GDN's Next Horizons Essay Contest 2014*

THE FUTURE OF DEVELOPMENT ASSISTANCE

Supported by the Bill and Melinda Gates Foundation

Winning Entry

"SCALING THE IMPACT OF DEVELOPMENT ASSISTANCE"

Abstract

Aid has played a major role in tackling some of humanity's most pressing problems. Nonetheless, stories of hunger, disease and illiteracy still abound, despite the heavy deployment of aid to mitigate these very problems. In recent times however, technology and an ever-growing population have necessitated a change in tact with regard to how problems are addressed and how aid is deployed to solve these problems. Market-based and pro-poor solutions are currently making ripples in social change circles. Impact investing is one of the channels through which aid can be harnessed to scale the impact, which can be used by individuals and foundations desirous of making the world a better place. There has been increased focus on how donor funding can be better targeted at provision of transformational capital to offer solutions to problems at the grassroots. By unlocking capital for use in such businesses, grant makers will bring environmental conservation to scale, create employment and improve the livelihoods of the poor globally. Impact investing is sustainable and can have a catalytic, productive, scalable and positive impact on the social and environmental spheres.

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**The GDN Next Horizon Essay Contest was launched globally by the Global Development Network (GDN) in 2014, with the support of the Bill & Melinda Gates Foundation. The contest invited contributions related to the future of development assistance to inform the ongoing discourse on development assistance with fresh thinking, and revamp policy debates with new voices. This essay is one of 13 winning entries selected by a high-profile Jury of aid policy makers, experts and practitioners chaired by Nancy Birdsall.*

Scaling the impact of development assistance

The benefits accrued through donor aid over the years cannot be denied nor underestimated. Take, for instance, smallpox; a highly contagious disease that is now a thing of the past, thanks to aid from the Carter Foundation. Then there is the deadly and debilitating polio, currently on its deathbed. The unrelenting fight against malaria, HIV/AIDS, hunger and poverty has helped save millions of lives over the years. Also, through donor aid, millions of children who could not have gone to school are now pursuing careers that they once could not even dream of. In many ways, the world has undoubtedly been made a better place by men and women who have dedicated their hard-earned resources to addressing and illuminating the plight of the marginalized.

However, this battle exists on a massive scale; and although the difference made by governments and donor agencies is significant in terms of addressing the problems of millions of people, millions more are still languishing in poverty, disease and illiteracy. This is proof that the efforts of donors and governments are no match against the magnitude of hardships that vast sections of humanity face today. There is no single panacea to these endless problems, which cannot be solved easily or swiftly, or through a one-size-fits-all approach. They require enormous effort, sufficient time and a strategic, multifaceted approach to reach a solution. Aid can be harnessed to achieve higher, more sustainable impact by integrating it with other financial tools.

The current aid model, in some cases, is not sustainable. This was evident at the height of the global economic crunch when donor taps in most countries ran dry. The current model, among its other shortcomings, has also been blamed for promoting the culture of dependency. In other cases, aid is top-down and always ignores the voice of the grantees. These shortcomings indicate the need to restructure the model and incorporate new ideas. At this point in time, it is important to reflect on what has worked, how it has worked and how we can create a bigger impact.

In recent times, however, a change in tact *vis-à-vis* how problems are addressed has gained momentum. Market-based and pro-poor solutions are currently making ripples in social change circles, and in particular the term impact investing has gained currency among investing and philanthropic circles. Different terms such as social investments, triple-bottom-line enterprises, and social impact enterprises have been used to refer to this very concept, of which there is no clear description, but all the definitions available are congruent with ventures that are set up deliberately with a view to generating profit as well as addressing social and environmental issues. In brief, impact investing refers to the deployment of financial capital in a venture that will intentionally create a desired and quantifiable social impact, along with some modest profit for growth and sustainability of the venture. Key to this concept is therefore the idea of measurement. The impact of these enterprises must be measured and reported in order to track the desired change and gauge its desirability, and in some cases replicate the venture or inject more capital into it.

Although still at a nascent stage, this venture has already had an impact on the lives of millions of people, making them more efficient and more productive. In Kenya, Ecotact, a sanitation company, has brought dignity to the lives of thousands of people who had no access to clean toilet facilities. Through an innovative facility that uses little water but maximizes on gains from human waste by producing methane and organic fertilizer, Ecotact has not only solved the problem of poor sanitation (to a large extent in urban areas) but it has also provided a solution for farmers who require affordable nutrients for their crops.

There are many other examples of impact investment the world over, that have gone a long way in providing working solutions and reducing poverty. KIVA lends as little as US $25 to young people to pursue education. The loans are payable at minimal interest upon completion of studies. This facility has enabled thousands of students from poor backgrounds to access university education. Other impact enterprises focus on low-cost housing, Information and Communication Technology (ICT) access and provision of affordable electricity generated through renewable energy sources. To ensure continuity of impact, one can, for instance, provide capital for a group that recycles waste to make mosquito nets — rather than simply giving out mosquito nets — at a cost that is affordable to the target population. In doing so, one not only creates employment but promotes environmental conservation.

Impact investments are not ‘business as usual’. They attract a higher risk, generate below-market-rate returns, and are therefore less attractive to many financial investors whose main objective is to rake in massive profits, sometimes to the detriment of the poor. Although the practice of impact investing is not new, the interest generated by impact investing as a vehicle for positive social and environmental change remains at a nascent stage. The concept is creating a buzz within some circles of individuals and foundations who share a powerful desire to improve society, but little more. Impact investing, however, has also the potential to be a complementary tool to strategic development intervention aiming at providing scalable solutions to the problems presenting humanity.

Why Impact Investing?

Donation-dependent non-profits and many non-government organizations that rely on donor funding are often unable to run programs that are sustainable. Sustainability is critical to any program that will have a lasting social change. In the current philanthropy model, a project aimed at providing mosquito nets for fighting malaria lasts as long as aid lasts. In an impact investing model, the enterprises would virtually grow and live long, independent of external funding – hence the potential of making the impact sustainable.

Although many investor funds have been established, a gap remains in this emerging market that can only be filled through aid. Impact investing looks unattractive to the profit-first funders. Although the social returns are impressive, financial returns are not very alluring. In addition, it is a high risk venture. Yet the benefits of deploying capital through impact investing are numerous. As a market-based solution to diverse issues, the funder is guaranteed a bottom-up approach, for it is the people at the ground level who know what their most dire problems are. When solutions are sought from them, there is assurance that priority will be given to their most immediate needs and the solution has a much higher chance to be compatible with their socio-cultural environment.

What also makes the impact investing market attractive is the ease in measuring the impact. Already, several impact rating tools have been developed through donor funding. These include the Global Impact Investing Rating System (GIIRS) and IRIS metrics. There is a surge in growth and initiation of entrepreneurs who are ready to set up small and large businesses that are unattractive to mainstream businesses but that have a major impact in terms of alleviating poverty. These entrepreneurs provide services such as provision of water to the underserved populations, sanitation, food, decent employment, among other things. A philanthropist can choose a program and easily identify a rating tool to determine where more capital should be deployed for greater impact.

Compared to the grant model, wastage of funds is minimized in this model. The 'grantees' know that the resources obtained are given in the form of borrowed money that they have to repay, thus incentivizing the need to manage funds prudently. Presently in some cases, aid is spent on activities with high administrative costs. For example, conferences would be significantly lower. Deploying capital in this investment, therefore, could also contribute to minimizing the misuse of aid.

Deploying aid to Impact Investing

There has been increased focus on how donor funding can be better targeted at providing solutions to the world's most glaring and serious problems. In response to this, many financial tools and emerging asset classes have been set up. These market-based solutions have also received attention from philanthropic organizations and individuals. Among them is the Rockefeller Foundation which has engaged in and remained at the forefront of scaling up impact through the promotion of impact investing

Impact investing consists of investors and entrepreneurs who form the supply and demand side of capital respectively. Development partners can enter the emerging sector either as an investor whose tentacles will go beyond providing capital or they can take on the task of capacity building. The biggest challenge lies not in getting capital, but in getting enough enterprises to take up the capital.

How can the impact of aid be scaled through impact investing? In considering the choice of impact investing as a vehicle that can be used to scale up impact, one can take a lesson from the micro-finance sector, which was started as a non-profit venture but it later grew to become a multi-billion dollar industry with a huge positive impact on the lives of millions across the world. In recognition of the potential of this emerging sector, Koh, Karamchandani and Katz (2012, 1) describe impact investing as "the next micro-finance revolution." To a large extent, micro-finance has been a product of aid. Rodin and Brandenburg (2014), explain that unlocking even a small percentage of the trillions of dollars in aid for impact investment would dramatically expand resources available to address the world's biggest social and environmental problems.

In a number of ways, aid can be harnessed and deliberately deployed to foster measurable change. Firstly, it can be deployed as capital for impact investing. This should be done either directly by the donor financing an existing enterprise on the strength of the size of social and environmental impact it has on the target area, or through an investor whose role is to provide seed-funding to start-ups or existing enterprises. By unlocking capital, aid can spur growth in this sector and ultimately scale up impact. It is advisable that the donating agency forms a subsidiary or joins an existing investor such as Root Capital, Acumen Capital or Grassroot Capital, among others, in order to remain focused on their core business. This capital should not be a donation to the enterprise. The grantees should be given a grace period upon which they start repaying the debt or have the debt converted to equity. In so doing, the business will be sustainable and its impact will be potentially scaled up.

Aid can also be channeled in the form of Social Impact Bonds. This involves a commitment that the donor will pay for the social or environmental service delivered by the enterprise or government. In issuing such a bond, aid will be a catalyst and a motivation for the entrepreneurs to deploy capital in ventures that will deliver more impact; this with a view to enhance their eligibility for receiving such funding. Injecting more capital into the existing enterprises that hold promise for a larger impact is a big shot in the arm for this sector. Bonds in this sector will make people feel more confident with regard to investing in the sector, as they will be assured of a return after they have successfully performed their duties.

Furthermore, aid can scale up impact also through research on impact investing. There is currently a need for more informed decisions in this sector: decisions that will be informed by solid scientific data through research. The Rockefeller Foundation, for instance, provided funds to different research institutions to examine the landscape of policy in impact investing in the global south. Such studies are crucial to the development of favorable policies that will scale up the sector as well as social economic impact. The sector requires initial due diligence and also well designed impact measurement tools and practices.

Aid can also be deployed in impact investing through programs that support the sector's wider ecosystem. Funds can be strategically disbursed to promote awareness among consumers with regard to the need to supply and consume the products of these social businesses, for one of the challenges faced in this sector is lack of consumer awareness *vis-à-vis* the existing products. For instance, if an impact enterprise uses recycled waste and employs the urban poor to make a product, consumers should be made aware of the social and environmental benefits of promoting such an enterprise through the access to its products. In addition, smooth deal flows are possible when investors receive applications for funding from the enterprises. In such cases, aid can be deployed to enable people to undertake capacity building, should they desire to do business in this sector. Furthermore, the intervention that is made through the deployment of aid should be directed towards crucial projects that are likely to have a broader impact to include other sectors of the economy. The investments identified should be program-related ventures.

While impact investing holds promise in terms of helping alleviate humanity's most pressing problems, it is nonetheless a small industry that can deliver large-scale impact only through intervention in the form of assistance through aid. It is one of the avenues where aid can be deployed to scale up social impact. Although investor capital is available, its potential to scale impact is hampered by the stringent conditions placed on it. It therefore requires low-risk-averse funders, such as philanthropists. This does not in any way imply that there is a high probability of such a business to fail, and due diligence should be conducted systematically on the target enterprise and its business plan.

Philanthropy can be a good catalyst for unlocking the potential of impact investing. Koh, Karamchandani and Katz (2012) decry the lack of deal flow in impact investing as a major challenge in the sector. However, one can look at donor funds as a factor that will stimulate deal flows. With enough communication on the existence of such funds, many existing and potential entrepreneurs would want to join the sector. On the basis of this experience and success stories, one would advise the donor community to diversify their approach to making the world a better place by embracing impact investing and boosting it. Their intervention should not be anchored in starting these enterprises themselves but in promoting the existing enterprises or promising start-ups through the provision of capital.

Philanthropists should, overall, not discontinue their grant-giving operations. Different problems require different types of interventions. The idea is that they should broaden their approach to include new ways to explore sustainability and bring impact to scale. Koh, Karamchandani and Katz observe that impact investing should not replace philanthropy, but rather complement it.

Challenges in impact investing

Concerns of real deal flows remain the biggest challenge to unlocking the available capital for the growth of impact investing. There are hundreds of investors in the global south, armed with billions of dollars, in search of deals that will proffer good financial returns as well as make scalable social impact. In the last few years, one common observation among these investors has been that there is a shortage of 'deal flow' and that this leads to poor assimilation of the huge funds. This situation is blamed on scarcity of 'bankable ideas.' In one instance, Monitor Group (2012) reports that Acumen Fund's investing experience reflects this reality: it had, under consideration, more than 5,000 companies in the past 10 years but invested in just 65 of them, indicating that there is a huge gap between the investors' aspirations and the reality of entrepreneurs at the ground level. The supply side is looking for deals but no one is involved in improving the available deals for them. Although the investors can play a role in stimulating or accelerating these deals, they are not best suited to do so as this is not their core business. Bannick and Goldman (2012, 5) describe this situation using the analogy of "the proverbial water pump waiting for the flood of deals, while no one is actually priming the pump!" Moreover, a recent study by SVA consulting revealed that impact investing has failed to flourish due to various obstacles. On the supply side, lack of large scale opportunities is a challenge. Most investors look for enterprises worth over US$ 50 million or above, and such businesses are hard to come by in the emerging markets.

Another obstacle cited is the lack of investment-ready businesses. It is difficult to meet an enterprise that promises financial returns as well as a measurable and desirable social impact. In addition, SVA (2015) cites the absence of an intermediary market as a challenge, for there are no established relationships between investors and entrepreneurs. For instance, most of the investors who have set up offices in Africa are foreigners, with limited or little exposure to entrepreneurs at the local level. Likewise, the entrepreneurs have limited or no knowledge about the investors. Hence, there is an urgent need for a link or intermediary between the two players.

How donor aid can address these challenges

Some of the obstacles cited above are too big for any individual firm to solve alone, and this necessitates the need for independent effort that can benefit all the players in this sector. A combination of for-profit and not-for-profit investments makes for a most strategic mix of solutions to achieving higher social impact. Also, the challenges mentioned above can best be met by seeking solutions from the players in this sector, with a strategic boost from donor aid. Bannick and Goldman (2012, 12) observe that capital appears to be thinnest precisely where it is needed the most — to prime the pump of innovation and deal flow.

Neither the supply nor demand side can bridge this gap, since in doing so there would be financial implications: namely, no returns. The best remedy to the challenge of lack of investment-ready enterprises is deployment of aid to catalyze the development of business that will offer scalable solutions with attractive financial returns and social impact. To realize this ambition, this paper proposes a number of interventions through which donor aid organizations can catalyze the social impact investment sector.

In this regard, cognizant of the fact that the donor community lacks the expertise and human capacity to undertake such initiative, I propose the formation of a body with a name such as the Social Impact Network Initiative (SINI). This should be the arm of philanthropists as well as Official Development Assistance dedicated to offering solutions, with the primary goal of accelerating impact investing through readying entrepreneurs for assimilation of capital from investors and linking up the two players in the industry. With a global headquarter and an advisory board that draws membership from the donor community, the supply and the demand side, this initiative should have regional offices that run the affairs by providing local solutions to the unique landscapes throughout different parts of the world. A similar body, Global Impact Investing Network (GIIN) exists. However, GIIN provides a platform for investors to meet and take part in activities that build this emerging asset class from the supply side perspective. Through GIIN and other networks, the supply side is well developed. The demand side lacks a common network that would help in engaging the supply side and other players collectively, hence the need to set up SINI.

To do this, a collective action between the SINI, the supply and demand side is crucial. SINI should, at the outset — through a call for proposals from interested and capable firms — conduct a thorough scoping study of mapping the entire current players in the impact investing scene. Within a span of 6 months, this first step should aim at providing a database of all the players in the supply side with such information as where they are based, what sectors they fund, the size of the enterprises and at what stage of business they fund, the regions they focus on, and any other pertinent information. The study should also identify what each investor terms as a good deal. This database should be constantly updated as there are an increasing number of new entrants into the field each day. The same mapping should be done to identify the players on the demand side. The database should be replete with successful case studies of enterprises in order to stimulate more ideas from the youth who may be interested in such ventures.

After mapping the current players, SINI should issue a call for business plans from existing and potential innovators with businesses and ideas that are likely to generate financial as well as measurable social and/or environmental benefits at scale. This call should be highly publicized through all the existing media channels. The ideas should be submitted to the regional headquarters. After submission, a committee with members drawn from the supply side and experts in social impact investing should shortlist the most promising ideas and invite the applicants to the next stage of developing their ideas or existing business. At this first stage, already, some investors will identify some ready entrepreneurs that they can take off with. The other set of entrepreneurs would be taken through capacity building programs aimed at preparing them for injection of capital from the investors. SINI should partner with interested universities to design courses and prepare faculty to incubate and prepare these enterprises with particular investors in mind until the successful and 'bankable' ideas are ready for take-off. At the same time, the supply side should be scrutinizing the demand side players who meet their criteria of lending among the pool undergoing mentorship and incubation.

By intervening through this model, the gap in shortage of deal flow will be bridged as well as that of lack of investor-ready businesses. SINI should act as an intermediary to provide investors with information on where prospective enterprises with opportunities that match their needs can be found. Through such intervention, donor aid will actively help in accelerating the deployment of capital to yield investor-ready enterprises that will contribute to solving the most pressing problems of humanity. Aid should be used to create conditions under which the gap between the supply and demand sides can be closed or narrowed.

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