G20 Development Working Group

INCLUSIVE BUSINESS

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International Labour Organization

International Finance Corporation
WORLD BANK GROUP

OECD

FOREWORD

The G20 has identified inclusive business as having a particularly important role for sustainable development – economic, social, and environmental.

Businesses and other actors are driving models that unleash the twin powers of investment capital and entrepreneurial creativity. It is becoming increasingly accepted that there need not be a trade-off between "doing good" and "doing well." Solutions in which impact and financial returns go hand-in-hand are driving profitability rather than impairing it.

What is Inclusive Business?

Inclusive business is a private sector approach to providing goods, services, and livelihoods on commercially viable basis, either at scale or scalable, to people at the base of the pyramid (BOP).

Companies with an inclusive business approach pursue market opportunities. They integrate people at the base of the pyramid into their value chains either as customers, suppliers (i.e. smallholder farmers), distributors, or retailers (i.e. micro-entrepreneurs, small mom-and-pop shops).

In addition to these commercially inclusive activities, businesses may also pursue broader socially inclusive goals. Inclusive business should promote sustainable development in all its dimensions – economic, social and environmental.

Inclusive business is at the heart of this space, promoting business models that not only benefit people at the base of the pyramid and provide solutions to some of their most pressing challenges, but also achieve sound financial returns.

	INCLUSIVE BUSINESS MODELS	INCLUSIVE BUSINESS ACTIVITIES	SOCIAL ENTERPRISE INITIATIVES
BOP's Relationship to Business	Core Value Chain	Ancillary	Ancillary or Core Value Chain
Financial Return Expectations	Market Returns	Market Returns or Below Market Returns	Not Profit Maximizing
Primary Funding Type	Commercial	Commercial	Mixed

The G20 Framework on Inclusive Business adopted by in 2015 focuses on business approaches that seize market opportunities that directly improve the lives of those living at the base of the pyramid. The Framework identified three categories of inclusive business: Inclusive Business Models, Inclusive Business Activities, and Social Enterprise Initiatives.

Companies with an inclusive business model integrate the BOP into their core business operations and look to realize market returns.

Companies with inclusive business activities include the BOP into their value chains, but in ways that are not central to the commercial viability of the company.

Social enterprise initiatives have the mission to improve individuals' and communities' economic and social well-being through the pursuit of explicit social objectives and are not structured to maximize their profits for redistribution. Of note is that social enterprise is a common term and that outside of the Framework, the term may or may not imply pro-poor inclusion of the base of the pyramid.

Building on the solid foundations of this Framework put forward under the Turkish Presidency of the G20 in 2015; the key learning from the platform, report and survey conducted under China's Presidency in 2016; and further efforts under the German presidency in 2017, Argentina considers it important to focus on the issue of inclusive business financing during its 2018 presidency of the G20.

Given these considerations, Argentina will aim to deep dive into the general recommendations on inclusive business financing from previous presidencies, shedding light on this key approach by reviewing best practices, proposing innovative models, celebrating state of the art efforts to bring greater pools of capital into the IIBB space, and promoting profit-with-purpose businesses.

This background paper discusses some of the main channels of financing for inclusive business. The three chapters were developed independently by the International Labor Organization (ILO), Organization for Economic Cooperation and Development (OECD), and the International Finance Corporation (IFC) a member of the World Bank Group.

ILO analyzes the future of work as it relates to inclusive business and finance for jobs mechanisms. The chapter includes a specific focus on Social Enterprise Initiatives.

OECD examines what it would take to advance progressive reforms in public procurement globally so that inclusive businesses can play a greater role. The chapter analyses related concepts such as Responsible Business and looks specifically at Social Enterprise Initiatives.

IFC dives deeper into the topic of financing across the three categories of inclusive business. The chapter includes an overview of the market, an investor landscape, and selected approaches to financing and instruments.

CHAPTER 1: FINANCE FOR JOBS

Authored by the International Labor Organization (ILO)

1. Introduction

The G20 has been looking at the issue of inclusive business for several years, including launching the Inclusive Business Framework in 2015 and the G20 Global Platform on Inclusive Businesses in 2016. Through the reflections thus far, the financing of inclusive businesses emerges as a significant obstacle. This chapter considers this issue in the context of the future of work, the changes that we are seeing and anticipating in the workplace, in both developed and developing countries.

2. Inclusive businesses and the future of work

2.1 What are Inclusive Businesses?

Inclusive businesses are commercial enterprises that involve low-income individuals across the value chain, as producers, workers, distributers and/or consumers. It is not corporate social responsibility or philanthropy, but rather uses market forces to create jobs and provide valuable services to and with the bottom of the pyramid (BoP) of low-income workers and households. It is intended to promote sustainable development by using business principles to achieve economic, social, and environmental goals, while potentially reversing the growing inequality that is afflicting developed and developing countries alike. The G20 definition of inclusive businesses includes social enterprises, sometimes known as social and solidarity enterprises, which innovate to solve social (and environmental) problems.

The experience of inclusive businesses in developed and developing countries are quite different.[1] In developing countries, inclusive businesses often involve technology to leapfrog over stages of development. For example, digital finance has emerged instead of brick-and-mortar bank branches; tele-medicine is compensating for inadequacies in the health infrastructure. In developed countries, however, many inclusive businesses have roots in associations or non-profit organizations that are adapting their business models to reduce their reliance on charitable donations.

One finds inclusive businesses across most sectors of the economy. Almost any type of business activity can be designed and structured to contribute to social objectives while generating profits. While many of the innovations fall into the IT sector, in fact technology is largely a means to an end. Often these enterprises innovate by utilizing technology to enable them to serve new markets, enhance efficiencies, or provide an entirely new set of services. Inclusive businesses in the finance sector have had perhaps the greatest outreach thus far, reaching millions of low-income households.

[1] In fact, the experience of each country is different, and it would be best to explore this across the spectrum of experiences. However, to simplify the discussion, the binary description is adopted in this paper.

For inclusive businesses to succeed, they need funding. As these are new business models, often leveraging untested technological solutions that would not have been available a few years ago, they often do not have a track record of success, making it hard to judge whether or not they are likely to succeed until they generate some initial results. In essence, they serve as an R&D arm of the economy. This R&D agenda, plus the fact that they are contributing to social and environmental outcomes, warrants a new approach to finance inclusive businesses.

2.2 Future of work challenges

Following the 2007 financial crisis, a backlash emerged against conventional businesses along with a corresponding interest in alternative approaches. Growing concerns about the impact of globalization on business' decision where to locate production, and the quality of newly created jobs, has compounded the interest in new ways of doing business. Thanks partly to the G20 endorsement, inclusive businesses have emerged as an important alternative model.

Today as we consider how the nature of work will be changing in the future, inclusive businesses remain high on the international agenda. Four future of work issues are of particular importance to the discussion of inclusive businesses: a) technological displacement, b) the prevalence of non-standard forms of work, c) the effect of climate change on the world of work, and d) changing demographics.

Looking forward, we need to consider how **technological developments**, such as automation and artificial intelligence, will affect employment. According to ILO (2017), since 2010 the number of industrial robots has increased by 9 percent per year, reaching over 1.6 million units at the end of 2015. While various (sometimes-conflicting) estimates of the job-destruction potential of new technologies have been suggested, the overall impacts are much less in developing countries where the direct effects of automation remain on the horizon. Indirectly, however, if technological advancements enable corporations to produce goods at home, they may end up "re-shoring" tasks to developed countries. For inclusive businesses, an important dimension to consider is what new jobs may emerge because of technological changes, including previously unknown occupations.

The second trend is the emergence of **non-standard forms of employment**, notably in relation to the rapid growth of the platform economy. While non-standard forms of employment can benefit workers and employers by providing greater flexibility, this form of work is more commonly associated with job insecurity, irregular incomes, limited access to social protection, and job dissatisfaction (ILO 2017). This represents a significant challenge for developed countries in the future, but for many developing countries, it reflects their reality today, particularly where informal enterprises and informal labour contacts are the norm. For inclusive businesses, this reality is a potential opportunity, especially if they can use technologies to organize informal workers, perhaps into a cooperative, and provide greater job and income stability than they can achieve on their own.

Thirdly, according to ILO (forthcoming), the effects of **environmental degradation** on the world of work will be particularly acute for the most vulnerable workers, especially those from lower-income countries. For example, in Assam, India, where tea production supports the livelihood of 2 million farmers, the changes in temperature and precipitation patterns are expected to cause a 40 per cent reduction in tea yields by 2050. Jobs and economic activities that damage the environment expose workers, and particularly vulnerable workers, to especially high risks. The projected temperature rises will reduce working hours by 1.9 per cent globally by 2030 due to heat stress. The transition to a green economy is urgent. Environmental degradation threatens 1.2 billion jobs that rely on natural processes, such as air and water purification, soil renewal and fertilization, pollination and pest control. The shift away from fossil fuels will require interventions to retrain and reemploy displaced workers. Inclusive businesses may be able to contribute to retraining displaced workers, while driving the shift toward sustainable energy solutions.

Lastly, according to ILO (2017), **demographic changes** are having profound impacts on labour markets, also with different outcomes in developed and developing countries. Emerging markets are experiencing a youth bulge as young workers enter the labour market, fuelling migration, urbanization, and youth unemployment. In contrast, many developed economies are experiencing an aging work force and longer life expectancies.

2.3 Opportunities for Inclusive Businesses

The promotion of inclusive businesses represents a potential solution to address some of the negative dimensions emerging from changes in the world of work. Although technologies are displacing workers, they also are creating entrepreneurial prospects, and some inclusive businesses are leveraging technology to create new solutions and new market opportunities.

Demography. In developed countries, new opportunities are driven by demographic changes that raise the demand for services in the care economy, particularly in health and elder care. Disadvantaged workers are also benefiting from inclusive businesses, which are more likely to employ or provide services to persons with disabilities and other vulnerable workers than mainstream enterprises. For example, Fighting Chance in Australia and Be Accessible in New Zealand are associations that have launched social enterprises to train and employ disabled workers.

Similar efforts can be found in developing countries, but with a focus on youth unemployment. For example, IkamvaYouth in South Africa facilitates peer-to-peer learning. Young people provide tutoring and mentorship to other youth through a learning process focused on promoting positive role models. Similarly, in Kenya, Mkulima Young is an inclusive business that seeks to make agriculture “cool”, to discourage the youth from migrating to the cities. Through social media platforms, it has reached a base of over 47,000 followers. Mkulima Young focuses inspiring young people to pursue economic opportunities in agribusiness through resources, information and a network of other young farmers (Ashoka 2015).

Inclusive businesses are also responding to the changing demands of consumers. Socially oriented businesses are experiencing significant support from customers who are increasingly choosing to purchase from companies with a compelling social mission and which give something back to the community. This approach might involve endorsements or certification from organizations like Fairtrade or the Rainforest Alliance, which signal that products benefit low-income producers and contribute to the sustainability agenda. Alternatively, companies such as TOMS shoes and Warby Parker eyeglasses, achieve their social impact through a corresponding contribution programme.

Gender. An important outcome of inclusive businesses is that they often facilitate women’s entry into the labour force (Borzaga et al, 2017.) According to the EC (2016), women are more likely to hold senior positions in social enterprises than in traditional SMEs. For example, in the United

Kingdom, 40 per cent of social enterprises were managed by women, compared to only 18 per cent in traditional SMEs. This finding is not limited to developed countries. Women's presence on the boards of financial cooperatives in East Africa ranges from 24 per cent in Kenya to 65 per cent in Tanzania.2 The large presence of women in inclusive businesses is due to the willingness of those enterprises to provide flexible and part-time employment, enabling women to balance employment with unpaid care work (UN 2014).

Inclusive businesses help address gender employment gaps not only by hiring women, but also by providing services that affect women's ability to gain stable employment. For example, inclusive businesses that provide childcare services allow women to join the labour force. Similarly, the provision of financial services that target women can help them gain financial independence. Moreover, the organization of women through social networks can enable them to bolster their advocacy skills (UN, 2014).

Green jobs. According to ILO (forthcoming), the implementation of measures in the energy sector to limit global warming to 2°C will result in around 20 million more jobs around the world. Indeed, climate change is causing dramatic changes to the world of work, requiring an emphasis on social enterprises that create green jobs, contributing both to climate change mitigation (e.g. renewable energy) and adaptation (e.g. waste management, converting to resilient agriculture practices). For example, M Kopa in East Africa offers an affordable payment plan for low-income customers to own the solar panels, and have connected 600,000 homes already in five years, employing more than a 1000 workers.

Growing populations and urbanization are putting considerable pressure on the housing sector. Inclusive businesses are making valuable contributions in eco-friendly housing, rooftop gardens, and renewable energy. Domestic services such as water, sanitation and waste management are also provided by inclusive business, often to fill a gap in public sector services. For example, cooperatives have been effective in organizing informal waste pickers, and thus improving their working conditions and incomes has been recognized (ILO and WIEGO, 2017).

Education and reskilling. One of the key strategies to align employers' needs with work force skills is to develop means to upgrade the expertise of prospective and current workers, especially those who have been displaced by technology. According to ILO (2017), work places will be increasingly emphasizing cognitive and problem solving skills, instead of physical strength or even technical skills. But how can workers retool?

Inclusive businesses are active in the education sector and they can contribute to the lifelong learning agenda through new education models, such as massive open online courses (MOOCs), like Coursera and Peer 2 Peer University. Inclusive businesses also facilitate mentorship and support services, which can be used to retool displaced workers. According to the EC (2016), many social enterprises have innovated new ways of matching talents to the right jobs, thus contributing to the improvement of the labour force's employability. In developing countries, technological advancements make it possible to cost effectively train large numbers of agents that are involved in the distribution of inclusive business services, including agriculture extension agents, health care workers, and agents for mobile payment platforms.

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[2] According to a study by the African Development Bank, only 14 per cent of the board seats in the largest companies in Africa were held by women (Natividad, 2015).

The democratization of education and skills training is also an important intervention to counteract economic inequality. A bifurcated education system in which children from wealthy families can pay for and benefit from the best schooling, and network with the scion of other privileged families, while poorer households are consigned to poorer quality schooling, exacerbates inequalities. Inclusive businesses that leverage technologies to lower barriers to access excellent education can potentially open up new opportunities for the next generation.

Platform economy. The push of workers into non-standard forms of employment is a pressing concern, particularly in developed countries, but it is a reality that cannot be avoided. Consequently, it is necessary to consider mechanisms that organise these workers and provide them with support services and social protection. The emerging platform economy can be seen as a threat, enabling employers to rely on services from independent contractors instead of employees; but it also represents an opportunity, a digital market to link producers and services providers with markets. For example, cooperative platforms can make inclusive businesses a more attractive option for new entrants to the workforce. It can also provide a path to formalization of informal enterprises, aggregating own-account workers to increase their market power (e.g. Smart Belgium, Freelancer's union).

In developing countries, where the majority of the work force is already involved in non-standard forms of employment, for example as entrepreneurs and employees in the informal economy, the emergence of such platforms create opportunities to organize workers. For example, Empower Pakistan is a social enterprise that provides digital skill training to youth, and then serves as a platform for them to provide their services to global market. Such an approach is particularly attractive for Pakistani women who, for social and cultural reasons, prefer income-generating opportunities from home.

2.4 Counter balance

Many of the trends and opportunities emerging from inclusive businesses suggest that they are well positioned to counterbalance some of the negative effects emerging in the future of work. Indeed as inclusive businesses innovate to generate social outcomes, then they are becoming well positioned as an antidote to the illnesses that may emerge from conventional businesses. For example, as capital-intensive and profit-maximizing enterprises shed jobs, through automation for example, inclusive businesses, particularly those involved in "high touch" services, can grow to employ workers (Borzaga et al, 2017).

In developed economies, inclusive businesses have an anti-cyclical nature, growing during periods of economic hardship as an effective means to preserve incomes and employment (Birchall and Ketison, 2009). Because many inclusive businesses operate in employment intensive sectors, they can create jobs while mainstream businesses are laying off workers. For example, in Spain, during the 2008-2015 period when the economy suffered mightily, the social economy created more than 31,000 enterprises and 210,000 jobs.

Similar results were also seen in Italy. Between 2007 and 2011, employment in cooperatives increased by 8 per cent while it decreased in the economy as a whole by 1.2 per cent and in private enterprises by 2.3 per cent. Since inclusive businesses tend to be stakeholder-oriented, as opposed to shareholder-oriented, these enterprises are not only creating jobs, but they seek to improve the quality of jobs as well. For example, the study found that workers in social enterprises were better remunerated relative to the turnover of the company than in for-profit companies, and they were more likely to have open-ended contracts providing greater job security. This is particularly true in cooperatives where the governance structure gives a voice to different types of stakeholders within the decision-making process, and therefore the enterprises are more attentive to the creation and preservation of employment (Borzaga et al, 2017).

Evidence of this counter balance function from developing countries is not available, but it is reasonable to assume that once inclusive businesses form a sufficient proportion of the economy, they are likely to make significant contributions to the creation of quality jobs and protection against economic downturns.

3. Financing inclusive businesses

Inequality is exacerbated by the conventional financial system. It is far easier to get additional money if one already has money, and if one uses those funds for productive purposes, the gap between the rich and the poor grows. Consequently, the design of financial interventions for inclusive businesses needs to consider means of compensating accordingly.

As with conventional enterprises, inclusive businesses require different types of finance at different stages of development (ILO 2016). During the ideation phase, grants and donations are the most appropriate. As the business progresses to the start-up phase, it may be able to attract social investments, perhaps through angel investors or crowd funding, but certainly it must be a form of patient capital that is either not thinking about a financial return, or at least not one in the near future. Franchising of inclusive businesses is another means of financing start-ups that warrants attention.

As the business starts to grow and moves toward having a positive cash flow, then it can take on additional forms of risk capital through equity and debt, which is likely to be necessary to take the enterprise to scale. Indeed, there is insufficient concessionary funding to meet the potential demand, so inclusive businesses need to eventually leverage private finance, ideally in local currency. The integration of inclusive businesses into the financial markets, especially local banks, may have the added benefit of bolstering wages and productivity (WESO 2017).

However, according to Martin (2014), this transition from grants to investments is a major challenge for inclusive businesses, to wean themselves off of patient capital and adopt the discipline and rigor associated with commercial sources. To increase the chances that they will succeed in making the transition, it is necessary to consider hybrid models of financing. To bridge this gap, there is a need for tiered capital structures that either blend patient capital with debt and equity, or facilitate the transition from one to the other in line with business' characteristics.

According to Shared Value, the demand for bank products that meet social and environmental needs is rapidly increasing. The value of business opportunities in education, health and the environment may be as much as $3 trillion by 2050; the estimated financing gap for small and medium-sized businesses (SMEs) in emerging markets totals $2.1 trillion (Bockstette, et al. 2017). These figures indicate that the financial sector needs significant improvements on the supply side, to be encouraged to adopt new approaches that sufficiently values social and environmental outcomes.

Inclusive businesses utilize market principles to achieve social outcomes, and therefore ideally they should be able to tap into the financial markets as well. While the transition to, and inclusion of, commercial financing for inclusive businesses is necessary, there are risks that need to be managed effectively. Perhaps the biggest concern is that finance without a social agenda may end up corrupting or co-opting the business' objectives.

This risk can occur in at least two different ways, as seen in microfinance, the inclusive business vanguard. The first is that commercial investors may steer the business toward better financial returns and make management decisions that undermine the social agenda. The second is that business' success may inspire copycat enterprises that do not have a social mission, and proceed to give the entire sector a bad name. Careful consideration should be given to de-risking investments to crowd-in private investors and banks into inclusive businesses, while putting in place safeguards to ensure that the social mission of these businesses is not crowded-out in the process.

Although we speak about the future of work, in fact the future is now. All of these trends have started, and they are accelerating, making the need for action all the more pressing. In that context, policy-makers have an obligation to make sure that in the next wave of industrialization does not further exacerbate the gap between the haves and the have-nots. But to create quality jobs and reduce inequalities requires a concerted effort to identify and nourish alternative economic models, including inclusive businesses. For inclusive businesses to succeed we urgently need to identify solutions to their most pressing challenges; often, their most pressing challenge is access to appropriate finance.

An interventionist approach in the financial sector can be justified because of the ancillary benefits provided by inclusive businesses. Development bank lines of credit and public procurement preferences for inclusive finance are important starting points. Crowd funding appears to be particularly well suited to help finance the start-up of inclusive businesses, and therefore requires specific regulatory accommodations. While the ultimate objective may be to enable these businesses to access commercial funding, in the short to medium term there is a need for specialized funders with relevant expertise and priorities.

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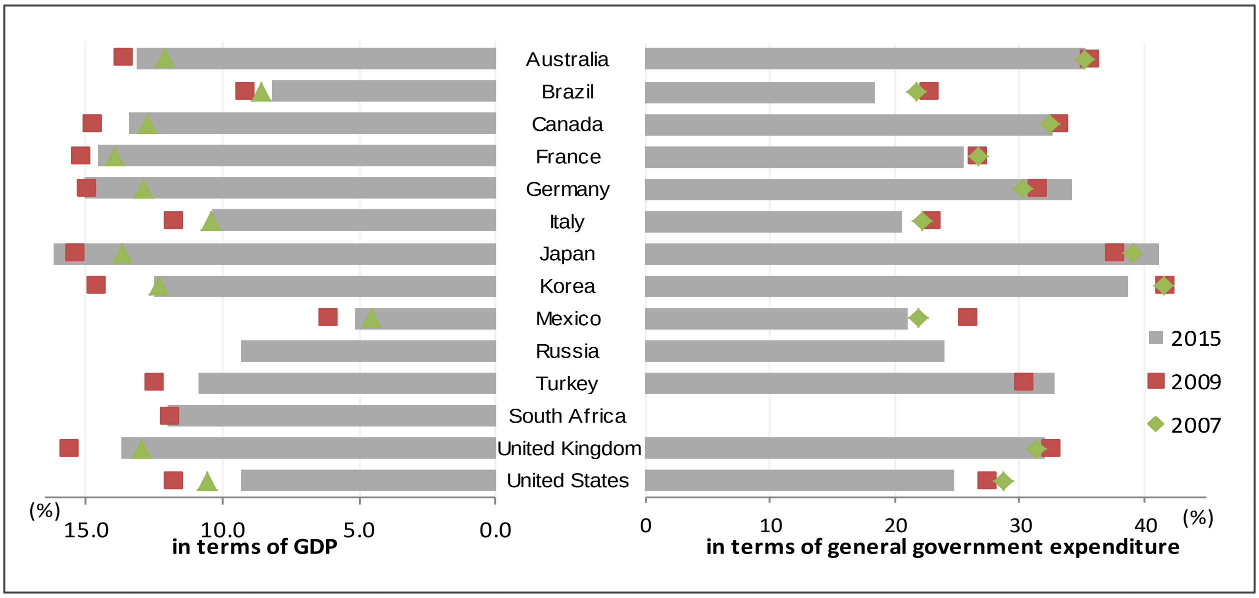
CHAPTER 2: PUBLIC PROCUREMENT

Authored by the Organization for Economic Cooperation and Development (OECD)

1. Introduction

Governments in G20 countries spend almost one-third of their government expenditure on public procurement, which represents on average 12% of the GDP.[3] It is around 15-16% in the European Union and more in other regions. This significant purchasing power encourages governments to use public procurement as a strategic tool to achieve broader policy objectives while delivering their mandates. The various policy objectives pursued through public procurement generally include protecting the environment, promoting innovation, supporting small and medium size enterprises, as well as providing support to certain social and economic groups (i.e. indigenous businesses, women-owned businesses, businesses hiring disadvantaged jobseekers including people with disability and ex-offenders, etc.).

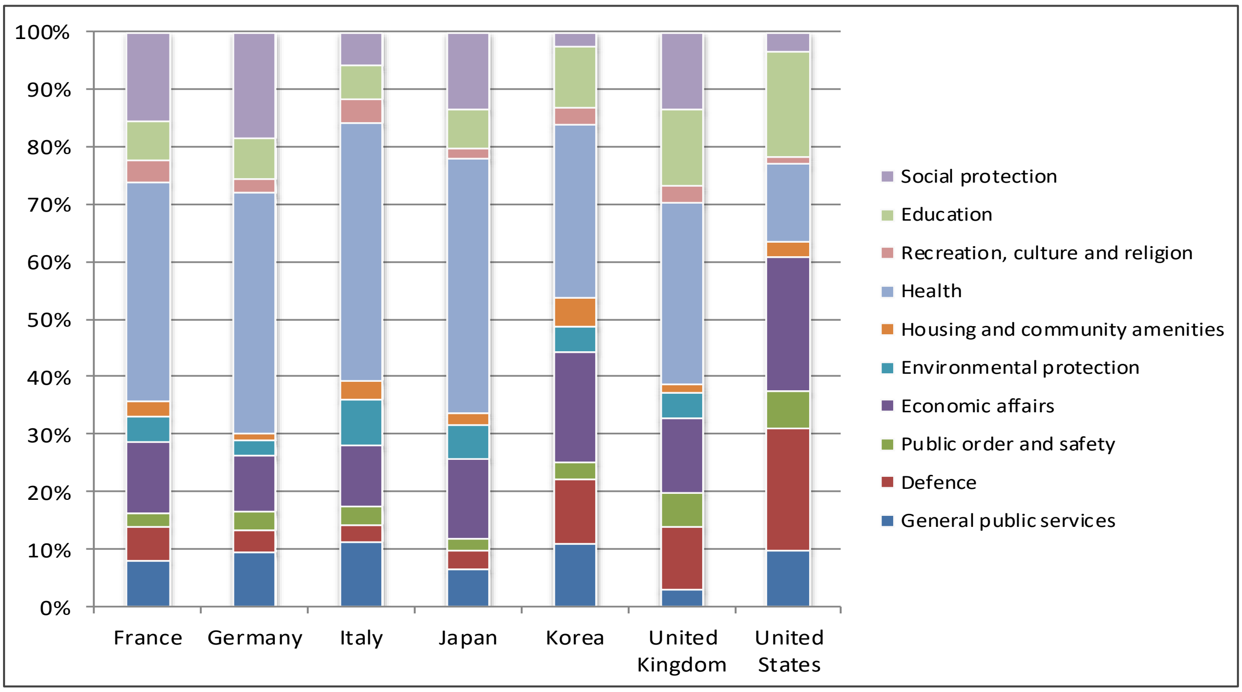
Size of public procurement in selected G20 countries[4]



Public procurement is closely linked with governments' mandate to provide public services to citizens. The largest public procurement spending areas include health, economic affairs, social protection and education. The primary objective of this government activity consists of delivering goods, services and works necessary to accomplish government mission in a timely, economical and efficient manner. The OECD Recommendation on Public Procurement stresses that the use of public procurement system to pursue secondary policy objectives should be balanced against the primary procurement objectives. In this context, governments implement various policies and strategies to spend this significant share of taxpayers' money on public procurement, which are under a wide range of goals, in an efficient and effective manner.

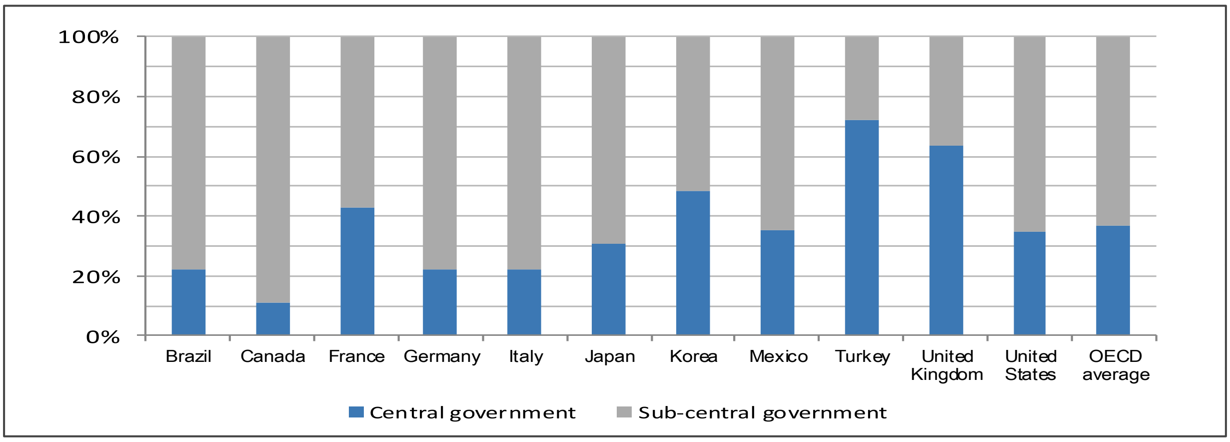
[3] This estimation only takes into account the data that are presented in the figures.
[4] Data based on OECD National Accounts Statistics database. Data for Brazil is for 2014 and based on IMF Government Finance Statistics database.

Structure of general government procurement by function, 2015



Public procurement policies and strategies established at the central level include some of the broad policy objectives according to the national priorities. Public entities across the government and also at different levels of government take also their own initiatives according to their functions and procurement needs. In particular, contracting authorities at sub-central level, where approximately two-thirds of public procurement spending takes place, could also have the advantage to better integrate regional and societal needs into their procurement activities in a more tailored way.

Share of general government procurement by level of government, 2015[5]



[5] Data based on OECD National Accounts Statistics database. Data for Brazil is for 2014 and based on IMF Government Finance Statistics database.

In 2011, the G20 adopted the following working definition of inclusive business for the G20 Challenge on Inclusive Innovation: "a private sector approach to providing goods, services, and livelihoods on a commercially viable basis, either at scale or scalable, to people at the base of the pyramid by making them part of the value chain of companies' core business as suppliers, distributors, retailers, or customers"[6]. In 2015, the G20 Inclusive Business Framework followed this same definition[7]. The analysis laid down in this chapter is consistent with this definition and the approach followed by successive G20 presidencies.

2. Responsible Business Conduct and its positive contribution to economic, environmental and social progress

Responsible Business Conduct (RBC) means that all businesses – regardless of their legal status, size, ownership structure, sector, or location – can contribute positively to economic, environmental and social progress with a view to achieving sustainable development, while at the same time avoiding and addressing adverse impacts of their operations. This encompasses impacts beyond the company itself and entails integrating and considering environmental and social issues within core business activities, including in the supply chain and business relationships. As such RBC covers many of the aspects of the private sector contribution to inclusive growth and inclusive business, linking it to broader sustainable development challenges. The OECD Guidelines for Multinational Enterprises (the Guidelines) are the leading international instrument setting out recommendations by governments to business on what they expect in terms of RBC in areas ranging from labour and human rights to environment and corruption.

Linking public procurement to RBC makes sense for several reasons:

- Public funds should not contribute to adverse environmental or social impacts of business operations.
- Governments expect business to behave responsibly, and should lead by example. Adopting RBC principles in the procurement process, such as supply chain due diligence, creates a better environment to deliver better outcomes.
- A growing body of evidence indicates that RBC pays off for business, and these benefits, such as reduced costs, higher quality products, and more efficient supply chains, also apply to governments.
- Governments have a national interest to encourage other countries to integrate RBC considerations into their public procurement processes in order to promote a level playing field for their own companies when operating abroad.

Global value chains are shaping the world economy. As largest consumers in the global and domestic marketplace, the purchasing power of governments can strategically leverage companies to behave responsibly. Sustainable Development Goal 12.7 calling for the implementation of sustainable public procurement policies and action plans reaffirms this potential. There is a growing trend among OECD countries to include environmental conditions,

[6] http://www.g20challenge.com/what-is-inclusive-business

[7] See p. 5 In http://g20.org.tr/wp-content/uploads/2015/11/G20-Inclusive-Business-Framework.pdf

and increasingly also social standards, in public procurement policies. However only certain initiatives take a RBC approach to procurement by considering the environmental, social and human rights related adverse impacts through supply chains of procured goods. These public procurement practices have moved away from a lowest price approach to value for money to take into account the broader impacts of the goods and services Governments purchase.

In this context, so-called "green" public procurement, whereby authorities seek to procure goods, services and public works with a reduced environmental impact throughout their life-cycle[8] is particularly advanced. More recently, green procurement efforts have been taken up as part of sustainable procurement, which pursues economic, environmental and social objectives. In particular with the adoption of the revised EU procurement Directive, in EU countries sustainable procurement has grown in size, but also in scope – to encompass a wider range of environmental, social and economic issues[9]. Sustainable procurement efforts intersect with and are relevant to the objective of promoting RBC standards. However, sustainable procurement does not per definition address all facets of RBC. Most human rights, labour and environmental related provisions limit responsibilities to the first-tier contractor or supplier but do not take into account environmental, social and human rights related adverse impacts through supply chains.[10]

While national legislation on public procurement provides the enabling framework for including RBC standards in procurement, the key challenge is the effective implementation of those standards in all stages of the procurement cycle. Good practices and examples can be drawn in this regard from countries' experience with green and sustainable procurement [which relate most commonly to the "doing good" component of RBC]. There is more limited experience on how to ensure that the procurement process guarantees that procured goods do not cause adverse impacts on human rights, labour rights and the environment in their supply chains. However, some noteworthy initiatives have taken place, in particular at the regional and municipal levels of government. Only some examples are reflected here.

2.1. Including RBC in tender documentation

Tender documentation can take into account RBC standards by for instance using RBC criteria in the pre-qualification and evaluation criteria ensuring the alignment of tender outcomes with RBC standards to participate in the bidding process, as well as in the criteria for awarding the contract. For example, in Australia, Canada, Finland, Norway, Switzerland, United Kingdom, and the United States, private security companies are required to be members of the International Code of Conduct for Private Security Providers' Association as prerequisite to participating in bidding processes[11]. This Code requires companies to conduct human rights based due diligence as well

[8] European Commission (2008) *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Public procurement for a better environment*, COM/2008/0400, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52008DC0400.

[9] European Sustainable Procurement Network (2016), *Procura+ Guide to implementing sustainable procurement*, www.procuraplus.org/fileadmin/user_upload/Manual/Procuraplus_Manual_Third_Edition.pdf.

[10] International Learning Lab on Public Procurement and Human Rights (2016) *Public Procurement and Human Rights: A Survey of Twenty Jurisdictions*, www.hrprocurementlab.org/wp-content/uploads/2016/06/Public-Procurement-and-Human-Rights-A-Survey-of-Twenty-Jurisdictions-Final.pdf.

[11] International Code of Conduct for Private Security Providers' Association, Frequently Asked Questions, www.icoca.ch/en/en/mandate/faq.

as to submit themselves to monitoring, assessment of performance, and corrective action for violations[12].

Some public procurement processes have used OECD tools to clarify the expectations on suppliers to provide risk assessment and mitigation strategies with regard to potential or actual adverse impacts of violations in their supply chain, in particular the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (hereinafter "OECD Minerals Guidance"). For example, in Denmark, suppliers participating in framework agreements established by SKI (Denmark's central purchasing body) are required to carry out due diligence based on the OECD Guidelines for Multinational Enterprises, as well as the OECD Minerals Guidance.[13]

2.2. Monitoring and follow up

The OECD Recommendation on Public Procurement emphasises the importance of appropriate impact assessment methodology to measure effectiveness of procurement in achieving RBC objectives[14]. When RBC considerations are part of the procurement process, contracting authorities and other responsible public authorities need to check if the contractor as well as by its sub-contractors comply with them. Under these provisions penalties might be incurred or contracts might be revoked in case of non-compliance. Some governments have developed sophisticated practices with regards to monitoring contractors' compliance with contract provisions, but they generally lack specific guidance for circumstances when negative impacts are discovered as part of the monitoring process[15].

However some interesting examples exist. In the apparel sector, the Sweatfree Purchasing Consortium (SPC) comprises 14 U.S. cities and 3 U.S. states, and seeks to ensure that the government apparel products are made without sweatshop labour[16]. SPC provides procurement authorities with model a procurement policies and codes of conduct, purchasing guides, labour compliance questionnaires, and online worker complaint forms. Participation in the programme also requires suppliers to be independently monitored for compliance with codes of conduct, showing that they are making credible efforts to address abuses.[17]

In the case of Sweden's municipal level health authorities, the procurement agency sends out questionnaires to suppliers of medical equipment to determine if proper supply chain due diligence practices are in place[18]. It then follows up on these questionnaires asking for audit results and whether a risk mitigation strategy was actually being used. In some cases, the public procurement agency can hire third party auditors to conduct on-site evaluations of suppliers.

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[12] International Code of Conduct for Private Security Providers' Association (2016) Reporting, Monitoring and Assessing Performance (Article 12), www.icoca.ch/en/monitoring

[13] National Procurement Ltd. Denmark (Statens og Kommunernes Indkøbs Service A/S or SKI for short) "Facts About SKI," https://www.ski.dk/Viden/Sider/Facts-about-SKI.aspx .

[14] http://www.oecd.org/gov/public-procurement/recommendation/; See section V iii).

[15] Id. at pp. 47-48.

[16] Sweatfree Purchasing Consortium (2017) "Members," https://cleanclothes.org/

[17] The Nation (2014) "How Local Governments Are Using Their Purchasing Power to End Sweatshop Labor," www.thenation.com/blog/180055/how-local-governments-are-using-their-purchasing-power-end-sweatshop-labor#.

[18] OSCE Magazine (2016), "Sustainable Public Procurement in Sweden," www.osce.org/magazine/293411.

3. Implementation of public procurement as a strategic governance tool to pursue broader policy objectives

Based on accumulated knowledge in the use of public procurement to pursue broader policy objectives (green, innovation, support to SMEs) the OECD could provide indications and directions on the implementation of procurement as a strategic governance tool to support broader policy objectives.

The OECD could signal the different policy options which are offered to countries to pursue broader policy objectives throughout the procurement cycle.

3.1. Enabling legal and policy framework

Public procurement is widely used by governments to pursue broader policy objectives according to their national priorities. They are manifested in various national programmes, national action plans and provisions in public procurement legal frameworks. There exist a high political commitment across countries on the strategic use of public procurement; however, the approach for their implementation varies widely according to the policy objective.

While the principle of non-discrimination and open competition, and the pursuit of best value for money are often found at the centre of public procurement systems, more flexibility is given to pursue strategic public procurement. However, under a wide range of objectives pursued in public procurement, consideration for policy priorities could be given.

- *Building the capability of public procurers and suppliers*
- *Developing indicators to monitor and evaluate of the impact of public procurement as a policy tool supporting various policy objectives*

3.2. Challenges in integrating RBC

While international policy frameworks and national procurement laws enable and some even call for inclusion of RBC standards, more needs to be done to ensure that RBC and in particular supply chain due diligence are taken into account in practice in all areas of public procurement. At the same time, it is possible to identify positive components coming from RBC in the public procurement systems of many OECD countries, though not necessarily named or framed as RBC.

To allow contracting authorities to include RBC standards in public procurement, a coherent domestic policy framework is needed. This is still a challenge in a number of countries[19]. Inter-agency cooperation can be instrumental to foster coherence between the policy framework and the design of tools for procurers to address supply chain risks. Beyond internal collaboration, dialogue with suppliers and relevant stakeholders can serve to better understand the capabilities

[19] International Learning Lab on Public Procurement and Human Rights (2016) *Public Procurement and Human Rights: A Survey of Twenty Jurisdictions*: www.hrprocurementlab.org/wp-content/uploads/2016/06/Public-Procurement-and-Human-Rights-A-Survey-of-Twenty-Jurisdictions-Final.pdf.

of businesses, practical challenges with implementing RBC, and how to tailor tenders more appropriately.

Another challenge relates to public officials' lack of technical knowledge on integrating RBC standards in the procurement process[20]. The changing perception of the real cost of a product or service in relation to potential environmental and social impacts requires a change of culture by public procurement officials which are traditionally risk-averse. This means that in order to effectively integrate RBC outcomes in public procurement, besides the technical knowledge and skills required to deal with procurement processes, officials, as well as government auditors should be trained to understand RBC considerations and their potential application to the technical stages of procurement.

In order to foster RBC standards in public procurement, effective monitoring mechanisms are needed to evaluate if "RBC proof" procurement achieves its goals, building the case for a stronger use in the future. Tools to track performance and measure impact are instrumental to make the "business case" for linking RBC and procurement, and as such can change the perception that products and services which pay due consideration to social and environmental objectives may be more expensive than conventional ones. Strong sustained leadership and political commitment at the highest level is needed to drive RBC policies forward. Public procurement is subject to many pressures, from cutting costs to meeting the demands of internal users and the public. Sufficient support and available resources are required for sustainable procurement to stay high on the political agenda.

Finally, strengthened international collaboration among public buyers may increase leverage for RBC standards. Socially responsible procurement could be advanced by bringing together practitioners to share learning and best practice, spread tools, exchange information on risks related to certain products and markets and share information on follow-up and monitoring. The OECD could provide a platform for convening practitioners and policy makers.

4. Lessons and good practices learned from green procurement, social procurement and sustainable procurement

Within the broader Inclusive Business Framework as defined during the G20 Turkey Presidency, social enterprises have been identified as initiatives aiming at improving individuals' and communities' economic and social well-being and at explicitly pursuing social and/or environmental objectives. A distinct feature of social enterprises is that they are not set to maximize their profits for redistribution among the stakeholders but to reinvest a significant part of these back into the enterprise in order to fulfil and strengthen its social and/ or environmental mission.

With this in mind, G20 governments, such as Australia, Canada, France, Italy, South Korea, and the United Kingdom, are discovering how buying from social enterprises can be an effective way

[20] See also: OECD (2016), *Going green: best practices for sustainable procurement*, http://www.oecd.org/gov/ethics/Going_Green_Best_Practices_for_Sustainable_Procurement.pdf

of generating social value that can help break the cycle of poverty and improve social cohesion. Through public procurement, public sector buys goods and services from social enterprises with a strong track record of delivering added social and environmental value. The procurement process is becoming in this way a vehicle to meet social, environmental, or economic objectives, such as the provision of basic services, the reintegration of long-term unemployment, and the integration of people from vulnerable groups. This type of procurement involves governments - and increasingly firms- strategically choosing to purchase a social or an environmental outcome when buying a good or a service by a social enterprise that has the expertise in delivering the required social and/or environmental benefit. Below are presented some good practices and lessons that have emerged from the integration of social enterprises to public and private procurement so far and could inspire and inform relevant policy actions in low-income and other developing countries.

4.1. Building a culture of sustainable procurement and ensuring political commitment

Sustainable procurement aims at social and environmental outcomes, which can be visible and yield gains in the medium- and long-run. At the same time, social and environmental considerations have not been fully mainstreamed yet in the public procurement as budget officers and administrators often view procurement from a "lowest price" perspective. To add a layer of complexity public authorities may not have a clear understanding of what is a social enterprise. To this end, there is a twofold challenge for governments; to spur a state-of-mind shift regarding the use of procurement for sustainability and to raise awareness on the benefits from working with social enterprises in this endeavour. In order to rise up to this challenge, sustained political commitment is essential. In this spirit, the Mayor of Victoria in Australia has established the Social Enterprise and Social Procurement Task Force which has developed a concrete action plan for considering the economic, social and environmental value from working with social enterprises. One of the important goals of this Task Force has been to raise awareness of the value of both social enterprises and social procurement.

Similarly, the City of Barcelona has demonstrated ambition and solid commitment to sustainable procurement since 2001. In 2010, it spent €43 million on green products and in 2013 €92 million on "greened" services (e.g. lighting). What is more, in the same year, it enacted the Municipal Decree for Socially Responsible Procurement for facilitating employment among vulnerable groups through the reservation of some contracts for employment centres and Work Integration Social Enterprises (WISEs). What is interesting in this initiative, is the creation of the Mixed Commission for Social Responsible Procurement comprised of more than 50 members from the non-profit, corporate, and third sectors, along with municipal agents, in order to ensure the Decree's technical viability and capture the interests and sensibilities of each group.

The Public Services (Social Value) Act in the UK is another example. The Act has helped public agencies and local authorities to consider the wider, long-term social and environmental value together with the more narrow, short-term financial value in their procurement. Since its entry into force in 2013, many local authorities have implemented a social value policy, statement or outcomes framework, which is translated into procurement.

At European level, within the framework of the 2020 Strategy for Smart, Sustainable, and Inclusive Growth, the 2014 Procurement Directives[21] demonstrate a strong commitment for using public contracts for broader social and environmental outcomes. The Directives offer a wide array of opportunities for including social considerations in the award of the contracts along with environmental and innovation aspects throughout the procurement cycle.

4.2. Providing guidance and developing the appropriate skills

Even when public authorities embrace the culture of sustainable procurement and recognise the potential of social enterprises, they struggle to define concretely what is a “socially or environmentally preferable” good or service and how to evaluate it during a tender process. Budget officers and administrators may not have the required skills or guidelines that will allow them to proceed effectively. The development of whole-of-government purchasing guidance material could encourage and facilitate government departments and agencies to include social and/or environmental considerations in the procurement and open-up opportunities to social enterprises. Scotland within the framework of its Procurement Reform Act (2014) has developed a Procurement Guidance Note that provides detailed information for each tender stage.

Another option is to organise workshops and exchange good practices with other administrations. For example, the Procura network brings together European public authorities and regions and stimulates knowledge sharing. Similarly, in France, the Réseau Grand Ouest (RGO) is a large network of public authorities form the West of France comprised of specific working groups, which meet regularly and exchange good practices and case studies regarding tender criteria, market activities, and measuring and reporting methods. Moreover, the provision of technical support and training to budget officers and administrators can help them to develop the necessary skills for incorporating social and/or environmental considerations to public procurement. For example, Poland has implemented since 2013 a training programme for civil servants in order to help them integrate social considerations in public contracts and understand the legal framework regarding social enterprises (more specifically, WISEs). However, the training can also be provided by entities that know social enterprises well and, therefore, can help procurers to understand the nature and the needs of social enterprises. The SAW-B association in Wallonia, Belgium, organises training courses both for local contracting entities for implementing social clauses and for social enterprises (more specifically, for WISEs) and brings together supply and demand for socially preferable goods and services.

4.3. Making public procurement accessible to social enterprises

Social enterprises ensure their sustainability through their operation in the market, and particularly in the public market. Yet, the size of the contracts and the complexity of the tender procedures can impede social enterprises from participating in public procurement. Smaller-size contracts in sectors where social enterprises can play a significant role can be an interesting policy option. For instance, in the UK although the Social Value Act applies to services contracts above

[21] 2014/23/EU (the Directive on concession contracts), 2014/24/EU (the Public Sector Directive), and 2014/25/EU (the Utilities Directive).

the EU procurement thresholds, guidance from the central government advises to apply it more widely and for smaller contracts. This is the policy in Plymouth Council , which applies social value consideration to every contract above £ 5000. In addition, making procurement calendars available, reducing the red tape whenever possible, and creating one-stop shops that provide relevant information can improve social enterprises' access to opportunities in the public market.

4.4. Promoting market access by social enterprises beyond public procurement

Finally, in addition to the public procurement, policy actions can encourage large providers of various types and sectors to strategically incorporate social enterprises in their supply chains and move beyond the traditional corporate social responsibility. In this spirit, the UK launched in 2016 Buy Social Corporate Challenge and engaged with seven large firms, such as Johnson & Johnson. The aim of the challenge is to reach at £1bn cumulative spending with social enterprises by the end of 2020. Last but not least, online matching platforms that bring together social enterprises, firms and government buyers, can stimulate supply and demand with social and/ or environmental considerations. The Social Impact Market in the Netherlands, which was launched in 2016 by the Social Impact Factory, is an online B2B marketplace where public authorities and firms can post their procurement needs and search for social enterprises that can meet their criteria. At the same time, social enterprises that are members of the platform can identify and access both public and private market opportunities.

i. European Commission (2008) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Public procurement for a better environment, COM/2008/0400, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52008DC0400

ii. European Sustainable Procurement Network (2016), Procura + Guide to implementing sustainable procurement, HYPERLINK "http://www.procuraplus.org/fileadmin/user_upload/Manual/Procuraplus_Manual_Third_Edition.pdf" www.procuraplus.org/fileadmin/user_upload/Manual/Procuraplus_Manual_Third_Edition.pdf

iii. http://www.g20challenge.com/what-is-inclusive-business

iv. International Code of Conduct for Private Security Providers' Association, Frequently Asked Questions, HYPERLINK "http://www.icoca.ch/en/en/mandate/faq" www.icoca.ch/en/en/mandate/faq

v. International Code of Conduct for Private Security Providers' Association (2016) Reporting, Monitoring and Assessing Performance (Article 12), HYPERLINK "http://www.icoca.ch/en/monitoring" www.icoca.ch/en/monitoring

vi. International Learning Lab on Public Procurement and Human Rights (2016) Public Procurement and Human Rights: A Survey of Twenty Jurisdictions, www.hrprocurementlab.org/wp-content/ uploads/2016/06/Public-Procurement-and-Human-Rights-A-Survey-of-Twenty-Jurisdictions-Final.pdf

vii. International Learning Lab on Public Procurement and Human Rights (2016) Public Procurement and Human Rights: A Survey of Twenty Jurisdictions: www.hrprocurementlab.org/wp-content/uploads/ 2016/06/Public-Procurement-and-Human-Rights-A-Survey-of-Twenty-Jurisdictions-Final.pdf

viii. National Procurement Ltd. Denmark (Statens og Kommunernes Indkøbs Service A/S or SKI for short) "Facts About SKI," https://www.ski.dk/Viden/Sider/Facts-about-SKI.aspx .

ix. OECD (2016), Going green: best practices for sustainable procurement, http://www.oecd.org/gov/ethics/Going_Green_Best_Practices_for_Sustainable_Procurement.pdf

x. OSCE Magazine (2016), "Sustainable Public Procurement in Sweden," HYPERLINK "http://www.osce.org/magazine/293411" www.osce.org/magazine/293411

xi. Sweatfree Purchasing Consortium (2017) "Members," https://cleanclothes.org

xii. The Nation (2014) "How Local Governments Are Using Their Purchasing Power to End Sweatshop Labor," HYPERLINK "http://www.thenation.com/blog/180055/how-local-governments-are-using-their-purchasing-power-end-sweatshop-labor#" www.thenation.com/blog/180055/how-local-governments-are-using-their-purchasing-power-end-sweatshop-labor#.

CHAPTER 3: AN OVERVIEW OF INVESTMENT TRENDS

Authored by the International Finance Corporation - World Bank Group

There are 4.5 billion people living at the base of the pyramid. This includes the 2.3 billion people who lack basic sanitation services; the 2 billion who are unbanked; the 1.6 billion who lack access to adequate housing; the 1.1 billion who lack access to electricity; the 400 million who lack access to essential healthcare; and the 202 million secondary school-age children who are out of school.[i]

From a business perspective, people at the base of the pyramid represent a $5 trillion market.[ii] Companies across sectors are taking an inclusive business approach to addressing these gaps and improving people's lives, while maintaining environmental, social, and governance standards. Base of the pyramid students get affordable and accessible education—from primary to tertiary levels—from the private sector. Patients get access to affordable healthcare for the first-time. Poor people get access to mobile money and those in urban slums and peri-urban areas get "last mile" access to water, power, and sanitation services. And in rural areas, smallholder farmers get integrated into value chains and accessing larger markets for their products, boosting their livelihoods.

For these reasons, the G20 has identified inclusive business as having a particularly important role for sustainable development—economic, social, and environmental—including its potential to contribute to the implementation of the Sustainable Development Goals (SDGs) and support G20 efforts to enhance growth and investment and to advance inclusion.

Past research by the G20 has shown that financing is a key challenge for inclusive business. But in recent years, investors have increasingly become more active and interested in this market and private sector flows for projects that impact the poor are increasing. How can that trend be accelerated?

	INCLUSIVE BUSINESS MODELS	INCLUSIVE BUSINESS ACTIVITIES	SOCIAL ENTERPRISE INITIATIVES
BOP's Relationship to Business	Core Value Chain	Ancillary	Ancillary or Core Value Chain
Financial Return Expectations	Market Returns	Market Returns or Below Market Returns	Not Profit Maximizing
Primary Funding Type	Commercial	Commercial	Mixed

The G20 Framework on Inclusive Business adopted in 2015 under the Turkish Presidency identified the basic funding types and financial return expectations across the three approaches to inclusive business. This chapter on investment and finance for inclusive business will build on previous G20 work and go deeper into the topic of financing, including an overview of the market and a discussion of new approaches and instruments, eligibility criteria, and how to be investment ready.

1. Market Overview

Finance for development leverages funding from public, private, multilateral, and non-governmental organizations to achieve sustainable development. At $135 billion in 2014, official development assistance remains a significant portion of external finance for developing countries. However, it has declined in relative importance compared to private capital flows—$662 billion (including foreign direct investment and portfolio investment); and remittances—$431 billion.[iii]

From foundations to private equity funds, entities are looking to channel capital into companies that will generate both pro-poor development impact and commercial return—the hallmark of inclusive business.

Multilateral Development Banks (MDBs) continue to play an important role in supporting inclusive business. Analysis in 2015 by the G20 showed that from 2005 to 2015 MDBs that have a specific focus on inclusive business, namely Asian Development Bank (AsDB), Inter-American Development Bank (IADB), and International Finance Corporation (IFC) together committed over $15 billion combined debt and equity to inclusive business.

Recent years have seen a surge in investors that identify themselves as doing "*impact investing.*" In 2017, this market was estimated at $114 billion, approximately half of which was in developing countries, including $11 billion in Sub-Saharan Africa and $10 billion in Latin America.[iv] This nascent field tackles a range of issues, including poverty, climate and beyond. Investments tend to be concentrated in countries with easier operating environments, lower regulatory challenges, and a more developed private sector. Existing data does not clearly identify which of these investments are poverty focused and/or market-based. Some may be from foundations making program-related investments (PRI) into inclusive business or providing catalytical funds (loans, guarantees, or first-loss grants) to high impact enterprises.

At the same time, in a low interest environment, more commercial-minded investors, such as fund managers and financial institutions, are looking to emerging markets for investment opportunities. This quest for higher returns is converging with the demand from large institutional investors and high net worth clients for higher environmental or social impact. It is currently

Being Investment Ready

A common challenge cited by investors is the lack of "investment ready" companies that focus on expanding access and reducing poverty. Companies can improve their "readiness" by:

1. *Plan for scale*: By thinking about how to scale their business at the onset, companies can get on the path to financial sustainability and long-term impact. Many investors have minimum deal sizes to manage costs and, without a clear path to scale, companies will have trouble accessing commercial finance.
2. *Seek investors that align with your objectives*: Early stage companies can be swayed by stipulations that may accompany grant funding to make business decisions that are not in the best interest of the company. For example, scaling too quickly or pursuing markets with limited business opportunities. Companies should look for investors whose risk appetite matches company priorities.
3. *Establish relevant impact reporting metrics*: Investors that seek a social return in addition to a financial return almost uniformly require investees to report on impact. Companies must integrate commonly-accepted impact metrics alongside typical business performance metrics.
4. *Implement Environmental, Social, and Governance (ESG) Standards*: While investors may want impact at the base of the pyramid, they will not deviate from established ESG standards, such as the Equator Principles. Governance in particular can be challenging for young companies driven by a single entrepreneur, as well as established family-owned businesses.

difficult to disaggregate broad sector-based investments from those that have a specific pro-poor focus and robust impact metrics.

Recommendation: The increasing interest among investors has spurred a myriad of initiatives. Despite good intentions, this can create confusion and lead to "social washing" where efforts are not substantiated with evidence of impact and standardized metrics are not available. Wherever possible, it is important to engage and align with market-wide efforts to guide this emerging space.

1.1. Investor Segmentation

Investors differ in their return expectations, attitude towards risk, and the mechanisms that they use to invest.

- **Attitude to financial returns**: Ex-ante expectations on the return on investment (ROI) is a key characteristic. On one end of the spectrum are investors considered "Impact Only"—those primarily focused on impact rather than financial returns. This could include organizations such as aid agencies, philanthropic foundations, and some impact funds that are used to grant making at zero financial return and are now offering instruments that may make a modest return or pay back the original investment capital. At the other end of the spectrum are commercially-minded investors that make investments with social impact and expect risk-adjusted market returns. These investors often do not believe in the "trade-off" between impact and financial return. They include a range of financial institutions, private equity funds, and some impact funds. (See Figure 1.)

- **Risk attitude**: Risk attitude, refers to the degree of an investors' aversion or appetite for risk when making financial decisions. In practice, the higher the risk of an investment, the higher the financial return expected. Some long-term investors such as pension funds, are mandated to only invest in lower risk, and consequently lower return paper. Venture capital investors typically are comfortable with higher risks and use a portfolio approach. For example, they may invest in 100 companies hoping that 10 out of the total will give them such a high return that it will off-set the low returns on the other 90.

- **Funding / Investment mechanisms**: Commercially minded investors (on the right-hand side of Figure1) typically look for standard financing tools such as debt, equity and guarantees. More impact seeking investors may expand its horizons by incorporating grants, convertible grants, concessional loans, patient equity or other type of blended finance offerings.

Figure 1: Illustrative Segmentation of Impact-Seeking Investors

		Categories of Investors Seeking Impact				
		Impact Only	Impact First	Balanced	Responsible	Commercial
Characteristics	Attitude to Financial Returns	100% financial trade-off	Lower than market-level	Risk adjusted	Risk adjusted; Market rate	Risk adjusted; Market rate
	Risk Attitude	Risk seeking	Risk seeking; Risk managing	Risk managing	Risk managing; Risk adverse	Risk adverse
	Funding / Investment Mechanisms	Grants	Convertible grants; Concessional loans; Patient Equity	Private debt; Private equity; Mezzanine finance	Private debt; Private equity	Private debt; Private equity
	Types of Organizations	Aid agencies; Foundations	Foundations; Impact investors	Impact investors; DFIs	DFIs ESG Funds	ESG, Private Equity, and Private Debt Funds; Financial Institutions

2. New Approaches to Investing

Many of the instruments that are being used by investors across the spectrum—i.e. debt, equity, and sometimes guarantees—are not new. What is new is the approach investors are taking to finance more impactful projects. For some, this means applying an inclusive business or 'impact' focus to the investment mandate. For others, it means adding new components to make the investment more impactful. Or using different types of instruments and investor money at the different stages of the company's life-cycle. (See salaUno box.)

2.1. Creating "Impact Funds"

An impact fund is a fund with the goal of implementing investments that generate a measurable, beneficial social and/or environmental impact, in addition to a financial return. Impact funds target a range of sectors with the greatest share of impact capital in developing countries going to microfinance and financial services (over 50 percent) then followed by health, energy and housing (each less than 10 percent).

Impact funds channel capital raised from a range of sources. As a percentage of funds raised, the largest amount was from pension funds and insurance companies, then family offices or high-net worth individuals, followed by banks, development finance institutions, or foundations.

Fund managers creating impact funds include both for-profit and non-profit entities:

For-profit: These fund managers target risk-adjusted, market rates of return, falling more towards the "Commercial" end of the investor spectrum. Deal sizes of for-profit fund managers are larger; analysis by the Global Impact Investing Network (GIIN) found that for-profit fund managers invested a median of $13 million across 6 investments. For-profit fund managers represented 66 percent of the sample analyzed by GIIN. Funds focused on the base of the pyramid include:

Novastar Ventures Ltd: A private equity and venture capital firm specializing in early stage investments in agriculture, education, energy, health and sanitation in base of the pyramid markets. It launched Novastar Ventures East Africa Fund with $80 million of committed capital from investors including CDC, FMO, Proparco, JP Morgan Social Finance, and Hivos-Triodos Fonds.

Other for-profit entities with impact funds have emerged and while they do not have a specific focus on the base of the pyramid, they are placing an increased emphasis on broader social and environmental outcomes. These include:

Moving Across the Spectrum

Mexican eye care company **salaUno** provides affordable and accessible services to low and middle-income patients. Within its first five years, the company provided eye care to over 230,000 individuals.

The company's founders used personal savings to start the company and tapped into grant funds for capacity building and other early needs of the company. To finance the expansion of **salaUno's network, they turned to more commercially-minded investors.** See case study.

The Rise Fund, a global impact investing fund managed by private equity firm TPG Growth. It raised over $2 billion from investors including UBS Wealth Management in 2017. It targets investments in several sectors (education, energy, food and agriculture, financial services, infrastructure, health, and technology) in companies in developed and developing countries where it can achieve positive social and environmental outcomes alongside competitive financial returns.

Blackrock Impact Fund, a mutual fund launched in 2016 by Blackrock—the world's largest asset manager—-aims to generate competitive financial returns and measurable social and environmental outcomes. It invests in a fixed income portfolio with social outcomes including corporate citizenship, high impact disease research, greenhouse gas emissions, ethics controversies, and litigation.

Non-profit: Most non-profit fund managers and foundations target either below-market rates of return or no additional return at all. These investors tend to fall in the "Impact Only" or "Impact First" end of the spectrum. Deal sizes for non-profit impact fund managers are smaller; GIIN analysis found a median of $10 million invested across 13 deals for non-profit funds—much smaller than the deal sizes from for-profit managers listed above. Non-profit impact fund managers represented 34 percent of the sample analyzed by GIIN. Examples include:

Department for International Development (DFID) Impact Fund, is a donor-driven fund of funds. It was launched in 2012 as a £75 million fund managed by CDC Group with a focus on stimulating investment into businesses in Africa and South Asia that benefit vulnerable or underserved people through patient equity and debt capital.

Acumen is a global venture fund created in 2001 that operates as a non-profit and focuses on agriculture, clean energy, education and healthcare. It has invested $110 million in 102 early-stage enterprises that serve low-income individuals in 13 countries around the world since 2001.

2.2. Strategic Investments via Corporate Venturing

Corporate venturing, also known as corporate venture capital, are strategic investments made by corporations through a fund or other investment vehicles into start-ups or existing companies. As opposed to the traditional venture capitalist's objective for above market financial returns, the corporate venture capitalist prioritizes receiving balanced financial returns alongside often intangible strategic returns. Corporate venture investments can be channeled into companies that serve the base of the pyramid. Examples include:

> *Pearson Affordable Learning Fund (PALF)* is an in-house venture capital fund by Pearson, the world's largest education company. Founded in 2012, PALF makes equity investments in innovative, for-profit startups that provide high educational outcomes in developing countries on a profitable and scalable basis. With $65 million in capital, PALF has invested in ten companies since 2012, reaching over 125,000 children in India, the Philippines, and across Africa. These investments reflect a strategic decision by Pearson to gain experiences that might be applicable to its core business in the long run.

2.3. Combining Investment with Capacity Building

Investors that have access to philanthropic funding should consider providing capacity building to investees. Growing companies may need assistance to improve their internal systems, such as accounting or corporate governance, in order for them to access the next level of financing. Examples of investors that are implementing this strategy include:

> *Grassroots Business Fund (GBF)*, a United States-based not-for-profit entity established 2008, implements a hybrid model that includes both for-profit and non-profit arms. On the for-profit side, GBF runs a $49 million investment fund that targets sustainable and inclusive business companies. The non-profit arm provides targeted and time-bound business advisory services to the fund's investees through an $11.5 million grant fund. The grant fund is made possible by donors and private philanthropists.

2.4. Emphasizing Impact Reporting

Investors seeking a social return often ask for a high level of impact reporting from their investees regardless of the type of financing provided—from commercial debt and equity to grants in some specific cases. For more commercial investments, investors must align expectations with what is practical and feasible. In some cases, the cost for impact reporting may be specifically stated in the project cost. Investors themselves must also develop their own internal systems to report the impact of their portfolio to their institutional and high net worth clients.

> *Communicating Impact*
>
> **Essilor** designs, manufactures and markets a wide range of vision care. Essilor operates in over 100 countries and is the world's largest manufacturer of ophthalmic lenses.
>
> Using the SDG Compass guidelines developed by GRI, the UN Global Compact and the World Business Council for Sustainable Development (WBCSD), Essilor identified that its activities align with 13 SDGs and is reporting on its contribution these goals.

A variety of organizations are tackling different angles related to increased consistency and expectations of impact reporting. For example, GIIN is helping to reduce fragmentation in terms of impact measurement among impact investors, hoping to take a step towards establishing norms in the industry. The Impact Management Project is examining the fundamentals of what "impact" means. And the Harmonized Indicators for Private Sector Operations reflects the efforts of 25 international finance institutions to benchmark indicators for private sector investment operations in general.

Recommendation: Governments can also help to guide investors and investees when it comes to reporting impact on the base of the pyramid. Many companies, especially large multi-nationals with inclusive business activities that are financed internally by the company, have been motivated by the SDGs to increase their inclusive business activities and clearly report on their progress (see box[v]). While such companies may have the resources to develop sophisticated reporting, there is a lack of clarity on how to report on activities and what activities will be "counted" at the country level. This is especially the case with goals that cut across the purview of sector ministries, such as ending poverty. Centralized responsibility at a country's cabinet-level could enable the provision of clear guidance to the private sector on how they can report their contribution, thus promoting transparency and accountability. This could open the way for companies to expand their activities, get public credit for the work they are doing, and attract investors.

Eligibility Criteria

Clear and transparent criteria for inclusive business is a critical building block that can help pave the way for government and other stakeholders to support inclusive business. Such criteria could take the form, for example, of a legal category in the form of a certification, accreditation, or recognition. Criteria should be practical and may need to be tailored by sector and localized to the country context. Examples include:

In the United States, while not specific to inclusive business, "public benefit corporation" is a legal form aimed at for-profit corporations that are specifically designed to solve social and environmental problems. It balances the financial interests of shareholders, the impact of operations on public stakeholders, and the intended public benefits identified in certificates of incorporation.[1] B Corps, on the other hand, are for-profit companies that are certified by the independent nonprofit B Lab. B Lab has certified companies in 50 countries, approximately one third of which entail a legal requirement.

In the Philippines, the Board of Investments (BOI) implemented an inclusive business accreditation system in 2017, focusing initially on investments in three priority sectors: agribusiness, housing, and tourism. The accreditation system underpins the BOI's incentives and support program for inclusive business, including simplified licensing, tax breaks, and eased restrictions.

3. Innovative Financial Instruments

Along with taking a new approach to inclusive business investing, investors have also started to use traditional tools in new ways to mobilize more private sector finance for inclusive business in developing countries. Instruments include concessional finance vehicles, results-based finance schemes, and Social Bonds on the capital markets.

3.1. Concessional Finance Vehicles

While its specific definition may differ between institutions, at its core concessional finance is the use of below market-rate funding to lower the risk of a project and therefore enabling the participation of investors that otherwise would be too risk averse. This type of mobilization of additional commercially-minded investors is often referred to as "blended finance."

Most concessional finance transactions involve junior/subordinated capital to protect senior investors, often by providing a first loss provision backed by grant funding. Such grants can be catalytic in mobilizing other types of funding. Guarantees and/or insurance are used to a lesser extent.

The top investors in concessional finance transactions have been multilateral development banks and development finance institutions. Others such as the Omidyar Network, Gates Foundation, Calvert Foundation and Shell foundation play a key role on the philanthropic side. The involvement of private investors is more fragmented with some representation from commercial banks and impact-driven investors.

The use of concessional finance has increased steadily in the last 10 years. Analysis of approximately 200 blended finance deals estimated that more than $50 billion had been mobilized.[vi] Three-quarters of the transactions established a fund; the remainder was for project finance. One-third of transactions were in low-income countries and 40 percent in Sub-Saharan Africa.[vii] Examples of blended finance funds include:

> *Crowding-in Investment*
>
> The Bill & Melinda Gates Foundation provides funds through concessional arrangements with the objective of crowding-in private investment in health, education and financial services for the poor. The foundation deploys different instruments, including below-market loans, equity investments, guarantees and other de-risking tools, depending on the context and what is needed to crowd-in private investors.

The African Agriculture Capital Fund is a $25 million fund aimed at improving productivity and profitability in the agriculture sector in Africa. The Gates Foundation, the Gatsby Charitable Foundation, and the Rockefeller Foundation were equity investors; a partial guarantee was provided by the United States Agency for International Development (USAID); and senior debt was provided by J.P. Morgan Chase.

The Global Health Investment Fund is a $108 million fund focused on accelerating the development of drugs, vaccines and diagnostics for diseases affecting low and middle-income countries. GHIF was created by the Bill & Melinda Gates Foundation and others in 2011. The Bill & Melinda Gates Foundation and the Swedish International Development Cooperation Agency (SIDA) offer a partial guarantee, while investors—including, among others, Children's Investment Fund Foundation, Grand Challenges Canada, GlaxoSmithKline, J.P. Morgan, AXA, KfW Development Bank, Merck, and the Pfizer Foundation—committed capital.[viii] GHIF is now an independent investment firm with eight investments as of 2017. The fund has the flexibility to invest mezzanine debt, convertible debt, preferred equity and other structures depending on the project.

Recommendation: While there has been some application of concessional finance for inclusive business deals, the largest sectors of focus to-date have been financial services, followed by clean energy and climate finance. This suggests that there is room for growth in other sectors that deliver services to people who live at the base of the pyramid, such as agribusiness, health, education, or housing.

3.2. Results-based financing mechanisms

Results-based financing is a new tool that is often referred to as Development Impact Bonds or Social Impact Bonds. Not to be confused with bonds issued on the capital markets, they are conditional payment obligation contracts that engage private investors to provide upfront working capital funding for a development program implemented by a third party (see Figure 2). Investors are remunerated by donors or governments—and earn a return—only if the program achieves its pre-agreed outcomes. [ix] Development Impact Bonds differ from Social Impact Bonds in that the former are mostly applied in low or middle-income countries and typically sponsored by a donor or government, whereas the latter are found in developed countries and usually sponsored only by the government.

Figure 2: Impact bonds – who does what?

Role	Description
Investor	Provides up-front capital to service provider
Outcome funder	Repays investor the principal plus an agreed-upon return if results are met
Service Provider	Implements program
Implementation Partner	Varies, but may include program design, technical assistance, evaluation

According to research by The Brookings Institution and Convergence, as of 2017 four Development Impact Bonds had been contracted and 24 more were in the design phase. The majority were in health (11), followed by employment (six), agriculture (five), education and social welfare.[x] Examples include:

The Educate Girls Development Impact Bond was launched in 2014 to enroll out-of-school girls and improve learning outcomes in India. As the service provider, the non-profit Educate Girls aims to enroll 15,000 children in 166 public schools over a three-year period. UBS Optimus Foundation (the investor) provided Educate Girls with working capital of $277,915 to implement the program. The Children's Investment Fund Foundation (the outcome funder) will repay UBS Optimus Foundation the full investment amount plus an extra return if Educate Girls meets the agreed upon enrollment and learning outcome targets. An independent evaluator will determine if the targets are met.

The Rajasthan Maternal and Newborn Health Impact Bond, currently in the design phase, aims to improve the quality of maternal and newborn health services. Service providers Hindustan Latex Family Planning Promotion Trust (HLFPPT) and Population Services International (PSI) will work with at least 450 facilities in Rajasthan to help them improve quality and prepare for certification. In this bond, the $4 million in up-front working capital is provided by multiple organizations; 80 percent is provided by the UBS Optimus Foundation and 20 percent by Palladium (implementation partner) and the service providers themselves (HLFPPT and PSI). Outcome funders—including USAID, Merck for Mothers, and starting the fourth year, the Government of Rajasthan—will investors for each facility that meets certification requirements, up to a maximum payment of $8 million. $1.7 million in grant funding was allocated to design and evaluate the bond.

Recommendation: While pay-for-performance structures are still nascent, it is a burgeoning area with the potential to have a big impact on the way the government engages with the private sector. Governments should continue to pilot such structures, especially in developing countries, and monitor the effectiveness during and after implementation. Mobilizing resources from a variety of sources to improve services for people at the base of the pyramid can increase the pool of available public-sector financing given budgetary constraints.

3.3. Social Bonds

Social Bonds are "use of proceeds" bonds issued on the capital markets that raise funds for new and existing projects with positive social outcomes, including inclusive business. Fund managers increasingly need to satisfy their clients' demand—from millennials to high-net-worth individuals—for products with impact that do not sacrifice financial return. Bond investors are increasingly looking for opportunities in the bond market that incorporate environmental, social and sustainability considerations. For example:

> *The IFC Social Bond Program* issued its first $500 million global benchmark Social Bond in March 2017 to expand financing for inclusive business. The Social Bond offers an attractive option for investors seeking triple-A rated impact-investment products. The three-year bond was 1.4 times oversubscribed and was bought by more than 40 institutional investors across the world—including central banks, official institutions, pension funds, and fund managers.

Since 2014, social bond issuance grew 17 times reaching approximately $9.6 billion in 2017. Social bond issuers have now diversified beyond supranationals and municipalities to also include commercial banks, with 20 separate organizations issuing to-date.[xi] Given the rapid scale of the Green Bond market reaching close to $200 billion in just over 10 years, the Social Bond market has the potential to follow that pattern.

The Social Bond Principles[1] emerged in 2017 through the International Capital Markets Association secretariat as voluntary process guidelines for transparency, disclosure and integrity in the development of the socially-responsible bond market. Efforts continue to improve clarity and alignment among issuers, investors, and across the private sector on issues including reporting and definitions.

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[i] For health figure see: World Health Organization (WHO) and the World Bank. 2015. *Tracking Universal Access to Health Coverage: First Global Monitoring Report*. Geneva, Switzerland: World Health Organization. http://www.who.int/healthinfo/universal_health_coverage/report/2015/en/
For education figure see: World Bank. 2018. *World Development Report 2018: Learning to Realize Education's Promise.* Washington, DC: World Bank. doi:10.1596/978-1-4648-1096-1. License: Creative Commons Attribution CC BY 3.0 IGO
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For housing figure, see: UN News Centre. 2017. *Affordable housing key for development and social equality, UN says on World Habitat Day* [Press Release]. http://www.un.org/apps/news/story.asp?NewsID=57786#.WjQTf3mos2x

[ii] Figure in 2005 purchasing power parity (PPP) terms. World Bank. 2014. *Global Consumption Database*. http://datatopics.worldbank.org/consumption/AboutDatabase as of terms.
[iii] OECD (2016), Remittances to developing countries far exceed official development assistance (ODA), in *Perspectives on Global Development 2017*, OECD Publishing, Paris. http://dx.doi.org/10.1787/persp_glob_dev-2017-graph60-en

[iv] Data from GIIN 2017 Annual Impact Investor Survey
[v] https://www.essilor.com/essilor-content/uploads/2017/05/SDG_Contribution_Report.pdf
[vi] Convergence and Business & Sustainable Development Commission. The State of Blended Finance. Working Paper. July 2017. https://convergence.finance/knowledge-detail/1qdtFkf5Fq86S4u8U4G8YU
[vii] ibid
[viii] https://www.brookings.edu/wp-content/uploads/2017/09/private-sector-investment-in-global-health-rd_final.pdf
[ix] Per Center for Global Development: "DIBs provide upfront funding for development programs by private investors, who are remunerated by donors or host-country governments—and earn a return—if evidence shows that programs achieve pre-agreed outcomes." https://www.cgdev.org/initiative/development-impact-bonds-0
[x] Gustafsson- Wright, Emily, Izzy Bogglid-Jones, Dean Segell, and Justice Durland. Impact Bonds in Developing Countries: Early Learnings from the Field. September 2017. https://www.brookings.edu/research/impact-bonds-in-developing-countries-early-learnings-from-the-field/
[xi] International Capital Markets Association