MILKEN INSTITUTE
CENTER FOR FINANCIAL MARKETS

EXECUTIVE SUMMARY

Priming SDG Markets

Can International Donors and Implementers Create an Impact Investment Pipeline?

Leveraging the power of markets is critical to fulfilling the bold ambitions of the United Nations (UN) Sustainable Development Goals (SDGs). The SDGs are a collection of 17 global goals set by the UN General Assembly in 2015 to end poverty, protect the planet, and engender prosperity for all by 2030. Estimates suggest that achieving the SDGs would require $2.5 trillion in additional annual investment, which has created a consensus around the urgent need to forge effective mechanisms for cooperation between the international donor community and the private sector.[i] International donors have approached this challenge by focusing on blended finance structures in which a combination of public, philanthropic, and private sectors invest together. But, while the growth of blended finance is notable and essential, it is constrained by bottlenecks of transaction costs and project pipeline development.[ii,iii] To fulfill the SDGs, the international donor system must re-orient itself to better enable the efficient translation of its grant-funded programs into opportunities capable of absorbing private capital and reaching commercial scale.

In pursuing this shift, can the international donor community apply lessons from other systems that have successfully mechanized the commercialization of social innovations? In many advanced economies, the universities, research institutes, and other organizations that receive grant funding from public or philanthropic sources have well-established processes for packaging these projects into early-stage companies for the private sector to bring to the next phase of commercial development. The international donor community has many of the same components that could be adapted to produce more investable innovation opportunities. Some large-scale donors provide billions in grants and service contracts to implementing organizations (IOs) to execute projects ranging from early-stage product design to last-mile distribution and service delivery. Also, there is a diverse, growing field of impact investors seeking early-stage investment opportunities aligned to the SDGs.[iv] Could these IOs provide the systematic coordination needed to transition donor-backed projects to private markets at scale?

In a study supported by the UBS Optimus Foundation, the Milken Institute's Center for Financial Markets analyzed how these IOs could become a fulcrum for generating more market-based solutions and better outcomes for children globally. Through greater collaboration across donors, IOs, and investors, there is a path for private capital to leverage commercial opportunities and lessons learned seeded by international donors.

We conducted the analysis in three stages. First, we distilled the global market of donors' child health and education programs to identify critical IOs within the field, as well as attributes of the donor landscape that could impede a systematic commercialization effort. We refined the list of more than 500 IOs using a scale analysis, an analysis of which organizations had the broadest donor relationships, and a qualitative review of their capacity and interests. Through this, we identified a set of IOs that were potentially positioned to translate donor programs into investment opportunities. Additionally, the process revealed four insights for enabling more effective private sector partnerships aligned to the SDGs:

1. **Further data transparency is needed to account for funding outflows from donors.**
2. **Data comparability among donors is difficult due to jurisdiction-specific reporting requirements.**
3. **Data on the underlying SDG challenges and investment gap are sparse.**
4. **Donor markets are highly fragmented, making it difficult to transact at scale with multiple actors.**

Second, we surveyed and interviewed the senior management of a subset of high-potential IOs across seven areas to gauge their interests in, experiences with, and capacity to transition donor-backed programs to private capital markets. The IOs included are Chemonics International, Inc., FHI 360, Mercy Corps, Palladium, PATH, Population Services International, and Save the Children. The seven areas of focus in the survey are Historical Experience; Mission, Structure, and Governance; Commercialization Opportunities and Challenges; Finance and Economics; Human Capital; Core Competencies; and Legal and Regulatory Considerations.

INSIGHTS FROM IO SURVEY

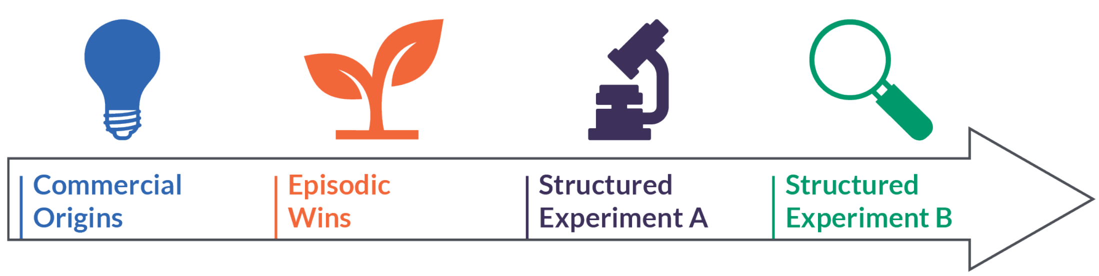
Internal Forces Facing IOs

- Commercialization is viewed as a key means to extend their overarching missions.
- All but one IO has created organizational policies to support commercialization activity, and a majority have begun to build structures around these policies.
- Strategic benefits, such as revenue growth and diversification, help justify commercialization.
- Core competencies and skills are not uniform among IOs.
- Common organizational weaknesses relate to investor networks and a lack of experience in structuring transactions.

External Forces Facing IOs

- Donor Relationships: many IOs report donors' growing interest in private sector approaches and blended finance; however, IOs also report a countervailing movement of open innovation policies, which limit the IOs' ability to generate intellectual property or profit from the donor programs.
- Local Market Receptivity: IOs cited challenges associated with operating as commercial enterprises or attracting market-rate funds to their projects.

Third, we conducted case studies of two IOs, FHI 360 and Mercy Corps, that are further along in their development, having both built similar investment fund strategies to systemize their approach. In this, we distill insights that may be transferable to a wider set of stakeholders. We broke the case studies down into a timeline of organizational phases:



Although FHI 360 and Mercy Corps' trajectories were unique, their experiences highlighted common decisions, milestones, and insights. The broader IO community will be able to use these lessons as they contemplate their own approaches to commercialization. The case studies revealed 10 insights:

1. **Intentions matter, but core competencies and human capital drive results.** For different strategic reasons, FHI and Mercy Corps funded and incubated employee ideas. While FHI pursued this approach to improve programming, it realized it needed to externalize ideas to scale and gain traction. Conversely, Mercy Corps intended to externalize the employee initiatives from the beginning but realized that employees wanted to remain part of the sponsoring institution. In both cases, the people involved could not scale successful enterprises. Strategic hires are key.

2. **A commercial culture is built over a long period of time.** The venture fund initiatives of both FHI and Mercy Corps are the latest incarnations of a long series of experiments with commercialization; first-order philosophical decisions occurred more than 30 years ago. IOs intending to engage private capital should prepare to have commercially-oriented strategies, tactics, and resources for the long term.

3. **There's a natural progression to initiating a commercialization tactic.** Over the course of both organizations' history with commercialization, at each stage of development, they exhibited a similar pattern of behavior and decision-making. Despite perceived legal and regulatory challenges or capacity issues in commercializing programs, it is important to note that both organizations got comfortable with the idea of having made the impact/mission strategic determination first before initiating a commercialization tactic.

4. **Market knowledge is critical, regardless of how the market is defined.** During its first foray into commercialization, FHI provided clinical trial services to a new customer base, and Mercy Corps provided a new lending service to existing beneficiaries. In both cases, specialized knowledge, in clinical trials for FHI 360 and in microfinance for Mercy Corps, allowed them to leverage their staff and networks to execute a commercialization strategy and overcome challenges.

5. **Tensions with the broader organization will always exist regardless of whether commercial initiatives are managed centrally or on a decentralized basis.** FHI took a centralized approach, and Mercy Corps took a decentralized one. Each IOs' board played an active role in rigorously evaluating progress and charting the next iteration. Engaging a board early and often is critical.

6. **Have a hypothesis, but be prepared to pivot based on results.** At each segment in the case study chronology, both IOs had a structured approach based on a hypothesis, but were comfortable with refining their approach based on real world learnings.

7. **Forge balanced, long-term relationships with partners.** The mix of capital and services should put the investor and investee on equitable footing. FHI Ventures' cost of acceleration services dramatically outpaced the capital invested, calling into question the sustainability of the model. Although Mercy Corps distributed the cost of venture development services across its larger platform, the value of those services to the investee was larger than the capital initially provided, creating a clear need to provide additional capital as the business grew.

8. **Program alignment is possible despite difficulty with high-risk initiatives.** Managers of programs were sensitive to the opportunity cost of dedicating time to support a venture that might or might not produce results for their program. Technical staff should be leveraged to bridge the divide between program and commercialization efforts.

9. **The broader the portfolio, the more important it becomes to invest later and lighter.** In transitioning to investing in a wider portfolio of ideas, both FHI and Mercy Corps focused on pre-revenue companies that were generated internally, and operated globally across numerous sectors. During that experience, both organizations realized a path toward scale might require targeting later-stage—Series A—companies that are sourced externally to better balance between capital and cost for development. Leveraging their expertise, to some extent both are exploring becoming impact investors of external deals themselves, in addition to generating "homegrown" ventures.

10. **Risk management is inherent in mission adherence.** Re-validating mission adherence during each phase of commercial decision making and paying constant attention to whether a strategy, approach or risk reinforces the mission were essential. It put both FHI and Mercy Corps on a learning-oriented trajectory in which either success or failure could be built upon and explained to the market.

What Next? Achieving the SDGs requires systematic change and integration across donors, IOs, and investors. To draw in scaleable private capital, donors will need to adapt how they structure their funding and IOs must make organizational changes related to how they operate. This research has identified a number of issues and strategies that stakeholders should consider to provide a new way for priming SDG markets to crowd in private capital. Additional research should further examine capabilities for IOs and impact investors to match skills with capitals. Concurrently, we encourage IOs and impact investors to explore and pilot new collaborations. Progress can occur through trial and error and constat testing of assumptions. While there will be inevitable failures, it is only through such temporary setbacks that IOs and impact investors will pave the way for scaleable systems change. **The full report is available online**.

ABOUT THE MILKEN INSTITUTE CENTER FOR FINANCIAL MARKETS

The Milken Institute is a nonprofit, nonpartisan think tank that helps people build meaningful lives in which they can experience health and well-being, pursue effective education and gainful employment, and access the resources required to create ever-expanding opportunities for themselves and their broader communities. The Milken Institute Center for Financial Markets conducts research and constructs programs designed to facilitate the smooth and efficient operation of financial markets—to help ensure that they are fair and available to those who need them when they need them.

ABOUT UBS OPTIMUS FOUNDATION

The UBS Optimus Foundation helps UBS clients deliver breakthrough solutions to pressing social issues in the areas of health, education, and child protection. As the only client foundation linked to a global wealth manager, it has a 20-year track record and is recognized globally as a philanthropic thought leader. In particular, the foundation has taken a leading role in driving innovative financing, for example, through investing in some of the world's first Development Impact Bonds (DIBs). In addition, the Foundation aims to use a variety of social outcome-linked financial mechanisms. The foundation takes an evidence-based approach and focuses only on programs that have the potential to be transformative, scalable, and sustainable.

---

i. Mara Niculescu, "Impact Investing to Close the Funding Gap," United Nations Development Programme, July 13, 2017, http://www.undp.org/content/undp/en/home/blog/2017/7/13/What-kind-of-blender-do-we-need-to-finance-the-SDGs-.html.
ii. "Creating Impact: The Promise of Impact Investing" (IFC, 2019), https://www.ifc.org/wps/wcm/connect/66e30dce-0cdd-4490-93e4-d5f895c5e3fc/The-Promise-of-Impact-Investing.pdf?MOD=AJPERES&CVID=mHZTSds.
iii. Susanna Rust, "Impact Investing: Tricky, but Worthwhile," *Investments and Pensions Europe*, May 2019, https://www.ipe.com/reports/special-reports/impact-investing/tricky-but-worthwhile/10030927.article.
iv. "Annual Impact Investor Survey: The Ninth Edition" (GINN, 2019), https://thegiin.org/research/publication/impinv-survey-2019.