidy. A harder sell for manufacturers when trying to incentivise investment.

LESSONS & OUTCOMES OF OPTION 2
(A pull mechanism example):

Pull mechanisms are results-based incentives designed to overcome market failures and encourage innovation and engagement.

- Smallholder farmers are provided with incentives as well as technical assistance to produce high-Aflasafe™ maize. Farmers are able to aggregate and trade commercial quantities of healthy, Aflatoxin-free maize.
- Farmers are free to share their knowledge of production technologies with other participating farmers thus supporting local innovation
- 80-99% reduction in Aflatoxin infected fields where Aflasafe™ fertilizer was used
- 56% uptake by smallholder farmers in creating Aflasafe™ fields
- 16% increasing smallholder annual net income from crop disease reduction
QUESTIONS RAISED IN PEER DISCUSSION

IMPACT INVESTMENT AND ROLE FOR SME SUPPORT
Despite their important catalytic role in economic growth, small and medium enterprises (SMEs) remain significantly underserved by financial institutions. The missing middle refers to the gap in available finance that SMEs fall into when looking for working capital or growth finance. The microfinance market in South Africa, in particular, is undeveloped and impact investment may be a solution to bridge the risk capital gap through intermediary investment organisations.

ADDRESSING THE DISCONNECT
How do we simplify impact investment principles and convey this information to the projects on the ground in emerging markets? How do we ensure a more equally informed transaction? Impact investor intermediaries need to act as translators in the field to ensure a fair and proper distribution of knowledge.

DIRECT LENDING TO FARMERS AND THE CHALLENGE OF RECORD-KEEPING
What are the investor requirements and preferences for direct lending to farmers? Accurate and consistent record-keeping is a critical first point of departure for this but access to technology and illiteracy levels are common challenges. What successful solutions are available locally to address this?

AGGREGATOR MODEL FOR FUNDING EMERGING FARMERS
Agricultural investors emphasised preference for funding agricultural aggregators or intermediaries as a way to 1) simplify transactions and 2) fund mentorship and technical support. Agricultural investors in South Africa also partner with various commodity associations to provide business development support to guarantee the profitability of their investments.

PUBLIC-PRIVATE COLLABORATION
How can our public funds help mobilise and create confidence for private investments? What is the role of government funding in development and innovative finance? How can we create more opportunities for dialogue between public and private investors about risk appetite and better streamlining of investment mandates?

CROSS-BORDER LEARNING AND SHARING
The group recognised that many of the challenges we face, particularly when working in smallholder agriculture, are not isolated issues and when discussed can be reduced to a common set of problems. How can we facilitate cross-border learning to leverage the lessons from our country neighbours in other emerging markets?

ABOUT SOLIDARIDAD
Solidaridad is an international NGO working in agriculture value chains. With 50 years of experience, Solidaridad is a frontrunner in the area of sustainable economic development.

We excel in facilitating the development of socially responsible, ecologically sound and profitable supply chains. We are an international market and solution-oriented civil society organisation working through ten regional expertise centres in almost 53 countries.

We aspire to transform production practices in such a way that provides fair and profitable livelihoods and business opportunities, guaranteeing decent working conditions and a fair living wage, without depleting the landscapes where people thrive, now and for generations to come.

ABOUT THE ASPEN NETWORK OF DEVELOPMENT ENTREPRENEURS (ANDE)
The Aspen Network of Development Entrepreneurs (ANDE) is a global membership network of organisations that propel entrepreneurship and small and growing businesses (SGBs) in emerging markets.

Our members include for and nonprofit investment funds, capacity development providers, research and academic institutions, development finance institutions and corporations from around the world. Launched with 34 members in 2009, ANDE now comprises of 290+ members collectively operating in more than 150 countries. ANDE’s headquarters is in Washington DC with eight regional chapter offices around the world.