

## Mobilising finance for development

8.1 The private sector in developing countries can find it difficult to attract the finance it needs to grow. Financial sectors in the region are maturing and innovative approaches are being taken to the market by Australian and other commercial banks in the region. The public sector, often through standalone financial institutions, is also providing financial products such as insurance, debt or equity directly to businesses and for specific projects in developing countries.

### **Increasing access to finance for businesses operating in developing countries**

8.2 International Financial Consulting observed:

...emerging economies feature heavy reliance on cash and other forms of collateral, which are impractical for growing businesses that require working capital, asset finance and trade credit products, among others.<sup>1</sup>

8.3 Many submissions called for additional financial instruments that focused on micro, small and medium size enterprises with a pro-poor agenda.<sup>2</sup>

8.4 The Australian Government has primarily relied on grants and contributions to multilateral development banks (MDBs), such as the World Bank Group and Asian Development Bank (ADB) for funding private sector development.

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1 International Financial Consulting, *Submission 89*, p.2.

2 For example, see: Pacific Islands Trade and Invest, *Submission 60*, p. 6; Oxfam Australia, *Submission 72*, p. 33; BMZ, *Submission 54*, p. 3.

8.5 The use of different financial instruments, however, may impact on international measures of Australia's contribution to development given:

...guarantees and equity investments often used by donors for direct partnerships with business only count as ODA [Overseas Development Assistance] if the investment fails or if it is channelled through multilateral organisations.<sup>3</sup>

## Multilateral development banks

8.6 MDBs provide a full range of financial services for businesses. These banks have long-standing programs to support investment in developing countries.<sup>4</sup>

8.7 The World Bank Group entities include the Multilateral Investment Guarantee Agency, which 'insures against political risk and provides credit enhancement'; the International Development Association which offers partial credit guarantees; and its private sector arm, the International Finance Corporation (IFC).<sup>5</sup>

8.8 The IFC has been helping developing country firms grow for over 50 years and 'now has an investment portfolio of close to US\$50 billion in nearly 2,000 companies in 126 countries.'<sup>6</sup> The World Bank Group described the IFC:

IFC employs a broad suite of financial products to help alleviate poverty and spur long-term growth by promoting sustainable enterprises, encouraging entrepreneurship, and mobilizing resources that would not otherwise be available. Financing products, which are tailored to the specific needs of each project, include loans, equity, trade finance, syndications, structured finance, and client risk-management services.<sup>7</sup>

8.9 Describing the diversity of financial instruments in use, the World Bank Group provided the following list of IFC products:

- Loans: IFC finances projects and companies through loans from its own account, typically for seven to 12 years. IFC also makes loans to intermediary banks, leasing companies, and other financial institutions for on-lending.
- Equity: Equity investments provide developmental support and the long-term growth capital that private enterprises need. IFC

3 Department of Foreign Affairs and Trade (DFAT), *Submission 21*, p. 21.

4 World Bank Group, *Submission 75*, p. 2; and Ms Lakshmi Venkatachalam, Vice President, Asian Development Bank (ADB), *Committee Hansard*, Canberra, 18 June 2014, p. 2.

5 World Bank Group, *Submission 75*, p. 2.

6 World Bank Group, *Submission 75*, p. 6.

7 World Bank Group, *Submission 75*, p. 7.

invests directly in company equity, and also through private equity funds.

- Trade finance: The IFC Global Trade Finance Program guarantees the trade-related payment obligations of approved financial institutions.
- Syndications: IFC's Syndicated Loan Program, the oldest and largest syndicated lending program among multilateral development banks, is an important tool for mobilizing capital to serve development needs. In FY13, it accounted for nearly half the funds mobilized by IFC, syndicating about US\$3.1 billion in B-loans and parallel loans, provided by more than 60 co-financiers - including commercial banks, funds, and DFIs.
- Structured finance: Products include partial credit guarantees, structured liquidity facilities, portfolio risk transfer, securitizations, and Islamic finance. IFC uses its expertise in structuring - along with its international triple-A credit rating - to help clients diversify funding, extend maturities, and obtain financing in the currency of their choice.
- Client risk-management services: IFC provides derivative products to its clients to allow them to hedge their interest rate, currency, or commodity-price exposures.<sup>8</sup>

8.10 The World Bank Group also noted 'the Australian financial markets are an important source of funds for IFC...ANZ and Westpac have both participated in IFC's syndications program', and that:

IFC launched a stand-alone Australian dollar domestic debt issuance program in 2007, and the ten different maturities of Australian dollar 'Kangaroo bonds' in the market now total over A\$8.8 billion. The bonds offer an attractive yield for Australian (and international) investors, and are repurchase-eligible with the Reserve Bank of Australia.<sup>9</sup>

8.11 The Asian Development Bank provides similar financial products and submitted that it is looking to further promote innovative financing solutions including:

...greater use of credit enhancement products; expand local currency financing solutions and to seek to increase the capital available for debt and equity investments with high development impact but larger risks.<sup>10</sup>

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8 World Bank Group, *Submission 75*, p. 26.

9 World Bank Group, *Submission 75*, p. 23.

10 Asian Development Bank, Pacific Liaison and Coordination Office, *Submission 86*, p.4.

## Bilateral Development Finance Institutions

- 8.12 A number of submissions suggested that, in order to promote private sector activity, Australia needs to consider using an even broader range of financial instruments or other risk reduction tools.<sup>11</sup> A number of bilateral donor countries have established Development Finance Institutions (DFIs) for this purpose.<sup>12</sup>
- 8.13 Mr Daniel Runde from the Center for International and Strategic Studies (US) described the role of DFIs:
- DFIs fill the investment gap in countries where business, investment, or political climate would otherwise dissuade private sector engagement, and are crucial in driving the expansion of local and international companies into the developing world.<sup>13</sup>
- 8.14 The Overseas Development Institute further described DFIs:
- DFIs act as both a catalytic and additional source of investment and development finance that provides money either for direct investments in particular projects or for development-orientated funds in commercial finance institutions within developing countries.<sup>14</sup>
- 8.15 Mr Runde observed that ‘following initial funding, most development finance institutions are self-sustaining, and often turn a profit on investments.’<sup>15</sup> Further, Grace Mutual observed:
- Investment stretches National aid budgets by preserving the capital to be re-used once it has been returned upon repayment. Australia can provide funding in such a way that it gets repaid and re-circulated multiple times.<sup>16</sup>
- 8.16 In addition to DFIs funded by donors, many developing countries also have their own publicly funded financial institutions. A recent study by the European Union noted:

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11 International Financial Consulting Ltd, *Submission 89*, pp. 3-4; Impact Investing Australia, *Submission 66*, p. 17; ANZ, *Submission 48*, p. 7; Mr Guy Winship, Chief Executive Officer, World Education Australia, *Committee Hansard*, Sydney, 7 November 2014, p. 40.

12 Details on development finance institutions can be found at <[www.edfi.be/members.html](http://www.edfi.be/members.html)>; <[www.ofid.org/ABOUT-US/OFID-Sister-Institutions/Bilateral-Institutions](http://www.ofid.org/ABOUT-US/OFID-Sister-Institutions/Bilateral-Institutions)>; and <[www.miga.org/documents/IFI\\_report\\_09-13-11.pdf](http://www.miga.org/documents/IFI_report_09-13-11.pdf)>.

13 Mr Daniel F. Runde, William A. Schreyer Chair in Global Analysis, Director Project on Prosperity and Development, Center for Strategic and International Studies (CSIS), *Submission 136*, p. 5.

14 Overseas Development Institute, *Submission 51*, p. 6.

15 Mr Runde, CSIS, *Submission 136*, p. 5.

16 Grace Mutual, *Submission 6*, p. 3.

... while MDBs and bilateral DFIs contributed approximately USD 37.8 billion in development finance in 2011, national development banks and funds have total reported assets in excess of USD 2 trillion and the real figure is much larger as this does not include Chinese development banks.<sup>17</sup>

8.17 Australia does not have a DFI. While some of submissions promoted the use of DFIs and suggested that Australia create its own<sup>18</sup>, Fairtrade Australia and New Zealand encouraged the Committee to consider recent research on DFIs by the European Network on Debt and Development (Eurodad).<sup>19</sup>

8.18 Eurodad's report contended a range of issues including that:

- DFIs show minimal support for companies from low-income countries.
- developing countries have virtually no say in how these institutions are run, or the decisions they make.
- DFIs lack transparency and often have no option for affected community to seek redress.<sup>20</sup>

8.19 Adam Smith International referred to the recent deliberations by the UK on the creation of a new DFI, and also encouraged Australia to consider the large number of DFIs already operating:

Our concern at the time was that there are a lot of development banks already. I think what the UK avoided doing, which Australia should also avoid doing, is becoming another development bank. There is the ADB, the World Bank, and even the BRIC countries are setting up a development bank as well. These are big, big amounts of money which Australian and UK money will never be able to compete with.<sup>21</sup>

17 Australian Council for International Development (ACFID), Exhibit 74: Financing for Development Post-2015: Improving the contribution of private finance, 2014, p. 23.

18 Daniel F. Runde, CSIS, *Committee Hansard*, Canberra 2 October 2014, p. 3; International Financial Consulting Ltd, *Submission* 89, pp. 3-4.

19 Ms Molly Harriss-Olson, Chief Executive Officer, Fairtrade Australia and New Zealand, *Committee Hansard*, Canberra, 29 August 2015, p. 42; and see Exhibit 78, 'Eurodad – A Private Affair'.

20 Eurodad, 'Call for review of unaccountable institutions channelling public money into private sector projects in developing countries', <http://www.eurodad.org/Entries/view/1546238/2014/07/10/Call-for-review-of-unaccountable-institutions-channelling-public-money-into-private-sector-projects-in-developing-countries>, *Media release*, viewed 18 May 2015.

21 Mr Jonathan Pell, Director, Asia Pacific, Adam Smith International, *Committee Hansard*, Sydney 20 August 2014, p. 59.

## Building financial sectors which meet the needs of SMEs

8.20 Despite the long term, and profitable, presence of DFIs and MDBs in developing countries, businesses often find it difficult to access the finance they require. DAI noted:

Despite the influx of resources to the developing world, access to finance remains a challenge, especially for growing SMEs, while for microenterprises and for marginalized groups access to the formal financial system itself remains an issue.<sup>22</sup>

8.21 As discussed in chapter three, microfinance (including credit) and new technologies are increasing access to financial services for individuals and micro-entrepreneurs. Australian Government initiatives, including the Pacific Financial Inclusion Program and Memoranda of Understanding (MoUs) with major Australian banks, are expanding access to financial services in the region.<sup>23</sup>

8.22 Formal businesses, such as small and medium sized enterprises (SMEs), face particular challenges. Impact Investing Australia observed that for many investors, funding SMEs is ‘costly and difficult’, emphasising that high due diligence costs, and small transaction sizes drive up the costs of investing in small firms.<sup>24</sup> It also observed that lending criteria by financial institutions can make it difficult for firms to access finance.<sup>25</sup>

8.23 Lending criteria, rather than funds available for lending, was highlighted by Pacific Islands Trade and Invest which referred to its recent survey of Pacific Island exporters:

Access to finance for growth is still their No. 1 challenge. So despite the liquidity that is actually in the Pacific Island countries, there is still a real struggle for small businesses to get their hands on that. A lot of that is around the fact that they are not cash flow positive businesses, they do not have the assets, the collateral, that often financiers are going to provide as well.<sup>26</sup>

8.24 Noting that ‘development of the financial sector and capital markets is an important priority for ADB’<sup>27</sup>, the bank indicated:

22 DAI, *Submission 110*, pp. 6-7.

23 DFAT, *Submission 21*, p. 49.

24 Impact Investing Australia, *Submission 66*, p. 9.

25 Ms Sandy Blackburn-Wright, Co-founder, Impact Investing Australia, *Committee Hansard*, Brisbane, 11 August 2014, p. 59.

26 Mr Caleb Jarvis, Vice-President, Australia Pacific Islands Business Council; and Trade Commissioner, Pacific islands Trade & Invest, *Committee Hansard*, Sydney, 7 November 2014, p. 25.

27 Ms Venkatachalam, ADB, *Committee Hansard*, Canberra, 18 June 2014, p. 2.

The second pillar to facilitate development of micro, small, and medium sized enterprises is access to growth capital on a systematic scale. We support this by interventions in local or regional banks and financial institutions by providing funds for on-lending.<sup>28</sup>

- 8.25 In the Pacific, Australia is providing a \$15 million grant to the ADB for the Pacific Business Investment Facility. The facility will fund tailored business advisory services for SMEs, to enable them to attract commercial finance. In addition, it will provide concessional loans to a small number of SMEs, in parallel with commercial finance, and facilitate links to trade and supply chain finance, including that provided by the ADB.<sup>29</sup>
- 8.26 The World Bank Group has also increased its focus on SMEs, including through a number of platforms which donors can support with either grant or non-grant funding. The platforms ‘catalyze investment, development and impact, while offering varying levels of potential returns to donors’.<sup>30</sup> The platforms often include some form of risk sharing instrument, combined with technical assistance to financial institutions or to individual businesses. Platforms include:
- The Global SME Financing Facility which supports high-impact projects with high-risk profiles, such as in conflict-affected areas, women-owned businesses, and those engaged in sustainable energy and climate change activities.
  - SME Ventures for SMEs in fragile and frontier countries in sub-Saharan Africa and Asia.
  - The Global Agriculture and Food Security Program (GAFSP) Private Sector Window aimed at MSMEs, smallholders, and farmers businesses.
  - Global Trade Supplier Finance (GTSF) for emerging market suppliers and SME exporters, helping to address the huge shortfall in supply chain finance.<sup>31</sup>
- 8.27 Financial sectors in many developing countries are also evolving to meet the needs of all businesses – whether micro or multinational. Australian banks are part of the changing face of financial markets in the region. ANZ discussed its recent efforts:

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28 Ms Venkatachalam, ADB, *Committee Hansard*, Canberra, 18 June 2014, p. 2.

29 ADB (2014), *Establishment of the Pacific Business Investment Trust Fund and Technical Assistance for the Pacific Business Investment Facility*, p. 3 and p. 9, <[www.adb.org/sites/default/files/project-document/82541/47373-001-tar.pdf](http://www.adb.org/sites/default/files/project-document/82541/47373-001-tar.pdf)> viewed 2 May 2015.

30 World Bank Group, *Submission 75*, p. 26.

31 World Bank Group, *Submission 75*, pp. 26-27.

We now have around 17,000 staff in 15 Asian markets and around 2,000 staff in 12 Pacific markets with over two million customers across Asia and the Pacific

...

ANZ has minority stakes in several banks in mainland China, and banks in each of Indonesia, Malaysia and the Philippines.<sup>32</sup>

8.28 Recognising that for some firms, access to finance will continue to be a challenge, ANZ suggested that DFAT continue to consider 'increasing access to debt or equity financing to enterprises to overcome poor availability of financial services in some countries.'<sup>33</sup>

8.29 DAI commented on recent innovations in financial markets and suggested to bridge the micro and SME financing gap donors should focus on financial markets in developing countries:

...our focus now must be on innovations that build on improvements in financial markets and work around remaining marketplace problems. International donors focus on private sector development to promote economic growth coincides with an exciting era in financial intermediation as new technology, regulations, and institutions help to reshape services and blur lines between banks and other financial intermediaries.<sup>34</sup>

8.30 Further, International Financial Consulting suggested that to address enterprise level finance challenges, Australia has the opportunity to take a lead role with:

...a well-defined new initiative to support private sector development...structured specifically to facilitate maturity and health in the [access to finance] ecosystem in partner countries. This would yield unprecedented market access for trade with Australia.<sup>35</sup>

8.31 The Committee notes that, to date, multilateral development banks and bilateral development financial institutions have had limited success in meeting the financing needs of SMEs. The Committee welcomes the advice that these institutions are creating new vehicles and providing guarantees to banks and other financial institutions to encourage them to service SMEs. However, there is also a role for Australia to support its own SME market to enable this vibrant sector to expand to emerging

32 ANZ, *Submission 48*, p. 2.

33 ANZ, *Submission 48*, p. 7.

34 DAI, *Submission 110*, pp. 6-7

35 International Financial Consulting, *Submission 89*, pp. 2-3.



markets building the private sector both in Australia and across the region.

### Australia's Export Finance and Insurance Corporation

- 8.32 The Australian Council for International Development suggested adapting the Australian Government's Export Finance and Insurance Corporation's (Efic) products to better assist Australian companies and NGOs to provide new services and programs in developing countries.<sup>36</sup>
- 8.33 For over 50 years, Efic has provided financial services to Australian companies operating in international markets, including developing and emerging economies:
- ...our role is to ensure the companies that have viable commercial export and international business opportunities have the finance that they need to succeed in international markets and in growing their businesses internationally. Efic provides its financial services and financial solutions in circumstances where the private sector is unwilling or unable to provide adequate support.<sup>37</sup>
- 8.34 Efic observed 'businesses of all sizes in Australia that are conducting business in emerging and frontier markets really are struggling with access to finance'.<sup>38</sup> The Committee had particular concerns that Australian small and medium sized enterprises (SMEs) were not being adequately served.
- 8.35 Efic identified SMEs as facing particular challenges, and emphasised that support for SMEs is now a core business focus. Efic reported that 90 per cent of its transactions in 2013-14 supported SMEs, and that it has:
- recruited additional staff to support its SME work, especially in regional areas where many Australian exporters are based;
  - introduced an accelerated execution process and simpler documentation for SME transactions, reducing transaction processing time; and
  - lowered its minimum support thresholds allowing Efic to support smaller, emerging exporters.<sup>39</sup>

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36 ACFID, *Submission 52*, p. 15.

37 Mr Andrew Hunter, Managing Director and Chief Executive Officer, Export Finance and Insurance Corporation (Efic), *Committee Hansard*, Sydney, 7 November 2014, p. 1.

38 Mr Hunter, Efic, *Committee Hansard*, Sydney, 7 November 2014, p. 1.

39 Mr Hunter, Efic, *Committee Hansard*, Sydney, 7 November 2014, p. 1; and Efic, *Annual Report 2013-14*, <[www.efic.gov.au/about-efic/our-governance/reporting/annual-report/](http://www.efic.gov.au/about-efic/our-governance/reporting/annual-report/)>, viewed 4 June 2015.

- 8.36 Further supporting SMEs, the Australian Government has amended Efic's Act 'to allow Efic to support exporters of goods, not just capital goods, increasing the number of exporters eligible for Efic assistance.'<sup>40</sup>
- 8.37 While noting that Efic is working to address constraints facing SMEs, the Committee questioned whether Efic is doing enough to assist SMEs to access aid and development opportunities.
- 8.38 Efic's annual report notes that it is supporting Australia's economic diplomacy agenda by working with DFAT, its portfolio agencies and other Government departments and agencies 'to ensure greater referral generation and coordination'.<sup>41</sup> Efic also has partnerships with MDBs:
- In 2011, EFIC signed a US\$65m risk sharing agreement (later increased to US\$90m) with the Asian Development Bank to help extend the commercial banking sector's capacity to support Australian exporters into some of Asia's most challenging markets. The agreement works within the ADB's Trade Finance Program (TFP), which provides guarantees and loans through banks to support trade in Asia.<sup>42</sup>
- 8.39 Despite these relationships and the fact that approximately 60 per cent of financial products or services provided by Efic in 2013-14 supported exports or investments in emerging and frontier markets, Efic advised that 'none had a specific 'development aid' focus'.<sup>43</sup>
- 8.40 Further, Efic suggested that any moves to expand its role to provide financial services to firms in developing countries would significantly change its focus, and that this may have broader implications for the organisation. Efic stated:
- The reason Efic has been around for 50 years is that we stick to what we do really well, which is export finance... What we are good at is assessing technical risk and the ability of the [Australian] company to complete an export contract.<sup>44</sup>
- 8.41 The Committee acknowledges Efic's concerns that expanding its mandate could have implications for its ongoing viability, but limiting itself to what it has always done may in turn limit Australian companies expanding into

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40 Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Bill 2014, <[www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bld=r5358](http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r5358)>, viewed 6 June 2015.

41 Efic, *Annual Report 2013-14*, <[www.efic.gov.au/about-efic/our-governance/reporting/annual-report/](http://www.efic.gov.au/about-efic/our-governance/reporting/annual-report/)>, viewed 4 June 2015.

42 Efic, Response to Questions on Notice p. [4].

43 Efic, Response to Questions on Notice p. [1].

44 Mr Hunter, Efic, *Committee Hansard*, Sydney, 7 November 2014, p. 7.

or entering emerging markets, and ultimately supporting the objectives of Australia's aid program to grow private sector development.

## Determining needs and opportunities for Australia

- 8.42 The use of financial instruments to promote development outcomes should be determined in light of what is required to support the development of sustainable financial sectors in partner countries. The Australian Government's, and specifically DFAT's, activities must complement, not duplicate, the work of other donors.
- 8.43 DFAT needs to continue to build its knowledge and expertise so it can best identify and assess options for partnering, and effectively engage with bilateral development finance institutions, multilateral development banks and commercial banks and financial institutions.
- 8.44 The Committee encourages further engagement with Australia's leading commercial banks and other financial institutions, particularly those that are already active across the region, to identify innovative financing options.

### Recommendation 20

**The Committee recommends that in those countries or regions where access to finance is a development priority the Department of Foreign Affairs and Trade:**

- **develop a more expert understanding of the financial sector in priority countries or regions, including financing constraints for groups (such as women) targeted by the aid program;**
- **ensure current activities impacting on the financial sector (including in microfinance, agriculture and governance) are made public and coordinated within the Australian aid program and with other donors;**
- **assess current and potential public-private partnerships' access to finance including with:**
  - ⇒ **multilateral development banks and bilateral development finance institutions; and**
  - ⇒ **commercial banks and financial institutions.**

- 8.45 The Committee is aware that the capital bases of publicly funded institutions, including national development banks, are very large and an Australian DFI may have difficulty in competing with these larger, established organisations.
- 8.46 While the use of non-grant funding to achieve aid program outcomes should be explored, the Committee does not believe that the Australian Government should create a standalone Development Finance Institution at this time. Instead, the Committee suggests that DFAT and the Treasury review existing institutions, and consider how they address finance needs across the region.
- 8.47 To better understand the risks and opportunities related to development finance, DFAT and Efic should be looking to Australia's peers. For example, in April 2015, the Canadian Government announced the launch of a 'Development Finance Initiative' housed in its export credit agency.

## Recommendation 21

**The Committee recommends that the Australian Government should:**

- **analyse if there is a need for an Australian development finance institution, including by assessing the unmet demand for finance at both the country and sector-specific levels across the Indo-Pacific region; and**
- **identify challenges, costs and broader implications of the creation of a standalone development finance institution, comparing this with:**
  - ⇒ **expanding the role of the Export Finance and Insurance Corporation; or**
  - ⇒ **partnering with current Australian financial institutions to provide innovative financing.**

## Private investment, impact investing and innovation

- 8.48 Increasingly, private investors – philanthropists, institutional investors and individuals (including members of diasporas) – are investing in developing and emerging markets and, in the case of impact investors, looking to make both social and financial returns. Targeting these impact investors is seen as one way in which to attract additional finance to achieve social and economic outcomes.

- 8.49 Impact Investing Australia observed ‘there is not only the potential to be leveraging private investment, but we need to.’<sup>45</sup>
- 8.50 The Committee took evidence of the ‘investments that intentionally seek to deliver a positive social and/or environmental impact, in addition to a financial return.’<sup>46</sup> Impact Investing Australia went on to note that:
- [Impacting investing] is different from grant funding because there is the financial return and it is different from mainstream investment because there is the clear accountability for the social. In some forms, also, you have really the first time that we are linking social outcomes to financial performance.<sup>47</sup>
- 8.51 Many submissions referred to the growth in impact investing, providing different estimates of its scale. Impact Investing Australia suggested that within a decade, the global market could reach between US \$500 billion and several trillion and \$32 billion in Australia.<sup>48</sup> These are not just investments in developed markets.
- 8.52 Save the Children Australia referred to a survey of 125 investment organisations by J.P Morgan and Global Impact Investing Network conducted in 2013, which found ‘70 per cent of their current impact investment assets under management are in emerging markets.’<sup>49</sup>
- 8.53 Microfinance is the largest and most developed sector for impact investing.<sup>50</sup> However, investments are starting to occur in other sectors, as Opportunity International observed:
- Impact investments have been made in a wide variety of sectors including agriculture, microfinance, renewable energy, small and medium enterprises, healthcare, affordable housing and community development.<sup>51</sup>
- 8.54 Dr Logue noted impact investments:
- ...which have so far been in the form of debt instruments, include vaccine bonds, green bonds and microfinance bonds [and are] all

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45 Mrs Rosemary Addis, Co-founder and Executive Chair, Impact Investing Australia, *Committee Hansard*, Melbourne, 15 August 2014, p. 39.

46 Impact Investing Australia, *Submission 66*, p. 4.

47 Mrs Rosemary Addis, Impact Investing Australia, *Committee Hansard*, Melbourne, 15 August 2014, p. 38.

48 Impact Investing Australian, *Submission 66*, p. 3.

49 Save the Children Australia, *Submission 38*, p. 10.

50 Impact Investing Australian, *Submission 66*, Attachment: *Impact – Australia: Investment for social and economic benefit*, p. 75.

51 Opportunity International, *Submission 76*, p. 6.

examples of innovative products that have attracted significant amounts of private and public capital.<sup>52</sup>

8.55 Impact Investing Australia noted that impact investing ‘involves a mix of investors with different priorities, and appetites for risk and return (on both the social and financial sides).’<sup>53</sup> Interest in impact investing is also wide spread, including individuals, members of diaspora communities and organisations such as philanthropic trusts, foundations, institutional investors including super funds, and venture capital funds.<sup>54</sup>

8.56 World Education Australia described how it was using a crowd-funding model to attract individual investors:

We get capital interest-free from the Australian public – you can go online and look at goodreturn.org – and we then lend it on interest-free through registered financial institutions in the countries in which we work. The clients pay interest on that so that our partner organisations are sustainable.<sup>55</sup>

8.57 Impact Investing Australia observed that crowd-funding is not paid back and acts like seed capital for social entrepreneurs. It further noted:

There has been some very exciting deal by deal progress made but nothing that can compare, say, to the UK, where they have had 15 years of policy environment that has been incredibly supportive. So they are years ahead and will remain years ahead until we have an enabling policy environment in Australia.<sup>56</sup>

8.58 QBE Insurance noted that it had first pursued impact investing through its foundation and that it was now looking to invest \$100 million through its investment portfolio:

Importantly, we are not looking to give away \$100 million. I think we really do believe that you can have your cake and eat it too. We really do believe you do not always have to make a choice between your investment profit and your investment purpose. I think there is a clever way of getting a win-win-win out of this situation, if it is done right. And that resonates with senior management and board at QBE.<sup>57</sup>

52 Dr Logue, UTS, *Submission 1*, p. [1].

53 Impact Investing Australia, *Submission 66*, p. 3.

54 Ms Sandy Blackburn-Wright, Co-founder, Impact Investing Australia, *Committee Hansard*, Brisbane, 11 August 2014, p. 63; Impact Investing Australia, *Submission 66*, pp. 9-10.

55 Mr Winship, World Education Australia, *Committee Hansard*, Sydney 7 November 2014, p. 40.

56 Ms Blackburn-Wright, Impact Investing Australia, *Committee Hansard*, Brisbane, 11 August 2014, p. 66.

57 Mr Gary Brader, Group Chief Investment Officer, QBE Insurance Group, *Committee Hansard*, Sydney 7 November 2014, p. 38.

- 8.59 The National Australia Bank is also supporting impact investing:  
In September 2014, NAB announced a \$1 million fund to support organisations in delivering finance solutions for important social and environmental issues. The fund will provide access to capital designed to increase the number of impact investments in the market for communities to prosper, both here in Australia and potentially in the Indo-Pacific.<sup>58</sup>
- 8.60 Impact Investing Australia noted that impact investing comes in many different forms ‘including debt, equity, public-private partnership structures, and hybrid combinations.’<sup>59</sup> It further commented on the collaboration between different parties to promote this investment:  
...investments could involve modest amounts of grant or risk-taking seed capital, or loan guarantees in order to facilitate and attract other forms of private investment. Often this ‘first layer’ capital is sourced from government and/or philanthropy; providing a powerful catalytic role in risk management, and spurring on other sources of investment capital.<sup>60</sup>
- 8.61 The challenges faced by impact investors are not too different from those faced by other investors, as Save the Children Australia observed:  
Despite all the enthusiasm and the clearly growing market for impact investment, as with last year, survey respondents identified one of the most limiting characteristics of the market as being a ‘shortage of high quality investment opportunities with a track record’.<sup>61</sup>
- 8.62 Dr Logue also commented on the need for education to build the market for impact investing:  
As observed with the current nascent market in Australia, connections between supply and demand can be hindered by the lack of common language, understanding of the requirements of investors, understanding of the challenges of social enterprises, and a lack of intermediaries to provide such education.<sup>62</sup>
- 8.63 In relation to impact investing, URS:  
There is a range of different things that are being trialled, from social impact bonds to the B-corporation movement. There is a

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58 National Australia Bank, *Submission 149*, p. 3.

59 Impact Investing Australia, *Submission 66*, p. 3.

60 Impact Investing Australia, *Submission 66*, p. 6.

61 Save the Children Australia, *Submission 38*, p. 10.

62 Dr Logue, UTS, *Submission 1*, p. [7].

range of things that are happening elsewhere, and ... it is good for the Australian program to evaluate what might work best and the regional priority there... I do not believe, and I think there is a range of writings that point to this, that there is something off the shelf that we should just pick up and deploy holistically through the Australian aid program.<sup>63</sup>

- 8.64 The National Australia Bank referred the Committee to a recent report which explored nine approaches relevant to the measurement of impact investments. The report noted:

There is a growing demand for measurement frameworks and agreed approaches. If impact investment is to become a significant force for social change then the social and environmental performance needs to be measured with the same level of robustness as financial approaches. This requires an approach that supports consistency, comparability and the ability to learn by experience.<sup>64</sup>

- 8.65 Impact Investing Australia noted that work is underway to accelerate impact investing, and that Australia is the only country outside of the G8 and EU which participates on the International Social Impact Investment Taskforce established in 2013.<sup>65</sup> Impact Investing Australia further noted with respect to impact investing in the region:

I feel that Australia could absolutely be a leader in this field. We have the location, the regional presence in the financial systems and the strength that could really start to leverage not only development outcomes but also our trade interests in the region.<sup>66</sup>

## Connecting investors to opportunities

- 8.66 New types of platforms are emerging to connect those who wish to invest in developing countries to businesses and projects in developing countries.
- 8.67 Dr Logue referred to platforms designed for impact investors, including: the Social Stock Exchange in London, the Impact Investment Exchange in

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63 Mr Mel Dunn, Vice President International Development, URS, *Committee Hansard*, Brisbane, 11 August 2014, p. 54.

64 National Australia Bank, Exhibit 88: Bessi Graham and Elliot Anderson, *Impact Measurement: Exploring its Role in Impact Investing*, National Australia Bank, The Difference Incubator and Benefit Capital 2015, p.7.

65 Impact Investing Australia, *Submission 66*, p. 15.

66 Ms Anna Bowden, Executive Manager, Impact Investing Australia, *Committee Hansard*, Melbourne, 15 August 2014, p. 39.



Mauritius and Social Venture Connection in Canada.<sup>67</sup> Dr Logue further suggested:

Such platforms and exchanges provide part of the essential market infrastructure necessary for an impact investing market to emerge and grow, including in developing countries, and the opportunity for foreign aid to be a catalyst in the development of such infrastructure and so mobilize private investors.<sup>68</sup>

8.68 Other platforms and individual governments have focused on specific investors – notably the diaspora. Impact Investing Australia stated:

... some countries such as Israel and India have utilised Diaspora Bonds, where high net worth and other private investors from the diaspora have pooled funding to support infrastructural and other development projects in their home country.<sup>69</sup>

8.69 Impact Investing Australia also drew attention to non-government platforms such as Homestrings:

Homestrings... connects high net worth diaspora investors to investment projects in their home countries. The program partners with home-country governments on developing the selected programs for investment, and outcome measurements. The fund is user-driven, so applicable to many geographical regions, but had an original focus on Africa. Homestrings currently has over 17 investments underway in various sectors, including: healthcare and hospital infrastructure development; agricultural value chain investments; real estate development; and sovereign bonds.<sup>70</sup>

8.70 Dr Logue recommended supporting intermediaries which can facilitate connections between investors and social enterprises, or projects.<sup>71</sup>

## Development Impact Bonds

8.71 One example of an impact investing instrument is the Social Impact Bond (SIB) which aims to attract private finance to address social challenges. Impact Investing Australia observed:

...in the UK market, the social impact bonds are just one per cent of impact investing. So, whilst the bonds are a useful tool, they are not the only tool, and there are many, many other tools.<sup>72</sup>

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67 Dr Logue, UTS, *Submission 1*, p. [4].

68 Dr Logue, UTS, *Submission 1*, p. [4]-[5].

69 Impact Investing Australia, *Submission 66*, pp. 9-10.

70 Impact Investing Australia, *Submission 66*, pp. 9-10.

71 Dr Logue, UTS, *Submission 1*, p. [4].

- 8.72 The Impact Investing Group noted that the first social impact bond was launched in 2010 in the UK and (at the time of its submission) Australia (the NSW Government) had launched three SIBs.<sup>73</sup> The United Kingdom became the first country to consider using the SIB model to address international development challenges, and in April 2014 announced that it would research and design the first Development Impact Bond (DIB) aimed at addressing sleeping sickness in Uganda.<sup>74</sup>
- 8.73 DFAT described DIBs:
- Development Impact Bonds (DIBs) are results-based contracts in which private investors provide the upfront funds for social or development programs and public sector agencies pay back investors their principal plus a return if, and only if, these programs succeed in delivering development outcomes. It is not a bond in a strict financial sense, but a mechanism to leverage private sector investment while driving efficiency in delivery through a payment for results approach.<sup>75</sup>
- 8.74 As a DIB is similar in form and function to a SIB in that they both seek to attract private investment to address specific issues and governments only pay if the outcome is achieved, experience with SIBs can contribute to understanding the potential of a DIB.
- 8.75 Dr Logue observed that ‘SIBs are not an actual bond (i.e., in the sense of a debt instrument) but rather a multi-stakeholder partnership’.<sup>76</sup> QBE Insurance Group noted that ‘they are going to look like, feel like and act like private equity’ and suggested ‘the word “bond” is probably going to become less relevant to the actual structures.’<sup>77</sup>
- 8.76 Professor Shergold highlighted additional benefits of using SIBs to fund social programs:
- ... first, they reduce the call on government but, second, they also allow you to attract additional funding from the private sector beyond what the government is going to be able to spend.<sup>78</sup>

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72 Ms Blackburn-Wright, Impact Investing Australia, *Committee Hansard*, Brisbane, 11 August 2014, p. 64.

73 Impact Investment Group, *Submission 108*, p. [11]

74 Department for International Development and The Rt Hon Justine Greening, ‘UK Development Bonds will combat global poverty’, <[www.gov.uk/government/news/uk-development-bonds-will-combat-global-poverty](http://www.gov.uk/government/news/uk-development-bonds-will-combat-global-poverty)>, *Media release*, viewed 1 May 2015.

75 DFAT, *Submission 21*, pp. 46-47.

76 Dr Logue, UTS, *Submission 1*, p. [6]; National Australia Bank, *Submission 149*, p. 2.

77 Mr Brader, QBE Insurance Group, *Committee Hansard*, Sydney 7 November 2014, p. 33.

78 Professor Peter Shergold, Chair, New South Wales Social Investment Expert Advisory Group, *Committee Hansard*, Sydney 7 November 2014, p. 15.

- 8.77 Professor Shergold further noted that addressing social issues sooner may reduce the need for other government interventions in the future and ‘that is what is going to flow on into the budgetary advantage.’<sup>79</sup>
- 8.78 Dr Logue also observed that state or national governments benefit from future cost savings if programs funded by SIBs are successful. However, she further noted that when considering the approach for development challenges ‘donor organisations that may provide the guarantee for the bond are not necessarily the ones that are reaping the cost savings.’<sup>80</sup>
- 8.79 The evidence highlighted two key challenges in designing SIBs and DIBs – measuring outcomes and determining the financial return or premium paid to the investor.<sup>81</sup> QBE Insurance observed:
- I suspect the biggest challenge will be hard numbers...[SIBs] only work if it is very clear what the outcomes are, if it is fairly clear what the cost of those outcomes are and, therefore, the benefit either to the donor or the local government of having the problem improved.<sup>82</sup>
- 8.80 With respect to measurement, Cardno observed:
- Measurement is very difficult in any development context, and it is particularly important and tricky in the context where release of payment to a private investor is entirely linked to demonstrating achievement. That puts an increased onus and importance on it.<sup>83</sup>
- 8.81 DFAT elaborated on how the need for measurable outcomes influences the purpose of the DIB:
- ... it has to be a very clear intervention that you can measure, like a vaccine or a pill, that gets to an individual and that has a pretty immediate result. It probably would not work for some of the big, intractable problems like reducing maternal mortality over a 10 year period, which requires multiple complex inputs and changes in a society to achieve, because that is very hard to measure and

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79 Professor Shergold, Chair, New South Wales Social Investment Expert Advisory Group, *Committee Hansard*, Sydney 7 November 2014, p. 17.

80 Dr Logue, UTS, *Committee Hansard*, Sydney, 20 August 2014, p. 2.

81 Professor Peter Shergold Chair, New South Wales Social Investment Expert Advisory Group, *Committee Hansard*, Sydney 7 November 2014, p. 14; DFAT, *Submission 21*, pp. 46-47; Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, p. 2.

82 Mr Brader, QBE Insurance Group, *Committee Hansard*, Sydney 7 November 2014, p. 34.

83 Mr Mark Pruden, International Development Business Unit Manager (Asia Pacific), Cardno Pty Ltd, *Committee Hansard*, Melbourne, 15 August 2014, pp. 20-21.

you probably could not generate the finance or the recurrent finance to sustain that for 10 years.<sup>84</sup>

8.82 With respect to pricing and determining the potential return for investors: Cardno Emerging Markets and Metis submitted:

- Pricing: The DIB model relies on funders' ability to ensure outcomes are valued at commercial prices that do not exceed the value society places on achieving those outcomes. Until there is a body of DIB price precedents/benchmarks, it is likely this value will need to be negotiated with potential investors.
- Risk/reward structure: The DIB model relies on partners to agree on an appropriate risk-return profile that weighs up factors such as the type and amount of risk; the investment term, liquidity and size; outputs vs. outcomes.<sup>85</sup>

8.83 Unlike the current experience with SIBs, with development impact bonds aid agencies would take on the role that governments have played to date. Dr Logue observed that 'it is very different when the donor is not in the same national context or region that is recouping the benefits of that instrument.'<sup>86</sup> Cardno Emerging Markets and Metis observed that:

Host government counterparts may be reluctant to support the DIB process due to its need for flexible implementation strategies which will likely include authorisation for locations and activities from different entities in the host country.<sup>87</sup>

8.84 Cardno also observed an additional challenge with the DIB model:

The mechanism is tricky. You are genuinely competing in the private sector for capital. If you are an investor looking at your 20 different investment options, at this stage would you choose supporting the reduction of sleeping sickness in Uganda with all the various things that could go wrong in achieving that outcome, particularly if you are a private investor who is not really comfortable or familiar with operating in that environment, relative to much safer investment options?<sup>88</sup>

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84 Mr Benedict David, Principal Sector Specialist for Health, Development Policy Division, DFAT, *Committee Hansard*, Canberra 23 June 2014, p. 13

85 Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, pp. 3-4.

86 Dr Logue, UTS, *Committee Hansard*, 20 August 2014, p. 5.

87 Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, pp. 3-4.

88 Mr Pruden, Cardno Pty Ltd, *Committee Hansard*, Melbourne, 15 August 2014, p. 21.

- 8.85 A number of submissions encouraged the Australian Government to explore the use of DIBs.<sup>89</sup> Most submissions, however, also recognised that DIBs are a very new concept with high transaction costs.<sup>90</sup> The Fred Hollows Foundation observed:
- ...we need to think about the up-front development costs when it comes to building this type of architecture and then ensuring that the size of early deals is sufficiently large to ensure that those up-front costs are worth making.<sup>91</sup>
- 8.86 In considering whether to use a DIB, Cardno suggested:
- [A DIB] genuinely needs to be assessed against all other mechanisms. It is not a replacement for all other types of aid. It is, I guess, a supplementary mechanism that I think has great potential in particular circumstances, particularly its ability to be taken to scale.<sup>92</sup>
- 8.87 Cardno Emerging Markets and METIS Analytics suggested that the Australian Government:
- Conduct scoping work to develop a framework concept note to: identify and assess opportunities based on development objectives, target countries and potential locations; and develop a core model which outlines operational and financial relationships among contributing partners and means of outcome verification.<sup>93</sup>
- 8.88 The Committee notes that a number of challenges were highlighted with DIBs. These included measuring outcomes, determining the return on the bond and working with partner governments, delivery partners and investors in different countries. Also of concern is the potential for high transaction cost of DIBs relative to existing partnership models.
- 8.89 A better understanding of the risks and benefits should be gained before progressing any Australian DIBs. The Committee encourages DFAT to fully engage with state and international government counterparts, multilateral development banks, and the private sector, including commercial financial institutions and advisory bodies, to learn from their experiences with SIBs and DIBs.

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89 Global Alliance for Improved Nutrition, *Submission 102*, p. 10; ChildFund Australia, *Submission 8*, p. [3]; Vision 2020, *Submission 34*, p. 6; Accenture, *Submission 23*, p. 9.

90 DFAT, *Submission 21*, pp. 46-47; The Fred Hollows Foundation, *Submission 14*, p. 6; Vision 2020, *Submission 34*, p. 6.

91 Dr Lachlan McDonald, Senior Health Economist, Fred Hollows Foundation, *Committee Hansard*, Melbourne, 15 August 2014, p. 64.

92 Mr Pruden, Cardno Pty Ltd, *Committee Hansard*, Melbourne, 15 August 2014, p. 22.

93 Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, pp. 3-4.

## Drawing on best practice

- 8.90 Impact Investing Australia, noting the Australian experience with social impact investing, suggested that ‘there is good capacity to partner with local expertise’.<sup>94</sup>
- 8.91 The NSW Social Impact Investment Policy was launched in February 2015 and includes actions to support the growth of the impact investing market in New South Wales. Supporting this policy is the Office of Social Impact Investment (OSII) which is a joint team from the NSW Department of Premier and Cabinet and the NSW Treasury. As well as promoting the impact investment market, OSII has created a Social Impact Investment Knowledge Hub.<sup>95</sup>
- 8.92 The National Australia Bank noted that it was in discussions with various partners about SIBs and encouraged building upon existing models:
- As the social impact bond market develops, it’s important to leverage global best practice to increase the speed-to-market and scale of these products.<sup>96</sup>
- 8.93 Submissions suggested that the Australian Government participate in global groups including:
- United Kingdom’s Department for International Development (DFID) ‘open source’ knowledge platform (once established).<sup>97</sup>
  - the Development Impact Bond Working Group, a partnership between the Center for Global Development and UK-based Social Finance, established in June 2013.<sup>98</sup>

## Growing the Australian market for impact investing

- 8.94 Impact investors face similar challenges to other investors, as well as a limited number of projects to invest in and a lack of platforms and market infrastructure to connect social entrepreneurs with impact investors. Partnerships with governments and other organisations are important for building the impact investing market both in Australia and in our region.
- 8.95 Impact Investing Australia noted that work is underway to grow the impact investing sector in Australia:

94 Impact Investing Australia, *Submission 66*, p. 18.

95 Department of Premier and Cabinet, New South Wales, ‘Social Impact Investment Knowledge Hub’, <[www.dpc.nsw.gov.au/programs\\_and\\_services/social\\_impact\\_investment/about\\_us](http://www.dpc.nsw.gov.au/programs_and_services/social_impact_investment/about_us)>, viewed 1 May 2015.

96 National Australia Bank, *Submission 149*, p. 2.

97 Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, pp. 3-4.

98 Impact Investing Australia, *Submission 66*, p. 8; Cardno Emerging Markets (Australia) Pty Ltd and METIS Analytics Pte Ltd, *Submission 20*, pp. 3-4.

An Australian Advisory Board has been established, bringing together leaders from across sectors. The appointment and role of the Advisory Board is aligned with the structures now in place in all participating countries under the governance adopted by the International Taskforce. The intention is to utilise links to the global work to elevate issues and action in a way that builds longer term capability, engagement and momentum locally.<sup>99</sup>

8.96 The Committee encourages the Australian Government to address factors to grow the impact investing market in Australia and to better enable investors to connect to opportunities in developing countries of the region.<sup>100</sup> It should:

- establish clear policies and clarifying requirements including for domestic charitable trusts and foundations;<sup>101</sup>
- help build capacity within the market;<sup>102</sup>
- provide information to the market;<sup>103</sup> and
- review taxation arrangements.<sup>104</sup>

8.97 The Australian Government's final report of the Financial System Inquiry, released on 7 December 2014, included discussion on impact investing. The Committee supports the report's conclusions that the Australian Government should:

- Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.
- Provide guidance to superannuation trustees on the appropriateness of impact investment.
- Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.<sup>105</sup>

99 Impact Investing Australia, *Submission 66*, p. 16.

100 ACFID, *Submission 52*, p. 11; Impact Investing Australia, *Submission 66*, p. 16;

101 Ms Jessica Roth, Representative, Impact Investment Group, *Committee Hansard*, Sydney 7 November 2014, p. 54; and Impact Investment Group, Responses to QoN 7 November 2014; National Australia Bank, *Submission 149*, p. 2.

102 National Australia Bank, *Submission 149*, p. 2; Impact Investing Australia, *Submission 66*, p. 16; Dr Logue, UTS, *Submission 1*, p. [7].

103 National Australia Bank, *Submission 149*, p. 2; Impact Investing Australia, *Submission 66*, p. 16.

104 Ms Jessica Roth, Representative, Impact Investment Group, *Committee Hansard*, Sydney 7 November 2014, p. 46; Mr Gary Brader, QBE Insurance Group, *Committee Hansard*, Sydney 7 November 2014, p. 34; Save the Children Australia, *Submission 38*, p. 11.

105 Australian Government, *Final report of the Financial System Inquiry*, <[www.fsi.gov.au/publications/final-report/appendix-1/](http://www.fsi.gov.au/publications/final-report/appendix-1/)> viewed 1 May 2015.

- 8.98 Australia's location and links to the financial sectors in the region ensure we are well-placed to play a leading role in the nascent impact investment market. The Australian private sector is already well-advanced in its thinking on both establishment and evaluation of impact investments. The Australian Government should embrace the opportunity to work in partnership with leading Australian organisations to maximise development impact through innovative financing.

## **Recommendation 22**

**The Committee recommends that the Australian Government through the Department of Foreign Affairs and Trade:**

- **continue to develop expertise and knowledge about the social impact investing sector in the Indo-Pacific region, with Australia's overseas diplomatic representatives assisting with this information gathering;**
- **work with the Australian Advisory Board on Impact Investing to identify areas of potential collaboration to promote more impact investing in the region;**
- **participate in relevant Australian, regional and global working groups on impact investing, including the working group on Development Impact Bonds; and**
- **develop a means of effective and continuous communication about the prospects for impact investing with potential investors, including the Australian public.**