INNOVATIVE FINANCE TOOLKIT

IMPACT-LINKED LOAN

INVESTOR:

Bemtevi

SOCIAL PURPOSE ORGANIZATION:

ASID Brasil (Ação Social para Igualdade das Diferenças)

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SOCIAL ENTERPRISES ARE CHARACTERIZED BY THEIR MISSION to create positive social and/or environmental impact through sustainable business solutions. However, traditional financing instruments, including debt and equity, don't generally consider the "value" of the impact created by these enterprises in their performance assessments, instead focusing purely on financial indicators. New financing instruments are needed that incorporate, evaluate, and highlight impact.

Impact-linked loans that link financial rewards to the achievements of positive social outcomes offer an effective alternative to traditional financing—e.g., investors can link interest rates to the achievement of pre-defined impact indicators. Investing through an impact-linked instrument creates positive incentives across three functional areas by i) reducing interest rates as impact milestones are reached, ii) reducing the cost of financing, and iii) creating incentives to continue generating positive impact.

An impact-linked loan is similar to a traditional loan, with the main exception that interest rates (and occasionally repayment obligations) are tied to the borrower's achievement of pre-defined and independently verified social outcomes. These instruments also help align incentives, linking the successful achievement of the established social outcomes with the economic sustainability of the impact enterprise/organization. In this case, the investor is willing to provide concessional finance and accept below-market returns as part of its commitment to prioritizing impact over financial upside.

Context

Created in 2015, **Bemtevi Investimento Social** is an impact investing fund and Certified B Corporation. It uses innovative investment structures to support impact enterprises in Brazil and help them maximize their social and environmental impact.[1] Bemtevi seeks to help social and environmental enterprises grow by providing greater access to financial and non-financial resources to improve well-being, with a focus on traditionally marginalized and underprivileged populations.

Bemtevi's three primary value-add activities are i) the Business Development Program, a three- to eight-month process that helps entrepreneurs improve and develop their business plans and access financing, ii) initiatives to connect investors and entrepreneurs based on the qualitative indicators of each project, and iii) social loans that link interest rates to the successful achievement of pre-determined impact outcomes.

ASID Brasil is a non-profit organization that offers specialized support to organizations that work with disabled people. With a strong focus on operational improvements, ASID works to help these organizations accelerate their growth and expand their scope to reach more people. ASID's model consists of two main areas of focus: i) the institutional development of organizations that offer direct assistance to disabled people and ii) the development of corporate volunteer and diversity and inclusion programs. ASID charges the private organizations it works with a consulting fee, while it provides services to direct assistance organizations on a pro bono basis.

1 Sistema B. Bemtevi: Investimento social [Bemtevi: Social Investment]. Retrieved from: https://www.sistemab.org/empresasb/bemtevi-investimento-social/

TABLE 1 General Information - ASID Brasil

Year Founded	2010
Headquarters	Curitiba, Brazil
Geographic Focus	Brazil.
Financing Sources:	Impact investors, companies, institutions, and foundations
Partners and Funders	Itaú, PWC, Samsung, BTG Pactual, Grupo Boticário, SAP, EDP, Fundação Telefônica Vivo, Grupo Votorantim, Itaipu Binacional, Fundação Grupo Volkswagen, Amil, JSL, Instituto BRF, and Bradesco, among others
Website	https://asidbrasil.org.br/

Opportunity and Deal Terms

Bemtevi is an impact-first investor primarily motivated by impact over greater financial returns. To participate in the Business Development Program, enterprises must not only have demonstrated social impact but must also i) be a for-profit organization that generates revenue through product or service sales and is financially self-sufficient, ii) offer competitive salaries to attract and retain talent, and iii) guarantee that all profits are reinvested in the enterprise[2].

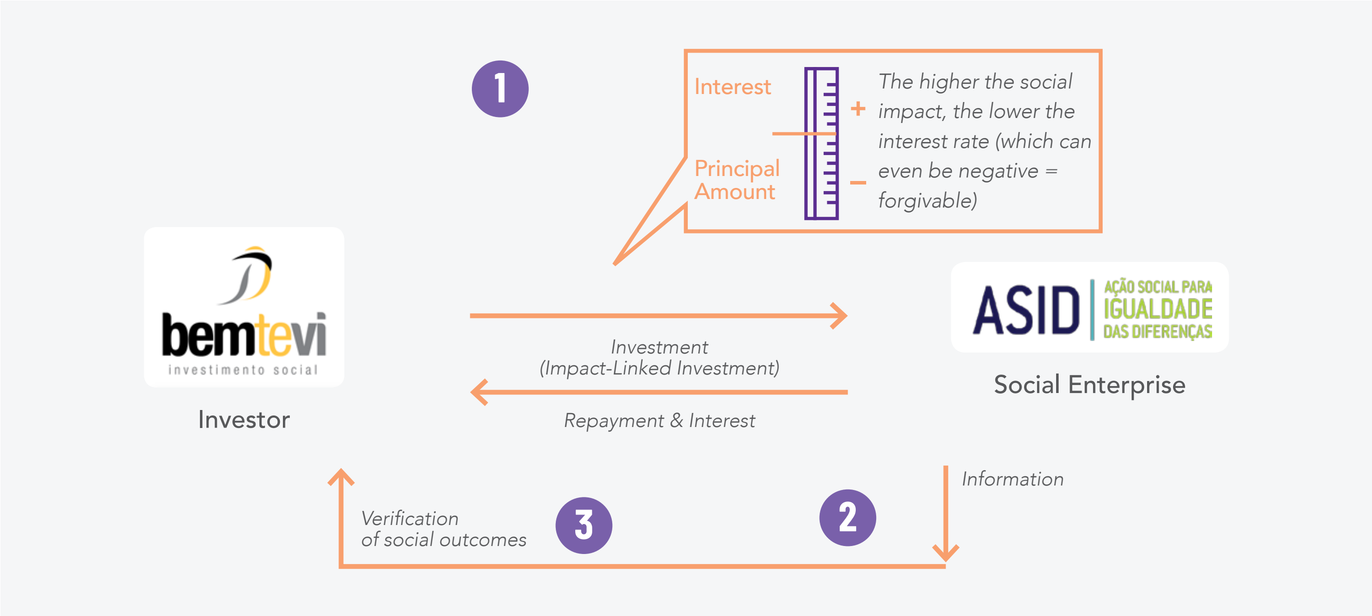
2 See https://www.bemtevi.is/empreendedores/ It is important that the impact enterprise does not intend to distribute dividends in the future to avoid conflicts of interest.

Bemtevi provided ASID with additional non-financial support from initial contact through the post-investment period. Before participating in the Business Development Program, ASID worked with the Bemtevi team to identify the enterprise's business model. Although ASID is technically a non-profit organization, its work with corporations was clearly a revenue-producing business line that fulfilled Bemtevi's three investment criteria. The Business Development Program implemented with ASID lasted a total of three months, as the enterprise had already established a clear social purpose, a structured management model, a theory of change, an impact measurement system with corresponding indicators, financial projections and goals, a solid management team, and a governance structure. ASID sought a working capital loan to grow its business development team, significantly expand its operations, and meet the demand identified in other regions of Brazil.[3]

The subsequent due diligence process included establishing financial projections based on ASID's business plan, potential customers, estimated cash flows, and a confirmation of the organization's potential growth based on its historical growth.

3 After strengthening its operations in Curitiba, Paraná, where it was founded and already had significant reach, ASID was interested in using the loan to expand its operations to São Paulo and start work on a project in Northeast Brazil.

FIGURE 1 How to Structure an Impact-Linked Loan



SOURCE: Created by authors.

ASSUMPTIONS

- Supporting organizations that serve disabled people and helping them improve their operations, capabilities, and programs increases opportunities for social integration.
- Supporting companies to integrate disabled people into the workplace increases diversity and job opportunities for disabled people, improving their quality of life and sense of self-sufficiency.

1 ASID received two loans from Bemtevi. The first loan, totaling R$ 60,000 (USD 11,700), was granted in September 2017 and repaid in December 2018. The second, totaling R$ 210,000 (USD 41,000)[4], was granted in April 2019 and repaid in December 2021. The grace period for each loan was 3 and 10 months, respectively, with a repayment period of 18 months. The rate of return was equivalent to inflation, and the interest rate was 0.0%, as ASID surpassed the established impact outcomes.

2 The indicators established in the contract were divided into i) social impact indicators and ii) economic/financial performance indicators (see Table 2), which were weighted at 67% and 33%, respectively. Impact and performance outcomes were evaluated monthly to establish the corresponding discount (if any).

TABLE 2 Indicators Aligned with the Theory of Change

Group	Number	Weight	Indicator
Social Impact 67%	1.1	10 %	Number of institutions in the ASID network
	2.1	5 %	Number of volunteers
	2.2	10 %	Number of direct beneficiaries
	2.3	5 %	Number of professionals who received training
	2.4	5 %	Institutional commitment
	3.1	5 %	Level of individual inclusion
	3.2	10 %	Organizational management growth
	3.3	5 %	Disabled people's sense of inclusion
	3.4	5 %	Number of disabled people included in the company

4 Currency conversion 1 USD = 5.12 BRL (as of September 22, 2022)

TABLE 2 Indicators Aligned with the Theory of Change (continue)

Group	Number	Weight	Indicator
	4.1	5 %	Disabled people participating in social routines
	4.2	5 %	Monthly income of the disabled person or family derived from involvement in projects and from inclusion
Economic/ financial impact 33%	5.1	15 %	ASID São Paulo sales numbers
	5.2	10 %	Gross margin of projects
	5.3	5 %	Payments to Bemtevi

SOURCE: Bemtevi.

2 ASID surpassed the established impact objectives and paid off both loans early. Payments were made monthly and were subject to a simple interest rate, which was calculated based on the successful achievement of the impact objectives. ASID was also given the opportunity to advance or extend the loan.[5] With the first loan, ASID achieved the established impact objectives, repaid the loan principal, and requested a subsequent loan from Bemtevi to continue to increase its impact. With the second loan, ASID successfully achieved the established impact objectives and repaid the loan principal adjusted for inflation based on Brazil's Extended Consumer Price Index.

Impact-Linked Interest Rate

The annual interest rate was set at 12% for the first loan and 10%, plus inflation adjustments on the principal, for the second loan. Discounts were tied to pre-determined economic/financial performance and impact objectives established in the loan contract.

5 For additional information, see Catelli, M. 2021. Investimento de Impacto No Brasil: Um Estudo sobre a Bemtevi Investimento Social [Impact Investing in Brazil: Bemtevi Investimento Social Case Study]. Universidade Federal de São Carlos, Campus Sorocaba. Centro de Ciências Econômicas. Retrieved from: https://tinyurl.com/2nbtqpkx

TABLE 3 Terms and Conditions

Can Replace	Traditional debt, grants, and (other) blended finance instruments
Enterprise Lifecycle	Early growth stage (post-revenue)
Risk/Return Profile	n/a
Maturity	2018 (first loan); 2021 (second loan)
Amount	USD 52,700 (total)

SOURCE: Bemtevi.

Impact-Linked Financial Rewards

The financial rewards granted based on impact and financial performance were weighted at 67% and 33%, respectively. Each indicator included details on how it would be measured, weighting, and monthly and cumulative impact targets. The interest rate discount was calculated based on the accomplishment of pre-established performance and impact objectives (see Figure 2). In general, if the impact enterprise successfully achieved at least 80% of the established financial performance and impact objectives, the interest rate would be reduced to 0%, plus adjustments for inflation.

Impact Verification

In this case, there was no independent verification. However, a management structure was agreed to by both parties that established the definitions and details of each indicator,[6] as well as the terms and conditions of the loan. The Bemtevi team assessed the corresponding outcomes each month.

6 The pre-defined details included the strategic aspects that would be measured, the responsible party, the formula that would be used for calculations, appropriate data sources, acceptable supporting documentation, frequency and timing of the outcome measurement, internal dissemination of outcomes, estimated measurement costs, the subjectivity of the measurements, and the objectives.

FIGURE 2 Impact and Performance Incentives - Interest Rate Discount

Discount	Condition
0 %	If the percentage of economic/financial performance and impact indicators achieved is between 0% and 49.9%, there is no reduction in the interest rate, i.e., the 12% annualized interest rate is maintained, plus adjustments for inflation.
33 %	If the percentage of economic/financial performance and impact indicators achieved is between 50% and 59.9%, the 12% interest rate is discounted by up to 33.3%, plus adjustments for inflation.
50 %	If the percentage of economic/financial performance and impact indicators achieved is between 60% and 69.9%, the 12% interest rate is discounted by up to 50%, plus adjustments for inflation.
66.66 %	If the percentage of economic/financial performance and impact indicators achieved is between 70% and 79.9%, the interest rate is discounted by up to 66.66%, plus adjustments for inflation.
100 %	If the percentage of economic/financial performance and impact indicators achieved is greater than 80%, the interest rate is discounted by up to 100%, plus adjustments for inflation.

SOURCE: Bemtevi.

Maturity

The average term for the loans was 18 months, with grace periods of 3 and 10 months, respectively. The rate of return was equivalent to the inflation rate, plus the corresponding interest rate as determined by the achievement of the established impact outcomes (see Figure 2).

When to Use this Instrument

- Impact-linked loans are especially attractive for **impact-first investors**, as these investors are more likely to accept below-market returns. This instrument is designed to incorporate the "value" of the impact generated as a core part of the financing agreement, providing incentives for impact enterprises to outperform on positive impact.

- It is critical for the investor and impact enterprise to **align objectives** in terms of how the financing will be used and the social and/or environmental impact it will be expected to generate. A good relationship between the investor and the impact enterprise is vital to effectively negotiate the impact-linked incentives and the corresponding interest discounts, allow the parties to align impact incentives, and encourage respect and open communication, thus increasing transparency around the indicators, impact incentives, and loan terms.

- **Monitoring the indicators** is critical for this type of instrument. This instrument is only appropriate if both the investor and the impact enterprise have the internal capacity to go in-depth on and manage the impact indicators and ensure efficient monitoring.

- It is important for investors that provide impact-linked financing to also **offer consistent, ongoing non-financial support to the impact enterprise**. This support helps strengthen the enterprise while also reducing the risk of default, as there is an inverse correlation between default and sound business management. This ongoing support can help the company identify areas of improvement in terms of both management and efficiency while also benefiting both the enterprise and its investors by decreasing the likelihood of non-payment.