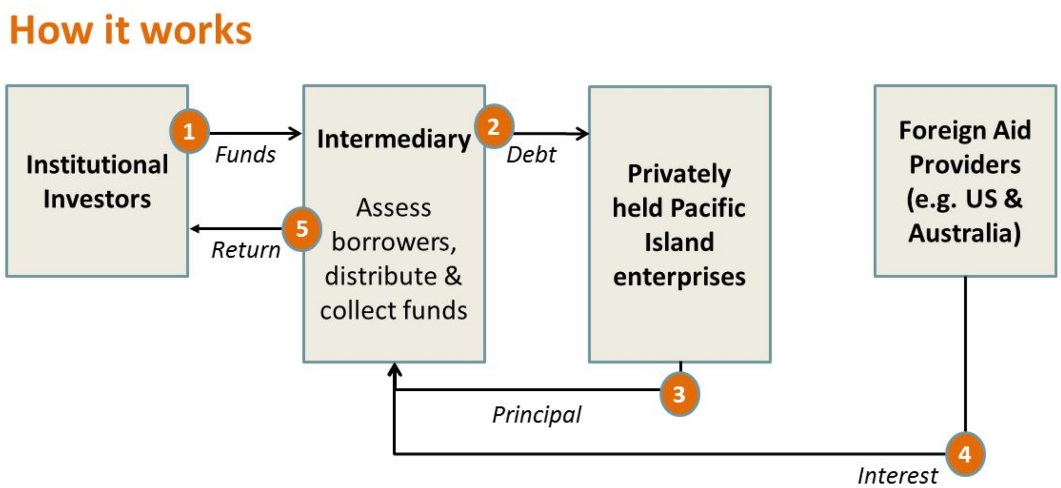
**Background:** The Pacific Island region is home to some of the most geographically remote and underdeveloped countries in the world. Of the 14 member countries of the Pacific Islands Forum, five (Kiribati, Samoa, Solomon Islands, Tuvalu, and Vanuatu) are currently classified as Least Developed Countries by the United Nations. 2010 per capita GDP in the region ranged from approximately $2000 in Kiribati to $3600 in Fiji (source: World Bank). Because of geographic barriers to trade, a lack of natural resources, and their strategic importance to foreign military operations, Pacific Island countries (PICs) have relied heavily on foreign aid.

While foreign aid is and will continue to be an essential source of income for PICs, there is considerable evidence that aid programs in their current forms are ineffective. The Pacific Islands Forum Secretariat recently released a report claiming that "despite high levels of aid, the Pacific is off-track to meet its Millennium Development Goals and the need to significantly improve development outcomes." The report asserts that foreign aid has created a culture of dependency in the Pacific that has contributed to the lack of economic growth and job creation in the region. The need to better synchronize aid flows and private sector development has been recognized for several years.

While efforts through the Pacific Aid for Trade Strategy and the Pacific Islands Private Sector Organisation indicate progress, we believe that there is considerable room for improvement. Foreign aid is incredibly important but it is much less efficient than private capital from a business creation standpoint. While it is not realistic to expect that foreign direct investment will ever replace international assistance in the Pacific region, the following strategy allows these two sources of funding to not only coexist but to support one another. This new model will attract outside capital to the region, support local businesses, and impose discipline on foreign aid money while concurrently allowing for above-market returns to investors.




**Our Impact Investing Strategy:** We propose establishing a system derived from the Social Impact Bond concept that is currently gaining traction with local governments in the UK and the US. Our model, however, will focus on the Pacific Islands and target inefficiencies in foreign aid, not safety net government spending. These bonds will provide capital in the form of debt to a portfolio of local businesses in select PICs. The bond will be repaid with principal from local borrowers and supplemented with interest from the governments of the US and Australia, the leading providers of foreign aid to PICs. Interest yields will be based on the level of social impact generated by the operations of borrowers.

1. Intermediary raises capital from institutional investors and creates an investment fund with, for example, a two-year term. Intermediary also works with aid providers like USAID and AusAID to identify tangible outcomes for which they would be willing pay. For example, AusAID would agree to pay some sliding scale of interest based on predetermined outcomes generated by funded businesses (perhaps one percentage point for 10 new jobs created).

2. Intermediary originates loans in the Pacific Islands. These loans could go to a wide variety of borrowers owned both by locals and foreigners. These businesses should scalable and committed to boosting local employment.
3. Borrowers repay loans: Borrower pays back ONLY principal (in effect receiving an interest-free loan)
4. Interest is paid to investors by aid providers on sliding scale determined by impact achieved by borrowers. If principal returned by borrowers is less than initial distributions than no interest is paid.
5. Funds are ideally returned with a profit to impact investors. Investors carry equity-like risk as their principal is not protected and the interest levels vary based on level of social impact.

**Benefits:**

- *New private sector capital:* the program creates a vehicle by which new capital can enter the region that is otherwise typically funded by government subsidies and an underdeveloped banking system.
- *Efficient use of capital:* Due to the for-profit nature of the program, borrowers would have to go through strict underwriting processes to be approved for a loan. In addition, the program would improve competition in the banking system and help in its development.
- *Risk sharing:* Aid providers only pay interest if the principal is repaid and the social benefits are realized.
- *Long-term government aid saving:* The program is intended to increase employment and reduce poverty, which should in the longer-term require less government aid to the region.

**Challenges & Risks:**

- *Government buy-in:* this program requires aid providers to add incremental capital (for interest) on top of existing aid programs, at least in the short-term before overall aid could be scaled back. However, in this program they only pay for projects that achieve impact.
- *Building a distribution network:* PICs cover a large geographic area and setting up distribution network of loan officers is challenging. One possibility is to partner with local banks by establishing a social impact lending program for which borrowers would need to qualify.
- *Measuring social impact:* The intermediary will have to carefully chosen, with experience in developing key metrics for measuring social impact. GIIN's Impact Reporting and Investment Standards (IRIS) and Acumen Fund's Pulse platform are starting points for defining, tracking, and reporting on the social performance of capital.
- *Project Risk:* investors bear the risk of a project not meeting its social impact objectives and therefore not getting their principal back, much less a profitable return. Therefore, investors could potentially make investments in baskets to diversify project risk.

**Sample Investment: KiriCraft Central Pacific:** Kiribati-based KiriCraft Central Pacific builds power catamarans and exports them to Australia and New Zealand. Founded in 2006 by Australian expat Michael Savins, KiriCraft has provided full-time employment for 18 I-Kiribati who are trained in boat building by three Australians. KiriCraft is able to produce and sell boats at a significant cost advantage to boats built in developed countries. Furthermore, KiriCraft competes favorably with other importers in Australia and New Zealand because of its preferential duty-free entry.

KiriCraft is able to manufacture boats at close to a 20% discount relative to its competitors in Australia. It is able to pass these cost savings on to the end customer allowing it to quickly establish a presence in the Asia-Pacific catamaran market place. From 2008 to 2010, KiriCraft secured more than A$1.78 million (US$1.85 million) in sales from Australia. KiriCraft is currently able to produce six boats per year.

The founders of KiriCraft were able to achieve their dreams and these impressive results due to access to capital. KiriCraft was the beneficiary of Pacific Aid for Trade program which provided them funding to build their business. The results are impressive – KiriCraft's sales constitute just under 1% of Kiribati's GDP and has provided jobs and training for the citizens of Kiribati. The Pacific Impact Bonds that we envision will make access to capital like this easier and more efficient and create similar financial and social returns.