

Reference document concerning “Overview of relevant and existing forms of innovative finance mechanisms, related opportunities and risks, and potential for ILO engagement” (GB.335/POL/4)

1. This note provides background information on innovative finance. It gives details of different existing mechanisms as well as their key principles. A number of examples and some selected models are provided. It should be read in conjunction with “Overview of relevant and existing forms of innovative finance mechanisms, related opportunities and risks, and potential for ILO engagement”. A more detailed explanation of the different types of innovative financing mechanisms and the ILO’s engagement with innovative finance is provided in the Working Paper No. 75 by the ILO’s Social Finance Programme.¹

1. Categories: functioning and principles

Functioning and goals

2. The various types of innovative finance practised can be categorized in terms of their key technical attributes and goals, such as blending private and public financing, mobilizing investment funding, linking payments to results, and leveraging technology. The financing involved can be both concessional and non-concessional, or a combination of the two. Concessional finance includes grants and financing that is provided on more generous terms than the market (non-concessional). The concessionality is achieved, for example, through interest rates that are below those available on the market, or by grace periods, or a combination of the two.
3. Innovative finance initiatives may differ depending on the extent to which they involve and blend both commercial and concessional capital. Commercial capital typically is financing that can be obtained in domestic and international capital markets through for example the issuance of bonds (debt obligations or form of borrowing by enterprises, governments and multilateral banks). Different mechanisms or opportunities may be more likely to utilize concessional capital as a way of making the financing affordable to the organization or incentivizing certain behaviours.
4. In this initial exploration of innovative finance, the categories shown below are used.

¹ A more detailed analysis of the concepts and practices involved may be found in *Innovative Finance: Putting your money to (decent) work*, available on the ILO social finance website at <http://www.ilo.org/socialfinance>. This is an internal working paper that is specific to the fields covered by the ILO’s Social Finance Programme.

Figure 1. Selected innovative finance mechanisms

	1	2	3	4
	Financial Products	Risk Mitigation Mechanisms	Results-Based Financing	Technology-Enabled Solutions
Description	Products meant to mobilise and raise funds from capital markets	Mechanisms aimed at reducing (perceived) risks	Payments are linked to certain outcomes being met	Financing mechanisms that leverage technology
Instruments	<ul style="list-style-type: none"> -Bonds & Notes -Loans -Microfinance & SME finance -Impact Investing Funds -Venture Capital & Private Equity Funds 	<ul style="list-style-type: none"> -Subsidies -Guarantees -Insurance and Options 	<ul style="list-style-type: none"> -Development/Social Impact Bonds -Outcome-Based Funds -Advance Market Commitments 	<ul style="list-style-type: none"> -Blockchain -Digital Technology -Crowdfunding

Table 1. Types of mechanisms

Mechanism	Description
1. Financial products	
Bonds	Bonds are instruments issued on the capital market to raise debt financing for a business or project over a defined period, and lenders usually receive interest payments over the lifetime of the bond or principal and interest at maturity when the loan expires.
Microfinance and SME finance	Microfinance is the provision of small-scale financial services to un-/underserved people. SME finance is the funding of small and medium-sized enterprises. Financial products for Microfinance & SME finance can be structured in the form of bonds, notes, loans, funds, and private equity.
Impact investment funds	Impact investment funds are vehicles that allow several separate and unrelated investors to make investments together in projects that deliver positive social or environmental returns, in addition to positive financial returns.
Venture capital (VC) and private equity (PE)	VC is start-up or growth equity capital or loan capital (also called risk capital) invested in a project in which there is a substantial element of risk, typically a new or expanding business. PE is ownership in a corporation that is not publicly traded, i.e., it involves investing capital in privately held companies. Some initiatives use VC/PE mechanisms for the sourcing, selection and assessment of investees but may not necessarily require a financial return.
2. Risk mitigation mechanisms	
Subsidies	Funds typically provided by the public sector to co-finance part of the investment or business costs. Subsidies include both grants and concessional funding, and can be used with any financing mechanism.
Guarantees	A financial instrument in which a guarantor, typically the official sector, agrees to pay any or all the amount due on a loan instrument in the event of non-payment by the borrower, and can be used with any financing mechanism.

Mechanism	Description
Insurance and options	Funds are paid out only when a certain event occurs, providing instant funds in emergencies and transferring risk to insurers or investors, who earn premiums in return.
3. Results-based financing	
Development & social impact bonds	A pay-for-success model that ties payment to the attainment of a pre-determined social outcome. The difference from traditional results-based financing is the involvement of the private sector, which provides up-front financing to the service providers with the promise of a return once results are achieved.
Pull mechanisms and outcome-based funds	Mechanisms or funds that provide grants or subsidies to project or business owners once they have developed the desired product or attained the pre-specified outcome.
Advance market commitments	Funds are committed to guarantee price or market for products once they have been developed.
4. Technology-enabled solutions	
Blockchain	Blockchain is a technique that uses encrypted digital ledgers distributed over a network that is secure and transparent.
Digital technology	Anything that involves digital or computerized devices, methods or systems.
Crowdfunding	Crowdfunding is an internet-based method of raising funds from many individuals or organizations; individual contributions can be very small.

Principles and sustainability

- In reviewing the mechanisms and their application to specific development challenges, a number of general principles can be used to assess and compare them. These principles can also help to consider the mechanisms best suited to achieve a specific development objective given the context, the target group, and the partners involved.
- First, the different mechanisms can be grouped according to the principles or goals they fulfil, such as scalability (massively increase the capital flow), complementarity (crowd-in the private sector), additionality (intervention is clearly additional to the status quo), effectiveness (mechanisms bring more discipline to implementation), efficiency (fewer resources are required to deliver the same outputs/outcomes), sustainability (programme becomes self-sustaining after upfront/initial funding), or predictability (making the reception of funds more predictable to improve planning for a programme).

2. Selected models of innovative finance

- Three innovative finance models are described here in more detail: (i) Development Impact Bonds and Social Impact Bonds; (ii) Blended Impact Investment Funds; and (iii) Outcome-Based Funds. These recent examples have been selected on account of their innovative nature and because they all represent multi-stakeholder partnerships involving both the private and public sector. Note that the descriptions serve to illustrate only the functioning of the mechanisms, and do not address cost implications or the actual results achieved.

Development Impact Bonds and Social Impact Bonds

- Development Impact Bonds (DIB) and Social Impact Bonds (SIB) are financing mechanisms designed to achieve social and development outcomes by bringing together private investors, implementers, governments and donors. Private investors loan capital for implementation to intermediaries and service providers. Implementers use capital to design and implement programmes that achieve desired social outcomes. Outcome funders pay back private investors' loans, with interest, if the service providers achieve pre-determined targets.

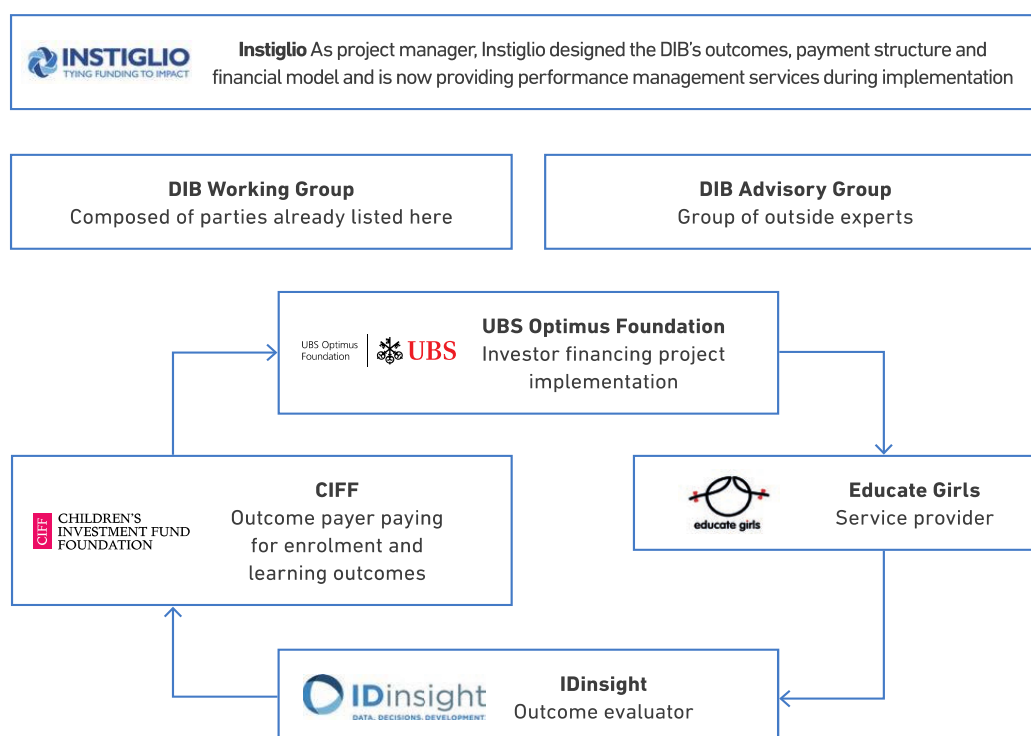
9. While commonly referred as a “bond”, the solution replicates in essence a payment-for-results scheme. In an SIB, the outcome payer is the government, while in a DIB, the outcome payer is a donor. The difference between SIBs/DIBs and traditional results-based financing is the involvement of the private sector, which provides up-front financing to the service providers with the promise of a return once results are achieved.
10. Impact bonds are an innovative way of financing international development and have the potential to leverage private philanthropic capital to address development challenges. Because a DIB/SIB ties financial returns and payments to rigorously measured social outcomes, it has the potential to sustain long-term, results-focused partnerships between non-profits, donors and investors.
11. Development Impact Bonds (DIB) have emerged as a potentially attractive instrument because:
 - they mobilize up-front financing from new private sector sources;
 - they tie funding to agreed and verified results, as payments are only made when -agreed outcomes are achieved;
 - they allow the public sector to transfer risk to private sector investors, making more efficient use of limited public funds;
 - they drive performance management and a relentless culture of monitoring and evaluation at the service provider level;
 - they allow flexibility for the implementers and service providers to decide how they wish to use the up-front capital to design and implement programmes that can best achieve the agreed social and/or environmental outcomes.
12. The mechanics of a DIB/SIB are usually the following:
 - *Form a public-private partnership on a priority subject area.* The government/donor defines the desired development, social or environmental outcomes. It usually works with an intermediary, service provider(s), and forerunner investors to conduct pre-feasibility assessments.
 - *Develop detailed project and outcome metrics.* The intermediary works with the government/donor and the service provider(s) to design payment-for-success metrics, i.e. the key performance indicators whose achievement will trigger the release of payments by the government/donor to the investors. Simplicity, attribution, and manageable costs of measurement are key considerations. The intermediary usually drives the design, negotiation, and structuring phases.
 - *Mobilize capital.* The intermediary raises capital from impact investors and from philanthropic sources (e.g. guarantee providers) to provide upfront funding to the service provider in order to execute the project.
 - *Deliver services.* The service provider executes the project. The intermediary is responsible for oversight, performance management, course corrections, financial management, and investor relations.
 - *Validate outcomes.* An independent evaluator measures the outcomes achieved by the project on the basis of the predetermined metrics. The project may or may not achieve its stated outcomes.

- *Release of payments.* When successful and based on the evaluation findings, the government/donor repays the upfront capital plus an interest. If the project does not achieve its outcomes, there is no payment or only a partial repayment.

Example

13. Taking the Educate Girls Development Impact Bond (DIB) as an example, a socially-motivated investor – the UBS Optimus Foundation (UBSOF) – puts in the working capital so the service provider – Educate Girls, a non-profit organization based in Mumbai that delivers an educational programme – can begin its work on the ground. Educate Girls delivers a comprehensive community intervention to enrol girls in school. This intervention includes identification of out-of-school girls through door-to-door surveys, explanation of the value of schooling to the parents and to the community, and multi-channel engagement with the household where a girl is out of school. The capital is disbursed in two phases: 40 per cent in the first year, and the remaining 60 per cent in the second year, conditional on Educate Girls’ reaching certain performance milestones. An outcome payer, in this case the Children’s Investment Fund Foundation (CIFF), promises to pay back the investor (UBSOF) the original amount plus extra returns in the form of a cap of up to 15 per cent depending on the extent to which the agreed targets are met. The targets are focused on (a) increased enrolment, and (b) the children’s progress in literacy and numeracy, which will be assessed regularly by an independent evaluator, IDinsight, over the course of the three-year programme.
14. The Educate Girls Development Impact Bond (DIB) aimed to increase enrolment and improve learning outcomes for 18,000 children, 9,000 of them girls, in 166 schools across Rajasthan, India. It achieved impressive results, achieving 116 per cent of the enrolment target and 160 per cent of the learning target in its final year.

Figure 2. Educate Girls Impact Bond



Source: [The Educate Girls Development Impact Bond: A New Finance Model for International Development.](#)

Blended Impact Investment Funds

15. An investment fund is a vehicle that allows a number of separate and unrelated investors, a group of individuals or institutions, to make investments together. By pooling their capital, investors can share costs and benefit from the advantages of investing larger amounts, including the possibility of achieving broader diversification among a number of different assets and thus spreading their risk.
16. Impact investment funds play a critical role in making it easier for institutional investors to allocate more capital to impact investments. In order to complement other available funding, impact investment funds often enter areas in which particular needs of the investees are not yet fulfilled due to market failures in developing or emerging markets. Impact investment funds vary based on their strategy, thematic (e.g. health, financial inclusion, etc.) and geographical focus, as well as on the instruments they use (e.g. private equity, debt).
17. A professional team of fund managers takes care of deal origination, due diligence, and managing the investment. For these services, investors pay a management fee.
18. Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries and sustainable development. Blending is one way of delivering concessional finance, meaning that public sector or philanthropic funding is used to leverage private capital that might not otherwise be invested for a social purpose by providing cornerstone investments and taking different risk positions.
19. According to Convergence, the global network for blended finance, there are four archetypes of common blended finance structures:²
 - Public or philanthropic investors are concessional within the capital structure (concessional capital).
 - Public or philanthropic investors provide guarantees or insurance priced below market rates (guarantee / risk insurance).
 - Transactions are associated with a grant-funded technical assistance facility (technical assistance funds).
 - Transaction design or preparation is grant funded (design-stage grants).
20. While they vary in terms of the target financial and social outcomes and the way they are structured, blended impact investment funds share several attributes: all these funds are designed to achieve a financial return alongside a clear social impact, and to use their governance structure to define and protect the fund's social mission. For this reason, they can appeal to both public and private investors. This leads to a multi-tiered structure of different capital layers, reflecting the specific needs of each class of investors regarding impact, risk and return. This structure is atypical in that investors in the highest risk class (junior shares) usually forego return in favour of clearly measurable impact. Funding from bilateral donors, development financial institutions, and charitable foundations plays a catalytic role in attracting private sector funding by taking the highest level of risk at a

² <https://www.convergence.finance/blended-finance>.

concessional rate. This allows the funds to achieve social outcomes at scale and address entrenched social problems that require large investment.³

Examples

21. Initiated by KfW (Kreditanstalt für Wiederaufbau) Development Bank and funded by the German Federal Ministry for Economic Cooperation and Development (BMZ), the Regional Education Finance Fund for Africa (REFFA) aims to provide customized financial services for the education sector in Africa in a demand-oriented, financially sustainable, and socially responsible manner.
22. The Fund and its Technical Assistance Facility partner with local financial institutions by supporting them in the development of sustainable financial services for private affordable education providers as well as learners and their families. In doing so, the Fund and the participating financial institutions help improve access to quality education and affordable education, while also contributing to the socially responsible economic development of African countries. The REFFA Fund and the accompanying Technical Assistance (TA) facility are managed by BlueOrchard.
23. REFFA is set up as public private partnership, where public funding sources are blended with funding from private investors. Different tranches of investors reflect a range of risk appetite and risk-return profiles depending on their level of seniority or subordination.
24. In another example from 2013, Habitat for Humanity's Terwilliger Centre for Innovation in Shelter launched *MicroBuild Fund*, the first impact investing fund dedicated to housing microfinance. The Fund lends to microfinance institutions, which in turn provide small loans to families to build homes. As of end 2018, MicroBuild has approved nearly US\$121 million across 31 countries to 56 institutions. This has resulted in a direct improvement in living conditions for more than 116,000 families globally, or more than 580,000 individuals. Within the MicroBuild portfolio, two underserved demographics represent a high proportion of the overall portfolio investments: 73 percent of the borrowers are women, and 70 percent of the borrowers are rural clients.

Outcome-based funds

25. Outcome-based funding models (also referred to as “pay-for-performance” and “results-based financing” models) refer to financing mechanisms where a funder makes payments conditional on the achievement of agreed outcomes. The full payment is only received if the agreed outcomes, i.e. measurable and independently verifiable social or environmental impacts, are achieved. Under this system, private finance is first deployed to achieve the desired outcomes, and only after agreed impacts (outcomes) have been verified is concessional money made available by the outcome “buyer”, often a foundation, development finance institution, or government. Outcome-based funding mechanisms have received significant attention over the past decade as public budgets face increasing pressure. “Payment-for-success” is also increasingly a component of development assistance through staged and performance-based grant funding. For development funders, outcome-based funding models can increase the efficiency and effectiveness of limited aid budgets:

³ World Economic Forum (2013), *From Ideas to Practice, Pilots to Strategy Practical Solutions and Actionable Insights on How to Do Impact Investing*, A Report by the World Economic Forum Investors Industries.

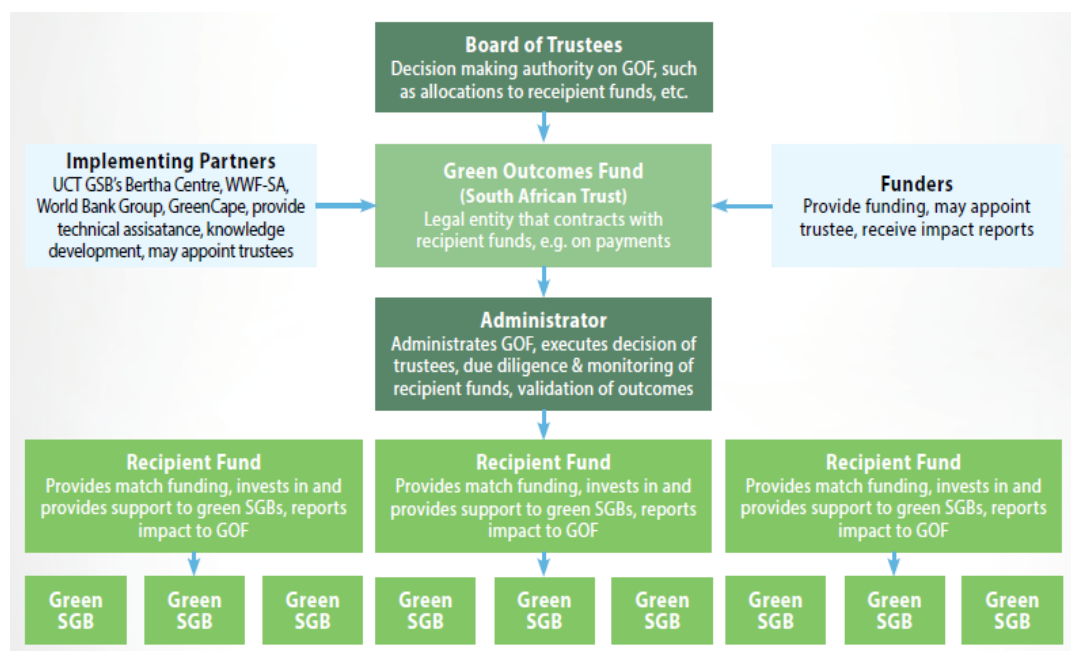
concessional development funding is conditional on achieving impact, while up-front costs (and risks) are covered by private capital.

Example

- 26.** The World Bank Group’s Climate Technology Program (CTP), together with its local partners, is pioneering a new outcome-based financing modality in South Africa that will test new ways to incentivize local fund managers (investors) to finance green Small and Growing Businesses (SGBs). This pilot takes the form of a Green Outcomes Fund (GOF) that contributes to global efforts to promote rapid development of the green economy. The Green Outcomes Fund (GOF) will provide outcome-based, matched (concessional) funding to local Recipient Funds (RFs) to incentivize investments in SGBs that make a demonstrable contribution to South Africa’s green economy, as well as job and enterprise creation, in priority impact areas. Payments can be used by the funds to cover the costs of originating green investments or providing necessary technical assistance and business development to green investees.
- 27.** The GOF will initially be a not-for-profit fund that will provide pure or reimbursable grants to local RFs in exchange for performance, namely the achievement of pre-agreed green outcomes. Central to the Green Outcomes Fund is the achievement of green outcomes in terms of a set of verifiable metrics. The specific metrics developed include new access to clean energy connections, the number of new green jobs created, tonnes of carbon dioxide emissions sequestered, and tonnes of waste diverted from landfill into productive uses, among others.
- 28.** Key questions for the GOF are the following:

 - Are local fund managers willing to increase investment in green SGBs if a portion of the cost to them of originating and investing in these businesses is covered?
 - Are local fund managers willing to commit to achieving a pre-agreed set of green outcomes associated with their investments which can be independently verified?
 - Are external funders that are focused on catalysing transition to the green economy (e.g. donors and foundations) interested in supporting local fund managers to achieve green SGB outcomes, and is such a modality an efficient and effective way to achieve a pre-defined set of outcomes?
 - Will these interventions result in greater funding to green SGBs in South Africa during and beyond the life of this pilot?

Figure 3. Green Outcome Fund



Source: World Bank Group: *Can Outcome-Based Financing Catalyze Early Stage Investments in Green Small and Growing Businesses? Lessons from South Africa*, Climate Technology Program In Brief No. 8, 2017, page 6.

3. Recent examples in areas of interest to the ILO

29. The following is a non-exhaustive selection of some recent initiatives involving innovative financing. Several involve the UN and multilateral agencies, in various ways. For example, the World Bank tends to be involved in a wide range of innovative financing initiatives as a trustee or fund manager, while UNDP tends to be the implementer or provider of technical assistance.

Table 2. Selected recent initiatives

Initiative	Description
ICRC Programme for Humanitarian Impact Investment ("Humanitarian Bond")	<p>Finances aid to help transform the way vital services for people with disabilities are financed in conflict-hit countries. It funds three physical rehabilitation centres in Africa (Nigeria, Mali and Democratic Republic of Congo) for a five-year period, providing services for thousands of people. The payment-by-results programme also includes training for new staff and the testing and implementation of new efficiency initiatives. The innovative funding mechanism has been created to encourage social investment from the private sector to support the ICRC's health programmes. A rising number of conflicts as well as a growing annual budget of the ICRC are the driving forces for this innovative funding model.</p> <p>After five years, "Outcome Funders" – the Governments of Belgium, Switzerland, Italy, the UK and "la Caixa" Foundation – will pay the ICRC according to the results achieved. These funds will then be used to pay back the social investors partially, in full or with an additional return, depending on the findings of the independent auditors, who will verify the ICRC's reported efficiency in the three new centres. The efficiency – the ratio of how many people receive mobility devices per physical rehabilitation professional – is compared to existing centres. If above the benchmark, the social investor will receive its initial investment plus an annual return. If the performance of the new centres is, however, below the benchmark, then it will lose a certain amount of the initial investment.</p>

Initiative	Description
Sticking Together Social Impact Bond	A programme by <i>Social Ventures Australia (SVA)</i> , a not-for-profit organization that seeks to deliver better social outcomes for people by learning about what works in communities, helping organizations be more effective, sharing perspectives and advocating for change. Launched in 2018, the programme will work with over 800 young people aged 18 to 24 who are unemployed and face major barriers to employment, such as disability, mental health challenges, a criminal conviction, or lack of a permanent home. The programme will find ways to improve each young person's connectedness, motivation and personal self-worth through the lens of home, health and relationships, and will also provide support to their employers.
Islamic Impact Bond for Refugees	<i>Near East Foundation</i> plans to issue the first tranche of USD14.49 million of a development impact bond in April 2019 to fund Syrian women refugees in Lebanon and Jordan, focusing on starting home-based businesses with the support of local organizations.
Impact Investing Alliance on Education	Announced in 2018, <i>Lumina Foundation</i> , <i>Robin Hood</i> , and the <i>Salesforce Impact Fund</i> , an initiative of <i>Salesforce Ventures</i> , will each put up \$5 million to back companies supporting adults with job retraining, equitable compensation, and inclusive work environments. The partnership will also invest in companies helping adults to complete high school, learn maths and science skills, and access higher education.
SEAF Women's Opportunity Fund	Launched in 2017, in partnership with <i>Investing in Women</i> , an initiative of the Government of Australia to catalyse inclusive economic growth and poverty reduction in South East Asia by investing in women-led businesses in the Philippines, Viet Nam, and Indonesia.
Education, Youth, Employment Bond	Launched by the <i>Inter-American Development Bank</i> in 2014, with the aim of building human capital from early childhood care and education, through formal education and programmes that improve transition from school to work.
Educate Global Fund	Established in 2015, <i>Educate Global</i> makes private equity investments in for-profit businesses with a direct impact on the educational outcomes of children and young people, initially within the East African region.
UNDP's ImpactAIM Venture Accelerator	Launched in 2017, initiated by UNDP and implemented by <i>Impact Hub Yerevan</i> and the <i>Catalyst Foundation</i> , with the aim of scaling up the impact of ventures to help achieve the SDGs in Armenia and beyond.
Global Fund to End Modern Slavery (GFEMS)	Incubated by <i>Global Development Incubator</i> and launched in 2017, GFEMS views modern slavery as a crime of economic opportunity and a violation of human dignity, and aims to scale funding and global commitment towards these issues.
Quality Education India Development Impact Bond	Launched in New Delhi in September 2018 following the success of the pilot <i>Educate Girls DIB</i> , with potential to fund improved learning outcomes over four years for more than 300,000 primary school children in Gujarat and Delhi.
AAWAZ II programme	Building on the success of <i>AAWAZ I</i> , this programme will be implemented from 2018 onwards jointly by UNICEF, UNFPA and UN Women, funded by the UK Department for International Development, its aim being to eradicate child labour and reach 7 million people across the provinces of Khyber Pakhtunkhwa (KPK) and Punjab in Pakistan.
Adaptation for Smallholder Agriculture Programme (ASAP)	IFAD's flagship programme to channel climate and environmental finance to smallholder farmers and help them adapt to climate change; the second phase was announced in 2017 and will run until 2025, benefiting 10 million smallholder farmers.
Humanity United	Part of the <i>Omidyar Group</i> , raised USD23 million in 2018 to invest in solutions fighting human trafficking and other abusive practices in corporate supply chains worldwide. The Fund is backed by <i>Walt Disney</i> , <i>Walmart Foundation</i> , the <i>C&A Foundation</i> , the <i>Soros Economic Development Foundation</i> etc., and <i>UK DFID</i> .
Better Brick – Nepal	Started in 2014 and supported by <i>Humanity United</i> , this programme has expanded to 40 partner kilns that employ about 8,000 workers and produce 222 million bricks each season. It works closely with kiln owners, labour brokers and workers to promote and ensure decent working conditions for all workers, and provides incentives for responsible production through access to better production techniques.

Initiative	Description
FundiFix	Launched in 2014, <i>UNICEF</i> supports FundiFix, a public-private partnership model that provides maintenance services to rural water supplies in Kitui County in Kenya, along with a Water Services Maintenance Trust Fund which subsidizes the maintenance service costs by blending government and donor funds.
Off-Grid Electric Bond	Issued in 2018 by <i>Symbiotics</i> , proceeds of the bond will be used to fund off-grid solar systems to low income households in Tanzania