Date: 31 August 2023

Case study: Financial Instrument of the Year

This award is for innovative financial instruments that form the underlying structure for impact investments, including, for example:

1. *funding instruments aimed at institutional funders;*
2. *impact delivery instruments to separate out innovation at large scale funding level; and*
3. *innovation in lending schemes to targeted beneficiaries.*

The Impact Bond Innovation Fund

Founding date	2016
Geography	South Africa
Sector	Early childhood development
SDGs	3 [good health and wellbeing] and 4 [quality education]
Web	https://www.tutuwafoundation.org/

Background

The Impact Bond Innovation Fund (IBIF) is one of the first social impact bonds transacted in South Africa. This SIB aimed to deliver early childhood development (ECD) outcomes in the Western Cape. The project ran from 2018 to 2020.

Originality of design

A social investment bond (SIB) is a payment by results financing mechanism. Investors provide working capital to implementing agents, typically NGOs, that act as service providers to deliver social welfare services. If the NGO successfully meets predefined outcome targets – such as improving school readiness through high-quality ECD services to a set number of children – outcome funders repay the investors. If unsuccessful, outcome funders do not pay and investors do not earn returns and could also lose their capital. This success, or lack thereof, at a social level is confirmed by an independent outcome auditor while financial success is also determined by an independent financial auditor. An intermediary often manages the relationships between the different participants.

Meeting unfilled needs

Lack of access to quality education in a child's formative years has been identified as a major constraint to learning in later years, which erodes the potential to earn an income and leads to enormous social costs. Early learning support is one of the first steps to giving a young child an equitable start in life. More than 3.2-million children in South Africa aged under five do not have access to any form of early learning. According to research by one of the Standard Bank Tutuwa Community Foundation's key strategic partners, Ilifa Labantwana, prohibitive expense as well as availability of facilities are two of the main reasons why so many children are not receiving early learning support. Furthermore, current investment by government and other sources is but a fraction of what is needed to meet demand. The majority of ECD operators are unregistered and therefore do not qualify for government support. Paradoxically, it is unregistered operators that serve the most vulnerable children and communities.

The IBIF model aimed to test the efficacy of home-based early learning models in low-income areas in Cape Town, where early learning facilities are a combination of being difficult to access, of low quality and prohibitively expensive. The aim was to uncover an effective model for delivering easily accessible and high-quality early learning services to young children. These services were delivered by intermediaries Mothers2mothers (m2m) and Foundation for Community Work (FCW).

The IBIF delivered early learning services to improve the cognitive and socio-emotional development of 2,000 children over a three-year period. The success of the programme was measured through the delivery of services to the targeted number of beneficiaries, as well as through a standardised test on early learning outcome measures (ELOM).

In the IBIF, three parties invested in the Impact Bond Innovation NPC, a special purpose vehicle set up to house the SIB. These funds were then used by the FCW in two low-income communities to deliver home-based early learning services for children aged three to five and their caregivers. Poverty and unemployment are prevalent in these areas, and many children come from families without the means to send them to pre-school. This can detrimentally affect later learning and progression through formal schooling. FCW's educational service, delivered by home visitors, aimed to ensure children were school-ready once they entered formal schooling at age five/six. It also sought to build the capacities of caregivers to contribute to the process of early learning in their children.

Theory of change

Home-based early learning in low-income areas in Cape Town, where early learning facilities are difficult to access, prohibitively expensive or of low quality, will lead to fewer children lacking access to quality early learning in their formative years. This will eliminate a major constraint to learning in later years and therefore access to economic opportunities in adulthood.

Impact thesis

The Foundation for Community Work (FCW), a non-governmental organisation delivering the services to the communities, met three targets for the investors to be repaid:

I. The recruitment of 1,000 children a year in into the programme, and the retention of these children in the programme over the course of each year (recruitment and retention). Over three years, this amounts to an overall target of 2,000 children, given ageing into and out of the two cohorts.

II. Beneficiaries attend (or receive) at least 50% of the programme over the year, measured by attendance records.

III. Success against the Early Learning Outcomes Measure (ELOM), an assessment tool which measures the extent to which ECD programming is adequately preparing children for grade R.

SDG linkages

The success of the intervention was measured against the ELOM assessment tool. With its focus on ECD, the IBIF addresses **SDG 4: quality education**.

Impact

For the FCW to be successful in the delivery of services, one public and one private outcome funder would repay the investors their capital at an interest rate above normal market rates.

Success was measured by (1) recruiting and retaining a certain number of children into the programme, (2) ensuring they attended a set number of sessions over the course of each delivery year, and (3) improvements in the ELOM test administered at the end of each intervention year. It measures "what children of particular ages and stages should know and be able to do", via a 45-minute test administered by a qualified ECD assessor. The test assessed, in a random sample of IBIF children, gross motor development, fine motor coordination and visual motor integration, emerging numeracy and mathematics, cognition and executive functioning, and emerging literacy and language. The score of each group that was assessed was compared to a reference sample of South African children of similar socioeconomic status and age. Being able to demonstrate better performance than the reference group formed the third outcome measure.

Success on these three measures was verified by the outcome auditor, Development Works Changemakers. Financial intermediary Volta Capital managed the investments, the outcome payment model and process of soliciting investment alongside the technical intermediary mothers2mothers (m2m), which also worked with FCW to build capacity and ensure social delivery was on track. Together they managed relationships between all participants and SIB reporting. The financial transactions of the SPV were audited by BDO.

The target beneficiaries were 1,000 children in Delft and Atlantis who were to be recruited into the programme every year for three years, with an added target of the retention of these children in the programme over the course of each year (recruitment and retention). Over three years, this amounts to an overall target of 2,000 children, given ageing into and out of the two cohorts.

The IBIF delivered annualised returns of 14% to investors. The children who participated in the programme saw a statistically significant increase in their ELOM scores, although they did not reach the desired targets. The primary reason is that the targets set were based on benchmarks for children in centre-based care where they receive higher dosage and greater repetition of content. Beneficiaries of the programme include not only the direct beneficiaries involved in the Western Cape pilot project but all those that stand to benefit from the concurrent discovery of cost-effective models for delivering early learning services to young children. Importantly, resources were applied to an area where there has been a policy or service delivery failure and that might not otherwise have been addressed through government funding.

The programme experienced some unintended consequences. For example, the project had a high staff turnover rate. Since they were working in violent areas of the Western Cape, Atlantis and Delft, staff members were exposed to violent crime such as gun violence, crimes in transit and domestic violence in the homes of the beneficiaries. To mitigate against this, the programme put in place safety measures to ensure that staff members were not vulnerable to crime and provided psychosocial support. Second, because the early childhood practitioners were trained as part of the intervention, they moved on to better jobs. To arrest this, the programme offered competitive remuneration.

To measure depth, as part of the programme, the children were subjected to a school readiness test. This was to see if the programme had equipped them with the necessary numeracy and literacy capabilities to access school.

To ensure duration, the programmes measured the retention of children in the programme through attendance registers.

To ensure scale, the programme targeted 2,000 children to ensure that it increased the number of children with access to early childhood learning.

Once success was measured, the score of each group that was assessed was compared to a reference sample of South African children of similar socioeconomic status and age. Being able to demonstrate better performance when compared to the reference group formed the third outcome measure.

Financial performance

Table 1: Financial performance of the IBIF

Maximum interest rate return associated with achievement of 100% of the social targets	16%
Annual interest return earned to October 2020	14%: I. Maximum payment received for recruitment and retention, paid per child beneficiary; II. Maximum payment received for attendance, paid per child beneficiary; and I. No payment made for the missed ELOM targets, paid on a cohort basis
Comparison: FTSE/JSE All Bond Index (ALBI): annualised returns from July 2018 – October 2020	6.25 %
Comparison: Annualised returns on interbank swaps, July 2018 – October 2020	7.39%

The intervention had investors who were looking for market-related returns and received them, even though this was a first of its kind programme. The organisation has a budget of approximately R50m a year which enabled it to undertake various activities, including grant making. In this particular example, the foundation was the biggest investor.

Potential for replicability

The intervention was confined to one province and one provincial government department. This model can be replicated across all nine provinces and involve even national departments. The foundation bond for job creation is a model that can be transferred to other sectors aiming to achieve social outcomes. While the focus of the intervention was on education and in one province, its success demonstrates the potential for the same model to be employed in different sectors and markets.

Risks

Table 2: IBIF risks

Key risk		Mitigants
Performance risk	Risk that service delivery performance targets are not met by FCW	• Careful vetting and selection of implementer in rigorous bid process • Setting performance targets based on robust technical assessment of performance feasibility from past data and experience • Dual-intermediary support to FCW throughout performance period to provide operational and financial technical assistance
Policy risk	Risk of policy changes at DSD or national level that may affect performance/ outcome funding	• This would invoke DSD TPA Force Majeure clause 10.1.8 whereby performance is not obligated based on proven cause by "acts of authority, whether lawful or unlawful…"
Political risk	Risk of general political disruption affecting performance/outcome funding	• This would invoke DSD TPA Force Majeure clause 10.1.8 whereby performance is not obligated based on proven cause by "acts of authority, whether lawful or unlawful…" and clause 10.1.5 "war, whether declared or not, civil war, civil violence, riots and revolutions, acts of sabotage"
Data risk	Risk that data collection is insufficient, inaccurate or not verifiable by M&E auditor	• Provision is made for appropriate data collection and reporting protocols, to which FCW is legally bound to carry through • Ongoing technical support from intermediaries to implement protocols adequately and troubleshoot • Routine data audits from intermediaries • M&E auditor independence and verification is according to agreed standards and protocol
Inflation risk	Risk of rising price/wages and cost base for programme spending	• FCW budget/service providers fees are fixed upfront; they absorb/manage any cost increase impacts • Investors may be indirectly affected if this starts to affect performance

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