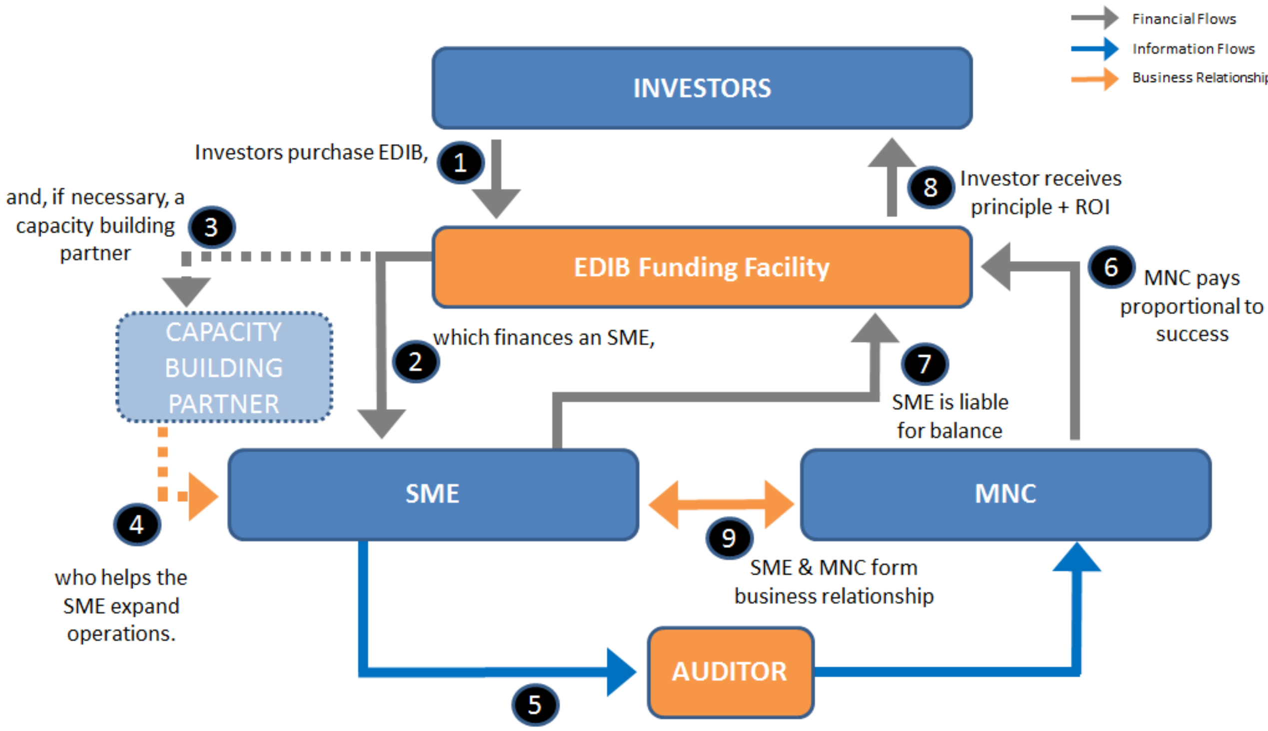
Overview

The Economic Development Impact Bond (EDIB) is designed to facilitate sector-specific economic development in frontier markets. We modify the structure of a Social Impact Bond to align the interests of local Small and Medium Sized Enterprises (SMEs), Multinational Corporations (MNCs), and institutional investors. The EDIB transfers the risk of economic development to capital markets, which are able to price and allocate it more efficiently than governments or grant-making foundations.



The Instrument

The EDIB brings three parties together in a risk and profit-sharing arrangement. A MNC with an interest in growing enterprises necessary to its value chain (e.g. a local supplier) sponsors a Bond[1] issued by the EBID Funding Facility. An institutional investor purchases the Bond, providing financing to an SME. At the outset, covenants are put in place that split the repayment burden between the SME and MNC based on the achievement of specified business metric milestones. The SME is thereby rewarded for business development success through subsidized funding. The repayment distribution is on a sliding scale depending on the metrics achieved by the SME: the better its performance, the more the MNC pays. Metrics achievement is determined by an independent third-party auditor. The EDIB Fund may also solicit partners who provide technical assistance and business development services to the SME (e.g. Technoserve). Further optional modifications include equity options in the SME and exclusive contract rights for the MNC. The entire scheme is administered by the Funding Facility.

The Funding Facility

The Fund will seek out viable projects and partnerships in frontier markets to create the appropriate risk-return balance between parties. Investment opportunities will range from $500,000 to $10mm.

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[1] In an alternative model, a large financing entity interested in funding economic development (e.g. USAID, DFID, GTZ, Gates Foundation) sponsors the Bond. These types of sponsors can achieve savings by only paying for capacity building projects that are already successful.

Investment horizon is 2-10 years and will include convertible minority equity stakes in the SME as well as the debt structure detailed above. Due diligence on the SME is performed by the Funding Facility, the MNC and potential investors. Investors will price the risk of failure into the Bond yield. The independent auditor will use predetermined methods for data collection to ascertain milestone success. The MNC's obligations can be structured in steps: as certain milestones are reached, specific coupon payments are made.

STAKEHOLDER	BENEFITS	RISKS
Institutional Investor	• Access to new asset class for frontier markets that provides fixed income • Financial and social returns (measured by economic development)	• Repayment risk: SME fails to reach metrics thresholds and no payment is triggered • MNC and SME default risk
SME	• Access to subsidized growth capital • Access to capacity building services	• Sponsor default risk • FX risk
MNC	• Creates local businesses necessary for its regional value chain strategy • Transfers risk of choosing winners to capital markets • Gets equity and exclusive contracts	• Uncertainty of time of payment • Competitors take advantage of built-out value chain • Lack of strategic flexibility due to commitments in specific region
Community	• Capacity development of local firms creates jobs, adds to tax base, and provides local services • Influx of knowledge, technology, and human capital	• Multiple firms may develop capacity to compete for MNC's business but not all will necessarily win contracts

Case Study: Building Local Food Processing Supply Chain for Coca Cola

Coca Cola is interested in capitalizing on growing demand for fresh fruit juice in Ghana ($10.4M growing at 10%). Currently, all juice sold in Ghana is manufactured abroad and shipped in. Ghana has significant fruit juice capacity but limited production facilities which can produce pulp at the scale and quality required by Coca Cola. Local SMEs engaged in pulp production are attempting to scale their operations but face a high cost of capital (~30% for a 5 year loan) from local banks and only approximately 15% are able to secure loans. Coca Cola is looking for a local supplier who can supply it with enough pulp to provide for 33% of juice market demand. One SME needs $2M to finance CapX and working capital expansion to be able to meet this requirement. Coca Cola could provide this $2M as a loan directly to the potential supplier, but has difficulty establishing its probability of success, and is unwilling to take on the default risk. Instead of lending directly to a SME, Coca Cola engages the Funding Facility to issue a 5 year $2.1M 20% coupon EDIB. Institutional investors purchase the Bond and provide $2M in CapX and working capital expansion financing to the SME. Covenants around the EDIB stipulate that Coca Cola will repay a certain percentage of the EDIB if the pulp provided by the SME meets specific quality metrics (measured by percent soluble solids, sugar, and acidity) and it is able to produce a predetermined quantity of pulp by a specific date. The sooner the SME is able to meet these metrics, the more of the EDIB will be financed by Coca Cola. The SME is liable for the balance of the Bond. If the SME is not able to achieve the set thresholds, it is forced to repay the entire Bond itself. $0.1M of the Bond is used to finance capacity building consulting services provided by Technoserve. Included in the Bond agreement is an option for Coca Cola to take equity in the SME (by covering a greater portion of the Bond) and limited time duration exclusive purchase rights.