Analysis of the Impact Investment Environment

A synthesis of existing guidance and tools

People in Need, September 2020
# Table of contents

Glossary of Terms .................................................................................................................................................. 1
1 Introduction ......................................................................................................................................................... 2
2 Overview of Impact Investment Environment ................................................................................................. 3
3 INGO Models of Engagement in Impact Investment: ....................................................................................... 5
4 Needs of Investees and Type of Support Provided: ............................................................................................ 10
5 Impact investors’ approaches to measuring & managing impact ................................................................. 11
6 Organizational readiness ..................................................................................................................................... 13
7 Useful links and resources: ............................................................................................................................... 17

This publication was produced within the project “Building capacities of Czech Development Actors in Impact Investment” Financed by the Czech Development Agency.
Glossary of Terms

Business Accelerator - A business accelerator is a program that gives developing companies access to mentorship, investors and other support that help them become stable, self-sufficient businesses. Companies that use business accelerators are typically start-ups that have moved beyond the earliest stages of getting established.

The Missing Middle - The missing middle is a global challenge for small and growing businesses that are too big for microfinance and informal local investors, and too small or too risky for banks, private equity firms, development finance institutions and other direct investors, which are usually focused on financing later stage and larger companies.

Impact Measurement and Management (IMM) To a large extent an equivalent of the term Monitoring and Evaluation frequently used in international development terminology

Impact Investment - is an investment made with the intention to generate a positive, measurable social and environmental impact alongside a financial return.

Market Systems Development – An approach to poverty reduction based on the central idea that the poor are dependent on market systems for their livelihoods. Therefore changing those market systems to work more effectively and sustainably for the poor will improve their livelihoods and consequently reduce poverty.

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1 https://beamexchange.org/market-systems/glossary/
Introduction

A look at the current state of development funding shows a stark contrast between the price tag to eliminate poverty and protect the planet by 2030, and the actual financial resources that are available.

The United Nations Conference on Trade and Development (UNCTAD) says achieving the Sustainable Development Goals (SDGs) will take between US$5 to $7 trillion, with an investment gap in developing countries of about $2.5 trillion.

Private funding and private capital hold another great potential for growth. As confirmed by the Addis Ababa Agenda for Financing on Development, Domestic and international private business and finance “... are vital complements to national development efforts. Nonetheless, we note that there are investment gaps in key sectors for sustainable development. Foreign direct investment is concentrated in a few sectors in many developing countries and often bypasses countries most in need and international capital flows are often short-term oriented.”

It also recognizes the potential of new investment vehicles, such as development-oriented venture capital funds, potentially with public partners, blended finance, risk mitigation instruments and innovative debt funding structures with appropriate risk management and regulatory frameworks.

Definition of impact investment and its emergence worldwide

In the last decade, the emergence of impact investing has become an important component of both venture philanthropy as well as traditional for-profit investment, but driven by a social or environmental cause. This presents an opportunity for all development actors to increase the scope and impact of their development efforts.

Impact investment (also known as social investment) is an investment made with the intention to generate a positive, measurable social and environmental impact alongside a financial return. The growing impact investment market provides capital to address the world’s most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.

Based on a recent report from GIIN, the current size of the global impact investing market is estimated to be $502 billion with over 1,300 diverse impact investors around the world.

2 https://sustainabledevelopment.un.org/frameworks/addisababaactionagenda
3 Ibid.
4 https://thegiin.org/research/publication/impinv-market-size
2 Overview of Impact Investment Environment

2.1 2.1 Main actors

Impact investment is a diverse field and has attracted a wide variety of investors, both individual and institutional. INGOs are just one stakeholder group active in the impact investing ecosystem. This impact investment ecosystem is comprised of the following actors, with INGOs actively engaging in every part of the ecosystem:

Making investments (providing capital to impact enterprises): Institutional investors; Community development finance institutions, development finance institutions, pension funds, insurance companies, religious institutions, foundations, investment funds and banks, NGOs, microfinance institutions, multilateral institutions, public sector, venture capital firms.

Individual investors: Angel investors, Competitions, Crowdfunders, High Net Worth Individuals

Receiving Investments: Social enterprises, enterprises with social or environmental impact

IMPACT

Technical Assistance (providing capacity development for social entrepreneurs or impact investors): business consultants, business schools, NGOs, certifying bodies, fellowships, incubators and accelerators, membership organizations, financial advisors, social measurement firms, specialty law firms.

Ecosystem building (use of advocacy or convening power to strengthen the investment ecosystem and foster systemic changes):

Policy influence/Awareness: Foundations, media, membership associations

Capacity development: business schools, NGOs, think tanks

Useful Databases:

5 https://www.humentum.org/sites/default/files/amplifyreport.pdf
The GiIN’s Investors’ Council Database has information on the leading institutional impact investors globally.

The Investment profiles on the GiIN website provide a good overview of the different types of actors involved.

List of COVID-19 investment funds and investment programs [https://thegiin.org/covid19](https://thegiin.org/covid19)

### 2.2 Sources of Investments

The most common sources for funding when INGOs are making investments are high net worth individuals (72%), organization’s unrestricted funds (52%), and institutional investors (e.g. foundations) (52%)⁶.

Most common sources when INGOs are receiving investments are high net worth individuals (59%), the organization’s own unrestricted funds (47%), and institutional Investors (41%)

The funding for working as a technical assistance provider or ecosystem builder typically comes from donor funds, or a management fee is charged to clients for the services provided (either enterprises or other impact investors). Corporations have also funded many of these types of programs. For example, a survey of 164 business accelerators in 2016 found that more than half had received corporate funding.⁷ These models have not proven to be very effective for generating income by NGOs, though it can generate returns if provided alongside debt or equity investments into supported businesses by the INGO, as is sometimes done.

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⁷ Ibid.
3 INGO Models of Engagement in Impact Investment:

The three main routes for INGOs engaging in the impact investing sector are:

1. **As investors**: INGOs provide non-grant funding either directly or indirectly to projects or enterprises delivering the work on the ground. More and more organisations are taking on this role. Habitat for Humanity, for example, has followed this approach by using its own grant funds to provide micro loans to small scale entrepreneurs. Consequently, they created the first housing-specific social investment vehicle.

2. **As recipients of investment**: INGOs can receive repayable capital, receiving debt or equity investments themselves. For example, Alive and Kicking received a loan so that they could invest in their social enterprise businesses.

3. **As convenors to support others’ impact investments**: INGOs provide support to the development of the impact investment market. Given their focus on impact, their proximity to the challenges they seek to address and their extensive networks, INGOs can effectively serve as the bridge between investors and those seeking investment by playing two key roles: providers of technical assistance or as market facilitators and convenors.

The table below documents some of the key characteristics, risks and advantages of the different approaches:

<table>
<thead>
<tr>
<th>Type of actors</th>
<th>Investors</th>
<th>Investees</th>
<th>Ecosystem builders/Technical Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main function</td>
<td>Organizations that make impact investments</td>
<td>Organizations that receive impact investments &amp; establish their own social enterprises</td>
<td>Organizations who provide technical assistance or use their networks to facilitate the impact investing market.</td>
</tr>
<tr>
<td>Popularity/use of the model</td>
<td>Approx. 80% (in 2018) of NGOs engaged in impact investments made investments (90% of these were direct investments into enterprises)</td>
<td>56% of INGOs involved in impact investing were developing enterprises themselves</td>
<td>78% of NGOs were delivering technical assistance, 67% were supporting ecosystem building.</td>
</tr>
<tr>
<td>Funding model used</td>
<td>Debt is the most common (79% of NGOs) followed by equity (62%). Models include funding enterprises directly, funding fund managers, and investing in development impact bonds. Only</td>
<td>Mostly debt, equity, or a combination.</td>
<td>40% charge fees for their technical assistance, others support their work with donor funds or provide it alongside an investment through their management fee (to receive returns on this in the future).</td>
</tr>
</tbody>
</table>

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8 https://www.bond.org.uk/resources/unlocking-investment-for-social-impact
24 percent of INGOs\(^9\) target market-rate returns, investments are usually in high-impact but low-return businesses or to play a de-risking role for other investors.

<table>
<thead>
<tr>
<th><strong>Funding source</strong></th>
<th>Most common source are high net worth individuals (72%), organization’s unrestricted funds (52%), institutional investors (e.g. foundations) (52%).</th>
<th>Most common sources are high net worth individuals (59%), organization’s own unrestricted funds (47%), and institutional Investors (41%)</th>
<th>Donor funds, or a management fee is charged to their clients (either enterprises or other impact investors)</th>
</tr>
</thead>
</table>
| **Investment amounts** | Investments being made range from $10,000 to $20 million (average of $702,500, versus an average of $3.2 million from other impact investors). The size of capital needs (and business maturity stage) can be categorized as follows:  
  - Seed or ‘pioneer gap’ ($20,000 - $250,000)  
  - Early stage ($250,000 – 1M)  
  - Early growth ($1M – 2M)  
  - Mature ($2M – 10M) | Investments being made range from $10,000 to $20 million (average of $702,500, versus an average of $3.2 million from other impact investors) | N/A |
| **Timeframes** | It takes an average timeframe of six months to a year to structure and finalize a deal. Funding timeframes can range up to 10+ years for higher risk/lower return ‘patient capital’ investments. | Equals the time needed for developing a successful enterprise with social impact. Usually at least 3 years | For TA, typically enterprises require help/technical assistance for a period of at least 1-2 years before they will be ready to present to investors. Ecosystem building, however, can take up to 5+ years to ensure sustainable systemic changes. |

\(^9\) [https://nextbillion.net/ingos-impact-investing/](https://nextbillion.net/ingos-impact-investing/)
<table>
<thead>
<tr>
<th><strong>How are deals and investments sourced</strong></th>
<th>The majority source deals through in-country pipelines (93%), personal networks (83%), networks and conferences (52%), and incubators.</th>
<th>Investors are mainly found through existing networks (65%), directly approaching high net worth individuals, foundations, or corporations (59%), and donor funds.</th>
<th>Mostly using their own funds, using their networks to identify their target groups. Nearly all INGOs doing this are working with entrepreneurs/enterprises, and 28% are working with impact investors (e.g. impact measurement, deal sourcing, etc).</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main services provided and approaches used by INGOs</strong></td>
<td>Directly funding enterprises is the most common (used by 90% of INGOs), followed by setting up an investment fund (45%), investing through an MFI (24%), and investing through an intermediary (21%).</td>
<td>Expanding existing social enterprises (53%) is the most common reason for receiving investments among INGOs, followed by development of new social enterprises (47%). The majority of enterprises being operated are at a pilot stage (53%), and a quarter (24%) of INGOs have multiple enterprises at various stages of development.</td>
<td>Most common forms of technical assistance to enterprises are: operations management (87%), impact measurement (83%), and product development/marketing (70%). Impact measurement &amp; deal sourcing are the most common forms of TA to investors (26%). For ecosystem builders, 83% are doing research, 54% are doing advocacy, mainly targeting impact investors (43%), and policymakers (33%)</td>
</tr>
<tr>
<td><strong>Main Risks</strong></td>
<td>Finding credible ventures or projects in which to invest that deliver both impact and are financially viable. Lack of investment expertise (e.g. reading financial models, quantifying risk, valuing investments, etc.) is also a key risk/challenge.</td>
<td>Risk can be higher with debt, as investment must be repaid regardless of how well the enterprise performs financially, so the revenue model must generate a surplus. Equity is a means of sharing risk with the investor as they only profit when you do.</td>
<td>It has been more challenging (though not impossible) to identify fundraising models capable of generating financial returns when engaging in these roles as a technical assistance provider.</td>
</tr>
<tr>
<td><strong>Main challenges</strong></td>
<td>Biggest challenge faced was identifying and accessing funding (76%), followed by deal flow (45%), org/staff capacity (41%), and legal environment (31%). An example on the challenges of identifying investable enterprises, 1 HQ staff member’s full-time work in one year found 120 enterprises, worked closely with 10, invested in 5.</td>
<td>Biggest challenge faced was organizational and staff capacity (82%), followed by identifying and accessing funding (71%), and legal environment (29%).</td>
<td>Biggest challenge faced was identifying and accessing funding (74%), followed by organizational and staff capacity (43%).</td>
</tr>
<tr>
<td>Advantages</td>
<td>Can recycle capital (e.g. supporting multiple enterprises over time), can attract new resources (funding, expertise, partnerships), can directly support more innovations, and can ensure greater long-term financial sustainability for supported enterprises.</td>
<td>Many impact investors provide technical support and access to their networks in addition to funding.</td>
<td>Lower risk than making/managing investments, can provide a learning opportunity, can leverage INGO expertise in core areas (e.g. impact measurement, use of networks, etc.).</td>
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<tr>
<td>Other considerations</td>
<td>Need a good network of partners/enterprises to identify viable enterprises. Need a clear impact and investment strategy, and access to capital (either through own funds or another fund manager). Missing middle is very expensive: 100k $ – 1 million $, requires segmentation and the range is different in different countries. Many INGOs focus on patient capital: 10+ years investment horizon, high risk appetite and lower returns are common.</td>
<td>Organizations with fixed assets, such as property or a track-record, will find it easier to secure investment. Legal structure needs to allow it, and if not, NGOs could be a subsidiary or independent entity to take on the investment.</td>
<td>Typically, enterprises require help/technical assistance for a period of at least 1-2 years before they will be ready to present to investors.</td>
</tr>
<tr>
<td>Lessons learned</td>
<td>Terms of investment must be determined on a case-by-case basis (these typically can’t be shared due to confidentiality). Involving High Net Worth Individuals (HNWIs) can unlock new sources of capital – utilize their network, however building a HNWI network takes time.</td>
<td>Essential you have a revenue model that generates a surplus so that you are able to repay the investment. Good management is key to a good/successful enterprise. If an NGO is taking on equity, it is important to make sure the investor is aligned with their mission and that they are the right partner for them.</td>
<td>Customized technical assistance is incredibly valuable and helps to optimize revenue and impact; it also increases investors’ confidence. Consortium approaches (such as ACRE fund) are challenging to implement, better to have a fund and investment manager. These approaches should not be used for fundraising, e.g. costs are usually not even covered.</td>
</tr>
</tbody>
</table>
4 Needs of Investees and Type of Support Provided:

The constraints of investees are individual and vary considerably, but mostly relate to:

- Access to good quality staff
- Access to financial services (loans, investments, insurance)
- Infrastructure
- Technology, Know-how
- Trust of customers (esp. in case of innovations)
- Government support (e.g. gov. subsidies for competition; lack of support for SMEs)
- Enabling and regulatory environment
- Access to global markets
- Protection of intellectual property

Investors have different approaches on how to support investees, but private investors mostly provide investees with:

- Direct advisory / coaching (management, strategy, finance management, etc.)
- Contacts (linking them with potential partners, suppliers or customers)
- Analytics
- Direct financial and non-financial contracts (directly), creating business opportunities

INGOs and investment facilitators use approaches widely used within the development cooperation field, such as:

- Capacity building (e.g. accelerators)
- Market Systems Development
- Long term funding (patient capital)
- Access to know-how and expertise (advisory, mentorship, coaching -> entrepreneurs as well as employees)
- Advocacy, Improving enabling environment
- Linking SMEs with networks and corporations (to include them in supply chains)
- Access to funding (not only by matching with investors, but also complementary grants/loans/connection to FI)
- Support with building pro-poor business models
- Preparing SMEs for investment

INGOs can assist Investors for example with/by:

- Working in frontier markets, which otherwise would not be reached by investors
- Access to market information
- Building portfolios
- Building relations with investees
- Building impact vision and strategy
- Expertise in high-impact sectors (e.g. WASH, food security, etc.)
- Co-investment / blended finance / -> risk mitigation
- Sourcing deals
- Measurement of impact
- Assistance with understanding and working in local context
5  Impact investors’ approaches to measuring & managing impact

According to the GIIN Annual Impact Investor Survey 2020, 60% of investors target both social and environmental impact, with large investors (>500M USD) being more likely to focus on both (79%) than small (53%) and medium (56%) investors. The remaining focus either only on social (40% small & medium, 7% large) or only on environmental impact (7% / 5% / 4%).

73% of investors use SDGs to define their impact targets.

Measuring tools & frameworks:
- SDGs (73% reporting use for at least one purpose)
- IRIS Catalog of Metrics (46%)
- IRIS+ Core Metrics Sets (36%)
- 89% use at least one external resource, some of the remaining 11% use “proprietary” frameworks (significant improvement over the past 10 years: in 2010 85% of respondents claimed to use their own systems, and only 2% used a third-party system)

88% of investors claim that their organization has increased the rigor of its impact measurement and management practice, and 80% say that there is greater demand externally from clients to make impact investments.

Only 27% of investors have their impact performance independently verified, although 65% report publicly on the impact of their impact investments. The Operating Principles for Impact Management, launched by the IFC in April 2019, call for independent verification and have a total of 94 signatories as of May 2020.

5.1  INGOs in impact investment measurement

Experience with social impact measurement is considered one of the strengths of INGOs, which can bring value to the impact investment ecosystem.

However, only about a quarter of the 45 INGOs surveyed by INGO Impact Investing Network in December 2018 had a well-developed strategy for measuring impact:
- piloting/adapting their impact measurement strategy (38%)
- still defining/developing a strategy to measure impact (29%)
- well-developed strategy (24%)
- no strategy (9%)

The most common tools and frameworks used by INGOs in the sector are:
- Theory of Change’ (73%)
- IRIS Metrics by GIIN (56%)
- ESG (Environmental, Social, and Governance Measures) (33%)
- Acumen Lean Data (36%)
- Social Return on Investment (SROI) (24%)
The main challenges in terms of impact measurement highlighted by INGOs closely match the ones identified by top impact investment actors from the 2017 GIIN survey (and they remain relevant in the 2020 GIIN survey):

- Collecting quality data (53%)
- Aggregating, analyzing, and/or interpreting data across a portfolio (47%)
- Identifying appropriate impact metrics (36%)
- Aligning expectations with our investors and investees (33%)
- Identifying/selecting appropriate impact targets (27%)
- Using impact data for decision-making (22%)

One of the four most common ways in which INGOs engage in the impact investment sector is by providing technical assistance to impact investors. 78% of the surveyed INGOs indicated providing technical assistance to entrepreneurs, enterprises, or investors, and 23% of these provide them with support for impact measurement and/or on balancing social impact & financial returns.

5.2 IRIS

Surveys with impact investors as well as INGOs working in the sector have shown that IRIS (the initial Catalog of Metrics published in 2009, as well as the enhanced system released in 2019 under the name IRIS+) is by now the most commonly used framework (two-thirds of impact investors surveyed by GIIN, approximately half of INGOs surveyed by Amplify Impact).

Key features of IRIS+

- **Core Metrics Sets** to increase data clarity and comparability. These are backed by evidence and based on best practices across the industry.
- **Thematic taxonomy** based on generally accepted Impact Categories and Impact Themes.
- **Updated IRIS Catalog of Metrics**, the generally accepted source of standard social and environmental performance metrics used by leading impact investors.
- **Curated resources and practical how-to guidance** to support day-to-day IMM implementation.
- **Alignment with the UN Sustainable Development Goals (SDGs)**, including both SDG Goals and targets.
- **Alignment with other major frameworks and conventions**, including the five dimensions of impact and more than 50 metrics frameworks, standards, and platforms.
- **Interoperability** with third-party data platforms and systems that use IRIS metrics.

The Catalog of Metrics is organized by sector (Agriculture, Air, Biodiversity & Ecosystems, Climate, Diversity & Inclusion, Education, Employment, Energy, Financial Services, Health, Real Estate, Land, Oceans & Coastal Zones, Pollution, Waste, Water, Cross Category). The guidance provided in the Five Dimensions of Impact, the Core Metrics Sets and the Thematic Taxonomy helps users to create customized measurement frameworks; issues such as demonstrating contribution (as opposed to just change) are also touched upon in this guidance.
6 Organizational readiness

What are some key considerations and risks for INGOs just starting in this sector? Key considerations are presented in a table in the 2018 Amplify reports\(^{10}\), starting with defining well the purpose/goals underlining impact investing engagement for the given organizations. Some key considerations are presented here in more detail.

6.1 Organisational Staff Capacity

**Skilled program staff with investment expertise**: Most INGOs engaging in impact investment are establishing small core teams with investing expertise, who have the necessary expertise on structuring deals, reading financial models, quantifying risk, conducting due diligence, valuing investments, and managing funds. Engaging experts (e.g. people on investment committees, etc.) to support key tasks and decision-making related to strategy can also be a lower cost way to bring on expertise rather than full-time recruitment, and has been done by some NGOs. It is important to ensure any new staff or consultants brought on are a good cultural fit with the NGO, and can push staff to think differently while also understanding and respecting the NGO core values.

- Oxfam have prioritized a small handful of Country Programmes for their impact investing work. They appointed 1-2 long-term staff in each Country Programme, via internal funding, based in-country to sustainably maintain relationships with enterprises but also provide ongoing capacity building.

- Lessons learnt from the ACRE fund found that it wasn’t viable to combine impact investing into the job description of, for example an existing Livelihoods Project Manager or Project Officer function. A **dedicated employee** should focus on developing the investment strategy; sourcing and screening businesses; conducting due diligence and ensuring alignment with the legal environment and financial regulations; maintaining relationships with investees, partners and investors; providing mentoring support to investees; collecting data and measuring impact.

**Using existing human resources effectively**: Existing members of the team with relevant experience should also be leveraged, such as finance staff, and project staff who have worked with MFIs and have entrepreneurship/enterprise development experience.

**Investments in training and capacity building**: There should be a well-defined internal training program or strategy to help build staff capacity to engage in the impact investing ecosystem. This can include trainings from external training providers, along with ongoing coaching from experts (sometimes accessed through NGO board members).

**M&E expertise**: NGOs should have a strong M&E team that is knowledgeable about impact investing and the specifics of social impact measurement and related metrics and industry standards.

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\(^{10}\) Amplify (2018) *The Next Mile of Impact Investing for INGOs*. Published by the INGO Impact Investing Network.
Ensuring organisational buy-in and involvement: There should be steps taken to support greater awareness and interest in the impact investment work across the organisation. This can be done through gradually building up the impact investing work, by assigning employees across the organization to provide inputs into developing the strategy, and further use of market-based development programming.

6.2 Identifying and acquiring funding

- **High-net worth individuals** are often recommended as a key resource for impact investors. Whilst NGOs may have a good private donor base to draw on, it is essential that there is a clear communication and donor targeting strategy mutually agreed on between different internal departments prior to external communication so as not to undermine future fundraising efforts.

- **Networks and partnerships**: organization needs to actively engage experts in the field. The organization should conduct a thorough exercise to identify different partners and intermediaries within the geographical and sector areas of focus.

- The Access to Capital for Rural Entreprises (ACRE) fund had originally planned a syndicate model in which they would charge the investors 10,000 GBP per year for receiving a pipeline of screened enterprises. However, they found that this model was not viable and ended up subsidizing their work by grant funding. The ACRE fund had structured itself to take route 3, linking up investors directly to the enterprise. However, a number of factors, including the administrative burden and complicated nature of matching investors to investees, meant that they recommend INGOs to establish a fund that investors could contribute to (route 1) instead of the syndicate model.

6.3 Deal flow

- An example of an impact investor’s staffs member’s work in 1 year: screened 120 enterprises, worked closely with 10, invested in 5. Having a strong screening and due diligence process is essential for ensuring the success of the investment.

- **The concept of the “missing middle” is very big and means different types of businesses in different countries.** Whilst NGOs may decide on a limit for the size of investments (e.g. up to 50,000 USD) this may not be relevant for filling in the gap of existing financial services in-country. NGOs should conduct an analysis of existing financial services in each targeted country to understand the gaps in the availability of appropriate investment (size, terms and conditions) and barriers our target groups face in accessing these services in order to define its own strategy.

- A useful framework for segmenting businesses (breaking up the very large ‘missing middle’ category), their finance needs, their motivations and growth potential, and their impact
potential, is through using the Enterprise Segmentation Framework\(^\text{11}\). NGOs can use this framework to better define their strategy and target group for their initial engagement in impact investment. This will be useful as it has implications for financing and other needs of these businesses, along with their impacts on livelihoods and the economy. The framework puts SMEs into the following four categories:

![Enterprise Segmentation Framework Diagram]

6.4 **Legal environment and organizational and legal structures**

- The legal environment in relation to investment can vary significantly across different countries in which we may want to make investments. Additionally, the trading and financial regulations that exist between the country from which the investment is made and where the investee is based may also vary. An in-depth understanding of the legal environment is

\(^{11}\text{https://www.omidyar.com/sites/default/files/Enterprise_Segmentation_Report.pdf}\)
essential to minimise risk to NGOs, the investor and the investees and therefore restricting impact investing work to, for example, 2-3 countries for the initial 3 years is recommended.

- Identifying the organizational structure within which impact investment activities will be implemented is an important consideration. There are a range of models from establishing separate entities which maintain a structural link with the NGO to having an impact investment program within the NGO itself (examples include developing subsidiaries, independent funds, externally-managed funds, set-up a foundation, etc.).
7 Useful links and resources:

- Organizational readiness Amplify table
- https://nextbillion.net/finance-access-emerging-markets-smes/
- https://thegiin.org/