

# **Using private investor capital to increase NGO impact:**

a framework and key considerations to facilitate engagement



Population Services International and Zurich Insurance Group Ltd

# Contents

<b>Foreword</b>	<b>1</b>
<b>Executive summary</b>	<b>2</b>
<b>Introduction</b>	<b>6</b>
<b>1. The nature of the problem: NGO funding challenges and how they affect operations</b>	<b>12</b>
<b>2. Role of private investor capital in increasing NGO impact</b>	<b>16</b>
<b>3. The investor perspective</b>	<b>32</b>
<b>4. Case study on developing dual-purpose assets: Movercado</b>	<b>38</b>
<b>5. Prioritizing the use of private investor capital for an NGO</b>	<b>44</b>
<b>6. Market for investments in NGOs: enablers of growth and a vision for the future</b>	<b>49</b>
<b>Glossary</b>	<b>56</b>
<b>Project team</b>	<b>57</b>
<b>Acknowledgements</b>	<b>58</b>

## Disclaimer and cautionary statement

The information in this publication was compiled from sources believed to be reliable for informational purposes only. All sample policies and procedures herein should serve as a guideline, which you can use to create your own policies and procedures. We trust that you will customize these samples to reflect your own operations and believe that these samples may serve as a helpful platform for this endeavor. Any and all information contained herein is not intended to constitute legal advice and accordingly, you should consult with your own attorneys when developing programs and policies. We do not guarantee the accuracy of this information or any results and further assume no liability in connection with this publication and sample policies and procedures, including any information, methods or safety suggestions contained herein. Moreover, Zurich reminds you that this cannot be assumed to contain every acceptable safety and compliance procedure or that additional procedures might not be appropriate under the circumstances. The subject matter of this publication is not tied to any specific insurance product nor will adopting these policies and procedures ensure coverage under any insurance policy.

© Zurich Insurance Company Ltd and Population Services International of the United States, 2014. All rights reserved. The text in this Document may be reproduced free of charge providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Population Services International and Zurich Insurance Company Ltd. copyright and the title of the document be specified.

## Foreword

**Zurich and Population Services International (PSI) were participating in meetings and conferences around impact investing, and we wanted to learn more. We thought it would be valuable – to us, and hopefully to others – to look at investments made with the intention of generating measurable social impact as well as financial return from two different perspectives: the NGO's (non-governmental organization's), and the institutional investor's.**



At Zurich, doing well and doing good are two sides of the same coin. Managing an investment portfolio in a way that creates financial value for our shareholders and customers, as well as has a positive impact on our communities and employees, is an integral part of our investment philosophy.

At PSI, delivering measurable health impact is at the core of all our activities. As a social marketing organization with over 40 years' experience working in developing countries, applying established commercial concepts to address complex public health challenges, PSI is no stranger to harnessing the power of private sector markets for social good.

Small-scale socially responsible investors looking for 'double bottom line' returns offer obvious benefits for individual social entrepreneurs trying to serve base-of-the-pyramid consumers. But what about large institutional investors, coupled with the scale that a large international NGO can

bring to addressing social challenges – can this combination offer better prospects for social impact and financial returns at scale? And conversely, are NGOs missing opportunities to use private investor capital to monetize their assets, leverage their infrastructure and know-how, and diversify their revenue?

Zurich and PSI, through a collaboration to better appreciate these opportunities, met with NGOs, investors, donors and intermediary stakeholders to develop a framework to illuminate potential opportunities and conditions for investments in NGOs, and the benefits that might flow from such investments. This report traces our learnings and describes that framework.

Our collaboration leads us to believe there is considerable value to be unlocked from investors and NGOs working together more strategically through well-structured financial models.



**Karl Hofmann**  
President and CEO of PSI



**Cecilia Reyes,**  
Zurich Insurance Group  
Chief Investment Officer

## Executive summary

This report was produced as the result of an ongoing collaboration between Zurich and Population Services International (PSI). It aims to facilitate more frequent and meaningful engagement between NGOs and impact investors via investments of private investor capital – investments that deliver both social impact and a financial return. While there is already significant interest among stakeholders, and there is a variety of literature on the topic, certain questions remain unanswered.

The opportunities for investments that offer both social impact and financial return may appear small and fragmented from the investor's perspective. Yet there are many large NGOs that achieve impact at scale. Could large institutional investors engage with NGOs to accelerate the pace at which impact investments are made at scale, and enhance NGOs' capacity to deliver impact? At the same time, among NGOs there is a limited understanding of

how to use private investor capital to increase impact. Could NGOs think beyond investments in independent social enterprises to financing models that employ private investor capital within the NGO? If so, how could these models work?

We engaged NGOs, investors and donors through structured interviews, workshops and informal dialogues to gather their insights. This report presents the results of these discussions through a framework that should help NGOs and investors speak a common language and better understand various financial models through which they can engage with each other.

This framework is based on the underlying premise that all NGOs have a mission to deliver impact, and that there are specific levers they can pull, or actions they can take to increase the impact they can deliver. We learned that NGOs typically face four main funding challenges that prevent them from achieving maximum impact:

**Shortage:** There are limited donor resources available and many NGOs are competing for these resources.

**Accessibility:** The risks involved with performance-based contracts – where a donor makes payments to an NGO only after achieving specific outcomes – can often be too high for NGOs.

**Timing:** The unpredictable nature of donor resource flows can leave NGOs without the necessary resources to implement projects at the time when impact would be greatest.

**Restrictions:** Donors often require NGOs to spend according to previously-agreed upon budget lines, limiting the flexibility with which NGOs can operate to deliver optimal impact.

The framework provides a lens through which it is possible to understand how private investor capital could potentially address some of these funding challenges. This framework is based on the recognition that unlike donations, private investor capital must return principle when borrowed, in addition to generating returns for investors. While this may be obvious, it represents a fundamental shift in operations for many NGOs.

Our framework addresses this challenge. It outlines the various financing models that NGOs can adopt in order to use private investor capital. These models are categorized according to how they provide returns to the investor – for example through untied future donations, or from income generated by assets.



### **Model 1: Using donations to pay back investors**

- Model 1a – Borrowing to fund immediate project needs: NGOs use private investor capital in the form of working capital loans to fund immediate project needs, and use future donations to pay back principle to the investor, along with any returns in the form of interest. This model addresses the ‘timing’ challenge.
- Model 1b – Sharing risks of performance-based projects: NGOs use private investor capital to implement projects and donors pay returns to investors once the NGO has achieved previously-agreed performance targets. Through this process, investors share some of the risks associated with traditional performance-based contracts with NGOs, thus addressing the challenge of ‘accessibility.’ This model includes, for example, development impact bonds (DIBs).

### **Model 2: Using income generated from dual-purpose assets to pay back investors**

- Model 2a – Generating income and impact through the monetization of dual-purpose assets: NGOs use private investor capital to develop, strengthen or scale up internal assets that can be ‘monetized’ to generate income outside the project. This might include distribution networks, tools and knowledge, or insight about ‘bottom-of-the-pyramid’ consumers. The income these monetized dual-purpose assets generate can be used to pay investors returns, and any remaining profits re-invested in NGO projects.

As such, this type of model addresses the ‘shortage’ challenge.

- Model 2b – Funding immediate project needs: NGOs use working capital loans to fund immediate project needs, similar to Model 1a, but in this case monetized dual-purpose assets enable NGOs to acquire the loan by generating an income stream that can be used to pay back investors. This model addresses the ‘timing’ challenge.

### **Model 3: Using income generated from independent social enterprises to pay back investors:**

- Model 3a – Developing and scaling up social enterprises: NGOs use private investor capital to invest in developing or scaling up fully-independent social enterprises; businesses generating both profits and social impact. The income generated from the social enterprises can be used to pay investors’ returns. Depending on the NGO’s share of the enterprise, remaining profits can be reinvested in NGO projects. This model addresses the ‘shortage’ challenge.
- Model 3b – Funding immediate project needs: NGOs take working capital loans to fund immediate project needs and use income generated from social enterprises fully or partially owned by the NGO to pay back investors. This model addresses the ‘timing’ challenge.

The individual NGO’s circumstances and mission determine which financial model could be used. The gap between an NGO’s need for funding and the supply of funds available to it dictate its specific challenges and the appropriate financing models.

## Executive summary continued

NGOs need to consider several key factors before deciding which, if any financial model to use. Points to consider include:

- Can the NGO manage financial distress if unable to pay back a loan?
- Is the NGO prepared for possible tension arising from any trade-off between profit and impact?
- As a result of diverting resources toward profit-generating activities, will the NGO need to address real or perceived mission drift?
- Is the NGO prepared for necessary changes to its organizational culture?
- Does the NGO have, or can they reasonably acquire the business planning, management and accounting skills to successfully manage profit-generating ventures supported by private investor capital?

When considering any investment with an NGO, investors may need to adopt additional processes beyond those that support their standard investment analysis. Points to consider include:

- Does the investor have non-standard financing structures to align incentives and minimize tension between profit and impact?
- Is the investor aware of the reputational risk it may face if an NGO defaults on a payment and the investor seeks recourse?
- Has the investor outlined options to de-risk investments, such as first-loss capital, donor guarantees, and corporate structures that place the charitable mission first, without violating any fiduciary duties?
- Does the investor require the NGO to demonstrate its ability to deliver impact via historical performance records?
- Is the investor able to capture portfolio diversification benefits from returns that are only minimally correlated with capital markets?

Donors play a significant role in influencing the successful implementation of many of the financial models proposed here. Although we do not present specific recommendations for donors in this report, we believe they should play an integral role in the dialogue around impact investment. Considerations for donors include:

- Is the donor willing to pay retroactively for impact generated by NGOs that used private investor capital (under Model 1a)?
- Is the donor willing to pay investors a return when outcomes are achieved in exchange for increased efficiency and lower risk (under Model 1b)?
- Is the donor able to shift from a reporting approach focused on line items in a budget and inputs to monitoring outcomes achieved (under Model 1b)?
- Is the donor willing to allow assets originally funded by donations to be 'monetized' or used to produce economic returns (under Models 2 and 3)?
- Is the donor willing to engage in new models to promote greater financial sustainability in development, even if this creates tension between impact and profit?

Over the longer term, private investor capital has the potential to complement existing NGO funding sources to unlock significant value by tapping into NGOs' experience and expertise. However, it is likely that the required 'ecosystem' will take time to develop and mature. General barriers to success include NGOs' discomfort with the concept of borrowing money, or losing control over assets, and the associated risk of financial distress. Additionally, many NGOs lack 'for-profit' business skills, capacities, infrastructure and organizational culture required to operate profitable business models.

Similarly, investors would not want to be in a position where they are forced to collect from an NGO that defaults or otherwise fails to meet expectations. Investors are also concerned about the processes and legal structures that will need to be put in place to deal with any tension arising from trade-offs between impact and profit.

Overarching enablers for growth include the continued standardization of governance mechanisms, performance metrics, and financial and legal structures to enable investors and NGOs to engage in these models at scale. An immediate next step is ongoing engagement among all participants to continue to test and prove models in situ. It is hoped that the framework presented here will provide an appropriate context to learn and further the discussion. But we feel that meaningful impact can only come from taking action and implementing solutions.

When NGOs play a significant role in helping to build tomorrow's model of impact investment, the rewards are many. NGOs will be able to become more resilient to stress related to funding challenges, and increase the efficiency and effectiveness of their operations to deliver greater impact. Investors will be better able to achieve their responsible investment goals. It could also allow investors to tap into types of assets that are uncorrelated with the wider capital markets, thus increasing portfolio diversification. Finally, donors will have the opportunity for their committed resources to go further and have a greater impact. We hope that this report provides a foundation for NGOs and investors to work together to use private investor capital to address some of the world's greatest social challenges.

# Introduction

**Setting the context:** Investment that generates a financial and social return has recently attracted interest and gained momentum. Discussions on when private investor capital might play a role in philanthropy at scale are taking place, and investors, donors, entrepreneurs, and non-governmental organizations (NGOs) are already experimenting with how private investor capital can support social impact. Investors are motivated by the opportunities for generating profit while at the same time being in position to fulfill responsible investment goals. Many NGOs see potential for increasing their impact by re-thinking and expanding the use of private investor capital in their overall financing structure, thus becoming more resilient. Donors are looking for ways to crowd in private capital to complement their diminishing budgets and reduce risks they currently bear, to continue to fund their operations at scale and improve aid effectiveness.

There are a number of efforts underway to design and implement financing mechanisms that can bring impact investors and NGOs together. These include social and development impact bonds, low interest loans for advanced procurement of health products, and low-interest housing and community development loans. They also include advance purchase commitments to motivate the development of drugs and vaccines for diseases that disproportionately burden low-income countries, and donor guarantees and first-loss agreements in investments in social businesses, as well as other examples. However, many of these mechanisms have not yet been proved successful. They lack the sophistication required to be implemented at scale and they have not yet managed to unlock large amounts of investment capital. This is particularly true with regards to investments in the type of social impact generated by NGOs.



## What does impact investing mean to Zurich?

Impact investing has become a widely-used and popular term over the past several years. Those directly involved have different ideas about what actually constitutes an impact investment. Zurich, as an institutional investor, believes three elements define impact investing:

1. **Intentionality:** Every investment has some positive impact: creating jobs, making products cheaper, etc. In impact investing, achieving a pre-defined goal is part of the investment's objective. The impact is not just a more-or-less random by-product of an existing portfolio of assets. It is selected because it generates a certain impact.

For Zurich, impact investments are selected to:

- Help communities become more resilient in face of social and environmental challenges
  - Make goods and services more accessible to underserved populations
  - Mitigate and help communities adapt to the adverse effects of climate change
2. **Measurability:** In impact investing, data are collected to quantify the positive impact of the investment. This can be supplemented by case studies. Different frameworks can be applied, for example, the Impact Reporting and Investment Standards (IRIS) of the Global Impact Investing Network.<sup>1</sup> But there is as yet no generally-accepted standard, and specific frameworks may need to be applied to specific situations.
  3. **Return:** While the notion of impact investing is generally related to investments that repay at least the principal amount of capital, the space covers the whole scope from philanthropists and program-related investors willing to accept concessionary returns, to market-rate returns. Fiduciary investors such as Zurich tend to have little or no room to trade impact for return, focusing on opportunities that offer both impact and return.

Given these general features, impact investing presents an investment style that can be applied across different asset classes. Two recent reports by the World Economic Forum suggest that this view of impact investing is supported by a number of market participants.<sup>2</sup>

<sup>1</sup> Global Impact Investing Network (GIIN). Impact Reporting and Investment Standards (IRIS). Retrieved from <http://www.thegiin.org/cgi-bin/iowa/reporting/index.html>

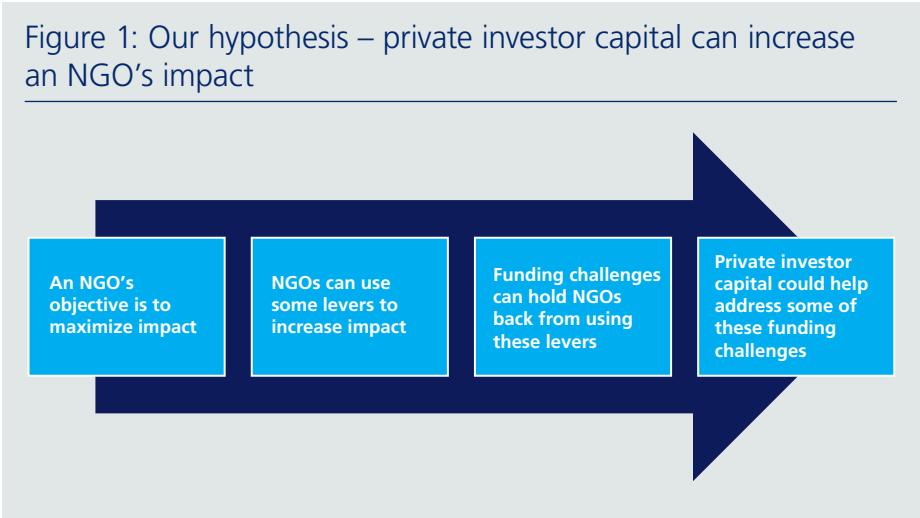
<sup>2</sup> 'From the Margins to the Mainstream – Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors.' and 'From Ideas to Practice, Pilots to Strategy. Practical Solutions and Actionable Insights on How to Do Impact Investing.' Retrieved from <http://www.weforum.org/issues/impact-investing>

# Introduction continued

**The gap between NGOs and investors:** There is already substantial literature on impact investing, but there have been few efforts thus far to document the specific considerations for impact investors and NGOs to successfully engage with one another. What seems to be missing is a common framework to understand how private investor capital could increase the social impact generated by NGOs. There is relatively limited support to help NGOs grasp the full breadth of opportunities to leverage private investor capital, over and beyond investments in independent social enterprises with a double bottom line, and to understand and implement the shifts in skills, mindset, and operations needed to engage with investors. On the investor side, there is little guidance on the unique nature of challenges that NGOs face and the opportunities that exist for private investor capital to help them increase impact. Investment Management of Zurich and PSI jointly recognized this as a challenge and began an effort to better understand how NGOs can use private investor capital to maximize impact, and how investors can evaluate opportunities to invest in the impact generated by NGOs.

**Our conceptual approach:** When considering the current gap between NGOs and investors, we decided that an appropriate first step would be to build a framework to understand the challenges NGOs face while attempting to deliver value to their ultimate beneficiaries – the poor and vulnerable, ‘bottom-of-the-pyramid’ populations. This required acknowledging a set of premises that serve as a basis for the project approach and this document. First, we work on the premise that NGOs have a mission to deliver ‘impact’ regardless of the sector they focus on e.g., health, education, environmental protection, or other social programs. Second, we acknowledge that there are different ‘impact levers’ that each NGO can use to increase their impact, and that they are often limited in doing so by specific funding challenges they face. Building on these premises, we hypothesize that private investor capital could address some of these funding challenges and thereby enable NGOs to deliver more impact than they would be able to otherwise.

Figure 1: Our hypothesis – private investor capital can increase an NGO’s impact



**Methodology:** To prove our hypothesis, we spoke with a sampling of NGOs, investors, donors and other key stakeholders. We used structured interviews, consulted relevant existing literature and case studies, and conducted a workshop in which investors and NGOs could review and validate key aspects of our framework. This report is the result of these conversations.

**Structure of the analysis:** The report is divided into six main sections that will address the following questions:

1. The nature of the problems What are the key funding challenges NGOs face in trying to finance their operations via traditional donors? How do these funding challenges affect their operations and their capacity to generate impact?
2. The role of private investor capital: How can private investor capital help solve NGOs' funding challenges? What are the main financing models that could be used to do this? How do NGOs pay returns to investors in all of these models? What are the key tax, legal and other considerations for NGOs to consider?
3. Investor perspective: How do investors assess the risk and return associated with investments in NGOs? What are some de-risking strategies to turn very high-risk investments or those investments where risk is difficult to assess, into more feasible opportunities? What are the unique tax and legal considerations for investors making investments in NGOs?
4. Case study of an innovative financing model: This section will look closely at how NGO and investor considerations can be applied to 'monetize' a 'dual-purpose' asset; an NGO asset that can be used both to deliver impact and a financial return.

5. Prioritizing the use of private investor capital: How can individual NGOs apply a strategic framework to evaluate the use of private investor capital? How can they prioritize their funding challenges and determine which financing model is best to use?
6. Market structure, barriers, vision and opportunities for growth: What are the main barriers to investing in the NGO sector? What are the key enablers to increase opportunities for investments in this sector? What is the vision for a future in which impact investments are made at scale?

**Audience for this report:** The findings in this report are addressed to two main audiences. The first is NGOs (i.e. non-profits with tax-exempt status) with either U.S. and/or international operations. The tax and legal considerations for engagement have been outlined from a U.S. perspective, but many of these considerations are likely to apply to any NGO. The second key audience for this report is impact investors – this includes a wide range of investors, from individual investors and foundations making program-related investments, to venture capital funds and institutional investors seeking to deliver both financial return and social impact. While not specifically targeted, the report could also offer valuable insights to donors, which often play a key and active role in facilitating partnerships between NGOs and impact investors.

## Introduction continued

### A key insight and its implications for NGOs

Private investor capital differs fundamentally from traditional donor funding streams because it requires NGOs to pay investors returns; the principal and interest in the case of a loan, or a share of the profits in the case of an equity investment.

This requirement to 'pay back' resources has significant implications for NGOs.

- NGOs need to have the business models and cash flows that are necessary to pay fair returns to investors. NGOs typically limit their use of private investor capital – when they use it at all – to investments in independent social enterprises with a 'double-bottom line' where they rely on income or equity generated from the enterprise to pay investors back. However, there is opportunity for NGOs to diversify their use of private investor capital to invest in other aspects of their operations.
- NGOs need to have the appropriate management capacity, culture, and financial and business skills to successfully implement these business models and engage with investors.
- The rate of the return paid to investors is determined by assessing the risks associated with the investment. Generally, the greater the risks, the greater the return an investor will demand for a commitment.
- Given these requirements to use private investor capital, NGOs should only do so when the additional impact generated by using the capital is greater than the costs associated with using the capital, i.e. the required returns. NGOs must determine if the impact they can generate with the capital warrants the associated costs relative to other possible sources of funding.
- Longer-term, the use of private investor capital could result in additional revenues for the NGO that can be used at the NGO's discretion to deliver more impact. Investments in income-generating assets could result in an ongoing stream of revenues for the NGO beyond what needs to be paid back to the investor. Similarly, investments in new and cutting-edge projects could later attract additional donor funding to areas that were previously too risky to fund.

### Key insights for investors

1. NGOs can be strategic and effective partners in developing impact investment strategies due to their technical knowledge across sectors including health, education, governance and the environment, their understanding of socio-economic contexts in developing countries, and their wide reach in terms of infrastructure, distribution networks and relationships with local communities, and bottom-of-the-pyramid consumers.
2. There is significant untapped value in NGOs' assets; both tangible assets such as property, equipment, and distribution infrastructure, and intangible assets including expertise working in developing markets, knowledge and data about bottom-of-the-pyramid consumers, and tools and resources that have market value. This presents an opportunity for investments in these assets, which could be used to generate returns and deliver impact.
3. Investing in, or with, NGOs can be complex from governance and legal standpoints. Even without tax incentives, NGOs have control and governance issues related to legal entities created to capture returns, regardless of contribution of the investor, thus leading to potential trade-offs between impact and returns.

By addressing the perceived and real barriers confronting NGOs and impact investors when they try to work together, we hope to spur many new investment-ready ideas that will eventually increase the scale of the NGO investment market. The report also raises a number of questions to put interested stakeholders on course to continue efforts to further explore this space and bridge the gap between NGOs and investors, thereby enabling an increased and more sustainable response to those in need.

# Section 1

## The nature of the problem: NGO funding challenges and how they affect operations

---

Before looking at how NGOs can use private investor capital, it is helpful to understand how NGOs go about delivering impact, and the funding challenges they face that hold them back from being able to deliver full value to their beneficiaries. This section outlines the ways to achieve impact, meaning those specific actions that either increase the scale or the efficiency of NGO operations, which NGOs can use to deliver greater impact to their beneficiaries.

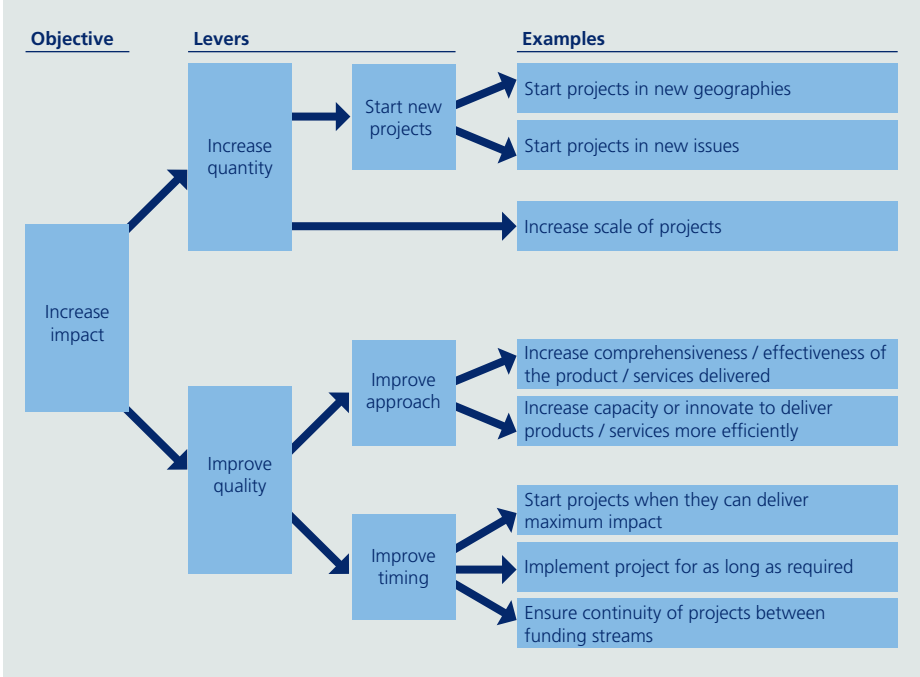
This section also outlines the four main funding challenges that keep NGOs from delivering this impact – shortage of resources, timing, accessibility, and risk. These challenges are typically a result of the inherent structure of the donation process, or in some cases are designed to incentivize competition and increase efficiency.



**‘Impact levers’ for NGOs:** Impact levers in this context refer to specific operations or actions that result in a measurable increase in the impact delivered to an NGO’s beneficiaries. Impact can typically be generated in two ways – by increasing the total number or size of impact-generating projects; and by increasing the impact delivered per project. Starting new projects or increasing scale of current

projects requires additional resources and will eventually increase the amount of impact generated. However, NGOs can also increase the impact delivered per project by taking certain actions, such as allowing projects to start at the optimal time. In such cases, NGOs do not necessarily need more resources, but they might need to pursue a different route to obtain these resources earlier.

Figure 2: Levers that can increase NGO impact



**NGO funding challenges:** Certain characteristics of the traditional funding process affect an NGO's ability to employ these impact levers, limiting their capability to generate impact in the most effective and efficient way. Analyzing the traditional funding processes from an NGO's perspective allowed us to identify four main funding challenges. These each affect the impact levers differently, and the extent to which they affect NGO operations varies depending on the funding mix of an NGO. For example, when NGOs have large unrestricted reserve funds, they have more flexibility and an opportunity to engage the levers of their choice in line with their strategic priorities. This could include piloting innovative new ideas that have not yet received donor's involvement, scaling-up interventions that are successfully generating impact, or supporting other organization-wide capacity-building efforts to improve staff productivity and project quality. However, aside from a few large NGOs with well-established grassroots fundraising capacity, most NGOs struggle to maintain and grow their pool of unrestricted reserve funding, and as such face one or all of these four funding challenges to some extent.

1. **Shortage:** This is the most basic of the funding challenges and most NGOs face it – insufficient funds are available to the NGO to deliver all the impact they would like to deliver. This is usually due to limitations in the overall pool of donor funds and/or competition among NGOs for these limited funds. This results in NGOs being unable to optimally scale up those existing projects proven successful to start new projects, improve certain aspects of specific projects, or invest in organization-wide capacities that would allow NGOs to deliver more impact on all projects.

2. **Accessibility:** This challenge arises primarily in performance-based projects when the NGO only receives funds from the donor after the project has achieved specific performance metrics. Here, NGOs face risks associated with providing their own cash upfront to finance the project. They also face the risk that due to unforeseen circumstances, they might be unable to achieve the promised objective or result. In such cases, the money spent may not be fully reimbursed by donors. Many NGOs can only absorb a certain amount of this type of risk, and have limited reserves of cash to forward-finance projects. As such, this often results in NGOs having to refrain from applying for outcome-based contracts with donors.
3. **Timing:** In this case, donor funds may be available, but not when they are needed most. There are usually two main reasons for this:
- a. **Unpredictability of grant issuance;** NGOs have a limited ability to forecast when donors will actually release funds, and grants may not be issued at predictable intervals.
  - b. **Lack of immediacy of disbursement:** After grants have been made, funds may not be immediately available on the first day of implementation.

These challenges can have a variety of negative consequences such as:

- Preventing NGOs from systematically planning and starting projects at the optimal time, for example in responding to humanitarian emergencies like earthquakes, floods, and epidemics.

- Creating gaps in critical interventions when funding from a donor ends before a new source of funding is disbursed – in this case NGOs need to either sustain the project with their own resources or shut down and re-start operations later, which results in additional costs such as recruiting new staff, restarting leases on office space, and selling and rebuying equipment.
  - Slowing the speed at which NGOs can scale up operations. This can happen in cases where donors do not make an immediate disbursement at the start of a project, even when a contract has been signed.
4. Restrictions: This challenge arises when donor funds are earmarked or tied to specific activities or line items in the project budget (with lengthy processes for obtaining approvals for budget adjustments), thus preventing NGOs from optimally spending donor funds for the greatest impact. For example, some donors will not allow more than a 10-percent fluctuation in spending on major line items in a budget, even if the NGO does not spend more than the total budget. Similarly, some donors do not pay for all of the indirect costs or overheads required by an NGO to implement a project. Such tight controls over how budgets are spent and the systemic underinvestment in cross-project capacities prevents NGOs from delivering impact at optimal scale and efficiency.<sup>3</sup>

**Donor constraints that lead to funding challenges:** All four of these funding challenges are often a result of intrinsic aspects of the donation process, and they can be more or less acute depending on the type of donor, the nature of their funding process, and how they source and deploy their funds. For example, government donors might be restricted due to their need to maintain direct oversight over money to ensure accountability to their constituents. Similarly, the timing challenge can be a result of the nature of donor funding cycles, due to their dependency on budget allocations, foreign and domestic policy, and other complexities that affect the mobilization of public funds.

In addition, some of the identified challenges can also be seen as healthy for the donor-NGO 'ecosystem.' For example, the features of the accessibility challenge can be an effective way to incentivize NGOs to be more efficient in their use of money, by only disbursing payments upon achieving the desired impact. Similarly, the shortage challenge could be viewed as an effective way to create healthy competition between NGOs that eventually results in more innovative projects that deliver higher impact.

As such, we are not suggesting that private investor capital should disrupt the current model for donation-based funding, but we think it could effectively complement traditional aid by helping to better align incentives of different parties to mitigate some of the funding challenges for NGOs, while keeping intact key elements inherent to the donation process.

<sup>3</sup> The Overhead Myth: A Guidestar Initiative to Improve Donor Choice (<http://overheadmyth.com/>)

# Section 2

## Role of private investor capital in increasing NGO impact

---

Private investor capital can complement donor-funded programs and play a role in mitigating some of the funding challenges that NGOs face, ultimately allowing NGOs to deliver greater impact to their beneficiaries, and improving aid effectiveness overall. Through various financial models involving impact investors, and in some cases, donors, there is the potential to structure investments of private investor capital that allow NGOs to increase the impact they can deliver to their beneficiaries.

This section presents a conceptual framework to categorize these financial models, as well as real-life examples of these models in action. It also outlines the various tax, legal and other considerations NGOs should take into account before they engage in these financial models. Note that the investor perspective is covered in Section 3.

**Key requirements for NGOs to use private investor capital:** Unlike grants from donors, when NGOs use private investor capital they need to pay investors returns. In the case of a loan, payments to investors require the repayment of the principal amount borrowed plus a return in the form of an earned interest. In equity-like models, returns are typically a share of the profits generated as a result of the investment. With this in mind, NGOs need to meet two fundamental requirements to use private investor capital:

- NGOs should have a business model that will generate the cash flows required to pay investors their returns.
- NGOs should only use private investor capital when it has the potential to have an impact greater than its costs. In other words, the capital must enable the NGO to generate higher impact than would be possible by using existing

donor money or reserve funds, or by waiting for donor funding in the future.

**Conceptual framework for using private investor capital to address funding challenges:** Regardless of the underlying business models and payback mechanisms, private investor capital has two key properties that NGOs can leverage:

- It allows NGOs to ‘move money in time,’ in other words, advance money so that it is available when needed most. In certain cases, this can generate higher impact than waiting to receive donations.
- It allows NGOs to allocate risks across different groups, including investors, based on their ability and appetite to tolerate risks. In certain cases, this enables ventures (companies, projects, initiatives) that would otherwise not be possible.

In the following section, we provide a framework that shows ways that NGOs can leverage these key properties of private investor capital through various financial models. This can be done by engaging all key stakeholders – donors, investors and NGOs – to address specific funding challenges. The framework categorizes and describes the financing models NGOs can employ to generate the cash flows required to pay back investors, and provides insights into the specific funding challenges that each model primarily addresses.

Figure 3: Framework for NGOs to use private investor capital to increase impact

Models		Description and funding challenges addressed
1	Using donations to pay back investors	<p><b>Model 1a:</b> Raise private investor capital to fund immediate project needs</p> <ul style="list-style-type: none"> <li>• Timing challenge by allowing NGOs to use private investor capital to fund immediate project needs.</li> <li>• Capital is paid back at a later date using future donations.</li> </ul> <p><b>Model 1b:</b> Raise private investor capital to share risks with investors on performance-based contracts with donors</p> <ul style="list-style-type: none"> <li>• Accessibility challenge by allowing NGOs to share risks with investors in specific ventures, when donors eventually pay for the impact generated.</li> <li>• Donor payments will include the costs of the venture and the return required by investors.</li> </ul>
	Using income generated from dual-purpose assets	<p><b>Model 2a:</b> Raise private investor capital to develop/scale up monetizable dual-purpose assets</p> <ul style="list-style-type: none"> <li>• Shortage challenge by using the capital to scale monetizable NGO assets.</li> <li>• Assets will often have a primary function to deliver impact (e.g. a distribution system for health products or data about bottom of the pyramid consumers used to reach beneficiaries), but will also have the ability to generate income which will contribute to pay back investors.</li> </ul> <p><b>Model 2b:</b> Raise private investor capital to fund immediate project needs which is paid back by NGO assets</p> <ul style="list-style-type: none"> <li>• Timing challenge by allowing NGOs to borrow working capital, and instead of relying on future untied donations to pay it back, as in model 1a, use income generated from the asset to pay back the investor.</li> <li>• Income from monetized assets is used to pay back investors.</li> </ul>
3	Using income generated from independent social enterprises to pay back investors	<p><b>Model 3a:</b> Raise private investor capital to develop/scale up independent, fully sustainable, social enterprises</p> <ul style="list-style-type: none"> <li>• Shortage challenge by allowing NGOs to use private investor capital to develop and scale-up independent, fully sustainable, social enterprises.</li> </ul> <p><b>Model 3b:</b> Raise private investor capital to fund immediate project needs which is paid back by enterprise profits</p> <ul style="list-style-type: none"> <li>• Similar to monetized assets within the NGO, the cash flows generated from these enterprises or an equity stake in the enterprise can be the basis for providing returns to the investor.</li> </ul>

While each of the models could address more than one funding challenge simultaneously, each one is particularly effective at addressing certain specific challenges as described.

The restriction challenge is indirectly addressed in all of these models, as private capital provides NGOs with greater flexibility than donor regulated-funds permit. However, private investor capital does not come free of restrictions: any engagement with investors will require specific oversight and governance mechanisms to be set up (more fully explained in Section 4) that will control the use of capital. It is possible that the engagement with investors will allow more flexibility to NGOs with regards to how and when to spend money, but it may introduce other restrictions, such as more explicit pressure on managing costs.

**Private investor capital comes with halo benefits:** NGOs that are able to successfully leverage private investor capital are likely to do so by developing skills and processes that use appropriate private sector methods and tools, for example, cost-saving incentives. This in turn has the potential to create a 'virtuous circle' of increased impact and efficiency that attracts additional donations and more investments of private investor capital from new investors.

#### Models for NGOs to use private investor capital:

This sub-section provides a description of each financial model in the framework previously presented. For each model, we outline the key stakeholders and their motivations, give examples of how these models have been used, and discuss key considerations that NGOs must weigh.



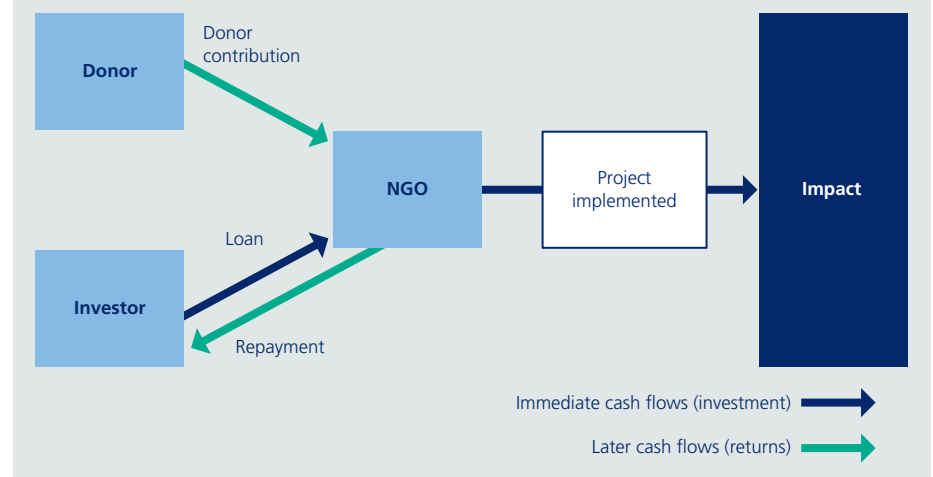
## Model 1: Using donations to pay back investors

### Model 1a: Borrowing to fund immediate project needs

Many NGOs face immediate funding needs. For example, they might need funds to provide relief during and immediately after an emergency, or working capital to begin implementing a project for which a contract with a donor has been agreed to, but receipt of funds is

delayed. In some of these situations, the value of the impact that can be delivered is time-sensitive. In these cases, NGOs can take out a loan to start operating as long as they have a reliable and predictable source of donations expected in the future: individual contributions in the form of small or major gifts, corporate employee contributions and planned giving, or a simple letter of credit from a donor.

Figure 4: Cash flows in Model 1a



## Model 1a in action – Pledge Guarantee for Health

Many NGOs are already taking working-capital loans to finance their immediate needs and generate additional impact. A good example of this model operating at scale is the Pledge Guarantee for Health (PGH), an innovative financing partnership designed to smooth out volatility in donor funding streams for health products by making these easier for low-income consumers to obtain. Over the last two years, PGH has facilitated bridge financing for public health products, allowing governments to take out low-interest working capital loans. PGH leverages guarantees from donors to remove business risk, ultimately driving enhanced value for donor dollars and delivering improved health outcomes. For example, in 2012 PGH closed a USD 12 million agreement with the government of Ethiopia to accelerate the procurement of over 600,000 contraceptives, nearly twice as many as would have been possible without PGH. The deal was backed by donor guarantees from the World Bank, the UK government's Department for International Development (DFID) and Merck. This procurement had a measurable impact – it made contraceptive implants more affordable, increasing access by 18 percent for over three million Ethiopian women. The result is expected to be a 40-percent enhancement in health outcomes, including reductions in maternal and child deaths.

In May of 2013, PGH launched a partnership supported by a five-year partial guarantee from the United States Agency for International Development (USAID) and the Swiss International Aid Agency (SIDA), which allowed PGH to leverage USD 100 million in credit from commercial banking partners. With this credit, PGH can then extend short-term, low-interest loans to traditional donor aid recipients including NGOs; this presents an opportunity for NGOs interested in using private investor capital to solve their timing challenges. Recipients are being empowered to employ these lines of credit from commercial banking partners to use donor-committed funding in advance of disbursement, resulting in increased buying power, and accelerated procurement and delivery, which will mean greater impact.<sup>4</sup>

### Key considerations for NGO engagement

- Impact generated vs. cost of return-seeking capital: As previously noted, the timing challenge can result in significant loss of impact and in some cases, additional start-up costs for NGOs. A loan can mitigate these costs, but at a price – the NGO will need to pay the principal and interest to investors. As such, NGOs should consider whether the additional impact delivered by taking out a loan is greater than the impact that could be delivered with the amount paid to the investor in interest.
- Donation forecasting: NGOs should be able to forecast future donations that can be used to pay back the loan. Such donations need to be sourced by donors willing to pay retroactively for previously generated impact, and who are comfortable with having part of their donations go toward interest to an investor.
- Financial distress: Depending on the size of the loan, NGOs should be prepared to collateralize assets against their debt; these assets could potentially be lost as a result of debt defaulting. Loss of assets can create financial distress for NGOs. During our interviews with NGOs, we found that the fear of financial distress was a key consideration or barrier that prevented NGOs from engaging in debt models. Mitigating actions can be established in advance, such as borrowing from donor guaranteed credit facilities.

<sup>4</sup> Pledge Guarantee for Health (2013). Retrieved from <http://pledgeguarantee.org>

### **Model 1b: Sharing risks of performance-based contracts**

Description: There has been a noticeable trend among many donors including the DFID, the World Bank and the Gates Foundation to favor performance-based funding; donors are increasingly providing funding to NGOs conditional upon the NGOs achieving specific, measurable outcomes. Donors see increased value in this approach due to the possibilities it offers to “rebalance accountability, reduce transaction costs, and encourage innovation.”<sup>5</sup>

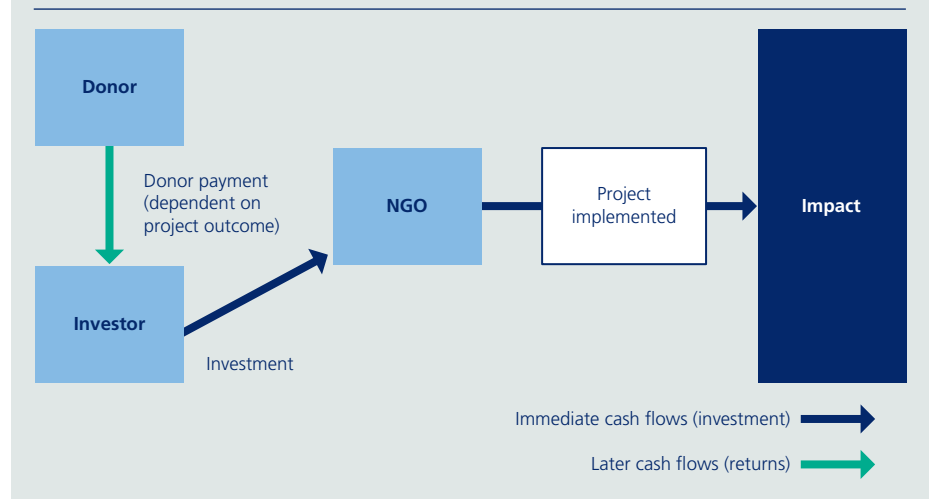
Additionally, this approach shifts a proportion of the risk from the donor to the NGO. The donor only pays for the outcomes that are delivered. However, for NGOs engaging in these contracts, such agreements come with considerable risk; NGOs need to frontload working capital required to start and implement their projects until measurable outcomes are achieved. If they are unable to achieve these outcomes, NGOs run the risk of not receiving any funding or receiving only partial funding from donors to pay for expenses incurred on a project. Lacking

untied funding reserves to forward-finance these initiatives, NGOs sometimes turn down performance-based contracts to keep the risk they face in managing the overall project portfolio at a level that does not threaten their organization’s sustainability.

When accessibility is the main challenge, investors can provide upfront capital and share a part of the risks in a venture, thus enabling more risky ventures to get to the starting line. There are two potential versions of such a model. The first is a proof-of-performance type of engagement, where investors provide up-front capital to an implementer such as an NGO, and donors agree to pay back a given amount based on the outcome generated (a social or development impact bond). The payback model can be structured in different ways: for example, on a per-unit-of-impact basis with a maximum cap, or a fixed amount with penalties or premiums for under- or over-performance. The difference between the amount paid by the donor and the costs of implementing the project is effectively the profit of the venture and can be shared between the investor and the NGO.

<sup>5</sup> Center for Global Development – Overview of World Bank Program for Results – January 2014. Retrieved from <http://www.cgdev.org/initiative/cash-delivery-aid>

Figure 5: Cash flows in Model 1b



### Model 1b in action – development impact bonds for low-cost private schools in Pakistan

Pakistan has the lowest rate of primary school enrolment in the world – in 2005 as many as eight million of its almost 20 million primary school-aged children were not in school. Low-cost private schools operated as micro businesses by local entrepreneurs are an integral part of the Pakistani education system, and could offer a scalable and sustainable solution to this problem, particularly since there is both willingness to pay and demand, even among poor families, to enroll their children in these schools if it offers them a chance for a better future.

Currently these schools could operate with 10- to 20-percent profit margins, based on the fees paid by every additional child enrolled, but they have historically struggled to access the capital they need to invest in improving and expanding their facilities. Donor agencies and the Pakistani government are unwilling to lend to low-cost private schools without a mechanism for accountability in terms of the resulting increase in access to, and the quality of education. Similarly, the return on these investments is often regarded as too uncertain or risky to attract mainstream investors directly. A development impact bond is currently being structured to address these issues and bring incentives for donors, investors and low-cost private schools into alignment.

Further examples of development impact bonds (DIB) are provided in a report by the Center for Global Development's impact bond working group.<sup>6</sup>

<sup>6</sup> Global Impact Investing Network (GIIN). Impact Reporting and Investment Standards (IRIS). Retrieved from <http://www.thegiin.org/cgi-bin/iowa/reporting/index.html>

The second version of Model 1b is a proof-of-concept type of engagement. In this approach, investors provide the upfront capital and take risks to fund the research and development of new technologies, medicines or vaccines, or the trial of a new device that could deliver impact. Donors or governments then make an advanced commitment to purchase certain quantities of this technology or product once it is designed, developed, and has undergone tests or trials. When it is ready to be used, the committed donor or government purchases are sufficient to repay the investment in research, development and provide a fair profit.

#### **Key considerations for NGO engagement**

- Impact generated vs. cost of private investor capital: NGOs should only engage in such a model if, by sharing risks with investors, the NGO is able to take on outcome-based contracts and deliver a positive impact to beneficiaries through interventions that the NGO otherwise could not take on. In addition, by improving the alignment of incentives for NGOs, investors and donors, NGOs should be able to generate more impact than if donors were only to give them a grant for the total sum of money – including any returns paid to investors.
- Competitive capabilities: To increase the impact NGOs can deliver through this model, NGOs should only consider engaging in this model when they can leverage their competitive capabilities. These might include more effective approaches or methodologies, being able to master the project cost structure, local footprint and infrastructure, and their understanding of the operational risks and ability to control them. An historical record of successful implementation of similar projects will likely be considered a signal to both investors and donors that the NGO has the capabilities required to deliver impact.
- Project scale: The project being implemented by the NGO should have the potential to be taken to sufficient

size to provide economies of scale. Greater scale will provide an incentive to investors and NGOs by offering potential to achieve greater efficiencies and thereby larger returns. Greater scale will appeal to donors due to the potential for greater impact per dollar of donation.

- **Measurable outcomes:** A key requirement for this model is the agreement between all parties on independently-measurable project outcomes, against which payments can be made. Metrics should allow measurement within the project timeline and at reasonable costs. In many sectors, lack of transparency and credibility in measuring the performance metrics can impede impact investments' growth. The Global Impact Investment Networks (GIIN) has developed Impact Reporting and Investment Standards (IRIS), a set of standard metrics to measure and describe organizations' social, environmental and financial performance metrics. This provides industry-wide benchmarks that support analysis by intermediary organizations, independent evaluators and the NGOs themselves. However, the success of this initiative at scale still requires further collaboration and cooperation between a number of stakeholders.<sup>7</sup>
- Adapting systems and processes: A potential benefit of this type of model is the transfer of business skills and expertise from private sector investors to NGOs, particularly with regards to performance management and outcome measurement. As such, NGOs should be open and prepared to work collaboratively with investors to allow them to adapt existing systems and protocols within the NGO to bring additional rigor to performance management and outcome measurement that could ultimately encourage efficiency and improve performance.

- Downside risks: Finally, NGOs should consider the negative consequences of failing to deliver promised outcomes. In addition to the financial downside of not receiving full payment for expenses incurred, there could be a larger reputational risk. Failure to perform would jeopardize the NGO's reputation not only with the donor, as is the case with traditional donor funding, but also with the investor, thereby reducing potential future funding and financing from both parties.

## Model 2: Using income generated from dual-purpose assets to pay back investors

### **Model 2a: Generating income and impact through the monetization of dual-purpose assets**

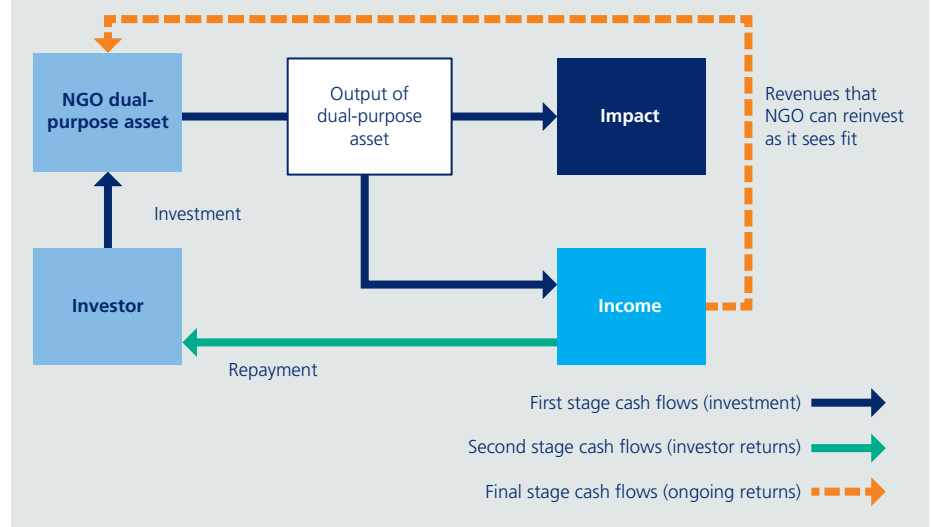
Description: Private investor capital provides NGOs with an opportunity to develop and scale up dual-purpose assets that can deliver impact across a range of projects, and generate income. Examples of such assets include physical assets such as buildings and vehicles, experts on staff who can charge a fee for their expertise on a consultancy basis, organizational infrastructure such as procurement,

supply chain and distribution systems, and proprietary data, knowledge and intellectual property generated as a consequence of project implementation. Private investor capital can be invested to scale these assets at an accelerated pace. Investors can be paid back with returns using the income generated from these assets, while at the same time NGOs can use the assets to support their operations, thus generating impact and/or unrestricted cash flows for themselves. NGOs can also benefit from the business expertise, technology, resources and advice that private sector investors provide. This is in addition to the capital invested in developing and scaling-up of these assets.

In this model, the assets could also simultaneously receive donor subsidies or be supported using the NGO's reserve funds. As a result, the assets could remain a subsidiary of the NGO with majority NGO governance. In some cases, such a model might evolve so that the asset becomes a fully sustainable enterprise. When that becomes the case, it can be spun off as an independent entity that may or may not have majority-NGO governance – this will move the asset into Model 3, which is described later in this section.



Figure 6: Cash flows in Model 2a



A case study of how Model 2a could work is included in Section 4.

#### Key considerations for NGO engagement

- Determine the financial sustainability of the asset: NGOs should only consider using private investor capital to develop or scale up dual-purpose assets if a sustainable business model exists to monetize these assets even when donor funding is restricted. The profits generated from the assets after the investor has taken their share of returns can be added to the NGO's reserve funds. This excess can be re-invested in other projects at the NGO's discretion, to generate further impact.
- Donor consent: If the assets being developed and scaled-up were originally donor-funded or continue to be supported through donor funds, NGOs need to consider the implications of donor ownership, including any restrictions the donors might enforce on the use of these assets. Many donors consider the monetization of donor-funded assets as a way to better leverage their original donation. This potential to achieve higher impact means donors

could be open to such models, as long as the income generated from such assets is fed back into impact-generating projects to the extent the business model permits. Donor funds such as USAID's Development Innovations Ventures (DIV) fund and DFID's Business Innovation Facility funds have been specifically set up to support the incubation of such dual-purpose assets until they are able to be spun off as fully sustainable social enterprises.

- Impact-profit tradeoff: In this model, there can sometimes be a tradeoff between impact and profit. Once brought on board, an investor will exert an influence on the decision-making process. Investors will be motivated to ensure the highest profit is earned through the venture, while NGOs will be motivated to ensure the asset continues to deliver a desired level of impact. As such, NGOs should be prepared to work with investors to develop clearly-defined guidelines on how to address these types of tradeoffs in advance of any investment or partnership. This topic is discussed in greater detail in the case study in Section 4.

- **Loss of proprietary knowledge:** Much the same as for-profit enterprises, NGOs often develop business processes and other related intellectual property. The loss of these assets by sale or otherwise could have negative consequences for the NGO's sustainability, and should be taken into account before entering into any agreement. For example, when monetizing knowledge assets such as training and capacity- building curricula, or marketing planning processes, given that NGOs will continue to operate in a primarily donor-funded environment, they will need to consider the long-term consequences of other NGOs and partners being able to access the knowledge and competency that gives them a competitive edge.
- **Considerations with monetizing knowledge and data assets:** When it comes to assets such as data, NGOs need to consider the ethical issues associated with data mining including concerns associated with sharing information about bottom-of-the pyramid beneficiaries with third parties.
- **Mission-drift:** Developing profit-seeking ventures can lead to 'mission drift,' which is the real or perceived diversion of critical internal NGO resources toward managing profit-seeking rather than

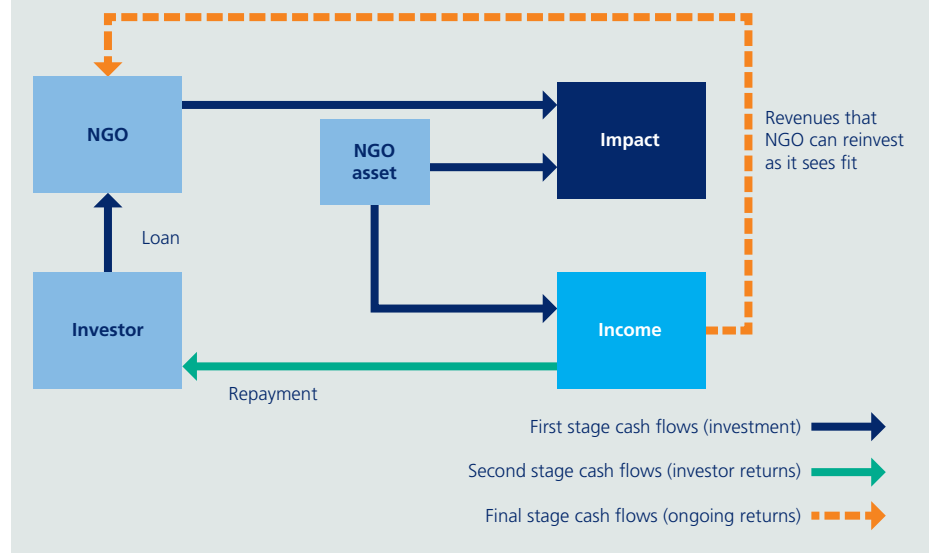
impact-generating activities. Mission drift comes with significant reputational risks to the NGO. Donors, partners, NGO employees and other stakeholders might believe that the NGO is more interested in activities that produce profit rather than its goal of delivering impact.

### **Model 2b: Funding immediate project needs**

**Description:** Similar to Model 1a, private investor capital can be used to fund immediate project needs and be paid back to investors using cash flows from existing monetized dual-purpose assets. At the same time, NGOs can also sell equity in income-generating assets to quickly raise capital. The cash flow in this type of model is outlined in Figure 7.

We believe that this model allows for more flexibility and independence than Model 1a; the cash flows are not sourced from future donations, but rather from the income earned from existing monetized assets, which are unrestricted and likely to be less volatile than donations. As a result, NGOs can use this model to finance strategic growth by changing their approach in ways that help them to remain resilient to stress. This could include investments in organization-wide capacities that are otherwise difficult to support with donor funds.

Figure 7: Cash Flows in Model 2b



### Key considerations for NGO engagement

Many of the considerations raised in Model 1a with regards to increasing impact and risks of financial distress apply to this model as well.

- Impact generated vs. cost of return-seeking capital: Before borrowing working capital against cash flows from NGO assets, NGOs must decide if the value derived from being able to put a project into immediate action due to a loan justifies the burden of interest payments. Similar to Model 1a, the incremental impact from undertaking a project immediately should be quantifiable. It should be higher than the impact that could be generated with the interest that must be paid to investors later on.
- Collateralization and financial distress: NGOs should have reliable, predictable cash flows from their monetized dual-purpose assets. Depending on the size of the loan, NGOs could also consider collateralizing these assets against their debt, taking into account any legal limitations that could restrict the collateralization of donor-funded assets. In such models, depending on the size of the loan (again, similar to Model 1a), the biggest risk NGOs face is financial distress resulting from defaulting on the loan; an NGO could lose key collateralized assets that are essential for it to continue to operate.

### Model 3: Using income generated from independent social enterprises to pay back investors

After a period of incubation, some NGO activities can evolve into independent, financially-sustainable social enterprises. Such social enterprises can use return-seeking capital like any other business to develop or scale-up their operations, paying investors returns using the profits from the enterprise (Model 3a). Additional income after paying back investors can be either fully or partially invested back into projects that deliver impact, depending on the level of ownership the NGO has over the social enterprise. It can also be used to pay back investors if the NGO decides to fund immediate project needs by taking out a loan (Model 3b). When people hear the term impact investing, this is usually the type of investment they think about.

Our report does not focus on these particular uses of private investor capital; there is already an abundance of literature and real-life examples of successful small-scale social enterprises. But we acknowledge that there is no exact way to distinguish between investments in dual purpose assets (Model 2), and investments in fully-independent social enterprises (Model 3), and that dual-purpose assets can often turn into fully sustainable social enterprises. Our framework mainly differentiates between the two models on the basis of the following major criteria:

- **Financial sustainability:** While an NGO asset is usually partially subsidized either by donor funds or the NGO's own reserve funds, a social enterprise needs to be completely financially self-sustaining for its business model to be viable. Similar to traditional private sector startup companies, startup social enterprise companies will likely have periods where the business loses money and they will take time to reach 'breakeven,' but they will still remain financially separate from the NGO's core operations. By contrast, when operating with a dual-purpose asset, allocating the NGO's management time, or using its existing infrastructure (for example, offices, equipment), a dual-purpose asset is often not factored into the costs of the business. Without support from the NGO's resources, the asset would not be financially sustainable.
- **Governance and use of the asset:** While equity ownership and control does not differentiate between the two models, we believe that in the case of a dual-purpose asset, the NGO will have incentives and perhaps even be required to use such assets to ensure it continues to support its own impact-generating programs and initiatives; this would not be necessarily be the case for a social enterprise.

### Model 3 in action – investment in the JITA sales network in Bangladesh<sup>7</sup>

In 2004, CARE Bangladesh started the JITA project to give a group of very poor women an opportunity to earn income and improve their livelihoods. These women sold consumer goods like shampoo, yoghurt, shoes and seeds, receiving a small margin selling these items door-to-door in their communities. JITA's rural sales network partnered with companies including Bata, Unilever, Square Toiletries and Grameen Danone Foods. After its success as an NGO project, in 2011, CARE U.S. decided to spin off JITA as an independent for-profit business, aiming to take the enterprise to scale in a sustainable way. CARE U.S. created a subsidiary entity called CARE Enterprises Inc. to act as partial owner of this new venture, and Danone Communities made a USD 700,000 investment. With support from the DFID Business Innovation Facility on tax and legal issues, and supported by a business plan, HR policies, and supply-chain strategy, JITA became an independent social enterprise.

JITA's commercial success since becoming an independent social enterprise have exceeded expectations. JITA made a profit in the first half of 2013, just 18 months after it began operations. It also achieved an unexpectedly large revenue from consulting services and research fees from clients interested in accessing the rural bottom-of-the-pyramid consumers in Bangladesh. JITA's growth targets are impressive; it aims to have more than 450 hubs and over 11,000 saleswomen serving seven million consumers. The business has not yet reached its maximum scale, and many areas of Bangladesh remain underserved, but JITA hopes to cover 80 percent of the country in the next five years. Such an expansion will allow JITA to continue to deliver increased social benefits and convincing commercial results.

There is substantial potential for these types of investments, but so far they have not been made at scale. A report by the Monitor Group in 2011 outlines a number of challenges that have prevented such investments from growing: the deals are often small and complex, and there are often high search and transaction costs

associated with fragmented supply and demand for capital; there is limited enabling infrastructure that brings the philanthropy and investing industries together in one space; and finally, there are not enough investment-ready ideas to absorb the available capital.<sup>8</sup>

<sup>7</sup> Business Innovation Facility (Dec 2013). Inclusive Business in Practice – Case studies from the Business Innovation Facility portfolio. The *JITA sales network: An inclusive business on the rise*.

<sup>8</sup> Monitor Group (2011). From Blueprint to Scale: The Case for Philanthropy in Impact Investing. Retrieved from: [http://www.mim.monitor.com/downloads/Blueprint\\_To\\_Scale](http://www.mim.monitor.com/downloads/Blueprint_To_Scale)

### **NGO requirements: shift in mindset and acquisition of skills**

Regardless of the business model chosen for generating returns, to succeed in engaging with impact investors, some NGOs may need to adjust their mindset and acquire specific skill-sets and resources.

With regards to mindset, the key adjustments required from an NGO's standpoint could include:

- Spending management: Focus on generating efficiencies by spending based on real-time need, rather than using budgets exactly as detailed in project budgets prepared in advance.
- Impact generated vs. cost of private investor capital and risk assessment: NGOs need to be cautious regarding the additional impact that private investor capital can generate. They should make calculated decisions about when, why and how much capital they should use, ensuring that they consider risks such as financial distress and mission drift.
- Internal consensus: NGOs will sometimes need to adapt their culture to meet new requirements. This means ensuring that their employees are comfortable with the strategic decision to increase engagement with profit-seeking entities. NGOs will also need to shift focus to explore opportunities for developing and scaling income-

generating assets. Senior management must seek broad internal engagement to ensure that employees are also comfortable with accepting that resources of the NGO will be used to generate profits to pay back investors, and understand the potential impact-return tradeoffs this could lead to.

In terms of skills and resources, to effectively engage with impact investors, NGOs will potentially need to acquire:

- Access to legal services to properly manage loans, special-purpose vehicles, or three-party contracts that must be drawn up between investors, NGOs and donors.
- Business and financial planning skills and capabilities including accounting and reporting skills to maintain balance sheets and profit-and-loss statements. Appropriate information and reporting systems will be required not only to evaluate the best ways to monetize assets, but also to assess the complexities associated with developing business plans and implementing and managing financially-sustainable operations.
- As a final point, NGOs should be able to allocate significant staff time and resources toward managing business-related systems and processes to ensure that these functions do not fall by the wayside within an organization whose core mission is to focus on impact.



## Pact's journey to derive investor benefits from assets<sup>9</sup>

In 2013, Pact's CEO presented an organization-wide challenge to its more than 3,000 global employees and 24 country offices – how could Pact produce greater impact against its stated goal of ensuring poor and marginalized people have access to the health products, services and information they need to enjoy a healthy life, the resources they need to keep to earn a dignified living, and the ability to gain lasting benefits from the sustainable use of natural resources around them? How could Pact achieve this by encouraging innovation, reaping the benefits and employing the returns? A major part of this challenge was in relation to how Pact could develop, monetize and market products and increase income-generating assets. Thanks to this initiative, and their creative responses to this challenge, Pact is now making progress in several areas.

Pact made two investments in the early stages of this challenge. In 2011, Pact's leadership created a new key performance indicator (KPI) designed to provide incentives for developing products. The creation of this KPI led Pact's employees to create an 'inventory' of more than 300 'Pact approaches' or 'Pact products or tools' in different states of maturity and development. In addition, in early 2013, Pact created a knowledge management business unit that launched an internal collaboration platform. This platform, already well-regarded within the Fortune 500 community, called JIVE, was dubbed 'Mosaic' internally. The platform now serves successfully as a new vehicle to engage Pact's most important global asset – trained staff – allowing its employees to share critical information and better use knowledge to innovate and add to their inventory; the platform has encouraged new product ideas and paths to generate returns. Pact strongly believes that the pipeline of products and assets drawn from this process will help transform its culture over time, allowing Pact to generate long-lasting ideas rather than one-off investments.

In 2013, Pact created a new product development unit and hired an 'entrepreneur-in-residence' who is working to take product development to a private-sector level of excellence. Pact implemented a simple five-step process for rapid business planning and prototyping of its most promising products/assets. The key breakthrough in gaining acceptance for this new program came when Pact took one of its most successful assets and used it as an example to show staff worldwide the approach they should use in product development. Pact started a partnership with an outsourced web/technology development firm, and made a prototype based on Pact's 'Organizational Performance Index' (OPI) to measure the progress made by the local organizations Pact trains to build their capacity in various areas. The progress was measured using 'OPI-online,' a web-based product that allows Pact's staff to see the progress made by these organizations based on practices, policies and staff skills and view their own progress on a multi-year basis. Each organization can also compare its progress with that of others; it lets donors see all organizations in a region or those involved in their own projects. Pact is currently working on other internal capacity development tools, as well as external third-party tools to be included on the platform. Pact is confident that this will set this web-based product apart from others in the market. They are now considering different ways to employ this investment – using the products in new donor-funded projects globally; and bringing these products to the larger international NGO marketplace, thus creating new revenue streams. Pact also presented OPI-online to the World Economic Forum in 2013 and has received positive feedback.

With OPI-online, Pact has not only developed an asset that is now a mature product that can be released, but it has also created an internal culture and system of product creation and development, which takes into account the importance of understanding of the steps needed to 'monetize' products. Pact now has many products in its five-step product development pipeline. They are either internally funding the development or seeking external grants or investments to develop these. Pact has also hired two innovation officers to write grant applications to seek funding, or to match product ideas with private-sector sources of capital.

Pact's efforts to create products serves two purposes. It furthers their current line of business services; it also puts Pact in position for new types of conversations with private-sector stakeholders, allowing them to seek funds for impact investment with the goal of realizing returns from these products. Pact is currently considering forming a separate legal entity that would act as new social enterprise incubator, potentially serving as the home for Pact's team in charge of creating new products, and allowing for different types of engagements with the private sector and impact investing funds. The new social enterprise would act as a 'bridge' between the standard NGO culture and a more private-sector approach. It could ultimately lead to creation of an 'ecosystem' of investments in innovative and products and assets.

<sup>9</sup> <http://www.pactworld.org>

# Section 3

## The investor perspective

---

This section outlines specific aspects that investors need to take into account, including risk-return assessment methodologies outside of standard risk assessments, de-risking mechanisms and tax incentives. In some cases these might also include diversification benefits for investors, which would make these opportunities more attractive. In addition, there are also legal and governance issues or conflicts of interest that might arise in some of the financing models outlined in this paper.

A detailed analysis of financial instruments is not provided; however, we do provide a basic introduction of how debt-like and equity-like structures could be applied within the NGO context via the financial models introduced in Section 2.

**Risk-adjusted return:** Investors require a return on their investments. Returns are based on various factors and costs the investors incur, but as a general rule, the higher the risks associated with the investment, the higher the return investors will expect. In this section, we highlight things that investors should consider that go above and beyond their standard risk assessment process.

There are a wide range of financial instruments available. In the simplest form, these can be grouped into two general types: The first group comprises debt-like instruments, where returns are paid in the form of interest, and the rate of interest is based on the risk associated with the likelihood that the NGO will be able to generate the cash flows required to pay the interest and return the principle. The second comprises equity-like investments, where investors have a claim on a share of future profits, and risks will be the driving factor in determining the equity share (a portion of future profits) that the investor requires for a given amount of capital.

Some investors may see additional value in Model 1b (NGO performance-based contracts) with its very low correlation with capital market risks. For example, the success of an NGO in reducing prevalence of malaria is not linked to the stock market, and thereby investments in this model can thus provide portfolio diversification benefits.

In debt-like investments, the main risks are:

- 1. Default risk:** This is the risk of losses due to the failure of the borrower to pay according to terms of the loan as spelled out in the contract. In assessing this risk, investors look at the proposed income streams that would be used to repay the loan. For example, under Model 1a, the loan is paid back using future donations. Investors would thus need to assess the probability of these donations materializing. Here is a non-exhaustive list of some key factors that might affect such assessment:
  - Historical fundraising record: NGOs with a strong track record of being able to raise donations when needed are less risky to invest in than those that do not have such a track record.
  - Percentage of untied funds in the funding mix: NGOs that have a larger and more predictable donor base for unrestricted donations are less risky investments than NGOs that do not have such a base; in the event that predicted sources of donations do not come in, NGOs could dip into their reserve of unrestricted funds to repay the investor instead of defaulting on the loan.
  - Diversified donor base: NGOs with a well-diversified portfolio of donors will be looked upon as more favorable risks than those that are dependent on a few donors for a large proportion of their fundraising.

- Donor adherence to pledges: NGOs whose major donors have a record of adhering to pledged donations and making them in a predictable, timely manner would be considered safer risks. Alternately, if an NGO receives written commitments from key donors, this would to some extent mitigate the risks from the investor's perspective.
- Seasonality of fundraising cycle and donor focus: Donations are subject to seasonality. This seasonality could be due to predictable things and events; for example, it is predictable that donations to charitable causes will spike during holiday seasons, or in the aftermath of environmental disasters like hurricanes or earthquakes. If the loan is made in a situation where seasonality would positively affect the donation flow, this would reduce the risk tied to the investment.

**2. Reputational risk:** In debt-like investments, investors must consider two main types of reputational risks:

- Negative publicity that arises because an NGO is in financial distress. If NGOs face financial distress as a result of taking a loan from investors, these investors run the risk of negative press and damage to their reputation, should they choose to exercise their legal right to claim collateral, liquidate assets, or in any way cripple the NGO. This might result in investors deciding to waive their legal right to recover their investment.
- Opposition to NGO mission. By investing in an NGO, investors are perceived to signal their support for the NGO's mission. If the NGO mission involves activities that might be considered by some to be controversial (for example, providing contraceptives), investors to that NGO also might be exposed to controversy.

In non-debt like models, such as equity or debt-equity hybrids, investors assume some degree of ownership of the business and the associated risks. Given these changes, a different set of risks should be considered:

**3. Project risks:** In outcome-based models (similar to Model 1b), project risk will be the most important risk for investors to consider. The key consideration in assessing this risk is the NGO's project delivery record. NGOs that have successfully completed projects on the specific issue and geography under consideration would be seen as more favorable risks by investors.

**4. Risk of misaligned incentives:**

NGOs might face a conflict when it comes to allocating resources to generate profits rather than impact. Investors will assess the likelihood that the NGO will properly handle these conflicts based on two aspects:

- Previous history of for-profit engagement: NGOs with a previous history of successful for-profit engagement would be considered more favorable risks, since they are more likely to have the mindset, expertise, systems and processes required to work in a for-profit environment.
- Governance structure: In a procedure similar to those used by for-profit entities, the board would have the final say on how conflicts are resolved. An investor should consider how their interests are represented on the board, should disagreements arise resulting from a trade-off between impact and returns.

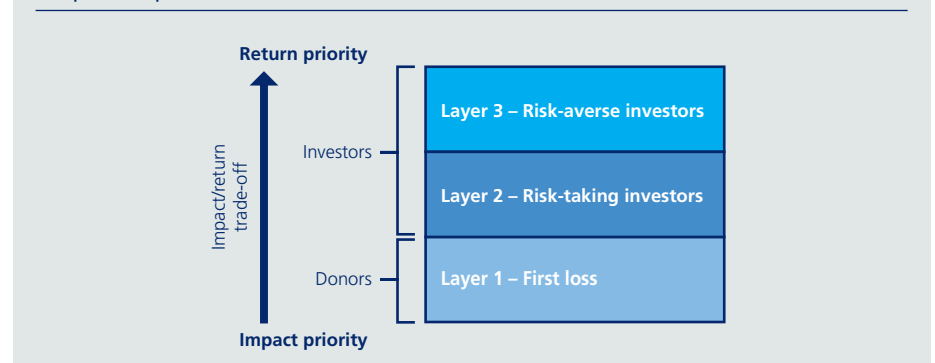
**5. Reputational risks:** Finally, as is the case with debt-like engagements, investors must consider the risk of opposition to the NGO mission.

**De-risking mechanisms:** A recent report, titled 'Investing for Social and Environmental Impact,' by the Monitor Institute outlines one of the main challenges preventing impact investment's 'marketplace building;' the report cites the often high risk presented by investors' adjusted return requirements. This results from an unclear understanding of how to assess and mitigate risks for social businesses.<sup>10</sup> In addition, certain types of activities may not generate enough return to compensate for all of the risk. To reduce risks arising from a venture, stakeholders can adopt various strategies. Three of the main ones are:

the impact produced. In not-for-profit activities, incentives might be different than those where a profit is produced; where organizations are not primarily seeking a profit, these can take on more risk without necessarily claiming priority over returns.<sup>11</sup>

- Layer 1 is composed of first-loss investors: These investors act like guarantors, absorbing a pre-defined amount of any initial losses. As a consequence, the overall structure is de-risked and more return-seeking investors can participate. Various types of donors have participated in this

**Figure 8: Layering allows investors with different risk appetites to participate**



**1. Layering risks:** While an investment opportunity might look too risky for a single investor, pooling investors with different risk-return profiles helps allocate risks more efficiently, enabling more ventures. Investors layered in this type of pooling will have different seniority in the structure, or a different rank when it comes to repayments, thus effectively taking different level of risks as illustrated in Figure 8. Risk-averse investors would be the last to be affected by potential losses, but they would also have the lowest claim on

layer, or investor class, including governments (Australia), foundations (The California Endowment), and NGOs (Habitat for Humanity).

- Layer 2 is composed of risk-taking investors: These investors represent a hybrid between donors and investors, often called 'concessionary investors.' These are willing to take higher risks than they might be compensated for financially, but they are not donors because they do expect some financial return. Any losses that exhaust the first loss layer dip into this layer.

<sup>10</sup> Freireich, J. and Fulton, K. (2009) Investing for Social & Environment Impact, Monitor Institute.

<sup>11</sup> Catalytic First-Loss Capital, Global Impact Investing Network, October, 2013.

- Layer 3 is composed of risk-averse investors: These investors are unable or unwilling to accept below-market returns and have a lower risk tolerance. They would typically be fiduciary investors. However, they still have an interest in achieving a positive impact and take on the risk that comes with providing leverage to the structure. In absence of the other two layers, they may not be able to participate in the investment.

**2. Donor guarantees:** This is a similar concept to layering, but one which involves donors, rather than a layer of impact-minded investors willing to absorb the loss if the investment fails. The donation acts as a ‘floor’ for investors, and it is the smallest payoff investors can expect from their investment (as opposed to losing the full investment). The donor funding helps mitigate some of the risks associated with the business models, especially new, innovative or unproven ones. One example is the Global Health Impact Fund, which was designed to stimulate investment in developing medicines that otherwise would have been neglected.<sup>12</sup>

**3. Insurance:** Certain risks can be mitigated by simply insuring against them. Examples include coverage for theft and political risk in countries where projects might be jeopardized by such risks, and weather or crop insurance to offset the impact of natural disasters.

#### **Legal and tax considerations:**

Legal contracts or business structures are needed for investors to invest in NGOs via the models identified here. As far as legal issues are concerned, investors need to engage with NGOs through structured contracts or through special-purpose vehicles to ensure that non-profit NGOs are able to accrue profits, and can be held accountable for providing returns to investors. Similarly, investors can also make certain strategic choices in terms of how they structure these financial models’

tax implications. Note that each of the investment models in Section II can be carried out using a variety of structures or contract options.

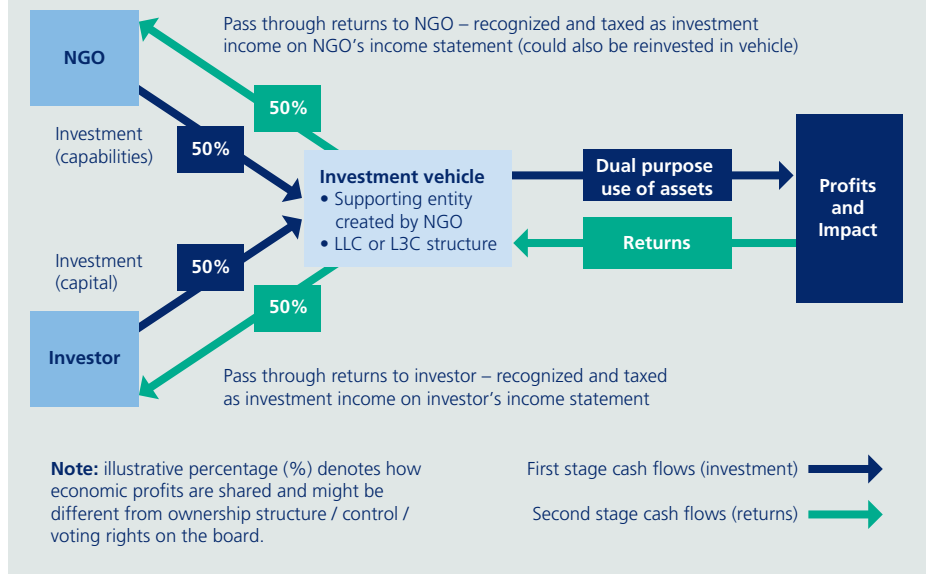
In debt-type models, the investment will need to be structured as a legal contract between the NGO and the investors, providing for a return on the principal to be paid out at agreed-upon intervals over the set loan duration. The structure may or may not be secured by collateral and or other types of guarantees advanced by the borrower. In case of default or the inability to make one or more payments at the required intervals, investors will have legal recourse to recover their investment. This could lead to the forfeiture of collateral, or require liquidating the borrower’s assets to the extent needed to recover the outstanding loan.

In debt-type models, no special tax benefits are available to investors investing in NGOs – at least none beyond tax credits that may be available for specific types of investments, for example low-income housing or program-related investments made by foundations. This is true for both concessionary and non-concessionary investments, such as investments that are made below, or at the market rate of return. In order to realize some tax benefits, concessionary investments can be structured as market-rate loans, plus a donation made by the investor to the NGO; in this type of structure, a donation could result in a tax deduction for the investor.

In equity-type models, investors and NGOs must work together to create a separate ‘vehicle’ or entity to carry out the project. The income generated by this entity derived from the project is shared by investors and the NGO. The proportion in which these economic benefits are shared has to be agreed in advance. It could depend on the capabilities that the two parties bring to the project – the investors (capital) and the NGO (expertise and skills along with any capital it may invest). Figure 9 illustrates how the legal structure might work in equity-type models.

<sup>12</sup> [www.healthimpactfund.org/](http://www.healthimpactfund.org/)

Figure 9: How an equity-type model might work to bring investors and an NGO together



The core of the structure is the investment vehicle, which serves as an entity combining the NGO's relevant assets and the investor's capital. A number of approaches could be used, depending on the objectives of both the NGO and investor. Besides a standard corporate status, the most relevant alternatives include the relatively new 'benefit corporation' (B Corp) and the low-profit limited liability company (L3C). Both of these give the corporation's owners and managers the latitude to designate 'achieving a charitable mission' as the company's primary purpose, without violating any fiduciary duties to the company's investors.

In the example illustrated in Figure 9, the most appropriate structure is either a traditional limited liability company (LLC) or the L3C. Both enable the investment

vehicle to qualify as a 'flow-through entity,' for which the entity's income is treated as income for the owners, thus avoiding double taxation. Depending on the legal structure used for the investment vehicle (standard for-profit LLC or B Corp / L3C), the vehicle's board has different options available when it comes to deciding on how to distribute any profits.

It is worth noting that while we presented this for an equity-type model, a similar structure would also be required for a debt-type financing model.

Specific legal and structuring recommendations depend to a great degree on the specific situation, and are beyond the scope of this document.

# Section 4

## Case study on developing dual-purpose assets: Movercado

---

This section describes an example of a potentially monetizable dual-purpose asset currently being considered by PSI. Movercado is a technology-enabled inter-related group ecosystem of beneficiaries, community agents, shopkeepers and others operating along the distribution chain. The interactions between these different entities is designed to increase the efficiency of delivering aid at the bottom-of-the-pyramid. It uses local markets, mobile messages and payment transactions. This chapter analyzes these assets in light of the business, governance, legal and tax considerations previously discussed.



**Description:** PSI implements donor-funded projects in Mozambique to encourage people to adopt healthy behavior. It uses communication campaigns to increase the understanding of disease risks and prevention strategies. It also helps meet needs by distributing subsidized health products and services through private-sector channels. A network of health care agents also delivers health messages and products at the community level.

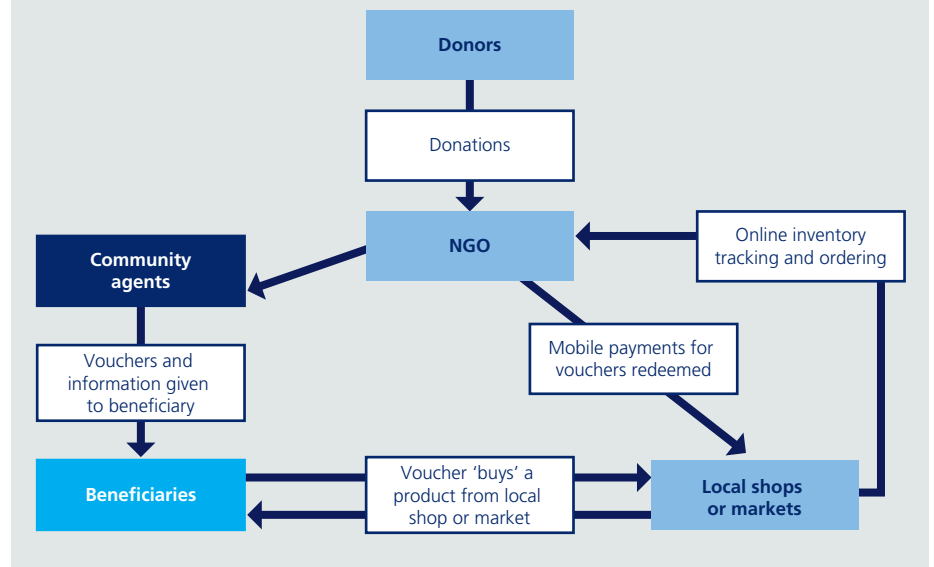
Some challenges its approach faces include:

- High cost of overseeing community agents providing health education and products to beneficiaries, and the difficulty of evaluating their work.
- Difficulty in targeting subsidies to those eligible through donor-funded programs.
- Giving away products for free to beneficiaries adversely affected local businesses that otherwise could have sold those products.
- Existing health programs were not allowing PSI to develop meaningful, long-term relationships built on sustained dialogue with beneficiaries.

To address these issues, PSI developed Movercado, a mobile technology-based system of beneficiaries, healthcare community agents, shopkeepers, implementing NGOs and mobile operators as illustrated in Figure 10. Using mobile phone text messaging and payment channels, Movercado, which defines itself as an 'ecosystem,' relies on local supply chains to help deliver health products to people at the bottom of the pyramid. The main features of its approach include:

**Beneficiaries receive follow-up personalized messages** after the initial contact with a community agent. These messages, delivered via SMS to beneficiaries' phones, are highly relevant to the individual receiving them and sent on an ongoing basis. As opposed to traditional behavior-change communication, Movercado uses algorithms to segment and determine the profile of individual consumers based on their demographic profile and answers they provided to previous questions. For example, whether a woman is pregnant. Using this platform, dialog with each individual can be automatically customized and efficiently delivered, thereby achieving both specificity and scale.

Figure 10: Movercado Ecosystem



**A voucher system that provides real-time mobile payments**, helps targeted beneficiaries who are eligible for subsidized products through donor-funded programs to access products such as condoms, water purification products and mosquito nets at subsidized prices through their local market suppliers. When a potential beneficiary is contacted by a community healthcare worker, they receive a code via mobile text message that they can present to specific local outlets in exchange for the product they are entitled to receive. The shopkeeper sends an SMS with the code to Movercado. Once PSI verifies that the beneficiary received the product, PSI immediately deposits the value of the good received into the shopkeeper's mobile-money account. In this way, PSI is able to target subsidies and does not crowd out local businesses, but can still provide free products to those who cannot afford to buy them.

**Movercado helps generate consumer insight and makes communication campaigns more effective.** Once a consumer becomes part of the system, Movercado can filter the dataset by age, location, family status or even by information on certain behaviors to specifically target and personalize the follow-up series of questions and messages sent through text messages. Beneficiaries receive an incentive once their response is validated (typically a small mobile-phone service credit), and in this way, Movercado is able to ask targeted questions to gather valuable insights about these beneficiaries. This has proved to be a faster and more cost-effective way to increase understanding of bottom-of-the-pyramid consumers' needs than traditional research methodologies.

- Movercado can also be used to make pipeline and stock assessments. Currently it is hard to measure how efficient PSI's pipeline of health products is, including the time a product spends in the pipeline, or the route the product may have taken to reach a certain outlet. Through Movercado, PSI gives shopkeepers incentives to send a unique code it places in boxes of products when they are opened; this gives PSI reliable, useful information about its supply chain.
- Movercado also allows beneficiaries to provide feedback on the services they get from the healthcare worker or community agent who contacted them, as well as on the products they purchased through the outlets. This feedback is given in exchange for small incentives such as free mobile phone

credit. This provides a way to measure the performance of healthcare workers and track the quality and uptake of products being circulated in the market, allowing PSI to adapt and improve its approach.<sup>13</sup>

There is significant interest among those working with Movercado to further develop and scale up this system. Organizations partnering with PSI, including donors and local businesses, see potential for adopting this solution elsewhere.

Business model for monetization: PSI is considering commercializing Movercado with a view to expanding its reach and improving its financial sustainability. PSI is also evaluating several different avenues for income-generation, as outlined in Figure 11.

Figure 11: Monetizing opportunities provided by Movercado

	Technology platform and mobile money capabilities	Branded network of outlets and promoters	Subscribing beneficiaries
Description	<ul style="list-style-type: none"> <li>• Cloud-based technology platform built for scale and usability with the ability to manage and track millions of concurrent algorithm-driven transactions with mobile vouchers and payments.</li> <li>• Payments can be triggered on specific actions like clinic visits or the sale of a product.</li> </ul>	<ul style="list-style-type: none"> <li>• Branded network of outlets that will accept and redeem mobile vouchers for products.</li> <li>• This network includes shops, service providers, transport providers etc. PSI also has a 'last mile' network of field promoters that link the wholesalers, manufacturers and distributors to bottom-of-the-pyramid outlets.</li> </ul>	<ul style="list-style-type: none"> <li>• Movercado has enrolled a network of beneficiaries, mostly at the bottom of the pyramid, who recognize the Movercado brand and system, who participate in voucher transactions, and engage in sustained dialogue with PSI.</li> <li>• PSI has also collected significant data on the behaviors, needs, tastes and preferences of these consumers.</li> </ul>
Monetization opportunity	<ul style="list-style-type: none"> <li>• Leasing it out to other NGOs or businesses, to use to implement their own programs or in other related capacities.</li> <li>• Charging third parties a fee to use the technology to deliver messages to subscribers.</li> </ul>	<ul style="list-style-type: none"> <li>• Charging a small license fee to shops and community agents for participating in the Movercado ecosystem.</li> <li>• Charging a small transaction fee on all transactions enabled by the network.</li> </ul>	<ul style="list-style-type: none"> <li>• Always ensuring the confidentiality of beneficiaries, there is an opportunity to charge third-party businesses looking to access and understand the behaviors of these populations, consumer needs, tastes and preferences.</li> </ul>

<sup>13</sup> See video that provides a detailed description of the Movercado ecosystem – <http://www.youtube.com/watch?v=6wx9YyOK94o>

Role of private investor capital: Movercado is currently operating in a limited number of regions in Mozambique. Private investor capital could potentially enable Movercado to be scaled up to additional regions and countries, investing in the technology platform and in marketing and business development to grow the network of outlets and subscribers, and personnel to provide general oversight and maintain the technology platform. Private investor capital could offer advantages over using donations or PSI's unrestricted funds to scale because it:

- Offers fast-acting access to funds, and provides the required amount of funds at the right points in time to enable rapid scale-up for increased impact.
- Provides the correct incentives and motivation for the financial sustainability of Movercado; to the private investors the approach implies that there is an additional level of discipline and efficiency that may otherwise be lacking if there were no need to make a return.
- Aligns investor requirements with objectives of the business, rather than donor restrictions and regulations designed for more traditional NGO activities.

#### **Key considerations and suggested risk-mitigation strategies for PSI**

- To successfully attract private investor capital to monetize and scale up Movercado, PSI will need to maintain the required business skills and expertise to develop a business plan and manage accounting, legal and other considerations unique to profit-making entities. Without this, or without a successful track record in running an enterprise, some investors might be wary of making an investment in Movercado.
- PSI will need to consider the ethical issues around data-mining. Caution is needed to ensure that information about beneficiaries is not used inappropriately.

- PSI will need to be cautious of mission drift – using Movercado for commercial purposes could adversely affect the internal culture of the organization. It could also affect relationships with partners, donors and other stakeholders in the community. One potential way to avoid this would be for PSI to invite senior employees, partners, donors and other key stakeholders to provide oversight to ensure that these are all engaged and comfortable with the commercialization of Movercado, and understand the potential benefits from any added revenues that could support other programs.
- PSI needs to carefully consider the trade-off between impact and profits that might result in conflict between investors and itself. These trade-offs could manifest themselves differently depending on the model.

For example, investors and PSI might be motivated by different things when it comes to the time that management devotes to business development: for example, enrolling a network of paying outlets, pricing studies, developing analytics, and the capacity to monetize data, etc. This would have to be weighed relative to the time needed for day-to-day activities to deliver crucial, life-saving interventions. Similarly, investors might be motivated to frequently lease the technology to third parties to deliver non-mission related messages to consumers.

By contrast, PSI might be wary of doing so, since too many unrelated messages through Movercado could dilute the impact of the health-related messages beneficiaries receive. To reduce tension, investors and PSI could develop in advance clear guidelines governing how trade-offs will be handled, including oversight by independent, third-party agents. There might also be an exit clause for investors if the trade-offs become untenable for them.

**Key considerations and suggested risk-mitigation strategies for investors**

In addition to evaluating standard investment risks (projected sales volumes, number of subscribers, number of enrolled outlets, willingness to pay for data etc.), investors need to also evaluate risks related to governance and control mechanisms. To 'operationalize' this investment, PSI and investors will likely have to create an investment vehicle that is legally-incorporated as a separate entity.

To ensure tax benefits to the investor, PSI as the mission-driven partner would likely have to maintain majority ownership and governance over the entity. This could be problematic for investors, as it limits their ability to direct operations to maximize profits. As already noted, PSI and investors will need to put together guiding principles and contractual terms in advance that clearly outline ways to mitigate any conflicts that might arise due to trade-offs between impact and profit.

# Section 5

## Prioritizing the use of private investor capital for an NGO

---

The previous sections have outlined various financial models through which NGOs could potentially use private investor capital to deliver greater impact. They have also outlined key considerations for NGOs and investors to engage in each of these specific models. However, before deciding to use private investor capital in specific operating and financial models, NGOs might also need to consider if the use of private investor capital aligns with their organization's overarching, strategic needs. NGOs also need to weigh whether private investor capital indeed solves specific funding challenges associated with the available supply of donor funds. This section presents one possible framework that NGOs could use to match their needs with the supply of funds, to identify the main funding challenges they face, and the financial model that best addresses it.

### **How to decide when to use private investor capital**

Thus far the analysis has focused on the use of private investor capital through different investment models on a case-by-case basis. For example, if there is opportunity to use a performance-based contract, an NGO might want to determine whether private investor capital helps to reduce the risk they are exposed to by taking on the specific project via a Model 1b structure. However, as NGOs begin to use private investor capital on a larger scale through various financial models, taking a more holistic portfolio approach might be helpful, as opposed to doing evaluations on a project-by-project basis.

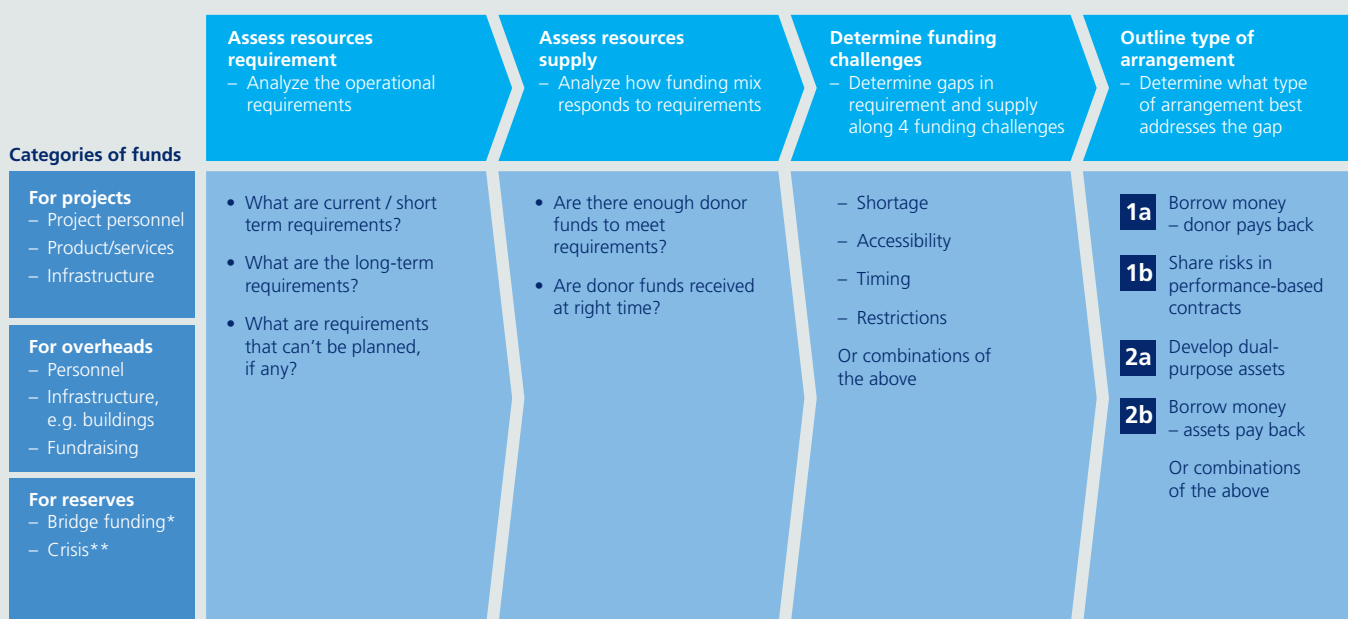
Most NGOs already use a strategic approach when raising funds in support of their mission. This typically matches the need for funds with the available supply of funds to determine gaps. To effectively approach the question of how and when NGOs should make the decision to use private investor capital, NGOs need to prioritize their biggest funding challenges and determine if private investor capital can help to address them.

Elaborating on the concepts presented earlier in this document, the framework illustrated in Figure 13 is intended to assist NGOs in thinking about the role of private investor capital in their overall funding mix.

This framework defines NGO requirements along the lines of three fund categories: project operations, organization-wide overheads, and reserve funds that can be used in the absence of donor funds for organizational priorities or to stabilize operations during times of uncertainty.

First of all, the needs of the NGO and/or its resource requirements should be assessed for each of these categories; what financial, human, and infrastructure needs does the NGO have at its disposal for projects it plans as part of its strategy, including the potential increase in overheads required to pay returns to investors? The next step in the framework is to understand the supply of funds, or what existing funds can support these three areas (project operations, overheads, reserve funds) and ensure the existing funding mix adequately meets these needs. Any gaps should be understood along the lines of the four funding challenges: timing, accessibility, shortage of resources, restriction, which private investor capital could potentially address. Once challenges have been identified, potential financing models or combinations of models can be assessed to determine if they can be structured such that they deliver greater impact than the cost of using private investor capital.

Figure 12: Framework for NGOs to prioritize use of Private Investor Capital



\*Refers to the need for reserves to due to the known volatility of donor funds

\*\*Refers to unforeseen events that can endanger the sustainability of the organization

### Identifying NGOs' need for funds:

To prioritize their overarching organizational need for funds, NGOs should analyze their resource requirements through the perspective of their mission, core objectives and strategic plan. For example, in the project operations category, scaling up to new geographies might be the top priority for an NGO that has recently proven an intervention's effectiveness. Improving the ability to be responsive and begin projects immediately might be a higher priority for an NGO with an objective to respond to humanitarian emergencies such as floods, earthquakes, civil unrest or war.

In a similar vein, in the overheads category some NGOs might face large constraints when it comes to being able to fund their administrative and fundraising costs, such as office space, utilities and salaries for staff supporting centralized functions like accounting, legal services, and fundraising. Other NGOs might have projects that lend themselves to minimal requirements in

terms of fixed costs. These constraints reduce the NGO's ability to invest in shared-service capacities, for example IT infrastructure, which reduces their overall operational efficiency.

Finally, the need for reserve funds among NGOs might vary. These might depend on their total revenues and what percentage of these their bylaws mandate them to maintain as reserves. It could also take into account the riskiness of their operations, as well as their appetite for piloting innovative projects that have not yet been proved to be effective or have not yet captured enough donor support to be funded at scale. Additionally, an NGO operating on a relatively small-scale and on a project basis may not require large reserves, while a multi-country international NGO working in areas with frequent fluctuations in environmental, political and social stability could require larger reserves to secure their work during difficult times.



**Analyzing NGOs' supply of funds:**

To analyze their fund supplies, NGOs could look at their overall funding mix, or the types of donors that provide a majority of their funding to determine if their donor base is meeting the needs they have identified. In general, irrespective of the funding mix, a shortfall will be a challenge for NGOs if their total revenues from all sources are insufficient to meet these needs. Timing is generally a bigger challenge for NGOs that rely on larger bilateral and multilateral donors, and foundations and corporations that have relatively long and unpredictable funding cycles. It is less a concern for NGOs whose donations are largely from individual donors, endowments and sales/enterprise as these types of donations are generally received on a more predictable and ongoing basis. Similarly, the 'accessibility challenge' will also generally be greater for NGOs that rely primarily on bilateral and multilateral donors; many of these are increasingly shifting toward issuing outcome-based contracts. Lastly, there is the 'restriction challenge'; this could affect NGOs that lack large flows of relatively unrestricted revenues from individual donors, product sales, funds provided by enterprises, endowments and/or investment income.

**Identifying funding challenges and appropriate financial models:**

By comparing the needs of resources with the supply of funds, an NGO can determine where their biggest challenges lie. For example, an NGO that depends mainly on bilateral funding from traditional donors might face timing challenges related to operating its project due to long and unpredictable grant cycles. But unless this NGO has operations that require large amounts of funding on an immediate basis (for example, to provide humanitarian relief during emergencies), timing may not be a substantial issue. As such, NGOs should be able to match their funding needs with supply in each of the operations categories to determine where possible challenges might arise, and to what extent. The table below provides an example of a partial list of questions an NGO's managers might ask themselves to identify their biggest funding challenges.

Once an NGO's specific funding challenges have been identified, NGOs can determine which financing model or combination of financing models is best suited to using of private investor capital to address the challenges identified. We already outlined in Section 2 how different models can address these various financial challenges.

Figure 13: Examples of questions for NGOs to identify main funding challenges

Example of matching NGO needs for funds with supply of funds					
Category of Operations	Need for funds		Supply of funds		Resulting funding challenge
Project Operations	Does the NGO need more funds to implement all the projects they want?	Yes	Can the NGO access donors that will fund all of these projects?	No	Shortage
	Does the NGO have plans to grow, diversify and/or expand project activities in the future?	Yes	Can the NGO access donors that will fund all of these projects?	No	Shortage
	Does the NGO face constraints on how much risk they can take on with outcome-based contracts?	Yes	Is the NGO's portfolio of donors moving more toward outcome-based contracts?	Yes	Accessibility
	Does the NGO often require working capital to begin implementation on signed contracts where donors do not provide advances?	Yes	Does the NGO have reserve funds it can tap into and use as working capital?	No	Timing
	Does the NGO have a mission to respond to humanitarian emergencies?	Yes	Can the NGO mobilize grants from donors rapidly at the time of need?	No	Timing
Overheads and cross-project NGO capacities	Does the NGO face constraints in funding their current overheads? Do these include cross-project infrastructure (e.g., IT system) support from donors?	Yes	Can the NGO access donors who are willing to disproportionately finance overheads to subsidize donors who do not cover the full cost of overheads?	No	Restriction
	Will the NGO's overheads increase in the future? Does the NGO want to invest in organization-wide supporting functions that improve the quality of deliverables across projects?	Yes	Can the NGO access donors who are willing to finance these overheads?	No	Restriction
Reserve Funds	Does the NGO plan to pilot innovative projects that have not yet been proven to be successful or received traction with donors?	Yes	Can the NGO access funding from donors who fund innovations/pilots?	No	Shortage
	Does the NGO need bridge funding to continue operations between projects, on a recurrent basis?	Yes	Can the NGO access grants, or tap into unrestricted funds specifically designed to bridge gaps between projects?	No	Shortage
	Does the NGO operate in volatile political, social and environmental geographies?	Yes	Does the NGO have enough reserve funds to sustain operations during unforeseen events or times of instability?	No	Shortage

# Section 6

## Market for investments in NGOs: enablers of growth and a vision for the future

---

The impact investing sector has grown considerably in recent years and has drawn the interest of an increasing number of investors. NGOs have been somewhat under-represented in this market. But there is still significant potential for additional impact to be delivered by making investments that leverage an NGO's physical assets, people, knowledge and capabilities. In this section, we highlight a vision for the future where such investments are made at scale, while describing key growth enablers and potential barriers to achieving this vision.

Over the longer term, private investor capital could significantly complement existing NGOs' funding sources, enabling NGOs to build on their experience and expertise to deliver significantly more value. It will take time for this type of impact investing 'ecosystem' to develop and mature. But we believe that private investor capital can have a significant impact. When used alongside other funding sources, it could help to free up 'traditional' funds for less financially-sustainable efforts. However, it is important to understand and appreciate the challenges and consider the timeline, maturity of this market and actions needed to develop it.

### Enhancing NGO resilience through borrowing (Models 1a and 2b)

The business model used to pay returns to investors might be one that relies on donations as in Model 1a, or profits from 'monetized dual-purpose assets' as described in Model 2b. But it is important to note that the need for, and attitude toward borrowing money varies across NGOs. Some of these with a broad, unrestricted fundraising base prefer to have large levels of reserves on hand to provide for emergencies; others may rely more on short-term borrowing to sustain operations. As described in this paper, borrowing money can help stabilize the cash inflows needed to run operations. This approach can make an NGO more resilient over the long term and better able to plan strategically to achieve and maintain long-term sustainability. Some NGOs have already put this into practice, and currently borrow to support operations. We estimate the current market, for this type of borrowing, to be between USD 500 million and USD 1 billion, based on existing liabilities of five large NGOs.<sup>14</sup>

### Vision for the future

This model has the potential to evolve by improving both efficiency and scale. In a first phase, standardized and readily-accessible loan facilities could help NGOs raise capital faster and at better terms and under more favorable conditions. These credit facilities do not have to be project-specific, but could provide general-purpose loans to NGOs much in the same way as those to for-profit entities. Lending could also be facilitated by banks and other financial institutions, for example through a pooled loan facility for NGOs. Over the longer term this model could evolve into a structured debt market where NGOs raise capital by issuing bonds. This model would appeal to a wider set of investors (banks, corporate investors, retail investors) with different investment horizons profiles, and sensitivity toward NGO missions.

### Barriers to growth

Many NGOs are uncomfortable with the idea of taking out loans; this may be linked to uncertainty about if or how they might repay the principal and interest, along with concerns that some risk associated with the transaction could lead them into financial difficulties. The amount of unrestricted cash NGOs have to provide the flexibility needed to repay investors is in most cases limited and volatile. There is also uncertainty about, and competition for donation flows. Investors, too, are reluctant to be put in a position in which they might be forced to collect from a NGO that defaults; they prefer to lend only to NGOs under conditions that pose very low risk.

<sup>14</sup> Included NGOs are, listed by decreasing size short-term/current liabilities, International Red Cross (USD 244 million), BRAC (USD 126 million), World Vision International (USD 257 million), Population Services International (USD 25 million), Oxfam (USD 12 million), as published in respective 2012 annual reports.

### Enablers for growth

Broader sources of unrestricted income will give NGOs more flexibility in planning their capital needs, and allow them to borrow when needed. This could occur through a more robust development of income-generating assets, as well as by better exploring potential sources of donations to understand the rationale of these models.

From an investor perspective, simplification, standardization of practices and diversification of investor types can help reduce transaction costs and increase the opportunity for scale. As previously mentioned, the development of credit facilities that specialize in general-purpose loans for NGOs and focused development areas could help to concentrate and solidify lending expertise to this space, thereby attracting additional investors and NGOs that otherwise might not have participated in this market.

### Risk-sharing in performance-based models, including donor contributions (Model 1b)

As previously described in Section II, this model calls for donors or governments to make a payments to investors according to a contractual agreement, based on the results an NGO achieves; a primary example of this type of arrangement is one based on development impact bonds. There is a nascent market developing for such bonds. Several of these bonds are currently being developed, and are getting closer to the point when they can be implemented.<sup>15</sup>

A high level estimate of the market size from an investors' perspective, is USD 400 million to USD 2.0 billion. This was arrived at by taking into account the fact that outcome-based international aid (OBA) is estimated to be approximately USD 3.5 billion (relative to approximately USD 120 billion of Official Development Assistance). We estimate that 10 percent to 50 percent of available OBA could be considered a realistic investment opportunity in the short- to medium-term, given this market's current sophistication and growth potential.<sup>16</sup>

### Vision for the future

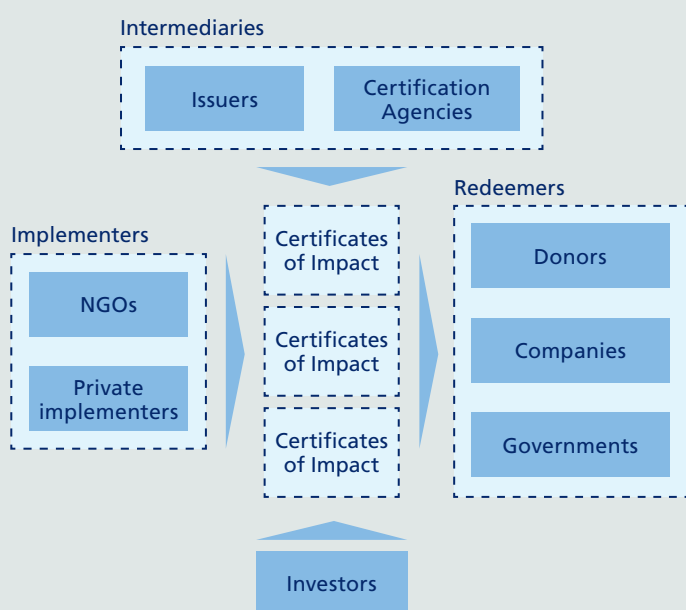
The long-term potential of this model depends on proving its effectiveness when it comes to aligning the various incentives attracting donors, investors and NGOs to increase efficiency and ultimately generate more impact. The importance of agreed-upon and standardized impact measurement and methodology cannot be stressed enough. When the model is established, it may lead NGOs and other implementers to issuing 'impact certificates' – contracts pledging that the impact will be achieved. These would be underwritten by pledging donors. Donors could redeem these certificates by making payments that are based on achieving the promised outcomes. Such certificates could be bought by investors and be effectively traded in a liquid public market. A high-level outline of the potential structure is described in Figure 14.

<sup>15</sup> Development Impact Bond Working Group Report, a partnership of The Center for Global Development and Social Finance, July 2013, [http://www.cgdev.org/sites/default/files/DIB\\_WG\\_REPORT.pdf](http://www.cgdev.org/sites/default/files/DIB_WG_REPORT.pdf)

<sup>16</sup> Sources: <http://data.worldbank.org> (Official Development Assistance), World Bank Global Partnership of Output-Based Aid (GPOBA), [http://www.worldbank.org/ida/papers/IDA15\\_Replenishment/Mid\\_Term/OBA\\_IDA15MTR.pdf](http://www.worldbank.org/ida/papers/IDA15_Replenishment/Mid_Term/OBA_IDA15MTR.pdf)

Figure 14: Overview of potential 'impact certificate' market

### Main actors of the ecosystem



### How the mechanisms could work

- Issuer and implementer designs a project intervention and agree on specifics with a redeemer (usually a big donor or government) which pledge to pay for impact generated
- Issuers issue 'Certificates of Impact' which outline key information such as:
  - Type of intervention and geographical area
  - Key investment risks
  - Return model (e.g. fixed with coupon or per unit of impact) and evaluation criteria
  - Expiry date (date at which the redeemers pay out based on the evaluation)
  - Redeemers pledging on the certificate
- Investors buy certificates. Depending on return model, value of certificates can fluctuate based on forecast of project success
- At expiry, an independent Certification Agency evaluates the project and set the value of the payout. Investor cash in based on assessment.

Source: Project team, Marie Stopes and TDK; Center for Global Development Working Paper 247 (3/2011)  
New York Times: 'Plan to finance philanthropy shows the power of a simple question' (11/11/2013)

Although it will take time for an established and liquid market in impact certificates to materialize, very significant benefits could be derived from it:

- More efficient allocation of money to development, leading to greater impact and higher delivery standards;
- Higher accountability vis-à-vis those benefiting from interventions due to greater transparency when evaluating and comparing interventions;
- Lower transaction costs for those redeeming the pledges, which would provide incentives for more non-traditional donors to redeem certificates (for example, through reduced fixed costs of setting up corporate social responsibility departments);
- Higher investment liquidity, as certificates are effectively tradable instruments, which would incentivize

investors with different investment horizons and risk profiles.

### Barriers to the Growth

Based on insights from the 'Development Impact Bond Working Group', a body formed by the Center for Global Development together with the UK-based organization Social Finance, we identified five major barriers to growth:<sup>17</sup>

1. Lack of standardized and agreed-upon metrics for measuring success, which could make it difficult to develop financial models based on outcomes.
2. Complexities associated with determining the risk-return profiles of the development impact bond proposition: investors in particular perceive the market to pose high operational and counterparty risks, driving up the return they demand to participate.

<sup>17</sup> The Development Impact Bond Working Group is a partnership of The Center of Global Development and Social Finance. <http://www.cgdev.org/page/development-impact-bond-working-group>. Center for Global Development and Social Finance (2013). Investing in Social Outcomes: Development Impact Bonds. Retrieved from <http://www.cgdev.org/sites/default/files/investing-in-social-outcomes-development-impact-bonds.pdf>

3. Challenges in developing a broad, clear understanding of the role of the different parties involved in development impact bonds. In particular investors may not completely understand the role that NGOs can have and how to best leverage their capabilities and existing footprint.
4. The extensive knowledge, resources and collaboration required among stakeholders to understand and implement 'development impact bonds' (DIBs).
5. High transactional costs: the idiosyncratic nature of each 'DIB' prevents re-using certain practices (operational, financial) associated with such bonds.

### Enablers for growth

Building on the recommendations of the Development Impact Bond Working Group, we believe the immediate next steps needed to make significant progress include these:

- Fund structures: Establish donors' and investors' fund structures through which transactions are done to reduce complexity and layer risks. An intermediary organization with experience in both international aid and investment could manage these funds.
- Transparency: Make information available and provide transparency within the fund structures to all parties to allow them to better understand risks.
- Evaluation metrics: Establish a set of metrics that is sufficiently 'refined' and accepted as standard by participants. Key characteristics should include measurability within a reasonable timeframe, and cost effectiveness. Independent certification agencies could lead certification processes. Standardizing such metrics would reduce costs during development.

- Economic valuation: Increased awareness among donors and implementers of the underlying economic benefits of adopting such models relative to traditional models.
- Risk mitigation: Further explore risk mitigation techniques to incentivize investors. Four techniques could be employed: appropriate pay-back structures through which donors or governments grant minimum threshold payments; leveraging third-party donor guarantees as collateral; insuring part of the operations (for example, property risks); and layering of different investors with different risk-return and social-impact preferences.

We recommend more active and inclusive engagement among all participants and potential participants through formal forums or selected partnerships. We also recommend actions for each group involved:

- NGOs and implementers: Proactively address donors and governments, proposing development impact bonds in areas where they offer competitive advantages. These groups can also pool together complementary capabilities to structure comprehensive proposals.
- Donors: Develop/agree upon a set of metrics, sponsor the development of facilities to provide knowledge openly and share structured information widely, making it available to all interested parties, and conduct more thorough internal assessments of when and how these parties could benefit from such models.
- Investors: Committed investors can take on the costs and risks of setting up the structures, pool together with other investors to share experiences and views, and more proactively engage with NGOs to explore untapped capabilities.

## Develop and/or scale-up monetizable dual-purpose assets (Model 2a)

Developing dual-purpose assets can be considered as a preamble to the more familiar impact investments in social enterprises (Model 3). However, dual-purpose assets offer some benefits from the investor perspective: dual-purpose assets often build on existing value, meaning assets are already funded and deployed on the ground; dual-purpose assets present potential for faster implementation, lower costs and greater scale due to the existing NGO footprint and distribution networks, market knowledge and relationships, human resources, and brand. In the short- to medium-term we believe that the NGO dual-purpose asset model opportunities are significant, with an estimated current value of monetizable assets among the largest five U.S.-based NGOs alone in the range of USD 1 billion to USD 4 billion.<sup>18</sup>

### Vision for the Future

This model is largely uncharted territory for both NGOs and investors. However, we envision an ecosystem in which NGOs can tap into private investor capital, and by doing so extend the benefits, value and impact of their assets. This will also allow NGOs to generate non-donation-based cash flows, all the while ensuring they stay true to their mission. The first steps will likely entail one-off 'pilot investments' in dual-purpose assets. This will help to crystalize and solidify the various operational, legal, and financial requirements. Since one of the problems from the investor's perspective is the limited revenue scale potential, we suggest that NGOs pool assets and efforts to create a more compelling and comprehensive proposal.

This can be particularly effective for intangible assets such as knowledge or data. Pooling would allow NGOs to share the risks and costs associated with developing and scaling these assets. They would be able to approach the market with a more comprehensive offering. Doing so will help the market to reach a scale in which institutional investors can make investments in this space, substantially increasing available capital to NGOs, and ultimately their impact.

### Barriers to Growth

As previously mentioned, this is relatively uncharted territory for both NGOs and investors. The few NGOs that have explored this option are often unaware of the intrinsic value of their monetizable assets and lack the business expertise to develop business plans and attract investors with the right risk-return profiles. For those that have already monetized assets, among other concerns there is often a struggle to change the culture within their organization to allow for a shift to include profit-making. At times there is also likely to be an inevitable trade-off between impact and returns, which could be disconcerting to some NGOs. Resource constraints also can hinder opportunities to carry out initial exploratory activities, as NGOs need to determine their high-level approach to asset monetization in advance of commencing any activities. Often NGOs do not have the resources to make the needed analysis.

Among investors, knowledge as to how to assess the risks and governance/controls associated with investments in internally-held dual-purpose assets seems limited. And the current small volume of such investments in individual NGOs, as well as the fragmented, and complex nature of these investments, poses a further challenge.

<sup>18</sup> This estimate was derived by assuming that 10% of total asset base of five large NGOs balance sheet, including investments, property and equipment, and trade receivables, is monetizable and assuming a price to book ratio (multiple) range of 2 to 8. Included NGOs and total asset base for calculation are: International Red Cross (USD 1.28 billion), BRAC (USD 1.25 billion), World Vision International (USD 1.23 billion), Population Services International (USD 548 million), and Oxfam (USD 775 million).



Finally, donors are not always inclined to look favorably upon donor-funded assets being monetized, particularly if this could result in trade-offs between profits and impact. This could raise potential ethical issues around selling donor-funded data or knowledge that would otherwise be open-source and more easily available to beneficiaries.

### **Enablers of growth**

The key immediate enablers of growth for investments in these dual-purpose-assets include:

- NGOs need to develop or acquire business or entrepreneurial skills: this would increase the likelihood for successful business planning, and providing a potent positive signal to investors.
- There needs to be better understanding of business risks in monetizing intangible assets: knowledge and data could provide a competitive advantage when it comes to accessing donor funds.
- NGOs could use pooling techniques to monetize intangible assets: by sharing content (data, training, knowledge) NGOs not only share costs and risks, but are in a better position to approach the market with a more compelling offering.
- NGOs should have some capabilities in deal structuring, for example in areas of valuation, legal, risk management and de-risking techniques to ensure their interests and ability to deliver impact are protected.
- More established governance and decision-making processes are required to address situations in which profits and impact conflict, to incentivize investors and address any conflicts that might arise.

Finally, we believe that there is an opportunity for NGOs to play a leading role in developing this area. A three-phase approach is recommended for NGOs:

- First, develop clear perspectives and agree internally with management and with the board on issues related to dual-purpose assets. Questions to consider include:
  - Does the NGO have monetizable assets?
  - Does it have basic capabilities and the right mindset to manage investments in these assets?
  - Should it pool with other NGOs?
- Subsequently, NGOs should develop business model concepts. This can be done through informal working groups developed with other NGOs and institutions that offer complementary business skills (entrepreneurs, consultants, training programs).
- And finally, NGOs should engage strategic or institutional investors and donors to develop an underlying financing model.

# Glossary

## **Collateral**

An asset bearing commercial value pledged by a borrower to secure a loan or other debt transactions. This asset is subject to seizure in case of default on a loan. Not every debt transaction will require collateralization.

## **Default (on debt)**

Failure to meet the financial obligations on a loan or other debt contracts by not making scheduled payments or by violating loan covenants in a contract. Default can trigger seizure of collaterals.

## **Development impact bonds**

A financial model to deliver international development aid based on a pay-for-performance contract and involving at least three parties: a donor or outcome payer, an investor, and an implementer or service provider. The investor provides capital up front, the implementer or service provider implements the activities, and the donor or outcome payer pays the investor returns on their investment if the implementer or service provider achieves predetermined targets on specific performance metrics. Typically, an intermediary agency helps to design and structure development impact bonds, and an independent evaluation agency is hired to evaluate progress against performance indicators.

## **Dual-purpose assets**

These are internal assets NGOs have developed in the course of implementing donor-funded projects that could be monetized to generate income outside the project. These include physical assets such as buildings or equipment or intangible assets, such as brand, knowledge, and data that can be used to generate impact and income. Income can be generated while generating impact, could be through the provision of services to beneficiaries at a basic fee or use of the assets to deliver services at a fee for non-impact related activities while they would otherwise be idle.

## **Equity type model**

This is a financial model in which the investor provides up-front capital for a venture, and can claim a share of the profits once the venture has paid off all liabilities (obligations).

## **Impact investing**

The term is used to refer to investments that can generate both social impact and a financial return. There are variations in the level of returns expected from the investment depending on the type of investors, but for institutional investors like Zurich, an impact investment is an investment that generates social impact and a market rate of return.

## **Mobile money payment**

Also mobile money or mobile financial services. A technology and distribution platform that allows financial transactions through the use of basic mobile phones (such as GSM). A user can buy credit from a local distribution outlet paying in cash and having credit topped up on his or her mobile phone. Users transfer money or make a payment by transferring a code through SMS: receivers cash in at a distribution outlet by showing the code.

## **Outcome-based contract**

Also known as performance-based contracts, this is a mechanism through which donors only disburse funds to NGOs once the NGOs achieve specific targets against key performance indicators that have been previously determined.

## **Special purpose vehicle**

In the context of this document, this is a business entity with an independent legal structure that allows investors and NGOs to contribute resources (e.g. capital, workforce etc.) toward a venture, with the governing body of this entity responsible for implementing this venture, and paying both the NGO and investors returns based on their share of investment/ownership of the entity.

## Project team

In September 2013, Population Services International (PSI) and Zurich Insurance Company Ltd formed a team drawn from both organizations to explore how NGOs could use private investor capital to deliver increased social impact. The core project team worked together through a three-month engagement process, receiving direction from one steering committee led by representatives from both PSI and Zurich.

The following members were a part of the core project team:

Brian Smith, PSI

Nayantara Watsa, PSI

Colleen Gregerson, PSI

David Walker, PSI

Marcus Forte, Zurich Insurance Company Ltd

Felix Kuehlmann, Zurich Insurance Company Ltd

Riccardo Reati, Zurich Insurance Company Ltd

Atri Chandramouli, Zurich Insurance Company Ltd

The following members served on the steering committee:

Cecilia Reyes, Chief Investment Officer, Zurich Insurance Group

Michael Vos, Chief Operating Officer, Investment Management, Zurich Insurance Company Ltd

Kim Schwartz, Chief Financial Officer, PSI

This project team was also supported by additional staff members from PSI and Zurich as needed.

# Acknowledgements

**PSI and Zurich would like to express our gratitude to the many organizations and individuals who made this work possible. We appreciated their generous contributions in terms of valuable perspectives, insights, expertise and active participation in discussions on how to move our thinking forward.**

We would like to particularly thank the following individuals for their willingness to engage with us multiple times over the course of the project through interviews and workshops, as well as for their thoughtful feedback during the review of this report:

Audrey Choi, Managing Director, Global Sustainable Finance, Morgan Stanley

Francois Jung-Rosenfarb, Senior Director, Social Enterprises, CARE USA

Glenn Rockman, Portfolio Manager at Lion's Head Global Partners, Global Health Investment Fund

Jack Newnham, Senior Consultant, PricewaterhouseCoppers Legal (representing DFID)

Jenny Yip, Program Investment Officer, Bill & Melinda Gates Foundation

John Baguley, Chief Executive Officer, International Fundraising Consultancy

John Whalen, Senior Vice President, Knowledge Management and Innovation, Pact

JP Gibbons, Environment and Conservation Investment Officer, Strategic Transactions Group, USAID

Karsten Robbins, Entrepreneur in Residence, Pact

Liesbet Peeters, Managing Partner, D. Capital Partners

Lily Han, Investment Principal, D. Capital Partners

Mathew Slovik, Executive Director, Global Sustainable Finance, Morgan Stanley

Michael Belinsky, Co-Founder and Partner, Instiglio

Michael Eddy, Co-Founder and Partner, Instiglio

Michael Sanders, Partner, Blank Rome LLP

Radha Rajkotia, Senior Technical Advisor for Youth and Livelihoods, International Rescue Committee

Richard Brass, Director, Berenberg

Robert Albrecht, Partner, Non Profit Audit, Gelman, Rosenberg and Freedman

Sam Hartwell, Chief Financial Officer, KickStart International

Scott McDonald, Director for Institutional Philanthropy and Partnerships, International Rescue Committee

Simon Winters, Senior Vice President for Development, Technoserve

Stephen Kelin, Principal, Non Profit Tax, Gelman, Rosenberg & Freedman

Tone Rosingholm, Executive Director, Social Finance, JP Morgan

William Warshauer, Chief Operating Officer, Pact

Whitney Pyles Adams, Senior Business Development Specialist for Global Health, CARE USA

Yasemin Saltuk, Executive Director, Social Finance, JP Morgan





Zurich Insurance Company Ltd

Mythenquai 2  
8002 Zurich, Switzerland  
Phone +41 (0)44 625 25 25  
[www.zurich.com](http://www.zurich.com)



Population Services International

1120 19th Street NW, #600  
Washington, DC 20036, United States  
Phone +1 202 785 0072  
[www.psi.org](http://www.psi.org)