Counter(Imp)acting Austerity

The global trend of government support for impact investment

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- Impact investments – those intended to create positive social or environmental impact alongside financial return – channel capital into impactful businesses, which are poised to partner with government in social service delivery.
- In a global trend, governments are increasingly turning to domestic impact investment as they balance the need for fiscal consolidation with the demand for investment in economies struggling to grow.
- In the past three years, governments across the UK, US, Europe, and Australia have made over USD 5bn available specifically for impact investment, almost half of which was announced in 2011 alone. Two significant funding vehicles – the European Regional Development Fund and the European Social Fund – have also recently awarded express priority to impact businesses in accessing up to EUR 550bn of funding.
- In order to leverage their funding, governments are developing public-private partnerships to encourage private-sector investment alongside their own and pursuing outcomes-based procurement with impact businesses in mind. We evidence this global trend by surveying the programs governments have put in place to support impact investments, and consider some of the benefits and challenges they face in doing so.

See page 15 for analyst certification and important disclosures.

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Governments turn to impact investment

For the purpose of this note, we use the terms "impact business" and "social enterprise" interchangeably, by which we mean businesses designed with the intent to create positive (social or environmental) impact beyond financial returns. Investments of capital into those businesses are referenced throughout as "impact investments".

As governments across the developed world grapple with austerity, many are faced with the reality of reduced public spending at a time when economies struggle to grow. As such, this period of fiscal consolidation has been an opportunity for impact investments, which can complement government services and attract private investment capital, to take a more significant role in delivering social services. We present the global trend across developed market governments to support impact investments through public-private partnerships and outcomes-based finance. In analyzing this trend, we show the consolidation required before surveying the initiatives governments are establishing to support the impact investment market.

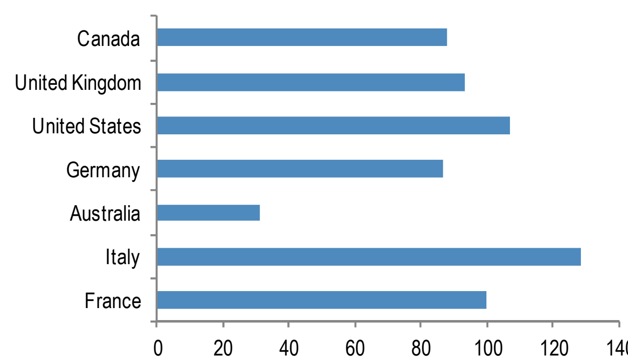
Counteract fiscal consolidation with impact investment

Stabilizing debt levels requires 5% of GDP consolidation over 25years

The global financial crisis has left many developed market governments managing extreme debt levels. The average debt-to-GDP ratio across Canada, UK, US, Germany, Australia, Italy and France is 90% , as shown in Figure 1. In order to manage financing costs, governments are now forced to show that budgets are under control and that there are clear measures in place to reduce deficits going forward. Figure 2 shows the required change in underlying primary balances to stabilize or reduce debt to 60% of GDP by 2026[1], as measured by the OECD. The required consolidation is severe: 5% of GDP on average to stabilize debt, or 10% of GDP on average to reduce it to 60% of GDP, with the highest level across our sample being 18% in the US[2]. Even if governments do not deliver the full extent of fiscal consolidation required as measured by the OECD in this analysis, there are significant consolidation efforts planned by many of these governments.

Figure 1: Gross debt to GDP ratio

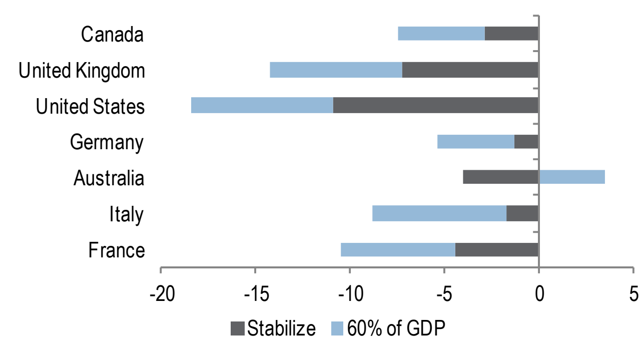
%, 2012



Source: OECD, J.P. Morgan

Figure 2: Fiscal consolidation required to stabilize or reduce debt

% of GDP. Debt reduction shown targets 60% of GDP (Maastricht criterion)



Source: OECD, J.P. Morgan. OECD notes that these estimates are based on underlying primary balances required in 2026, based on gradual but steady consolidation paths to stabilize debt-to-GDP ratios in the long-term baseline scenario. Within these assumptions, debt stabilization may take place at undesirably high levels.

[1] *OECD Economic Outlook, Volume 2011/1.*

[2] Notably, Australia's debt-to-GDP ratio is more moderate, and there is less of a need for fiscal consolidation as a result.

Fiscal consolidation is insufficient, coincident investment in growth is critical

This particular period of fiscal consolidation coincides with a critical need for economic growth in several countries. Before lending to governments, markets demand clear procedures for reducing budget deficits, but they simultaneously punish any consequent drop in growth that is viewed as too severe. As a result, the policy response of each government needs to be nuanced: finding ways to encourage job creation, near-term growth and economic stability while reducing government spending and/or increasing taxes.

When choosing where to invest, choose the best mitigant to social spending cuts

Striking this balance will require delicate attention to how and where the government chooses to invest the limited capital that it can deploy. It seems natural to allocate funding or policy support towards the market segment that is the most effective use of capital. For example, the US government's USD 2bn Start-Up America initiative includes a USD 1bn impact investment fund designed to increase the economic impact of small business investment by specifically funding entrepreneurs located in underserved communities[3]. This kind of directed financing towards intentionally impactful and financially sustainable business – what we will refer to as "impact businesses" – could create quality jobs and encourage economic growth in the areas that need it most. Impact businesses may be able to deliver better returns – both economic and social – for the same "dollar" spent. They can also attract private capital, lessening the financing burden for the government. We believe this makes the market for impact investments – the investments that finance impact businesses – a key recipient of government support today and in the future.

Whether or not the motivating factor is directly caused by fiscal consolidation, the coincident trend is clear: governments across developed markets are increasingly turning to the impact investment sector for delivery of domestic social services as they cut spending. We present some of the impact investment initiatives that governments are sponsoring, as well as the benefits and challenges they face in doing so. This is not meant to be a comprehensive list, but rather a list that highlights some of the key initiatives being implemented currently as evidence of the global trend. Much of the activity is happening as we go to print, and we anticipate that this list will continue to grow.

UK building integrated impact investment marketplace

In the UK, impact businesses (or "social enterprises" as they are commonly referred to by the government) already contribute GBP 24bn annually to the UK economy (1.5% of GDP) and employ over 800,000 people, many of whom live in disadvantaged areas or belong to traditionally excluded groups[4]. The government has explored ways of supporting the impact investment sector for over ten years, since the launch of the Social Investment Task Force in 2000. Now, as the government considers how to deliver public services with a constrained budget, it is exploring innovative outcomes-based financing solutions like payment-by-results contracts. These contracts allow the government to outsource the provision of a service to impact businesses or other private-sector contenders and only pay for that service once a defined set of outcomes is delivered. The structure has the attention of many

[3] Small Business Administration policy memo on Start-Up America Impact Investment SBIC Initiative, 7 Apr 2011.
[4] *Growing the Social Investment Market: A Vision and Strategy*, HM Government, Feb 2011.

other governments around the world who are also exploring this new procurement mechanism. We analyze the benefits and challenges by considering the largest example to date: The Department of Work and Pensions' ("DWP") Work Programme.

Changing government procurement practices: Outcomes-based financing

Payment-by-results contracts

The Work Programme is one of the most prominent payment-by-results contracting schemes in the UK. The programme, launched in 2010, is designed to pay contractors using the money saved by the government from transitioning the long-term unemployed back into work, thus removing them from welfare support. The suppliers – those companies that will be commissioned to find employment for the target populations – are paid on a staggered basis, reflecting achieved outcomes: there is an upfront fee, a job outcome fee once the individual is employed, and a sustainment fee once the individual has maintained the employment for a given period. Importantly, the sustainment fee is meant to make up a "substantial" portion of the total amount the government will pay[5], and the government will not pay anything should the outcomes not be delivered.

Social Impact Bond

Aside from the Work Programme, another prominent example of this kind of procurement is the Social Impact Bond. The pilot Social Impact Bond was issued earlier this year in the UK, raising GBP 5mm in a bond whose payout is linked to the government savings achieved by reducing recidivism at Peterborough Prison. Notably, unlike traditional bonds, investors stand to lose their full principal should there be no reduction in recidivism[6] since, similar to the Work Programme contract, the government will not make any payment if the defined outcomes are not achieved.

Understanding the risk transfer inherent in outcomes-based financing

Both working capital and risk capital are required to win these contracts

Clearly, both structures benefit the government from a cashflow standpoint, since the government will pay after an outcome is achieved, rather than before. Furthermore, the government may be exempt from paying a substantial portion (or potentially all, depending on the contract) of the funding if outcomes are unsuccessful. Hence, delivering on these contracts requires working capital to cover operating costs until payments are received, and risk capital to cover the risk that outcomes are unsuccessful (and no program payments are received).

Transferring risk to the right recipient

In this respect, there is a difference between the Work Programme's payment-by-results contracts and the pilot Social Impact Bond as currently structured. The Social Impact Bond transfers the impact delivery risk (and hence the risk of financial return) from the government to third-party investors who provide capital to the service providers and take the risk that outcomes may not be achieved. By contrast, the Work Programme's payment-by-results contracts transfer the impact delivery risk from the government to the service provider. Perhaps for this reason, as well as the size of the

[5] *The Work Programme Prospectus – November 2010, www.dwp.gov.uk.*

[6] While principal is also at risk in traditional bonds, the senior position of bondholders in the capital structure of the investee company means that bondholders will likely recover some of that principal upon default (40% recovery is currently assumed in CDS pricing). For more on social impact bonds, see *Social Impact Bond Primer,* Social Finance and http://nffsib.org/.

contracts themselves, most of the Work Programme contracts were awarded to large mainstream service providers rather than impact businesses that may have been less able to take on the financial risk transfer[7].

In the next iteration, the DWP's GBP 30mm Innovation Fund, each procurement contract is meant to engage a Social Investment Partnership comprising a financial sponsor (or consortium of sponsors) who will then engage one or more service provider[8]. This arrangement enables the impact business to transfer the risk to investors, as in the case of the Social Impact Bond. The next natural question is: how much risk are investors willing to take on these new products?

Finding the right risk and return profile

The social impact inherent in these financial instruments can invite investors to concede somewhat on the returns they expect, if the risk seems balanced. The pilot Social Impact Bond returns principal to investors if the rate of reoffending is lowered by more than 7.5%. Below that, capital is lost, and above that the capital can yield anywhere in the range of 2.5% to 13%[9]. The Work Programme priced the value of employing different categories of candidates, with a sliding scale referencing the difficulty of success[10]. Some market participants have anecdotally provided feedback that the pricing does not sufficiently capture the additional cost of the hardest to reach outcomes, and some fear this will lead service providers to focus rather on the easiest to employ populations. In both instruments, the upside is capped while the downside is not, and the probabilities of realizing the impact are yet to be determined. As such, the risk assessment for both products is challenging, particularly given the return is fixed income in nature, while the risk is more equity-like[11]. Developing a successful market for this new kind of investment will take some pioneering investors to test these instruments, especially given the cost of due diligence on such unique and (most likely) small investments. One flagship entity may act as a cornerstone investor in just such opportunities.

Engage cornerstone investors, like Big Society Capital

With the aim of growing the impact investment sector more generally, the government established Big Society Capital (“BSC”) in July 2011[12]. Backed by a projected GBP 600mm in capital, this organization is designed to provide financing directly into impact investments and also to invest in infrastructure and initiatives that would encourage faster market growth. BSC will further leverage this dedicated pool of capital to direct private capital into impact investments generally (including potentially payment-by-results contracts). Although the establishment of BSC is a sizeable milestone, the UK government has been investing in impact business on a smaller scale for a few years. Table 1 shows some of the other financial support that government departments have put in place, including the Department of Health’s

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[7] The scale of the individual contracts, between GBP 10mm and GBP 50mm per year, may have been a difficult for impact businesses to take on as prime contractors.
[8] *Innovation Fund Prospectus*, http://www.dwp.gov.uk/docs/inn-fund-prospectus.pdf
[9] Ibid.
[10] *The Work Programme Prospectus – November 2010, www.dwp.gov.uk.*
[11] See footnote 6. More risk-sharing with the government could reduce the downside exposure, but could coincide with more prescription for achieving outcomes. Anecdotally, some investors prefer the freedom to manage their investments rather than downside protection.
[12] http://www.cabinetoffice.gov.uk/content/big-society-capital.

GBP 80mm Social Enterprise Investment Fund, the GBP 30mm Scottish Investment Fund and the Scottish Government's GBP12mm Third Sector Enterprise Fund[13].

Table 1: UK government-funded or facilitated domestic programs

	GBP, mm	USD, mm
DWP's Work Programme (payment-by-results contracts, per year, for five years)	400-2000	640-3200
Big Society Capital (gov't sponsored impact investor)	600	960
Social Enterprise Investment Fund - Dept of Health	80	128
DWP's Innovation Fund (payment-by-results contracts over three years)	30	48
Scottish Investment Fund	30	48
Scottish Government's Third Sector Enterprise Fund	12	19
Investment and Contract Readiness Fund	10	16

Source: UK Cabinet Office, UK Department of Health, Scotland.gov.uk, J.P. Morgan.

Ensuring impact businesses are ready to compete

While the prospect of capital will help to ensure that impact businesses can financially manage payment-by-results contracts, for example, they also need to be "investment ready" in order to access that finance. When UnLtd, a UK-based foundation that supports social entrepreneurs, solicited applications for an early stage co-investment program, 630 applications were received. However, fewer than 10% provided adequate financial projections. UnLtd believe this points to a lack of awareness of the type of data an investor would require. Based on their experience, entrepreneurs often require an early stage, higher risk seed investment of GBP50-200k plus at least nine months of intensive technical support[14] to prepare them for institutional investor conversations.

Several programs are now being developed to address this need in the UK. Co-investment programs like the Big Venture Challenge aim to accelerate this investment readiness process by attracting angel investors in alongside matching grant funding and technical assistance, to strengthen and de-risk the propositions[15]. The UK cabinet office has also launched a GBP 10mm Investment and Contract Readiness Fund to help social businesses attract capital and better compete for public sector contracts[16]. Impact businesses are specifically encouraged to tender for payment-by-results contracts and parliament is considering a bill that would require local authorities, when entering into public procurement contracts, to give greater consideration to economic, social or environmental wellbeing during the pre-procurement stage[17].

Growing the outcomes-based impact investment market to scale

The Innovation Fund and the pilot Social Impact Bond total GBP 35mm of impact investment opportunity, but the size of individual investments within those programs remain small. Further, those investments require significant due diligence on both the financial and social metrics, given the unique nature of the contracts. While smaller contracts may be more accessible for impact businesses, intermediaries that allow investors to share the due diligence expense could improve transaction costs for

[13] The term "third sector" is often referenced interchangeably with social enterprise.
[14] Based on conversations with Jo Hill, Director of Ventures, UnLtd.
[15] Ibid.
[16] http://www.thirdsector.co.uk/news/Article/1081611/Cabinet-Office-launches-10m-fund-help-voluntary-organisations-become-contract-ready/
[17] http://services.parliament.uk/bills/2010-11/publicservicessocialenterpriseandsocialvalue.html

investors. And on the government's part, centralizing commissioning processes could help local governments to utilize this procurement technology and help investors and suppliers reduce the costs of applying for small, varied contracts.

Through outcomes-based finance, investment readiness support and the public-private investment capital available from Big Society Capital, the UK government is building momentum in moving towards an integrated impact economy. Next, we see how similar programs are working across the Atlantic in the United States.

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USA investing for impact at home and abroad

Direct funding for domestic impact investments

Governmental bodies in the United States, at both the federal and state levels, have also responded to the domestic impact investment opportunity. Table 2 highlights some of the significant initiatives in place to support the domestic impact market. At the federal level, the Obama administration announced in July that it will commit USD 1bn over five years to a Small Business Association ("SBA") Impact Investment fund, which will invest growth capital in companies located in underserved communities.[18] For example, The State of Michigan Retirement Systems, in partnership with The Dow Chemical Company and InvestAmerica, established the InvestMichigan! fund, which is the first SBA fund and will invest up to USD 130mm over the next five years[19]. Separately, two "Innovation Funds" have been established – one by the Department of Education and one by the Corporation for National and Community Service – to provide a total of USD 700mm in grant funding to proven, high-impact, financially sustainable and scalable impact businesses.

Table 2: US government funding for domestic programs

	USD, mm
SBA commitment to Impact Investment Initiative	1000
Investing for Innovation Fund (Dept of Education)	650
2012 Budget allocation towards Pay-for-Success Bonds	100
Social Innovation Fund (Corporation for National and Community Service)	50

Source: Whitehouse.gov, OPIC.gov, J.P. Morgan.

Importing innovative service procurement practices

In the 2012 federal budget, there is also an allocation of USD 100mm to promote "pay-for-success projects", another name for outcomes-based finance that aim to reduce the aggregate level of government investment needed to achieve successful outcomes with minimal administrative requirements on service providers so as to allow for maximum flexibility to improve efficiency and effectiveness[20]. This federal support for pay-for-success contracts is dependent on the budget being passed, which is still under review. Separately, several states (and countries, as we will see) are exploring outcomes-based finance. The Commonwealth of Massachusetts issued a formal request for information on such financial structures as social impact bonds and pay-for-success contracts[21], and is expected to follow-up with a Request for Proposals in the coming weeks. Anecdotally (and informally), we believe several other states are exploring this type of concept as well.

While this research is focused on domestic impact investment initiatives that are developing at a time of austerity, three US development organizations are also capitalizing on the impact investment concept to deliver their interventions. We present these in the grey box below.

[18] *Fact Sheet: White House Launches "Startup America" Initiative,* Whitehouse.gov.
[19] *Michigan businesses first in country to benefit from new impact investment initiative*, 26 Jul 2011, www.investmichiganfund.com.
[20] http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/ggp.pdf.
[21] *Massachusetts pursues social innovation financing to spur innovation and build on program success*, 06 May 2011, www.mass.gov.

Impact investments abroad: OPIC, USAID and State Department programs

While they are not focused on the domestic market like the initiatives mentioned above, there are three significant impact investment programs operated by US governmental institutions working abroad: The Overseas Private Investment Corporation ("OPIC"), the US Agency for International Development ("USAID") and the Office of the US Secretary of State.

On 27 October 2011, OPIC announced that it would be deploying USD 285mm to six impact investment funds, catalyzing a total of USD 875mm of investment, (assuming the required matching funds are raised). The recipient funds span such impact objectives as healthcare in Africa, financial services in Latin America and global forestry. The call for funds solicited a record 88 responses; the response was so positive that OPIC expects to announce additional approved facilities in 2012.

With a similar funding objective, USAID's Development Credit Authority ("DCA") is a government-backed initiative that utilizes partial, risk-sharing US Treasury-backed credit guarantees to catalyze impact investments in developing markets. One of these guarantees recently facilitated a USD 25mm investment into the African Agricultural Capital Fund, which comprised USD 17mm of equity funding from the Bill & Melinda Gates Foundation, the Gatsby Charitable Foundation, and the Rockefeller Foundation, and a USD 8mm commercial loan from J.P. Morgan, 50% of which was guaranteed by USAID through this program. Alongside this financial support, USAID also provides technical assistance to borrowers and financial institutions for business development services. The DCA was established in 1999 and has facilitated over USD 2.3bn of private capital debt financing in more than 64 countries[22]. Going forward, the goal is to use these guarantees to channel another USD 2.5bn in financing over the next five years.[23]

With an approach designed to be financially and politically sustainable, The Global Partnerships Initiative within the Office of the US Secretary of State is piloting a program that they hope will allow businesses to improve their market position and unlock economic value while delivering positive social and environmental impact. The program will work with a small consortium of companies to identify targeted, cross-sectoral business challenges whose solutions should strengthen their performance and yield positive social and environmental returns. It will then work with leaders in technology, design, and innovation to generate business ventures that address the identified business challenges, thus creating opportunities for strategic investment. Following the initial pilot in Brazil, the program will expand into other emerging economies in Latin America, Asia, and Africa[24].

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[22] Based on interview with Christopher Lee at USAID and http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit
[23] Ibid.
[24] Based on interview with Lalarukh Faiz, Senior Partnerships Advisor within the Global Partnership Initiative, which is located in the Office of the U.S. Secretary of State.

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European programs refine an existing concept

Although the term may be new, impact investment is a more familiar concept in continental Europe, where lenders like Crédit Coopératif have been lending with reference to social outcomes for over 100 years[25]. As such, some of the recent European market building activity has focused on formalizing investment channels towards these businesses, in some cases utilizing already existing programs.

European Social Business Initiative promotes social investment funds

In April 2011, The European Commission adopted the Single Market Act, a series of measures to boost the European economy and create jobs in the wake of the financial crisis[26]. As part of this Act, the European Commission established the Social Business Initiative, which works towards three goals for social businesses: improving access to funding, improving visibility, and improving the legal environment[27]. In response to the funding priority, a European financial instrument of EUR 90mm will be established to provide social investment funds and financial intermediaries with debt or equity, for example (operational 2014)[28]. Further, express priority will be given to investment in social enterprises within the European Regional Development Fund ("ERDF") and the European Social Fund ("ESF")[29]. The ERDF finances companies, particularly small and medium sized enterprises ("SMEs"), to create sustainable jobs, infrastructure projects, and financial instruments designed to support local development across the European Union ("EU"). The ESF sets out specifically to improve employment and job opportunities in the EU. These two funds have a total of EUR 277bn available for the 2007 – 2013 budget period, which is co-financed by member countries to a total of just over EUR 550bn[30]. These programs are summarized in Table 3, which also shows some of the programs utilizing JESSICA program funding, explained below.

European Investment Fund to catalyze EUR 100mm for impact businesses

In the same vein as the UK's Big Society Capital, the European Investment Fund plans to invest up to EUR 50mm, with EUR 50mm of matching private sector capital, into financial intermediaries that will then invest in impact businesses[31]. The program is scheduled to begin in early 2012.

Table 3: European program funds

	mm	Cur	USD, mm
Social Business Initiative Fund (operational 2014)	90	EUR	126
Express priority to social businesses for ERDF and ESF funding	Up to 550,000	EUR	Up to 770,000
Programme d'investissements d'avenir social enterprise allocation	100	EUR	140
European Investment Fund (government funds)	50	EUR	70
European Investment Fund (matching funds)	50	EUR	70
KfW Impact Investment Financing Facility	n/a		n/a
JESSICA programs			
Northwest Urban Investment Fund	100	GBP	160

[25] www.credit-cooperatif.coop
[26] http://ec.europa.eu/internal_market/smact/index_en.htm
[27] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/735
[28] *More Responsible Business Can Foster More Growth in Europe*, press release, 25 Oct 2011 and *Communication from the Commission to the European Parliament et al*, http://ec.europa.eu/internal_market/social_business/docs/COM2011_682_en.pdf.
[29] Ibid.
[30] http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm#1
[31] http://www.thirdsector.co.uk/news/1100083/?DCMP=EMC-CONDailyBulletin

Spanish Energy Saving and Diversification Institute	127.6	EUR	178.6
Regeneration Investment Fund for Wales	30	GBP	48

Source: Europa.eu, E.I.B, J.P. Morgan.

Already established European Union programs may see more utilization

In the same way that the existing ERDF and ESF funds will prioritize impact businesses, the current climate can encourage impact businesses to better utilize existing facilitating programs. One example is the Joint European Support for Sustainable Investment in City Areas ("JESSICA"), which provides capital and guarantees to promote collaborative sustainable development in Europe's urban areas. The idea is to catalyze public-private partnership investments, like the Northwest Urban Investment Fund of GBP 100mm (USD 160mm)[32] or the FIDAE, a fund established by the Spanish Energy Saving and Diversification Institute, which is initially endowed with EUR 127.6mm (about USD 180mm), and hopes to leverage private finance towards a total investment target of EUR 600mm (USD 840mm) by the end of December 2015[33]. Table 3 highlights just some of the funds that have been taking advantage of the JESSICA program.

National financing for social enterprises

Germany's KfW launches impact investment financing facility

Alongside the pan-European effort, there is also a trend in impact investment support at the national level within Europe, including those initiatives already highlighted in the UK. In Germany, for example, KfW established an impact investment financing facility to begin on 1 January 2012, targeting "enterprises seeking to solve a social problem with an innovative business model and an explicit general welfare agenda that have already successfully negotiated the first steps as businesses and are now looking to expand"[34]. The program will supply up to EUR 200,000 in equity capital to support each business (which will need to be matched by private funding) and also to encourage lending to these businesses from commercial banks. All recipients will be enterprises that operate within Germany, rather than abroad.

France supports social economy through Programme d'investissements d'avenir

In France, the concept of social (or solidarity) economy is more familiar than it is in some of the other countries we discuss. In fact, France integrated the social and "solidarity" economy into national policy through the Programme d'investissements d'avenir ("PIA"). The EUR 35bn PIA program was established in 2009 to stimulate the economy during the financial crisis. Within the various components of the program, there is a EUR 100mm plan to support the social economy sector[35].

Italy supports small businesses, and impact investments indirectly

Italy does not yet explicitly support social enterprises through its legislation, but it is a leader in supporting entrepreneurs: the percentage of the government funds devoted to the development of the SME sector is 37%, compared to the European average of 10.6%[36]. In July 2011, the government passed a law decree laying out fiscal

[32] http://www.eib.org/

[33] http://europa.eu/rapid/pressReleasesAction.do?reference=BEI/11/99&format=HTML

[34] http://www.kfw.de/kfw/en/KfW_Group/Press/Latest_News/PressArchiv/2011/20111025_54309.jsp

[35] http://www.caissedesdepots.fr/activites/investissements-davenir/financement-de-leconomie-sociale-et-solidaire-100-meur.html

[36] Ministry of economic development, SBA Report, 2010, page 32

consolidation plans and establishing new funding to promote growth, including innovation and venture capital funding and fiscal incentives for young entrepreneurs and the unemployed. This builds on the support for the "SME") sector that followed Italy's adoption in 2010 of the EU Small Business Act (2008), which broadened the activity of the EUR 1.4bn Fondo Italiano di Investiment to include investments into enterprises with less than EUR 10mm in revenues. While these initiatives are not designed explicitly to support impact businesses, impact investments tend to fall within the SME sector scope and may be indirectly supported. We will keep an eye on Italy for more explicit support in the future, particularly as other European programs become more established.

Australia pursues several impact investment initiatives

Australia has taken up the momentum as well, with several initiatives supporting the impact investment marketplace at both the federal and state levels. Table 4 summarizes three funding vehicles that channel financing towards impact investments. The largest allocation of capital to date has been an AUD 74mm investment in impact businesses by the government through the Jobs Fund and the Innovation Fund, which have broader investment mandates[37].

Table 4: Australia government financial sponsorship

	AUD, mm	USD, mm
Investment in impact businesses through Innovation Fund and Jobs Fund	74	77
Social Enterprise Development and Investment Funds ("SEDIF") (government funds)	16	17
SEDIF (matching funds)	16	17
Social Benefit Bond demonstration project	3	3
Social Benefit Bond pilot funding	36	37

Source: University of New South Wales, J.P. Morgan.

SEDIF funding designed to stimulate impact investment market

Building off of that investment, the government created the Social Enterprise Development and Investment Funds ("SEDIF") to "stimulate the social impact investment market in Australia, increasing access to capital for impact businesses as they work to create jobs and support highly disadvantaged people and communities throughout Australia."[38] As with many of the other public-private partnership programs we have seen, this funding is only accessible if recipients identify 1:1 matched financing from private or philanthropic investment. The financing was awarded to Foresters Community Finance and Social Enterprise Finance Australia ("SEFA", a consortium of corporate and other entities with experience in the social enterprise sector[39]). The government has invested AUD 16mm in these two funds alongside AUD16mm of private capital for a total of AUD 32mm[40].

Exploring outcomes-based financing

At the state level, we see a focus on financial innovation to directly finance social interventions. In September, the government of New South Wales launched a Request for Proposal to identify two pilot Social Benefit Bonds (another name for Social Impact or Pay for Success bonds), focused in the areas of out-of-home care

[37] *National Consultation on the Social Enterprise Development and Investment Funds*, Australian Government, Oct-Dec 2010.
[38] *National Consultation on the Social Enterprise Development and Investment Funds*, Australian Government, Oct-Dec 2010; www.deewr.gov.au.
[39] www.sefa.com.au
[40] *Investment funds to grow Australia's social enterprises*, 9 Aug 2011.

and recidivism, for a total of AUD 36mm[41]. This followed from a feasibility study completed by the Centre for Social Impact at the University of New South Wales, which concluded that the Social Benefit Bond concept is feasible in New South Wales and that investors were most interested in structures where risk is partially guaranteed by government. The Commonwealth Senate Economics References Committee has also been exploring finance options for the not-for-profit sector[42].

Canada following the UK's example

In their first set of conclusions in 2000, the UK's Social Investment Task Force recommended the establishment of an organization to allocate capital to and support the growth of impact investments. Ten years later, this recommendation was realized with the official launch of Big Society Capital in July 2011. Canada is now following in Britain's footsteps at a fast pace, with the Canadian Task Force having recommended in December 2010 that the federal government establish the Canada Impact Investment Fund and that provincial governments should follow suit. Already, one of the unpublished recommendations of the Canadian Task Force has materialized, as the Centre for Impact Investing was announced in September. The Centre is designed to build the marketplace, acting as a hub for several activities including: research and public policy; metrics, market and product development; and education, engagement and talent building.

According to research commissioned by the Canadian Task Force, there are currently at least 30 social finance investment funds in Canada, but most are under CAD 1mm in assets. In addition to allocating capital, the Canadian Task Force has also recommended that policymakers explore tax incentives and the development of innovative financial structures to encourage capital allocations.[43] If the Canadian experience follows that of the UK after the Social Investment Task Force, then we may see significant sponsorship of the impact investment market evolve over the coming years.

[41] http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds_trial_in_nsw_FAQs
[42] NSW Treasury Request For Proposal Social Benefit Bonds Trial
[43] *Mobilizing private capital for public good*, Canadian Task Force on Social Finance, Dec 2011.

While we highlight a few select programs, there is a map of the global impact investment policy landscape available in *Impact Investing: A Framework for policy design and analysis,* which was published in January 2011 by Insight at Pacific Community Ventures & The Initiative for Responsible Investment at Harvard.

For more on the European landscape, readers should refer to *The Atlas of Job Creation: Good Practices for Social Inclusion,* which was published by The European Federation of Ethical and Alternative Banks in 2010.

Policy can help reduce barriers to entry and growth

While we have referenced mostly financial investment programs for impact investments, policy interventions can also have a significant effect on the growth of the sector. Some governments are convening working groups like the White House Convening on Impact Economy (US, June 2011[44]) or supporting research teams to consider how the government should direct its policy support, like The Social Investment Task Force in the UK (2000 – 2010) and in Canada (2010). In the UK, the government created the Cabinet Office of the Civil Sector (previously Office of the Third Sector) assigned specifically to oversee the impact investment market. Canada's government has similarly established the Advisory Council on Social Entrepreneurship (2011[45]). With dedicated policy support, governments are further encouraging positive consequences from the financial support in place.

Supporting growth already in motion

For decades, governments have allocated capital toward impact investments in emerging markets through development finance institutions such as OPIC in the US, the UK's Commonwealth Development Corporation (CDC) or Germany's KfW. Some of these institutions also operate domestic funding programs, and we may see more of that kind of support – like KfW's program – as domestic needs grow. Already, the domestic market in the European Union, for example, makes up 10% of all European businesses and employs over 11 million paid employees[46].

While impact investment is not new, the recent explosion of growth in the sector is substantial. For example, research conducted in the UK by Social Enterprise UK found that the proportion of social enterprises that are 2 years old or younger (14%) is three times that for standard small businesses (4%). The level for London alone is even higher at 20%. With the impact investment sector growing so quickly, the success of the market will depend on the convergence of investment, procurement practices, technical assistance and policy to address the challenges presented by public-private partnerships and outcomes-based finance. As a result, it will require coordinated innovation to ensure that these factors converge to support the market, and help to mitigate the effect of the fiscal consolidation to come.

[44] *Building an Impact Economy,* The White House Blog, 22 Jun 2011.
[45] www.enterprisingnonprofits.org
[46] *More responsible businesses can foster more growth in Europe,* 25 Oct 2011.

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