Date: 30 September 2023

Combined 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:

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

Outstanding Individual Achievement of the Year

This award is for an individual(s) who has made an outstanding contribution to the growth of impact investments on the continent.

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.

The Standard Bank Tutuwa Community Foundation's contributions

The Standard Bank Tutuwa Community Foundation was one of three first-loss investors in the IBIF. The goal of its participation was to provide demonstration effect to other potential investors in SIBs. As these were the first two SIBs in South Africa, the transaction costs of contracting, mediating and running the bond were expectedly high. However, as it does not have obligations to provide capital returns to its investors, the foundation was ideally placed to participate in these pioneering transactions. The foundation was also well-placed to invest in these initiatives as its close association with Standard Bank meant that it could tap into its financial technical skills. At the same time, the foundation was able to sensitise the bank to the concept and inner workings of a social impact bond; an important and worthwhile undertaking since the real scalability potential of social impact bonds lies in their ability to attract mainstream investment assets.

CEO Zanele Twala's expertise in early childhood development and youth development and advisor Justin Prozesky's experience in finance and investments symbolise a harmonious blend of societal commitment and financial prudence. Their investments were not just about financial returns; they were about societal change, underlining their visionary approach. Drawing from their unique expertise and experiences, they undertook several pivotal roles to ensure the SIBs' successful execution and impact.

- **Governance**:

  A special purpose vehicle (SPV) was established to serve as a conduit for the necessary funding. Additionally, a governance structure was instituted in the form of the IBIF Board. This board consisted of all parties involved: investors, intermediary organisations and SIB service providers.

  Zanele and Justin served as board members of the IBIF, playing a pivotal role in collaborating with the intermediary to establish the SPV. Their combined expertise, with Zanele's background in early childhood development and NPOs and Justin's expertise and experience in finance and investments allowed them to make valuable contributions.

- **Legal contracting:**

  Justin and Zanele reviewed all legal and contractual documents to discern any risk implications for the foundation. They sought external expertise from the legal firm, Bowmans, to ensure a comprehension evaluation of potential risks and review legal contracts.

- **Convincing the Board:**

  One of the most significant responsibilities was to persuade and educate the board about the distinction between conventional grants and impact investing. This involved highlighting the dual advantages of securing both social and financial returns from investments. Given the board's diverse expertise in education and finance, their communication strategy was tailored to address the perspectives of all board members and alleviate any concerns about potential risks.

- **Knowledge sharing and continuous learning:**

  The intermediaries, including Volta Capital, Mothers2Mother and Yellowoods, established various platforms for knowledge exchange and learning. This facilitated discussions on challenges, accomplishments and the intricacies of the innovative financing tools. The primary goal was to foster continuous improvement by identifying areas of intervention and making necessary adjustments to SIB implementations.

- **Research and documentation**

  The foundation, under Zanele's leadership, commissioned research to document experiences, successes and challenges related to SIBs. They were able to produce three detailed reports in collaboration with Krutham (then Intellidex) and another was produced by the Bertha Centre at the University of Cape Town.

- **Staff development:**

To deepen their understanding of impact investing, Zanele and Justin enrolled in an impact investing course. They also arranged for two of the foundation's staff members to undertake the same course at the Graduate School of Business at the University of Cape Town.

Zanele and Justin are also proactive members of the Impact Investing South Africa Working Group. This platform allows them to participate in various activities that champion the growth of an impact investing ecosystem in South Africa.

Zanele and Justin have been recognised for their pioneering efforts in the realm of impact investing in South Africa, particularly within the foundation. They have participated in and been invited to numerous knowledge-sharing platforms where they have shared insights gleaned from their experience with two significant SIBs. These platforms include notable conferences and forums such as the Independent Philanthropy Association of South Africa (IPASA), the annual Trialogue CSI Conference, FoundationXchange, Next Generation and the Investment Impact Index course. Their attendance at two GSG Global Impact Summit conferences – one held within South Africa and another virtual – further emphasised their commitment to engaging with and contributing to the global discourse on impact investing.

Moreover, various foundations and trusts, including the First Rand Foundation, Kagiso Trust and the Momentum Foundation, have sought Zanele and Justin's expertise, inviting them to share their journey and the accruing benefits of impact investing. This outreach and acknowledgment from their peers underline the recognition and respect they've garnered in the field. In acknowledgment of their first-time investor status on the Bonds4Jobs, Yellowoods, a pivotal family foundation in launching the Bonds4Jobs, presented their foundation with a commemorative plaque. This gesture signified recognition of their inaugural investment in the Inclusive Youth Employment Pay for Performance Platform (Bonds4Jobs or B4J). Through these engagements and recognitions, it is evident that Zanele and Justin not only contribute to the impact investing field but are also acknowledged leaders and sources of inspiration and knowledge for their peers in South Africa.

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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