Impact Investing and Government Finance: Innovations in private finance and the role of government

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Outline

- Impact investing and global financing trends
- Impact investing deal structure: example
- Links with government financial management & macro performance
QUESTION:

Does your government currently use private funding for social and environmental programs?

A) Yes
B) No
Impact Investing is a new approach to investing that incorporates social and environmental outcomes

- **Defines a universe of investors** that seek social and environmental return, as well as financial return

- **A wide array of investments** from private equity to bonds: varying return expectations, varying impact

- **A range of actors**: private investors, pension funds, businesses, philanthropies, NGOs, governments
Key Players

Developed/Less Developed Countries

Public Sector

Foundations
LLCs
Pension funds
Insurance funds
Private investors

Social impact investing

Donor/MDBs
Bilateral Multilateral Banks
Green Climate Fund

Social Enterprises

For profit

Non-profit

INGOs, NGOs, Foundations

Public Sector

Investors

Non-profit

For profit

Social Enterprises

Donor/MDBs
Bilateral Multilateral Banks
Green Climate Fund

Social impact investing

Developed/Less Developed Countries

Key Players
Impact Investing typology

B2B:
- Private equity
- SRI
- Microfinance

B2G:
- Green bonds
- Government securities

G2B:
- PPP
- “Pay for success”
- SIB

G2G:
- MDBs
- DIB
- GAVI
Supply of funds: public v private external capital

Expanded role of private investment

- Net ODA and Foreign Assistance, Constant $ 2013
- Net ODA and Foreign Assistance, Current $
- FDI, net inflows
4. Drivers: Financing the SDGs

- Price Tag: $3.5 – $4.5 trillion a year.
- Financing Gap: $1.5 - 2.5 trillion a year

![Graph showing funding gap](image)
QUESTION:
What is the biggest constraint to using private investors to finance social and environmental programs?

A) Limited understanding of the private sector instruments by government
B) Limited government management capacity
C) Resistance from civil society
D) Lack of interest from private sector
Deal structure
Example: Social impact bond deal structure

- **Government**
  - Payment based on measurement of desired outcome
- **Intermediary**
  - Funding
  - Service provider
  - Service provision
  - Target population
  - Rigorous evaluation of outcomes
  - Outcomes
- **Impact Evaluator**
- **Investors**
  - Financial returns dependent on outcomes
  - Investment for service provision
- **Monitoring**

Outcomes achieved through service delivery
Linkages with government finance
QUESTION:

Does your government have adequate budget, accounting and evaluation policies to support private financing of “public goods”?

A) Yes
B) No
The value proposition for governments

E.g. Capital market issues: Align benefits and costs

Upfront investment

Investment/Impact

Impact

Repayment

Repayment
The value proposition for governments

<table>
<thead>
<tr>
<th>Gain</th>
<th>Cost</th>
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<tbody>
<tr>
<td>Budget saving</td>
<td>- Payout = $Pr(success) * $</td>
</tr>
<tr>
<td>+</td>
<td>- Social cost ?</td>
</tr>
<tr>
<td>Social benefit</td>
<td></td>
</tr>
<tr>
<td>+</td>
<td></td>
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<tr>
<td>Externalities (tax, security expense)</td>
<td>?</td>
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Criteria to Identifying Impact Investing Opportunities

Quantifiable outcome

Social Gain > Social Cost

Scalable

Additionality
Role of Government in Impact Investing: Fiscal Management

- New management culture
- Results-based budgeting
- Accrual accounting
- Enabling Fiscal Management
- Monitoring and Evaluation
- Multi-year budgeting
- Value for money
Role of Government in Impact Investing: Market Conditions

**Seed Capital**
- Pre-feasibility funding
- Pilot programs
- Co-funding of initial projects

**Capital Market Development**
- Local capital market funding

**Budget Funding**
- Dedicated line items for PFS
- Accounting and auditing systems
- Multi-year budget commitments
- Improved M&E

**Institutional capacity**
- Dedicated office
- Training for public servants and market providers
Conclusion:

 Not a panacea

 Can mobilize private capital for social/environmental impact

 A tool that may best be used for complex problems

 Government roles: a) create commitment mechanisms for fiscal policy and improve management systems, b) create the enabling environment, b) develop new management culture for risk taking
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