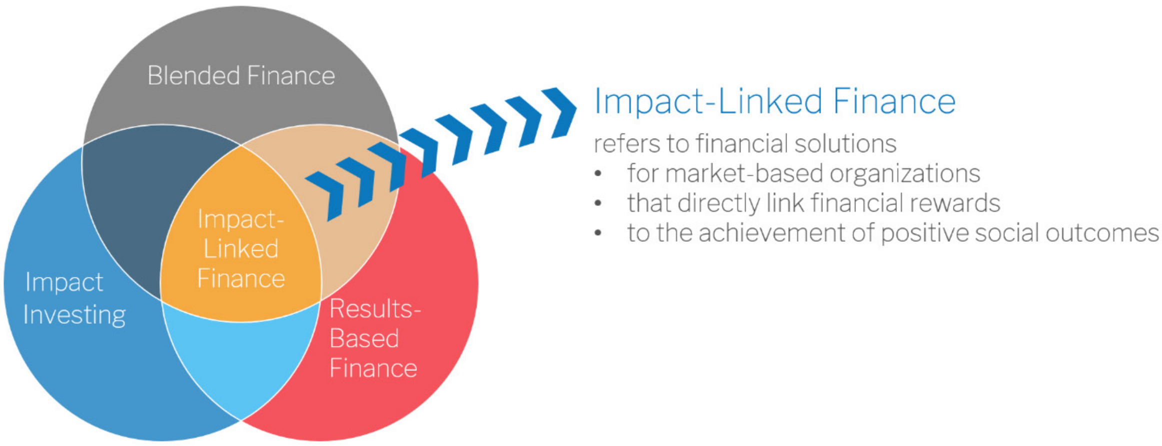
Impact-Linked Finance Glossary

Terminology suggested to be used by the Impact-Linked Finance community of practice



Additionality

Time-limited rewards are aimed at incentivizing the impact enterprise to deliver additional (i.e. more, faster and/or better) outcomes that would otherwise not have happened. Impact-Linked Finance can also be additional in financial terms, e.g. by enabling the impact enterprise to

- (better) raise private capital via receiving an additional revenue stream (in case of Social Impact Incentives or "SIINC") or
- lower financing costs (in case of other Impact-Linked Finance instruments).

This is one of the core Design Principles for Impact-Linked Finance.

Design Principles for Impact-Linked Finance

Nine Design Principles for Impact-Linked Finance represent a springboard for a broader involvement of practitioners, experts, academics and other stakeholders in this innovative practice. To ensure the most effective use of Impact-Linked Finance, any of these transactions need to consistently follow these principles. Three core principles are particularly vital:

(1) Incentives to the value creator (financial rewards should be directed to the primary value creator, which is typically the impact enterprise)
(2) Focus on outcomes as opposed to outputs (outcomes are measured wherever feasible and useful, and used for determining the level of financial rewards*), and
(3) Impact additionality (financial rewards should drive the organizations to deliver additional outcomes that would not have happened without such incentives). More information can be found here or in the publication Accelerating Impact-Linked Finance, co-authored by the Boston Consulting Group and Roots of Impact.

**outputs can be used in case there is strong evidence of linkages to outcomes*

Direct and measurable outcomes

Impact-Linked Finance aims to incentivize direct and measurable outcomes. As such, the focus lies on the case-specific impact that is attributable to the impact enterprise's intervention. Inputs, activities or outputs (which are generally more likely to be the focus of results-based finance) are not at the core of Impact-Linked Finance. Instead, the positive changes and effects spurred by the solution of the impact enterprise take center stage. If outcomes are not available, or if it is not feasible to measure these efficiently, outputs can be used as proxies. In these cases, there needs to be supporting evidence on how those outputs lead to outcomes. The enterprise should ideally either be measuring such outcomes or be able to provide relevant raw data. This ensures that an Impact-

Linked Finance practitioner can identify the baseline data necessary to structure the right incentives.

Effective impact finance

"Effective impact finance" is how innovative Impact-Linked Finance instruments and mechanisms are often referred to. "Effective" characterizes the use of public and catalytic funds to enable deep(er) and (more) transparent impact.

In the case of Social Impact Incentives (SIINC), this also includes mobilizing private investment. Effective impact finance solutions comprise innovative finance, blended finance, Social Impact Incentives (SIINC) and other Impact-Linked Finance projects and programs.

Exit

An exit in the context of an Impact-Linked Finance transaction does not refer to the usual exit strategy of selling financial or business assets. Rather, it describes the "end game" after an Impact-Linked Finance transaction has completed its entire cycle. There are two potential types of exit: Impact enterprises can a) reach or maintain (commercial) viability while continuing to deliver the outcomes incentivized, or b) enter into public contracts.

Financial leverage

Financial leverage denotes how much additional (repayable) investment the enterprise is able to raise with the support of Social Impact Incentives (SIINC). The underlying assumption is that enterprises will become more attractive for investment thanks to the additional revenue stream or funding coming along with this type of Impact-Linked Finance support. Financial leverage is also referred to as financial additionality.

Impact enterprises

Impact enterprises provide impactful solutions to social and/or environmental problems, and as such, are the main focus of Impact-Linked Finance. Unless specified by the outcome funder, there are no specific criteria that such enterprises need to meet (e.g. legal entity, revenue model, type of impact) other than having a market-based model. For the purpose of consistency, it is recommended to use the term "enterprise" rather than "organization" or "company".

Impact leverage

Impact leverage refers to how much an Impact-Linked Finance instrument can incentivize the enterprise to increase the depth and/or breadth of its impact. From a donor's perspective, impact leverage is equivalent to "value for money".

Incentives to the value creator

This specific Impact-Linked Finance Design Principle defines that financial rewards should be directed to the actors that create the impact. Typically, these actors are the impact enterprises creating impact "on the ground". However, such actors can also be:

- intermediaries supporting impact enterprises, or
- investors, provided that the incentives lead to practices that the investors would not have performed otherwise (e.g. lending to very small businesses that would not be attractive investment targets without these incentives).

Measurement period

The measurement period is the period during which the enterprise needs to create the pre-agreed impact. Upon verification of the data provided for any given period, the enterprise will receive the agreed upon financial rewards. Impact incentives are bound to specific periods. In the case of Social Impact Incentives (SIINC), this period generally spans either 6 or 12 months.

Outcome payer / funder

An outcome payer or outcome funder is an entity that:

- provides non-repayable capital to reward the enterprise for the impact created (in case of Social Impact Incentives), or
- compensates investors for providing financial rewards once a pre-defined impact is achieved (in case of other Impact-Linked Finance instruments).

Typical outcome funders are development agencies, NGOs, foundations, development finance institutions or similar organizations.

Rewards for impact / outcomes

This term is used when referring to the financial rewards that are provided to impact enterprises or other actors, based on their impact achieved. Rewards for impact should not be defined as grants or subsidies. While in the case of SIINC for instance, the rewards are indeed non-repayable, the purpose of the incentives are not to subsidize enterprises as typical grants do, but rather to enable them to sustainably grow both in impact and economic terms. All Impact-Linked Finance instruments are aimed at incentivizing enterprises to (continue) deepen(ing) their impact, also beyond the instruments' lifetime (see "exit" listing).

In addition, in this context, rewards are often mentioned with reference to "social" outcomes (e.g. for Social Impact Incentives | SIINC), which however, should be understood to include environmental outcomes. As a suitable alternative, the term "positive outcomes" may support this notion better.

Time-limited payments / financial incentives

These terms are another way of describing Impact-Linked Finance instruments. This emphasizes the fact that incentives are provided only for a limited time, e.g. in the case of Social Impact Incentives (SIINC) typically from 2 to 4 years.

TYPICAL DESCRIPTIONS OF IMPACT-LINKED FINANCE

General descriptions:

Incentives aimed at enabling fundamental shifts in the business model towards greater impact.

Effectively leverage public or philanthropic funds to catalyze private investment.

Mobilizing private investment(s) / capital for development.

Support creating a bridge to self-sustainability.

Maintaining commercial viability.

Descriptions for Impact-Linked Finance:

Impact-Linked-Finance is enabling fast-scaling impact enterprises to optimize for impact without compromising on their commercial viability

Impact-Linked-Finance is an effective way of aligning impact with the economic viability of enterprises.

Linking financial rewards to the achievements of positive social outcomes.

Impact-Linked-Finance lies at the intersection between blended finance, impact investing, and results-based finance.

Rewards for positive outcomes can be built into financing instruments across the board, from equity to debt and guarantees.

By 'baking' impact into finance, Impact-Linked-Finance is closing the gap left by impact investing, venture capital and other forms of early stage investing,

Impact-Linked-Finance is highly effective because it…

> …enables entrepreneurs on the ground to push the frontiers and optimize for impact.
>
> …stimulates entrepreneurial drive and creativity in order to achieve positive outcomes.
>
> …makes creating impact a business that pays off and mobilizes private investment to scale.
>
> … fully aligns interest between entrepreneurs, investors and public and catalytic funders.
>
> …has the potential for leading the way towards a finance practice with impact at the core.

For Social Impact Incentives (SIINC):

Social Impact Incentives (SIINC) can act as an additional revenue stream that directly improves the enterprise's profit & loss (P&L) statements.

Social Impact Incentives (SIINC) is a funding instrument that rewards impact enterprises with time-limited payments for achieving social impact.

The additional revenues enable them to improve profitability and attract investment to scale.

The Social Impact Incentives (SIINC) model makes it possible to scale without compromising on generating strong positive impact.

For Impact-Linked Loans:

The higher the social outcomes the lower the interest rate. The interest can even be negative, which would translate into loan forgiveness.

Impact-Linked Loans effectively lower financing costs and create a strong incentive for enterprises to outperform on positive impact.

Interest rate (and potentially repayment) is linked to direct and measurable impact and follows the concept of better terms for better impact.

TYPICAL MESSAGES TO AVOID IN THE CONTEXT OF IMPACT-LINKED FINANCE:

Positioning Social Impact Incentives (SIINC) or Impact-Linked Finance as grants or subsidies.

Social Impact Incentives (SIINC) specifically, and Impact-Linked Finance more broadly, should not be defined as grants or subsidies, as this would misrepresent the nature and purpose of such financial instruments. While SIINC is a non-repayable instrument, most other Impact-Linked Finance instruments may have a concessional or catalytic component, yet generally do feature repayments. Moreover, the underlying idea is not to simply cover enterprises' costs, but rather to provide time-limited rewards that encourage and ensure that enterprises are able to deepen their impact, and continue doing so also once the Impact-Linked Finance support draws to an end. Sustainability – whether in form of market-based or public exit – thus lies at the heart of Impact-Linked Finance.

Describing Social Impact Incentives (SIINC) / Impact-Linked Finance as providing subsidies for lowering the price for poorer customers.

While the utilization of Impact-Linked Finance is at the enterprise's discretion, such rewards are not meant to simply temporarily decrease the costs for reaching poorer customers. What such instruments actually aim for, is to allow enterprises to build the necessary systems and operations that allow them to better target vulnerable groups, in the short-, medium- and long-term. Indeed, increasing an enterprise's outreach to groups, where the impact of using a certain product or service can be the greatest (e.g. bottom of the pyramid, women or indigenous peoples), is a common metric utilized in Impact-Linked Finance. However, while the financial rewards are time-limited, the impact increase shouldn't be. The aim thus is to trigger an impact continuum, and not to provide a one-off payment for a specific amount of impact. Exceptions can be made in cases where time-limited payments have a demonstration effect for spurring a public exit, e.g. with a local government.

Picturing Social Impact Incentives (SIINC) / Impact-Linked Finance as mechanism to subsidize investor returns.

Social Impact Incentives (SIINC) can indeed be seen as an additional revenue stream for enterprises, and as such, are meant to increase the company's attractiveness for private capital (financial additionality). However, the focus of any Impact-Linked Finance instrument is not to increase investors' returns, but rather to allow the enterprise to deepen its impact by enhancing and de-risking impactful operations and/or attract private investment that otherwise could not be mobilized.