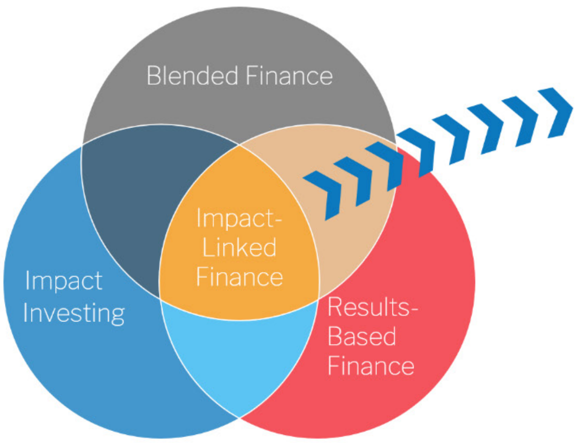
Frequently Asked Questions on Impact-Linked Finance

PREAMBLE

This document is aimed at providing further clarifications on Impact-Linked-Finance. It is divided into two sections. The first part tackles general questions on Impact-Linked Finance that are relevant for a variety of stakeholders, whereas the second part focuses on stakeholder- and SIINC-specific explanations. Overall, given that Social Impact Incentives (SIINC) is so far the most established Impact-Linked Finance instrument, slightly more space is dedicated to it.



Impact-Linked Finance

refers to financial solutions

- for market-based organizations
- that directly link financial rewards
- to the achievement of positive social outcomes

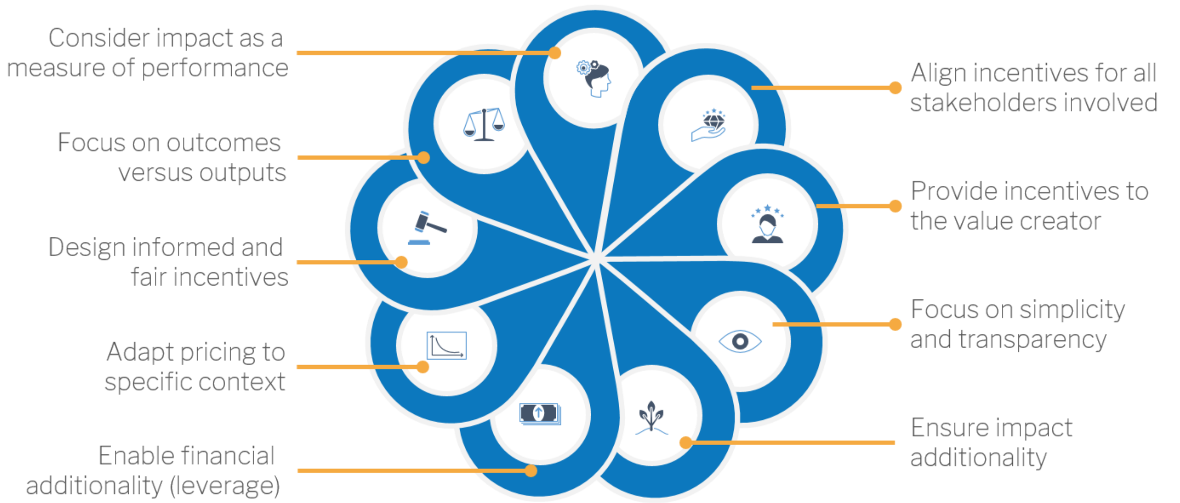
GENERAL IMPACT-LINKED FINANCE Q&A

What is Impact Linked Finance?

Impact-Linked Finance refers to financial solutions targeting market-based organizations, with financial rewards directly linked to the achievement of positive outcomes. By providing "better terms for better impact", Impact-Linked Finance aims to enable and incentivize enterprises to deepen and / or accelerate their positive impact, while continuing growing their businesses. Impact-Linked Finance is highly tailorable, can take different forms and can be applied to various financial instruments – from equity to debt to guarantees. For example, lenders can link the interest rate of their loans to pre-defined impact performance metrics, decreasing the rate depending on the impact the enterprise achieves. Impact-Linked Finance is therefore a powerful way to "bake" impact into the core of finance. It aligns positive impact with economic viability and lies at the intersection between blended finance, impact investing and results-based financing.

Impact-Linked Finance features nine key design principles (see figure below), namely: 1. Consider impact as a measure of performance / 2. Align incentives for all stakeholders involved / 3. Provide incentives to the value creator / 4. Focus on simplicity and transparency / 5. Ensure impact additionality / 6. Enable financial additionality (leverage) / 7. Adapt pricing to specific context / 8. Design informed and fair incentives / 9. Focus on outcomes versus outputs. More information on Impact-Linked Finance can be found here.

Design Principles for Impact-Linked Finance



What are the main benefits of Impact-Linked Finance?

- For enterprises, Impact-Linked Finance provides catalytic funding that allows them to grow and scale, in both commercial and impact terms. In other words, by providing the enterprise with "better terms for better impact", Impact-Linked Finance ensures that creating social or environmental outcomes is a "business that pays off". While all Impact-Linked Finance instruments aim to have a catalytic component, the exact level of concessionality varies according to the instrument, the program and/or the funder/investor.

- For outcome funders (e.g. public or philanthropic entities that aim to achieve a catalytic effect), the benefits of Impact-Linked Finance arise in the form of an effective use of their capital. By paying* or discounting** only for the impact created, Impact-Linked Finance automatically guarantees an effective and efficient use of their funding. In other words, outcome funders pay or forego on repayments only when, and for, the amount of real impact achieved.

- Investors may also benefit from Impact-Linked Finance, although it depends on their role they have within the concrete instrument. With Social Impact Incentives (SIINC), for example, investors benefit indirectly because the enterprise they invest(ed) in receives an additional revenue stream (due to the fact that SIINC is not repayable), which enhances its return profile. If investors are very impact-oriented, they may themselves engage in repayable Impact-Linked Finance instruments, for example Impact-Linked Loans. In this case, their benefit is similar to the one of the outcome funders: they enjoy a catalytic effect and an efficient and effective use of capital that spurs additional impact, while still making a return.

A general benefit arising from the Impact-Linked Finance practice is that investment is mobilized to scale effective, market-based solutions that have a social and/or environmental impact. Indeed, all Impact-Linked Finance instruments should ideally trigger additional investment that is directed to impactful enterprises. This can be either (1) directly, i.e. in the case of instruments such as SIINC that require the enterprise to raise private investment in parallel, or (2) indirectly, i.e. in the case of instruments that increase the level of interest by investors, because the enterprise receives concessional and catalytic capital or was enabled to grow further. Moreover, for all Impact-Linked Finance instruments, the rewards generally go directly to the value creator, i.e. the enterprise in the field. As such, no money is "lost on the way" and is relatively quickly and easily deployed.

* e.g. in the form of incentive payments, as is the case of SIINC.

** e.g. in the form of interest rate reduction, as is the case in Impact-Linked Loans or multiple reduction, as is the case for Impact-Linked Revenue Share.

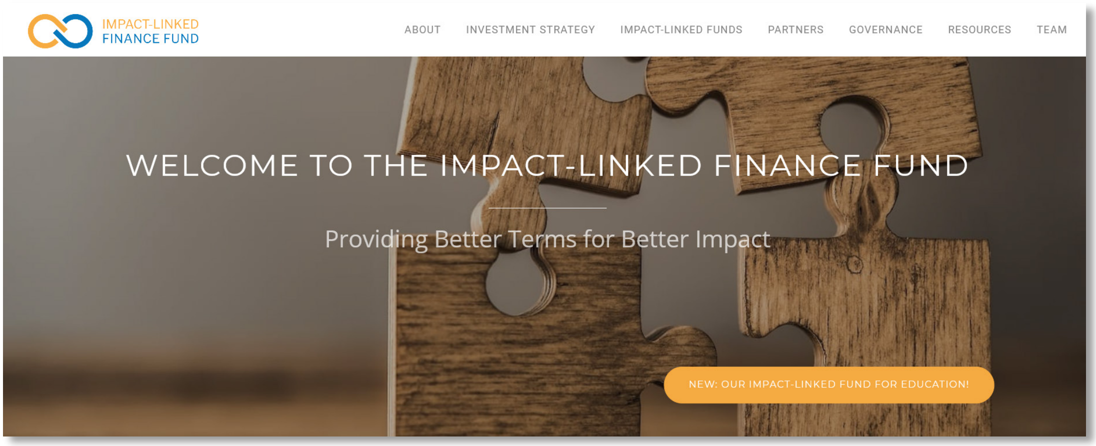
What track record does Impact-Linked Finance have?

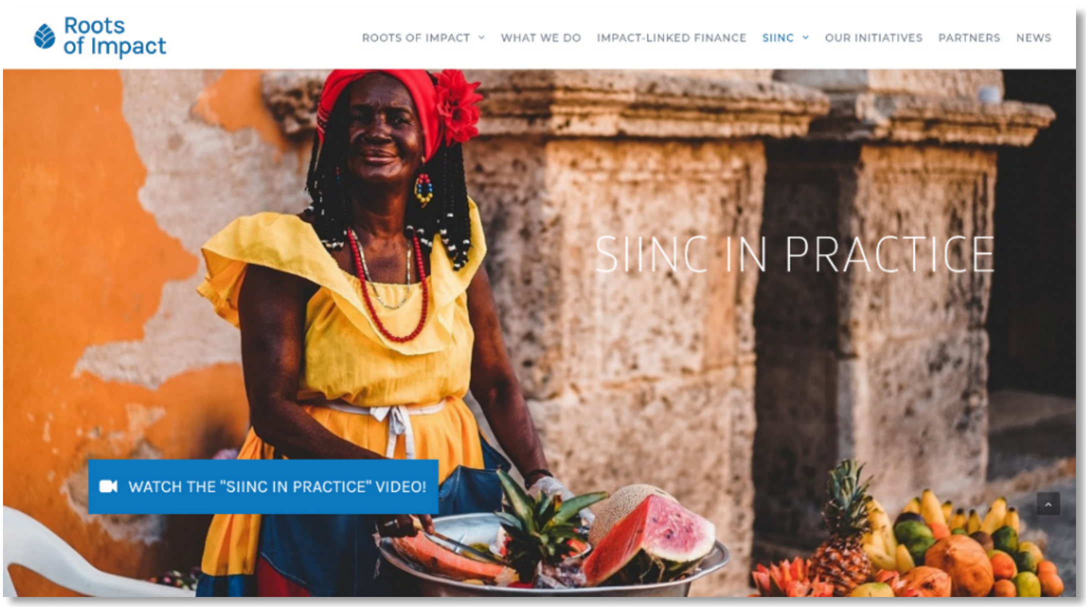
Impact-Linked Finance has a proven track record with numerous transactions in a variety of sectors, including healthcare, agriculture, off-grid energy, WASH, financial inclusion and vocational skills development, and in different regions, including Africa, Asia and Latin America. Exact transaction numbers constantly increase. To provide an idea, as of January 2022, Roots of Impact and its program partners alone have completed 28 transactions, with another 17 transactions in preparation and another 8 in the pipeline. This includes SIINC, Impact-Linked Loans and Impact-Ready Matching Funds, as well as Impact-Linked

Revenue Sharing Agreement and Impact-Linked Grants. Organizations such as the Swiss Agency for Development and Cooperation (SDC), KFW DEG, IDB Lab, Aqua for All, Medicor Foundation, Jacobs Foundation and GIZ/EnDev have already engaged as outcome funders in these Impact-Linked Finance transactions.

Since 2021, the newly established Impact-Linked Finance Fund acts as THE platform for upcoming Impact-Linked Funds focused on specific sectors and regions. Examples are an upcoming Impact-Linked Fund for WASH, an Impact-Linked Fund for Education and an Impact-Linked Fund for Gender-Inclusive FinTech.

For more information on ongoing SIINC programs please visit Roots of Impact's "SIINC in practice" website. All information on Impact-Linked Funds as well as many helpful resources around the topic of Impact-Linked Finance can be found on the Impact-Linked Finance Fund's website.





IMPACT-LINKED FINANCE INSTRUMENTS Q&A

Which Impact-Linked Finance instruments exist?

There are a variety of Impact-Linked Finance instruments. Some (the so far most frequently used) will be explained in more detail below, while others exist in design but are yet to be implemented. It is worth noting that many more traditional investment tools can be transformed to include an impact-linked component. This allows to tailor them to many different enterprises and situations.

To be rightfully called "Impact-Linked Finance", the instruments need to follow the Impact-Linked Finance Design Principles described above. The most important feature to be fulfilled is linking financial rewards to impact, which results in "better terms for better impact". The below list gives an idea of the most utilized Impact-Linked Finance instruments, including their variations. They are considered to be "blended" once structured to inevitably and directly include both, public/philanthropic funding and investment. Most Impact-Linked Finance instruments can be blended.

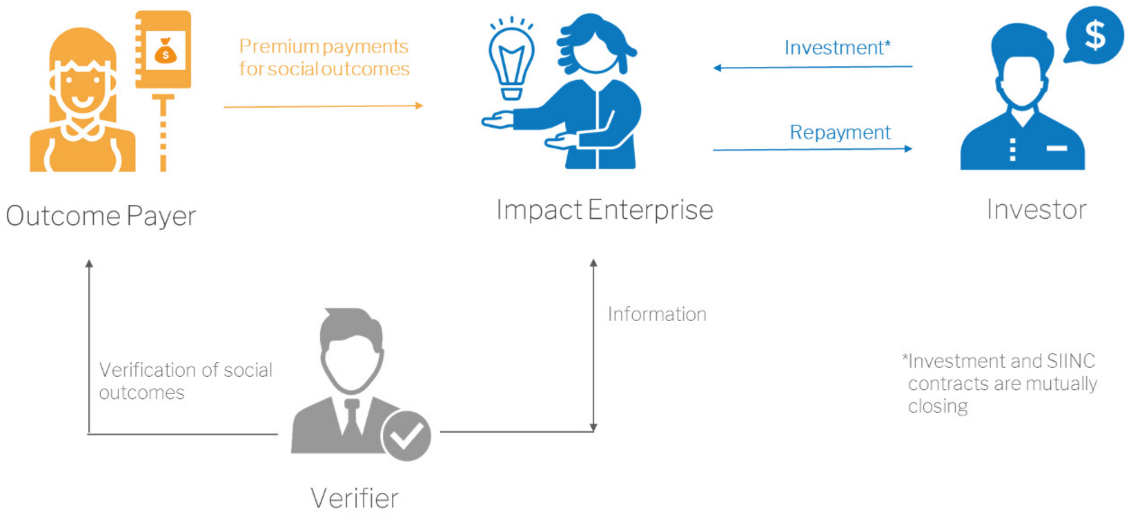
Blended Impact-Linked Finance instruments	Non-blended Impact-Linked Finance instruments
SIINC incl. repayable- and convertible-variations	Impact-Linked Loan
Impact-Linked Loan/Note with compensation	Impact-Linked Grants
Impact-Linked Revenue or Profit Share Agreement with compensation	Impact-Linked (Convertible) Note
Impact-Linked Guarantee	Impact-Linked Revenue or Profit Share Agreement
Impact-Linked Loan Guarantee	
Impact-Linked Portfolio Guarantee or First-Loss Capital	Impact-Linked First-Loss Capital
Impact-Linked Shares with compensation	Impact-Linked Shares
Impact-Ready Matching Fund	

What are Social Impact Incentives (SIINC)?

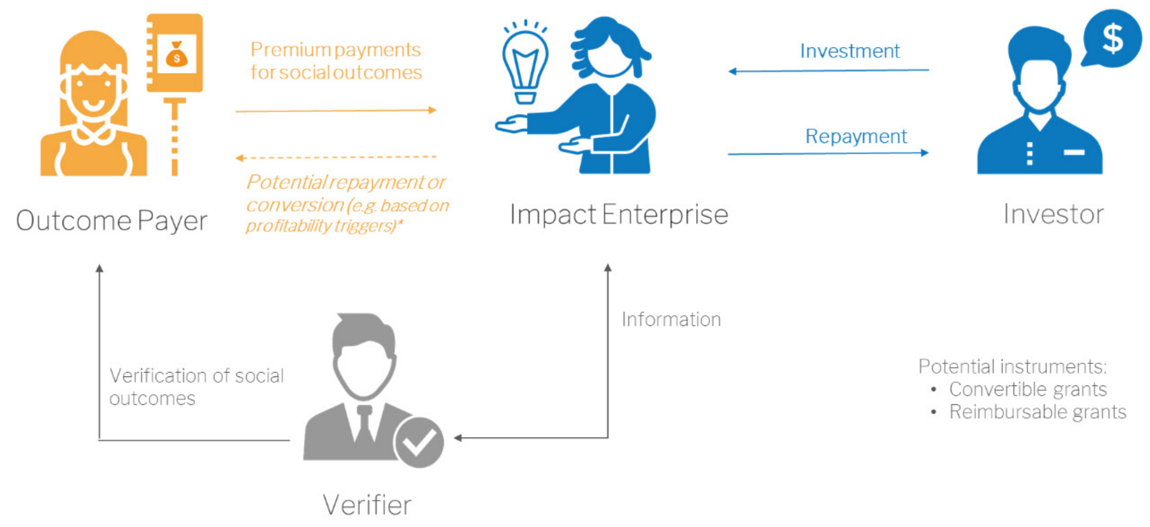
SIINC stands for Social Impact Incentives. SIINC is an Impact-Linked Finance instrument that rewards impact enterprises with time-limited payments for achieving additional positive outcomes (often referred to as "impact additionality"). Such financial rewards are non-repayable and can be utilized as the enterprise deems fit. By representing an additional revenue stream, SIINC enables impact enterprises to improve their profitability and attract (more) investment to scale (generally defined as "financial additionality"). In order to receive SIINC, enterprises need to successfully close a (repayable) investment round in parallel. As per common practice to date, financial leverage rates between 1:1 and 1:12 can be obtained. As such, SIINC effectively leverages public or philanthropic funding to catalyze investment in underserved markets with high potential for positive impact. This feature classifies SIINC as a blended finance instrument.

SIINC can also have a repayable component: In a Convertible SIINC, the financial instrument can be transformed into e.g. equity or shares by the end of the SIINC period. Another variation is a Reimbursable SIINC, in which (part) of the payments have to be returned, for example upon achieving a certain level of profitability. More information on SIINC can be found here.

SIINC



Reimbursable / Convertible SIINC



What is an Impact-Linked Grant?

If the enterprise is not raising repayable investment, an Impact-Linked Grant may be used to provide the same outcome-based financing as is the case with SIINC, but without the requirement for a direct financial leverage. Impact-Linked Grants can take different forms but the same principles of providing funding upon achievement and verification of impact need to apply.

What is an Impact-Linked Loan?

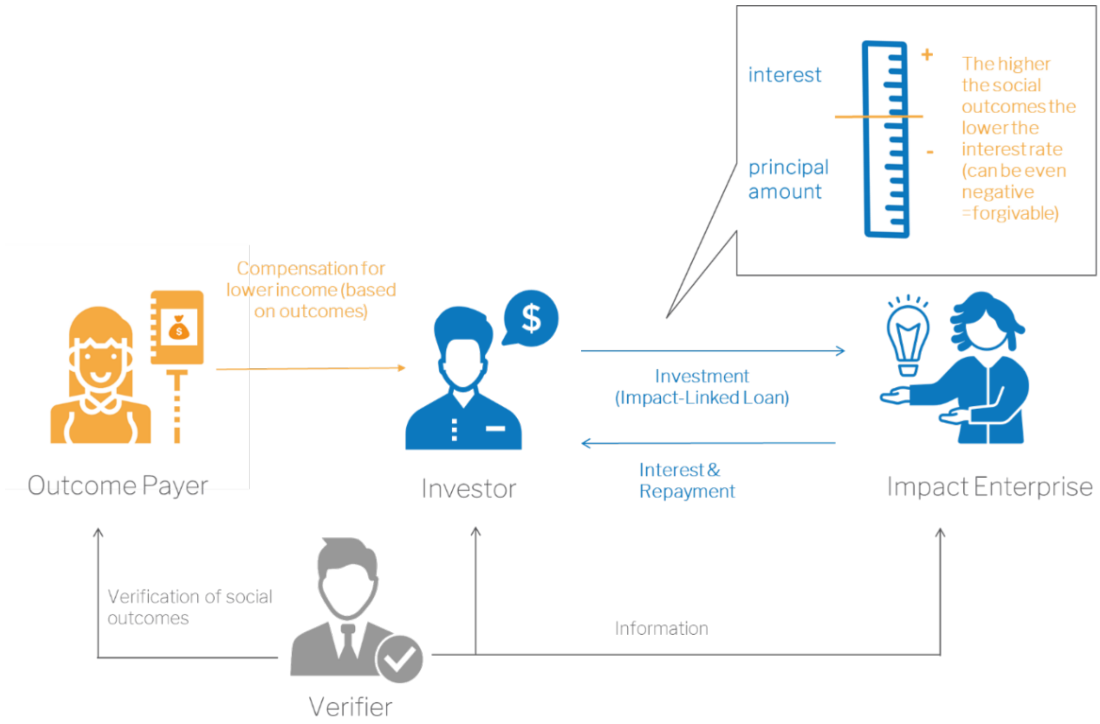
An Impact-Linked Loan is similar to a traditional loan, yet the main difference is that the interest rates (and potentially even the repayment obligations of the principal amount) are tied to the borrowers' achievement of pre-defined impact milestones. The enterprises receive "better terms for better impact": The higher the impact achieved, the lower the interest rates to be paid. In specific scenarios and contexts, - and depending on the investor -, (partial) loan forgiveness can be defined for achieving very high levels of impact.

The terms and conditions of Impact-Linked Loans can vary significantly. The loan amount, for instance, should be dependent on a variety of aspects, including the maturity and growth stage of the enterprise. This is to make sure that the loan does not overburden the borrower's balance sheet. Similarly, the loan maturity should be based on the enterprise's ability to repay and on the purpose of the loan proceeds.

As per the common practice of the Impact-Linked Finance Fund and Roots of Impact to date, Impact-Linked Loans typically have a longer duration (2-5 years) and can include a grace period. However, exact terms can be adapted as deemed best for the concrete case. There is also the option for public or philanthropic funders to provide investors with a compensation to make up for lower returns, in which case the Impact-Linked Loan becomes a blended finance instrument.

Impact-Linked Loans are particularly suited for enterprises, whose growth stage, profits and losses as well as balance sheets allow to take on debt. As opposed to SIINC, there are generally no co-investment or leverage requirements for Impact-Linked Loans.

Impact-Linked Loan

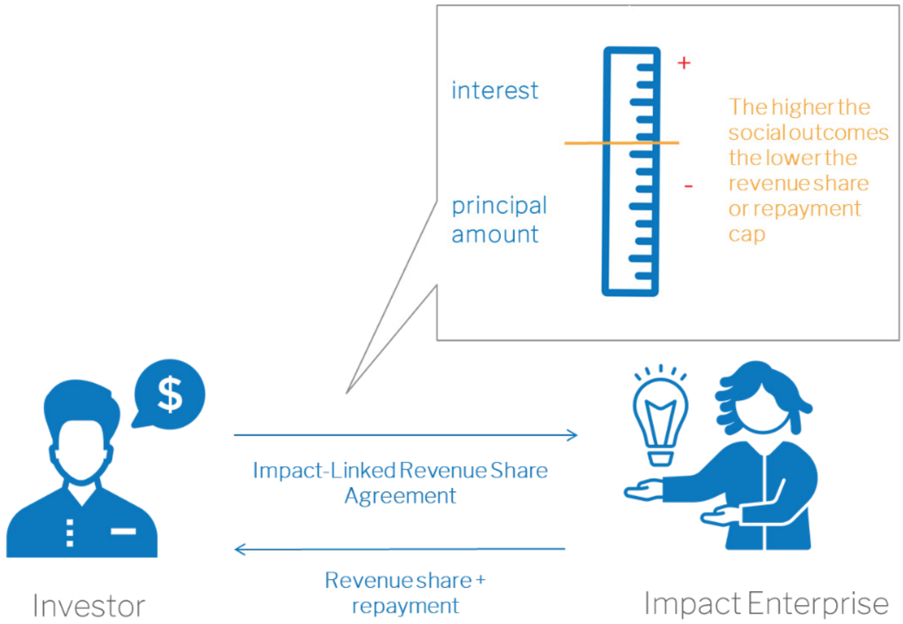


What is an Impact-Linked Revenue or Profit Share Agreement?

In an Impact-Linked Revenue or Profit Share Agreement, periodic repayments to the investor are based on an agreed upon percentage of either (a) the revenues (“revenue share”), or (b) the profits ("profit share"). In both cases, the repayments are limited to a predetermined return on investment (“cap”), and the exact reimbursable amount (typically expressed as the "multiple" on the initial investment) is linked to impact. The higher the impact achieved, the lower the repayment obligations.

This instrument not only allows the enterprise to partially pay back by creating impact, but also to enjoy higher levels of flexibility in its repayment obligations. Since payments are not tied to a fixed amount or interest rate but rather fluctuate with the enterprise's revenues (or profits), the enterprise is able to meet its payment obligations even in times of low revenues (or profits), without incurring the risk of overburdening itself.

Impact-Linked Revenue Share Agreement

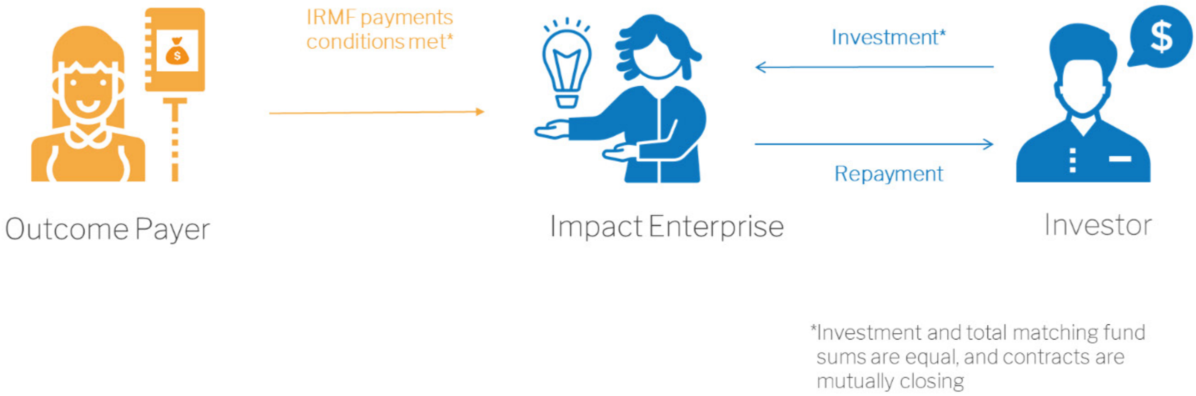


What is an Impact-Ready Matching Fund?

An Impact-Ready Matching Fund (IRMF) is a hybrid Impact-Linked Finance instrument that features matching funds that are conditional to the enterprise establishing an impact management and measurement (IMM) system. IRMF is typically provided to impact enterprises in seed stage. The disbursements are linked to milestones depending on the implementation of an IMM system, while also matching 1:1 an investment round (with a potential cap, e.g. up to US$ 100K) that the enterprise needs to raise in parallel. In other words, IRMF is a matching fund that includes results-based technical assistance funding. As such, the model requires a public or philanthropic funder to commit non-repayable funding tied to the amount of investment provided by a third-party investor.

As per Roots of Impact's practice to date, the achievement of milestones is assessed by the provider of funding or by an independent verifier. IRMFs are typically targeted at seed or very early-stage enterprises that show great potential but are not yet ready to engage in more advanced Impact-Linked Finance models (such as SIINC and Impact-Linked Loans that require impact, commercial and financial plans that are strong and structured). IRMFs have first been implemented within the B-Briddhi program that Roots of Impact created and runs with its partners, the Embassy of Switzerland in Bangladesh and LightCastle Partners (more details available on the B-Briddhi website).

Impact-Ready Matching Fund (IRMF)



Do Impact-Linked Finance instruments involve technical assistance funding?

With the exception of the Impact-Ready Matching Fund (IRMF), none of the above-mentioned instruments have an innate technical assistance feature. Nonetheless, such an assistance can always be provided in parallel of, or prior to, any Impact-Linked Finance transaction. Exact definitions (e.g. whether linked to the achievement of results, provided by external providers or by the funders themselves) of such technical assistance can be adapted program- and case-specifically. When implemented in parallel to an Impact-Linked Finance transaction, technical assistance can be used to strengthen the enterprise's capacity to create and/or measure impact. In case the enterprise has an insufficient impact measurement and management system, technical assistance may be best provided prior to (developing) an Impact-Linked Finance transaction.

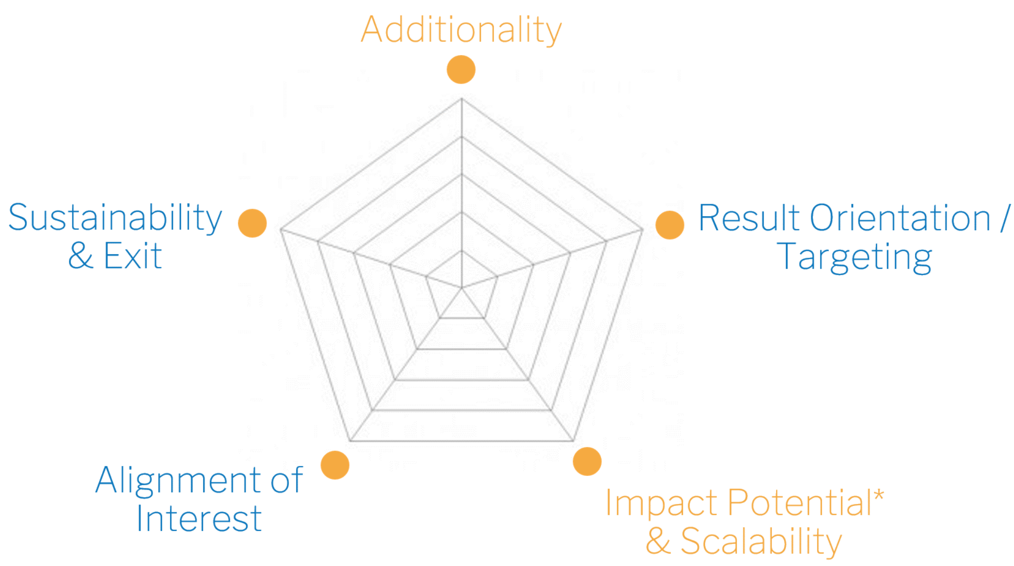
What is the Impact-Linked Finance Fund?

The Impact-Linked Finance Fund is a Dutch foundation that provides Impact-Linked Finance to impact enterprises through a variety of sector- and/or region-specific funds (called "Impact-Linked Funds"). In addition, the Impact-Linked Finance Fund acts as a knowledge hub for the practice of Impact-Linked Finance and advocates for embedding impact-related principles and terms in other areas of business, policy, and finance.

The Impact-Linked Finance Fund was established by Roots of Impact and iGravity in order to pool their know-how and activities for implementing scalable funds. Examples are the Impact-Linked Fund for Eastern and Southern Africa and the Impact-Linked Fund for Education.

These Impact-Linked Funds provide innovative finance and technical assistance in multiple forms and use a variety of non-repayable and repayable financial instruments that link financial terms to realized outcomes. The ultimate vision of the Impact-Linked Finance Fund is to catalyze private sector investment for the benefit of high-impact enterprises by improving their risk-return profiles and enable them to create additional impact.

The below figure gives an example of the type of support that the Impact-Linked Funds can provide to impact enterprises at different growth stages. More information can be found here.



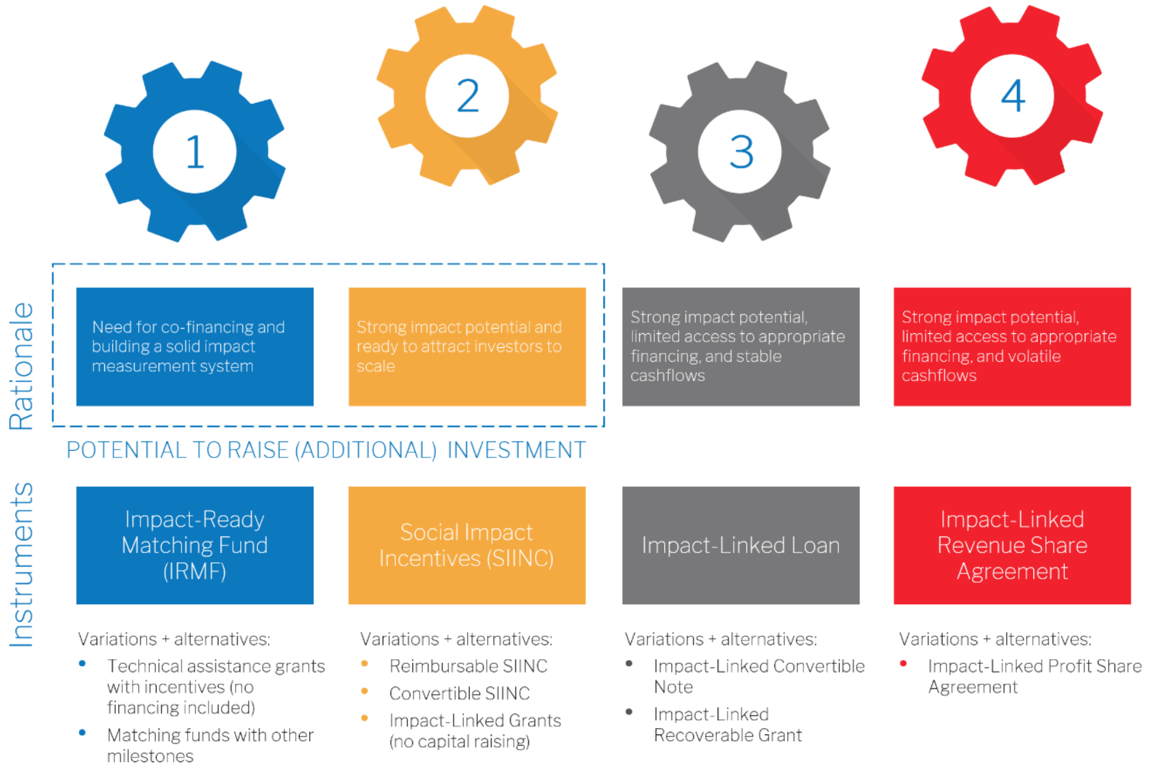
* incl. cost-effectiveness analysis

Which Impact-Linked Finance instrument is best used for which case?

There are a variety of Impact-Linked Finance instruments, each having their very own characteristics and suitability criteria. Which instrument is best used in which case depends on a variety of aspects, for example the stage of the enterprise, its ability to raise investment or repay debt, or its impact measurement and management practices. From a funder's perspective (whether philanthropic or public funder or investor), the choice will also be dictated by the level of concessionality that the capital providers are willing to accept, i.e. how patient the capital is and what the providers risk-return preferences are.

The Innovative Finance Toolkit (co-created by Roots of Impact for the B-Briddhi program) gives more details and examples of financing instruments and illustrates the most suitable application for each one of them. In addition, the Impact-Linked Finance Navigator below gives some high-level guidance on which instrument is best to use when:

Impact-Linked Finance Navigator



Which types of enterprises or intermediaries are best suited for Impact-Linked Finance?

A diverse range of instruments can give the right type of funding to different kinds of enterprises in various growth stages. For instance, Impact-Linked Loans are generally provided to more mature enterprises that are able to repay debt, and yet can highly profit from low-cost capital as a reward for creating additional impact. However, there are some criteria that are particularly suitable for enterprises looking to receive Impact-Linked Finance support. These include:

(1) strong and sustainable business models,
(2) highly scalable solutions,
(3) short- or mid-term potential for commercial self-sustainability or public contracting,
(4) strong evidence for positive impact on disadvantaged and vulnerable groups, and/or
(5) measurable and trackable outcomes that can be attributed to the solution.

Ideally, but not necessarily, Impact-Linked Finance addresses potential (temporary) tensions between impact and commercial goals. This can be the case if deepening the impact (e.g. serving low(er) income groups or more remote areas) may (initially) lead to higher risks and lower profitability. Impact-Linked Finance can help enterprises overcome such tensions, for example by helping them bridge the initial low economies of scale. Moreover, Impact-Linked Finance – specifically repayable instruments – can also be used for financing impactful activities that enterprises would otherwise find difficult or impossible to obtain funding for (with similar terms).

Impact-Linked Finance can also be directed to (financial) intermediaries in order to enable them to focus on underserved, high-impact segments. For example, incentives can be provided for serving (more) vulnerable groups, whether in terms of gender, location, ethnicity, or ticket/business size. An example are financial rewards to a provider of high-additionality loans to agricultural SMEs in rural areas (for more details, check out this article). High additionality in this context means that no other lender would provide these (small) loans to enable agricultural SMEs to (better) serve more smallholder farmers. Depending on the intermediary and the instrument, Impact-Linked Finance can spur both, a permanent and a provisional business model shift towards more impactful approaches.

Are there any additional criteria that an enterprise needs to fulfill to be eligible for Impact-Linked Finance?

Generally, enterprises need to have an adequate impact measurement and management (IMM) system in place to ensure reliability of data and allow for the identification of the right baseline and targets. For example, historical impact data facilitate impact projections, which in turn allows to better identify the additionality and best suited incentive brackets and targets. However, should an enterprise not have such a system, a variety of options are available depending on the concrete case, the instrument and the funder/ investor, e.g.:

(1) Having an independent third party perform a baseline assessment to identify the right baseline,
(2) adding a pre-Impact-Linked Finance technical assistance to develop an adequate IMM system,
(3) having a technical assistance program running in parallel so to strengthen the enterprise's IMM system, or
(4) developing an incentive scheme that aims at rewarding the enterprise for independently developing and implementing an IMM system (e.g. with the support of an external service provider or by hiring relevant personnel).

How long does a typical Impact-Linked Finance transaction last?

The length of Impact-Linked Finance transactions varies from case to case and from instrument to instrument. Funders' preferences of course play a role as well. In general, the lengthier the transaction, the more impact can be created and the more catalytic the instrument can be. As per the common practice of Roots of Impact's and the Impact-Linked Finance Fund to date*, SIINC transactions generally last between 2 to 4 years. Impact-Linked Loans often have longer tenures, e.g. 3 to 6 years. In general, the flexible structure of Impact-Linked Finance creates a great level of adaptability to the case-specific situation and needs. It is left to the transaction manager (and the funders/investors) to decide which transaction length is best.

* With Roots of Impact being an early practitioner and pioneer of Impact-Linked Finance, its past practice can serve as a guideline, but the transaction details such as size, time etc. can diverge and be adapted to specific needs and desires.

Which kind of impact is rewarded, and how is it incentivized?

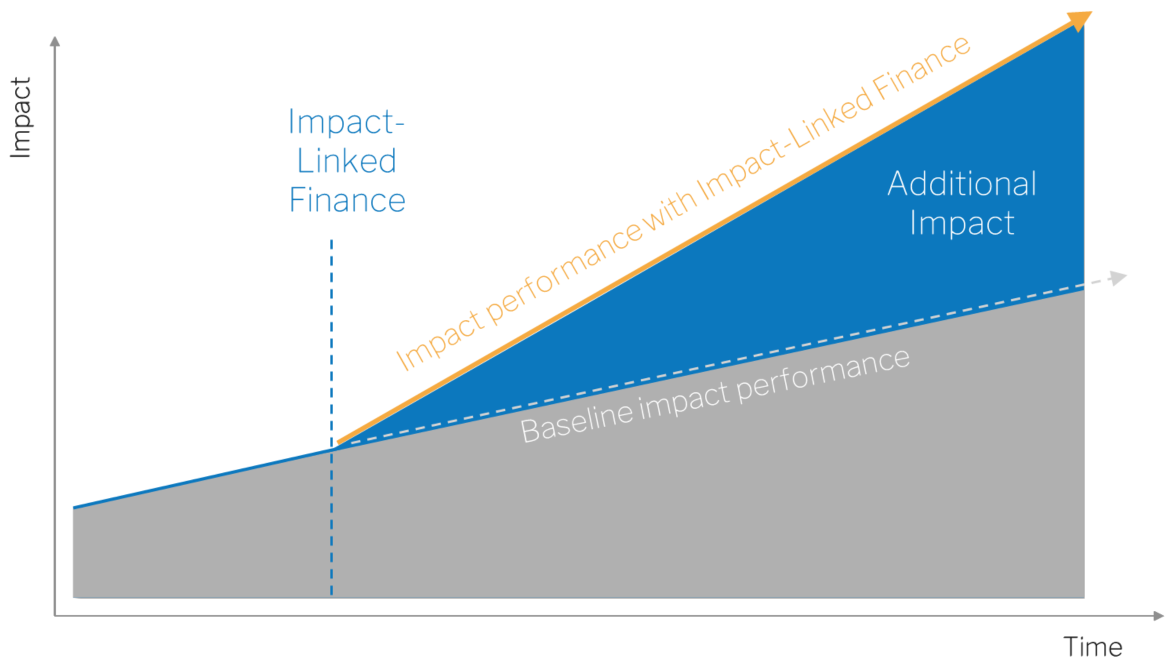
In Impact-Linked Finance, impact is generally understood as either (1) verifiable, measurable outcomes or as (2) proxy-outputs with strong evidence of their linkage to specific outcomes. For example, if there is clear evidence that the safe water provided by a specific solution leads to health improvement (e.g. via a thorough and independent impact report or an academic paper), incentives can focus on access to water for low-income groups rather than on the actual health status of single customers.

In general, incentives are identified on a case-by-case basis and in close collaboration with the entrepreneurs, so to ensure that the metrics and targets are both desirable for, and attainable by, the target enterprise. The incentives are identified with a bottom-up and enterprise-centric approach. This collaborative process entails a close assessment of the enterprise's impact model and measurement system as well as its growth plan. This allows to better understand where additional impact could and should be created as well as what level of impact the enterprise would be creating, regardless of a potential Impact-Linked Finance support (baseline). Such a bottom-up approach ensures that all stakeholders involved are fully aligned and that the right type of impact is incentivized and rewarded.

Incentives are often aimed at increasing the breadth (quantity) and / or depth (quality) of impact. For example, performance-based rewards may be provided if the enterprise reaches more customers from low(er)-income or remote communities (breadth) or if their living situation (e.g. income, health) is further improved (depth). Moreover, in the interest of additionality, incentives are provided only for additional impact that is achieved on top of what the enterprise would achieve anyways*, regardless of the Impact-Linked Finance support (see figure below). This ensures that the enterprises are incentivized to increase their impact beyond business as usual. A case study of a finalized SIINC transaction provides further insights into potential incentives. Additional case studies that can be found here.

* This is different in cases, where the creation of impact in not commercially viable at the time of the transaction and the enterprise would not be able to continue creating the impact. In these cases, the incentives can close the commercial viability gap. This allows the enterprise to become financially sustainable and attract private investment.

The Impact-Linked Finance effect on impact performance



Can Impact-Linked Finance reward environmental impact as well?

While the transactions done by Roots of Impact and the Impact-Linked Finance Fund to date have been focusing on social outcomes (e.g. customers' income increase), rewards can be also be linked to environmental impact (e.g. healthier soils or CO2 saved). A precondition is that there is sufficient relevant evidence. As compared to social impact, though, environmental outcomes, may be harder to measure and/or require longer timelines to unfold (possibly with exception of reduction of emissions, where many benchmarks, verification mechanisms and standards already exist). Moreover, it may be more difficult to collect the required evidence to use outputs as proxies. Nonetheless, rewards for social and environmental impact are equally relevant and welcome.

Are there concrete examples for types of impact that Impact-Linked Finance can incentivize?

In general, incentives vary from sector to sector and from case to case. There are some recurring metrics, though, such as (a) increased reach of vulnerable people, (b) increased economic benefits for customers, (c) better service quality / customer satisfaction, and (d) gender smart indicators. Below you can find some examples that provide you with a better idea of what can be incentivized:

Enterprise's sector	Instrument	Incentives	Metrics
Vocational skills development	SIINC	SIINC aims to incentivize the enterprise to increase the proportion of more vulnerable students (target group D, which so far, has proven to be the category that featured the lowest training-to-placement ratio) being placed into jobs, and ensure that these graduates stay employed for at least 1 year.	Metric 1: Percentage of target group D students placed Metric 2: Percentage of target group D students employed after 1 year
Agriculture / irrigation	SIINC	SIINC rewards the enterprise for increasing its B2C pay-after-harvest sales (as compared to sales requiring upfront payments of the full amount), which entails lower financial barriers for smallholder farmers as well as impactful after-sales support. SIINC further rewards the enterprise for spurring a greater income increase among customers.	Metric 1: Percentage of pumps sold via the pay-after-harvest model Metric 2: Percentage increase of smallholder farmers' income
Financial inclusion	Impact-Linked Loan	The Impact-Linked Loan incentivizes the enterprise to enhance its services targeted to customers at the Bottom of the Pyramid. It encourages the enterprise to focus on the still early-stage yet very impactful business line of serving the most vulnerable, and to ensure that services to the target group are provided at a comparable level to other groups.	Metric 1: Percentage of new loans disbursed to vulnerable customers Metric 2: Net promoter score of these customers (customer satisfaction)

Enterprise's sector	Instrument	Incentives	Metrics
Telecommunication	Impact-Linked Loan	Metrics focus on incentivizing the enterprise's expansion into communities that would normally be too small or too poor to gather the up-front investment required for the installation of the infrastructure and roll-out of the service.	Metric 1: Number of new communities with under xy members in areas with existing networks Metric 2: Number of new communities with under xy members in areas with new networks.

What happens if the enterprise does not achieve the agreed-upon impact targets?

Impact-Linked Finance instruments do not build their reward system on the attainment of one single, absolute target (as is often the case in Social/Development Impact Bonds, where rewards are only released upon reaching a specific milestone). Instead, they focus on relative impact performance. In Impact-Linked Finance, each metric generally has an incentive bracket that typically starts above the baseline and features different levels of attainable impact, up until (and sometimes beyond) a specific target. Such an incentive bracket allows to reward for different levels of impact. This is in line with the concept of "better terms for better impact", where every additional level of impact (until reaching a certain cap*) is considered. Nonetheless, if the enterprise does not reach the minimum outcome level, it will not receive any payments for that specific period (or interest rate/principle/multiple reduction, respectively, depending on the relevant Impact-Linked Finance instruments).

* If the enterprise creates more outcomes than the pre-agreed target, it may receive a higher reward than the total amount foreseen for that specific measurement period. However, financial incentives are generally capped to ensure that they do not exceed the maximum funding amount or total discount envisioned.

What is the size of rewards provided for creating additional impact?

As per the common practice of Roots of Impact and the Impact-Linked Finance Fund to date*, a variety of aspects should be considered when deciding on how much financial rewards (whether in the form of cash incentives or interest rate / principal / multiple reduction) should be provided to ensure a correct impact pricing. Such aspects include: (a) cost-benefit or cost-effectiveness analyses, (b) unit cost calculations, (c) growth and exit valuations, (d) financial assessment, (e) additionality reviews, and more. These thorough assessments aim at ensuring that the right incentives are provided without distorting the market.

* With Roots of Impact being an early practitioner and pioneer of Impact-Linked Finance, its past practice can serve as a guideline but the transaction details such as size, time etc. can diverge and be adapted to specific needs and desires.

Are SIINC and other Impact-Linked Finance instruments a subsidization mechanism? How can market distortion be avoided?

By providing catalytic, non-repayable capital to market-based solutions, SIINC inevitably implies a subsidy element. However, SIINC and any other rewards from Impact-Linked Finance can be categorized as smart subsidies: They indeed support private sector actors, but with the sole objective of correcting market failures in underserved markets with high potential for development impact. The art of effective Impact-Linked Finance instruments is to provide "market-correcting incentives" only up to the level where risk and return are in line with alternative investments that the investor could choose – a practice called "minimum concessionality". If this level is attained, there is no market distortion and investors do not benefit disproportionately. It is common practice to calculate an appropriate level of support (or price for additional outcomes) to ensure that enterprises are not over-supported via Impact-Linked Finance. Moreover, incentive levels often decrease gradually to ensure that by the end of the intervention, the enterprise is able to continue creating impact in a sustainable way – either through market forces alone (economies of scale) or by bringing public authorities on board (public contracting).

How does Impact-Linked Finance differ from other approaches?

Impact-Linked Finance is placed at the intersection of results-based financing (RBF), impact investing and blended finance. As such, it includes features of all three approaches. Similar to RBF, Impact-Linked Finance links its rewards to the achievement of certain (levels of) impact. The difference is that it focuses on outcomes created by market-based organizations that are raising private investment in order to scale. RBF, however, pays for outputs, irrespective of whether the organization raises investment or not. The aspect of raising investment is shared with the impact investing space. While both approaches seek positive impact, impact investing typically does <u>not</u> include rewards for achieving it, though. What blended finance and Impact-Linked Finance often (but not always) have in common are certain structures, where both public/philanthropic funders and (impact) investors come together. The difference is that Impact-Linked

Finance does not systematically create risk reduction and/or return enhancement but achieves these effects rather indirectly.

How does Impact-Linked Finance differ from conventional impact investing?

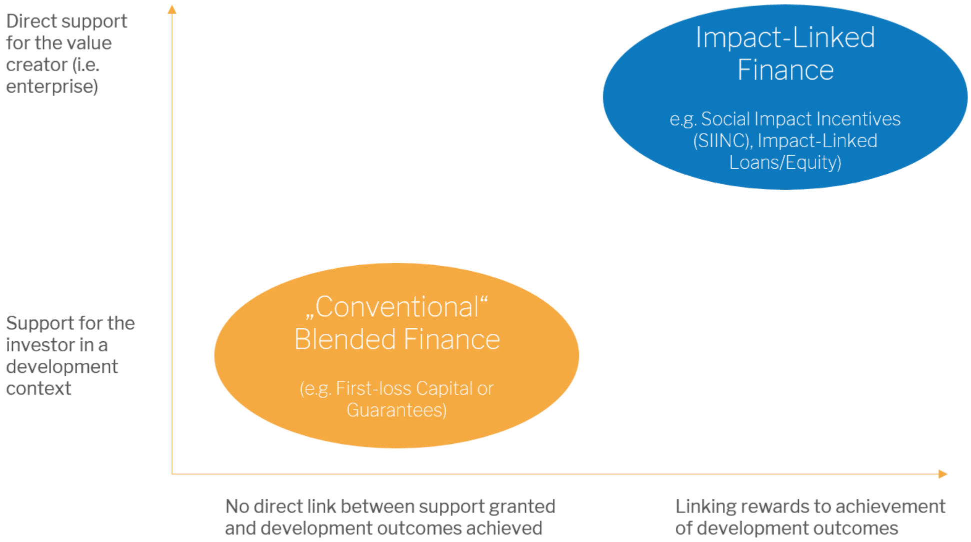
There are a variety of aspects distinguishing Impact-Linked Finance from conventional impact investing:

(1) For impact investing, impact is generally an ex-ante selection criterion rather than a performance criterion. By contrast, Impact-Linked Finance considers impact as fundamental aspect during the entire investment cycle, since rewards are provided for achieving impact (out-) performance.

(2) As outlined by the annual impact investor surveys of the Global Impact Investing Network, the vast majority of impact investors focus on commercially attractive (yet impactful) solutions. Impact-Linked Finance, on the other hand, optimizes for impact and features a broad spectrum of possible financial returns for outcome funders or investors. These typically span from “impact-only” to concessionary or “lower than market-rate”. The exact terms are adapted to the specific case. For example, an Impact-Linked Loan can have an interest rate reduction ranging from 12% to 0%. It can even include a (partial) debt forgiveness, depending on the funders’ willingness and ability to be concessional. In general, Impact-Linked Finance tends to provide concessional terms once impact targets are met in order to ensure its catalytic function.

How does Impact-Linked Finance differ from conventional blended finance?

SIINC is probably the most prominent blended Impact-Linked Finance instrument to date. Yet it still differs to a certain extent from more conventional blended finance approaches. Conventional blended finance instruments typically focus on supporting investors, for example by de-risking transactions with the help of first-loss capital or by enhancing their financial return potential. By contrast, Impact-Linked Finance instruments focus on supporting the value creator, i.e. the enterprise on the ground, by providing tailored financial support that addresses the enterprise’s needs and helps it to scale in commercial as well as impact terms. Also, in conventional blended finance, there is typically no direct link between financial support and development outcomes. Instead, blended finance structures generally tend to assume that positive outcomes will materialize. Impact-Linked Finance, on the other hand, establishes a direct link by providing financial rewards only for positive outcomes that are verified and achieved.



How does Impact-Linked Finance differ from conventional results-based financing?

While Impact-Linked Finance is closely related to results-based financing (RBF), there are some differences to more conventional RBF instruments. For example, RBF often tends to focus on the achievement of outputs rather than outcomes, and on quantity (e.g. number of toilets installed) rather than quality (e.g. whether toilets are actually being used). By contrast, Impact-Linked Finance tends to reward outcomes – or proxies thereof – and to target both breadth/quantity and depth/quality of impact. Only when outcomes are not measurable (e.g. when it takes long time for the outcomes to unfold and when there is no reliable mechanism to assess the impact), outputs can be used, and only if strong evidence-backed linkages to outcomes are available.

Moreover, RBF programs (except impact bonds that focus on non-profit interventions) rarely have a blended finance component that crowds in (commercial) investment. Also, they do not focus on leveraging additional capital for scaling purposes. Impact-Linked Finance instruments, however, can be defined as catalytic and concessional capital in and of itself (e.g. Impact-Linked Loans), and sometimes also blend in investment (as is the case for SIINC where raising repayable investment is a contractual requirement).

How does SIINC differ from a Social or Development Impact Bond?

There are some common traits between Social Impact Bonds (SIBs) and Development Impact Bonds (DIBs) on the one hand, and SIINCs on the other hand. For instance, both are mostly outcomes-based and involve public/philanthropic funding as well as investment. Also, the financial rewards are depending on the level of impact that is being created and verified. Nonetheless, there are some fundamental differences, not least in terms of who exactly receives these financial rewards and when.

For example, in SIBs and DIBs, the social intervention is typically performed by a non-profit organization that receives upfront funding from investors. The financial rewards (repayment + returns) only flow back to the investors once this non-profit organization has reached certain levels of impact. In addition, the funding is typically directed to interventions that focus on prevention measures, cost savings and/ or new solutions that need proof of concept. By contrast, SIINC rewards the value creator itself: It provides direct, impact-linked payments to enterprises with market-based solutions to social challenges, and these targets enterprises are either in, or close to, scaling stage. Often, DIBs/SIBs aim at de-risking the testing and rolling out of impactful service delivery models. SIINC, however, aims to incentivize enterprises with proven solutions to scale (i.e. broaden and/or deepen) their impact and enables them to do so without compromising on commercial growth.

Another important differentiator lies in the risk distribution between the stakeholders. In SIB or DIB structures, investors are the only stakeholder carrying the risk. They provide upfront funding to the non-profit organization delivering the social services, and are only reimbursed by the outcome funders if the non-profit organizations achieves the pre-defined outcomes. In SIINC, the risk is much more distributed and evenly shared among stakeholders. Firstly, the outcome funders do not provide any financial payments upfront, but only upon verification of the impact created. Secondly, they don't need to bear the entire cost of the intervention including the investors' returns, as is the case in SIBs/DIBs. Secondly, the enterprise may lose on some financial rewards by underperforming on the impact targets in certain periods, but it's typically never "all or nothing", as it tends to be in SIB's/DIBs.

Another differentiator is that SIINC is adaptable to different stakeholders and situations. For example, it can be shaped to certain terms, sizes, contracting and procurement mechanisms, timelines, sectors and similar aspects. SIBs/DIBs, however, often require special purpose vehicles, minimum ticket sizes, and other specific settings that may decrease the bandwidth of interventions as well as the types of stakeholders suitable for these mechanisms. Also, SIB/DIBs generally involve more stakeholders as compared to SIINCs. This may increase the time and resources that are needed to align all (possibly quite diverging) interests among different stakeholders.

The below table gives a summary comparison between typical SIBs/DIBs and SIINCs:

Criteria	SIBs/DIBs	SIINCs
Purpose	De-risking the testing and rollout of new service delivery models by non-profit organizations	Mobilizing (more) private sector investment towards high-impact enterprises to enable them to scale/broaden/deepen their impact
Focus	Preventive, more efficient and new (“proof of concept”) social interventions	Innovative impact solutions with strong potential to scale
Target organizations	Non-profit organizations providing social services	Market-based, high-impact enterprises ready to scale
Risk distribution	Investor(s) carry the impact and financial risk. If impact is not achieved, they will not receive reimbursement + returns by the outcome funder(s). If the enterprise succeeds in creating pre-defined impact, outcome funder(s) bear all the financial costs (i.e. cost of the intervention plus investor return).	Financial and impact risks are distributed among outcome funder(s) and impact enterprise.

How does Impact-Linked Finance differ from a typical performance-based contract?

Performance-based contracts (PBCs) and Impact-Linked Finance instruments are closely related concepts: The former can become an instrument of the latter, if performance is identical with impact and funding is provided to market-based organizations. Some distinctions can be made, though. In the majority of cases, PBCs are provided to non-profit service providers and results are mostly measured in terms of outputs (although increasingly also of outcomes). Compared to SIINC in specific, there is the additional difference that PBCs do not require the enterprise to raise capital. Instead, a public or philanthropic funder provides payments based on performance. SIINC can thus be seen as a PBC with two important features: Payments are 1) outcomes-based, and 2) conditional to a market-based organization raising investment.

Compared to SIINC, PBCs can also differ in the timing of disbursements. Sometimes, donors provide upfront payments to allow the (typically non-profit) service provider to set the program and ramp up resources. This is not the case for SIINC. SIINC provides incentives only once the level of impact achieved in a given measurement period has been verified. Also, SIINC transactions typically have clear exit scenarios in mind, for example scenario (1) where the enterprise will successfully bridge its commercial viability gap and become self-sustainable (market-based exit) or scenario (2) where a government body will contract its services long-term (public contract exit). In contrast, the main aim of a PBC is to provide more effective (often non-profit) interventions, but not necessarily sustainable solutions.

There are exceptions to the above-mentioned distinctions, however: Some Impact-Linked Finance instruments don't necessarily have the requirement of (a) raising repayable investment and (b) pursuing either a market-based or a public-contract-based exit scenario. For example, the purpose of Impact-Linked Loans is rather to provide concessional and catalytic capital where commercial investors are more reluctant, e.g. to help an enterprise establish a new, impactful business line. Nonetheless, the focus on market-based solutions as compared to non-profit interventions remains the main distinguishing factor between traditional PBCs and Impact-Linked Finance instruments.

STAKEHOLDER- AND SIINC-SPECIFIC Q&A

FOR ENTERPRISES

Are there any specific features that enterprises need to fulfil if they want to be eligible for SIINC?

While suitability criteria greatly depend on the specific SIINC program, there are some recurring criteria that apply across the board. These include having:

(1) a track record (often 3+ years),
(2) a proven business and revenue model,
(3) reached financial sustainability or a clear plan to do so,
(4) an impact focus, and
(5) an adequate impact measurement and management system in place.

SIINC can support enterprises in different stages of their lifecycles. In many SIINC transactions so far, the focus did lie on enterprises in start-up or early growth stages, not on those in expansion or maturity stage. For more early-stage enterprises, technical assistance, development grants and/or Impact Ready Matching Fund (IRMF) may be more suitable, since they support enterprises to become "SIINC- or Impact-Linked Finance-ready". In IRMF, this is done by supporting enterprises to enhance their impact management and measurement (IMM) systems or investment readiness profiles, while also matching an investment (with a potential cap) that the enterprises need to secure.

How much repayable capital do I have to raise in order to be eligible for SIINC?

The exact amount of repayable capital to be raised is dependent on the outcome funder, the Impact-Linked Finance program and the context. As per common practice to date, a financial leverage between 1:1 and 1:12 can be achieved. For example, if the enterprise is to receive up to € 250,000 in SIINC payments, it would need to raise between € 250,000 and € 3,000,000 in repayable investments. Past programs such as SIINC for WASH have had minimum leverages of 1:3, for instance. While the financial leverage does provide an idea of the catalytic effect that SIINC can have in helping an enterprise to attract additional private capital, exact attribution is difficult to measure. As such, SIINC generally does not focus on financial additionality alone, but also on impact additionality.

Do I have to close an investment round before applying to SIINC?

No. Ideally you should be in the process of engaging with potential investors when applying for SIINC. The time span for raising and closing investment varies from program to program, but you generally have up to 12 months' time to raise the necessary financing round. If selected, you could (and should) use the SIINC memorandum of terms or contract to get (more) investors on board, as SIINC payments can boost your financial forecasts. Closing an investment round is a necessary condition for receiving SIINC.

Am I still eligible for receiving SIINC if I just recently closed an investment round?

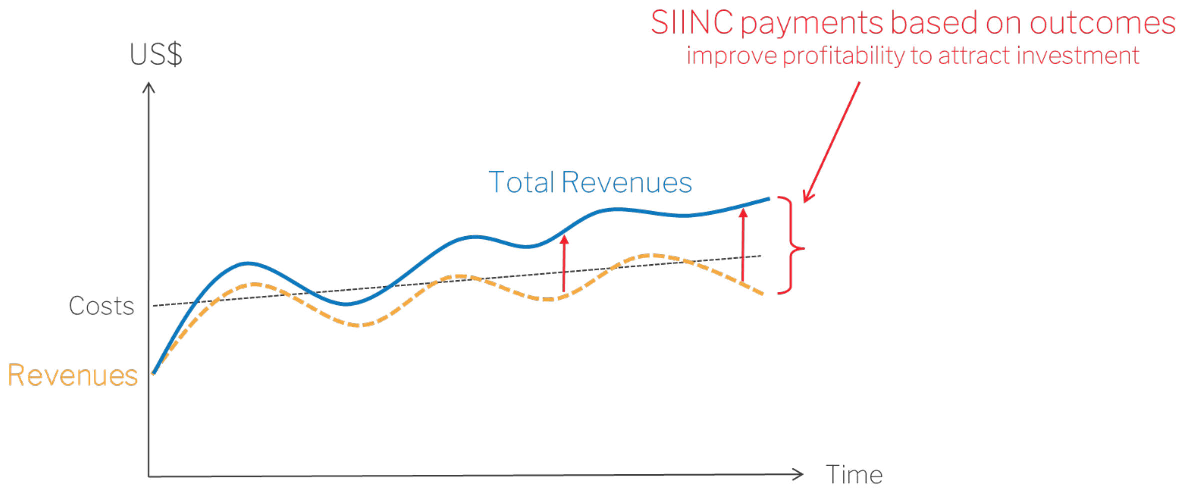
The answer to this question is program- and funder-specific and may depend on the case-specific context. Since the idea behind SIINC is to also provide a financial leverage (i.e. to support the impact enterprise to attract investment), having already raised capital slightly misses (part of) the purpose of SIINC. However, if SIINC can spur the enterprise in creating significantly greater positive impact, some flexibility may be granted, depending on the concrete circumstances.

Can I raise grants instead of an investment to qualify for SIINC?

No, or better: not only. SIINC is provided to selected enterprises under the condition that they raise repayable investment (i.e. equity, debt or mezzanine). You can raise additional grants in parallel to complement the repayable investment, but not exclusively.

How can I use a SIINC contract to attract more commercial capital?

You can integrate the support that Impact-Linked Finance offers to boost your income statement and make your operations more attractive. SIINC can be seen as an additional revenue stream (see figure below), which encourages you to adapt your future projections accordingly. If required and possible, official documentation or even direct involvement by the transaction manager and / or outcome funder can be organized.



Do I have to pay back SIINC?

No. The time-limited payments provided by SIINC are non-repayable. However, enterprises need to raise an investment round in parallel to benefit from SIINC, so some form of repayment will apply, but not with reference to SIINC as such.

FOR PUBLIC OR PHILANTROPIC OUTCOME FUNDERS

What are the main advantages of SIINC for donors?

With SIINC, donor funding is delivered via an outcomes-based structure, providing incremental financing based on the level of impact achieved. This is why SIINC is an effective way of “scaling what works”, leveraging entrepreneurship and innovation. You as a donor only pay for the exact impact that the enterprise creates, which ensures an efficient and effective allocation of funds and spurs mid-term self-sustainability for the enterprise. Moreover, SIINC contracts encourage the enterprises to optimize for impact and deliver additional impact at marginal cost, which provides great value for money for an outcomes funder. Since SIINC requires the enterprise to raise private investment in parallel, your funding also has a financial leverage in addition to the impact leverage. As such, your funding has a significant catalytic effect, helping enterprises to grow in financial and impact terms.

What is the role of an outcome funder in the SIINC implementation?

The extent to which you, as an outcome funder, are involved in the process is discussed on a case-by-case basis. It is common practice for funders to suggest the program's focus and targets and to be (actively) involved in the program's design phase. Depending on the type of mandates (discretionary or not), funders will be included in other stages of the process as well. For example, they may be part of the Selection Committee that chooses the final enterprise candidates and in the Decision Committee that approves the incentive structures specifically designed for each candidate. A variety of supporting documents, such as detailed scorecard assessments, cost-benefit-analysis, material explaining the incentive schemes and the reasoning behind it, will be provided throughout the process, so as to keep the funder up to date.

FOR INVESTORS

Which role do investors play in a SIINC contract?

SIINC is the only Impact-Linked Finance instrument that explicitly and unavoidably requires the enterprise to raise an investment round in parallel. Yet the investors are not part of the SIINC contract: They enter into a separate agreement with the enterprise, without which the SIINC transaction cannot be closed.