

Social Impact Incentives

A performance-based approach to catalyzing impact investment and encouraging entrepreneurial solutions for pressing social issues

- Summary -

Many high-impact social enterprises need investment in order to scale significantly. **For these mission-driven organizations it is often much harder to achieve economic returns in line with the traditional market.** One would expect that the majority of investors are not willing or able to compromise on financial returns, but this is even the case for the majority of impact investors who are looking for double-bottom-line returns. Thus many social enterprises do not succeed in attracting investors or the need for investment could lead them to focussing on more commercially attractive business areas instead of high-impact activities (e.g. going up-market instead of serving the bottom of the pyramid). In order to **attract growth capital, safe-guard their social effectiveness or even deepen their impact** a solution is needed to facilitate scaling these high-impact social enterprises while acknowledging the realities of the market.

The Social Impact Incentives [SIINC] model is an innovative and catalytic instrument for bringing together high-impact social enterprises, impact investors and public or philanthropic funders. An outcome payer (e.g. a philanthropic organization, development agency or public funder) agrees to make premium payments to the enterprise based on the social contribution generated by their operations. These premiums are paid in parallel to the revenues the enterprise generates through its activities. In this way, **impact is incentivized with the social performance of the enterprise being directly linked with its levels of profitability and thus its attractiveness for investors.** The SIINC model can therefore leverage public or philanthropic funds to catalyze private investment in areas where there is high social impact, but where current conditions would provide below market-rate financial returns. In this respect it is **a new and powerful tool in blended finance.** SIINC provides the social enterprise with a means for establishing itself in order to achieve **long-term financial viability** while offering the outcome funder strong and on-going social returns on the resources they invest.

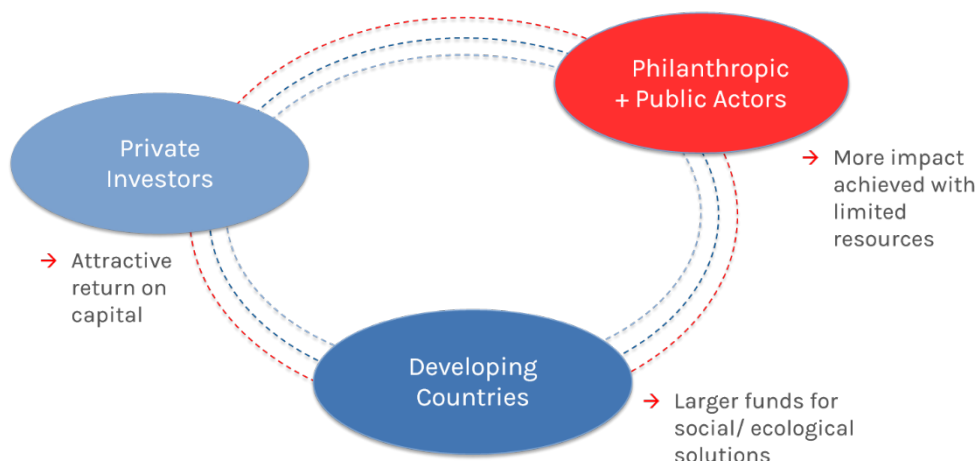
The first use of the SIINC model will be in a Public Private Development Partnership (PPDP) from Roots of Impact with support from Ashoka and in collaboration with the Swiss Agency for Development and Cooperation (SDC) and the Inter-American Development Bank (IDB). In this program a number of social enterprises in Latin America and the Caribbean will be identified and supported using Social Impact Incentives, allowing them to take on investment and scale their operations. The project partners are seeking to establish the SIINC model as a game-changing innovation in development finance and impact investing.

Context: Social Enterprise, Impact Investing and Blended Finance

Social entrepreneurship has become a driver of significant social change over recent years. A number of **social enterprises use market-based models, harnessing market mechanics to generate and scale their social impact**. These models could provide more sustainable alternatives to aid-based interventions and, due to the potential for long-term financial sustainability, they make up the target operations for SIINC-based interventions.

The potential of social enterprise has not only been recognized by the social sector but has also increasingly drawn interest from the business sector as it brings along new market opportunities, as shown by the rapid development of the impact investing industry. Nevertheless, many investment opportunities have strong potential for social or environmental impact but cannot generate the financial returns expected by impact investors. Moreover, because of the market where they operate, they are perceived as having high financial risk. Others suffer from a lack of information or track record given the novelty of either the market or the business model.

It is at this intersection of development, social entrepreneurship and impact investing that the SIINC model has emerged. The objective was to establish **a new approach to use development finance in making high-impact social enterprises more attractive for investors**, thereby increasing their potential to scale and further amplifying their positive social contribution. The SIINC approach will be established as a powerful new tool to complement the range of blended finance instruments currently available.

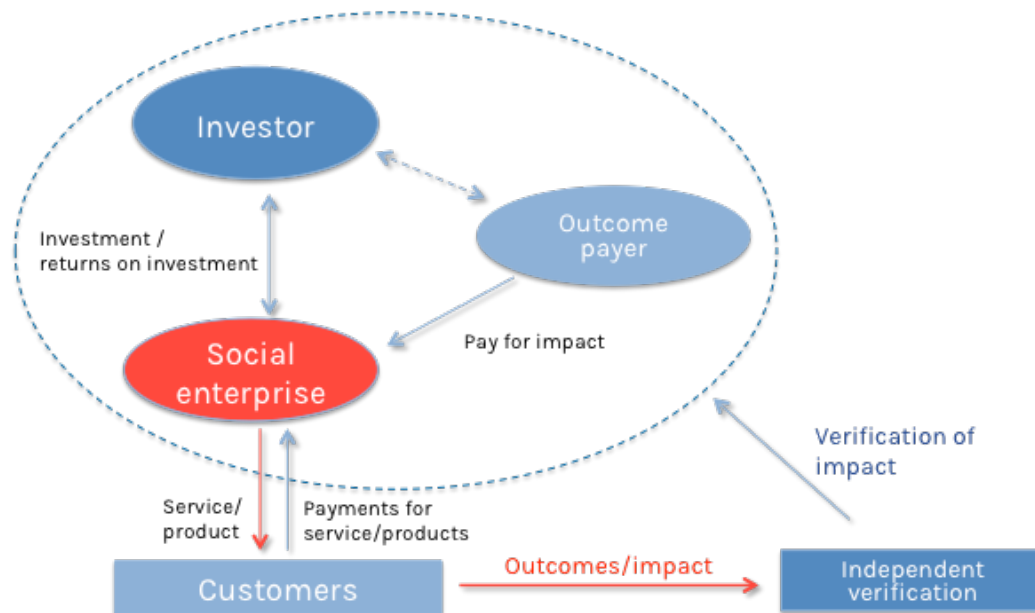


Source: Based on OECD/WEF Blended Finance Vol. 1

Introducing the SIINC model

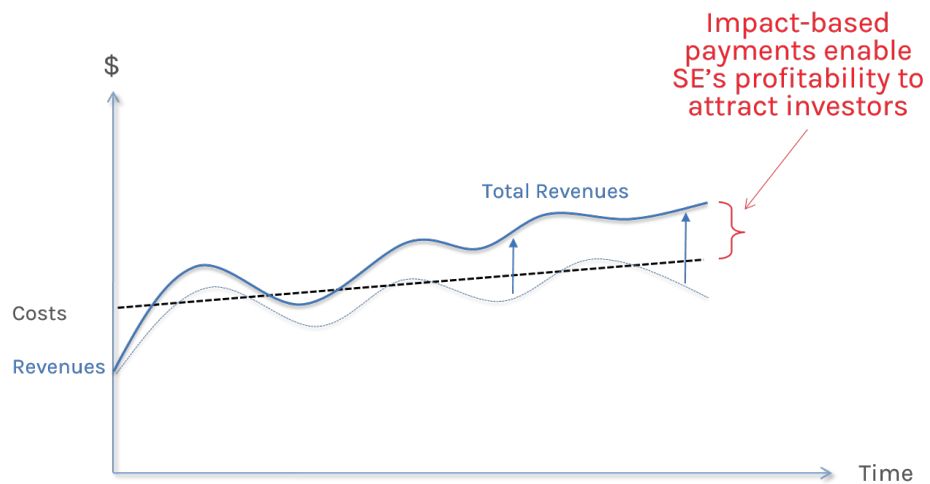
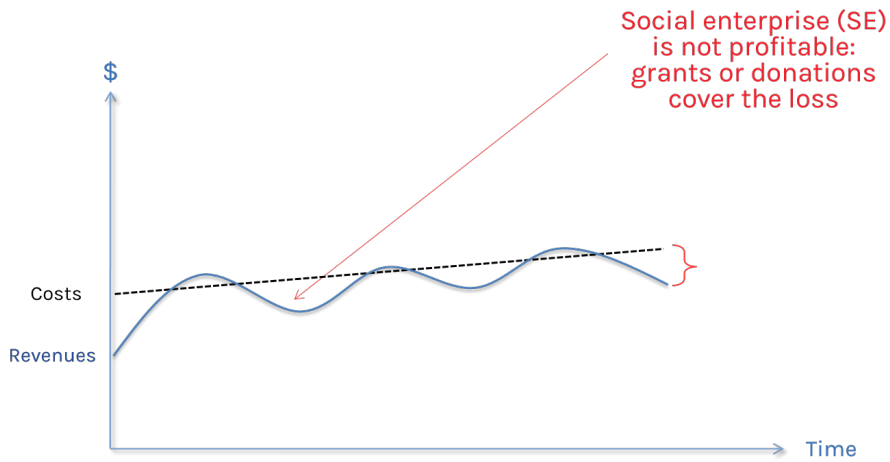
The Social Impact Incentives model is tailored to meet the needs of three distinct actor groups: Social enterprises who are seeking investment in order to scale their operations and thus generate more positive social impact; public and philanthropic funders seeking to maximize the impact generated by their funds; and impact investors seeking sound social and financial returns on their investments. The SIINC approach helps by **aligning the interests of each of these groups in a stream-lined manner**. The outcome-funder

agrees to pay premiums to the social enterprise based on their social performance, thus making the enterprise attractive enough to catalyze investment from the impact investors. The basic model is shown here:

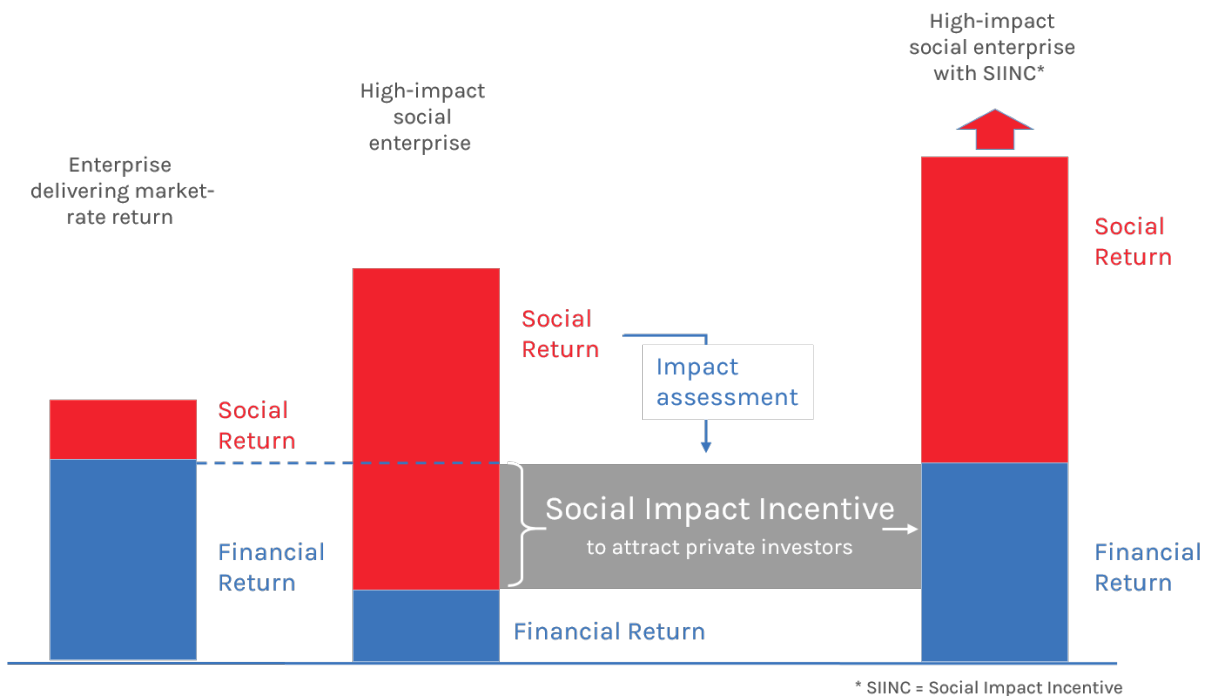


The structuring of a SIINC is designed to be **as straight-forward as possible**. In the basic model, there is an individual investment contract between the social enterprise and the investor which can be structured to meet the specific needs of both. There is a further payment agreement between the outcome payer and the social enterprise based on the social performance indicators. While there is much room for variation, the aim is that an agreement is reached between all three parties on the levels and conditions of the social impact incentives arrangement before the intervention begins. An impact base-line is established with **payments calculated on incremental outcomes directly related to the impact targets**. Payments are structured and linked to impact, while independent verification of the results has to be provided.

The underlying objective is to support social enterprises in their efforts to scale their impact. Through incentivizing the social impact of the operation, outcome payers assist the social enterprises in **expanding their operations with full mission-alignment**. The influence on the revenue streams of the social enterprise can be shown as follows:

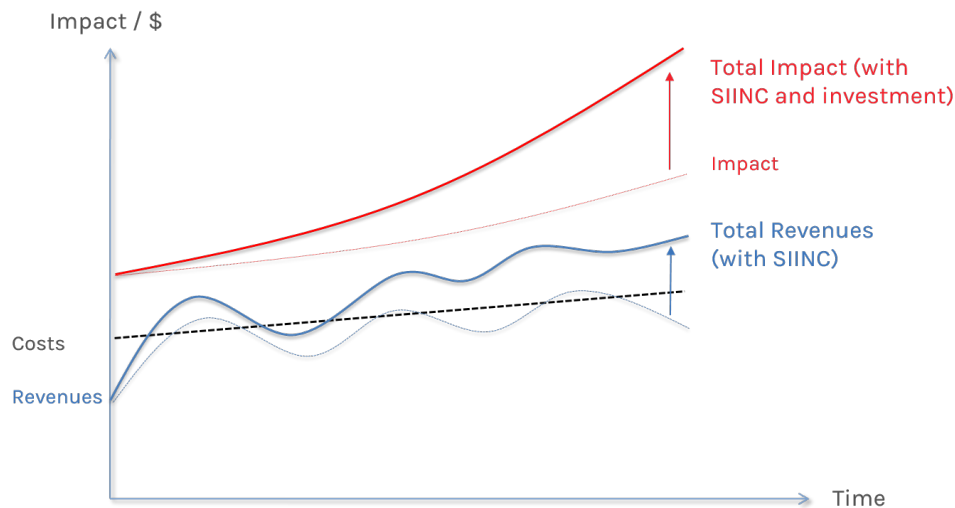


Improvements in the revenue streams and profitability of the enterprise increase the attractiveness for investors, leading to investment and enabling the expansion of the operation.



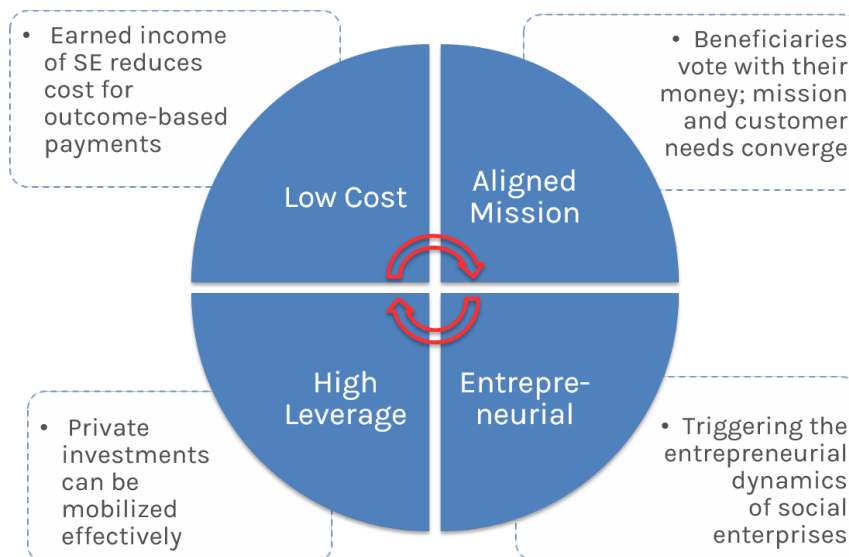
* SIINC = Social Impact Incentive

The increase in revenues is, however, closely tied to the social performance of the enterprise. It is therefore crucial to also consider the shifts in impact generated through the SIINC model. The following graph superimposes impact onto the second cost/revenue graph above to illustrate the sought-after results:



At the end of the SIINC intervention, one of two scenarios come into play with regard the **on-going financial viability of the social enterprise**. Depending on the business model of the enterprise, there can be **either a public sector approach or a market-based one**. In the first scenario, the business model is based on selling a service or product to a public sector entity, for example a local health authority, an education ministry or a city council. The strategy in this case would be to **convince the public body of the effectiveness of the social enterprises offering**, leading them to pay for the good or service in the longer term. In the second scenario, the strategy will be different where the social enterprise is active on the open market. In this case it is not political decision-makers who need to be convinced as to the value proposition of the social enterprise, but beneficiaries who are also customers. Securing private investment, achieving further proof-of-concept, increasing revenues, and lowering per-unit cost greatly improves the organizational capacity of social enterprises and offers a real possibility to scale and achieve long-term financial sustainability. The SIINC intervention would offer the opportunity for the social enterprise to establish itself on the market and **achieve a level of scale where the operation becomes economically viable**.

For investors, the risks involved are limited in that a supplementary impact-based revenue stream is ensured through the premium payments and the operation has the chance to establish its market. For the outcome payer there is major potential to utilize resources in an efficient manner that ensures high levels of impact through a **focus on results, the long-term financial sustainability of the enterprise and the additionality and leverage inherent within the SIINC model**. The characteristics of the model are visualized here:



First implementation in Latin America and the Caribbean

The SIINC model will be implemented for the first time in a PPDP in Latin America and the Caribbean (LAC). In this pioneering program from Roots of Impact with support from Ashoka, the Swiss Agency for Development Cooperation (SDC) have made funds available to support and scale high-impact social enterprises in the LAC region. The funds are to be administered by the Inter-American Development Bank (IDB)'s Multilateral Investment Fund (MIF) through a specifically-designed facility. Further expertise from the IDB will come via their Social Entrepreneurship Program (SEP), which provides financing through local partner organizations to individuals and groups that generally do not have access to commercial or development loans on regular market terms. The SEP brings a wealth of local knowledge, experience and a broad network around the topic of social entrepreneurship.

SIINC LAC will make a double contribution: On the one hand there will be the direct impact generated by the social enterprises supported. On the other hand, should this prove to be a pioneering contribution, other SIINC-based programs may be inspired by this novel understanding of and model for the utilization of development resources.

Roots of Impact is the lead advisor to the SDC and the IDB/MIF in the SIINC LAC program, and will be responsible for tasks such as SIINC-suitability assessment, a comprehensive pre-investment process, investment readiness check, impact modelling (parallel to the financial modelling to enable SIINC structuring) and impact measurement and reporting. There are a series of challenging steps in the SIINC process. The first of these, for example, is assessing the suitability of an enterprise for a SIINC-based program: The enterprise must have an established track-record in generating impact and be looking to scale. Roots of Impact have developed a customised SIINC suitability assessment based around various criteria including additionality, impact scalability and potential for future financial sustainability.

Aside from the project partners already mentioned, a number of local organizations are involved in the SIINC LAC project. The aim is to establish SIINC in the region, but also to further adoption and scaling of subsequent projects in other regions. The potential is immense and will be tapped through clear, timely and strategic communication of the results, methodologies and lessons learned.