Innovation in Development Policy:
Maximizing Impact and Results

Testimony Submitted by
Alix Peterson Zwane, Ph.D.
CEO, Global Innovation Fund

House Committee on Foreign Affairs
Subcommittee on International Development, International Organizations, and Global Corporate Social Impact

Friday, April 16, 2021

Chairman Castro, Ranking Member Malliotakis, and members of the subcommittee, thank you for convening this hearing on maximizing results in development through innovation. It comes at an important time for the country, and the world, as we build back better from the global pandemic.

Before I begin, I would like to recognize and congratulate the Committee on the creation of this Subcommittee. The work you are doing here is vitally important, made even more so in the current global crisis, and I very much appreciate the chance to join you to share my thoughts on how best to drive innovation and maximize its impact.

For the international development community, 2021 presents an opportunity and an obligation. Accelerating innovation in development agencies and programs is vital for building back the progress lost, or at best paused, by the pandemic. The World Food Program estimates that 149 million people (including refugees) were acutely food insecure in 2019 and COVID-19 is projected to have brought that total number of people to 272 million by the end of 2020. Such deprivation has not only a short-run toll. It makes pregnancy riskier and makes it harder for children to thrive with lasting consequences. Because aid budgets are only a fraction of the resources needed to recover lost ground and equitably grow the global middle class, we need to get more capital off the sidelines for development innovation too.

I am the CEO of the Global Innovation Fund, or GIF, which was launched by the United States and United Kingdom governments in 2013, as a multilateral vehicle for investing in innovation, making early stage debt and equity investments, as well as grants, to improve the lives of poor people. Since then, the governments of Australia, Canada, and Sweden have backed GIF, along with private philanthropies and corporations. I have included an annex with further details about the organization and how we contribute to tackling development challenges.

Innovation is typically defined in the development context as new solutions with the potential to address an important development challenge more effectively and cost-effectively than existing approaches. Innovation in development allows scarce resources to go further and compresses timelines to meet development goals. While this was also true before the pandemic, it is particularly important at this moment.

Innovation offers significant social returns, often greater than traditional aid models. As an example, just five of GIF's early innovations, have generated over $53 million in discounted social benefits directly attributable to GIF's investment. With modest assumptions, projecting

out five years, just these five investments will generate $134 million in discounted social value, recovering the costs of GIF's entire early portfolio and its operations. Even when some bets on innovation don't pay off, the portfolio as a whole can. This work was inspired by an analysis led by Nobel Prize winning economist Michael Kremer for Development Innovation Ventures, one arm of USAID that funds innovation, calculates that over eight years they have generated a social rate of return of at least 77 percent.

These rates of return compare favorably to several benchmarks. The social value being generated by GIF's current portfolio, even after adjusting for risk, is some 180 times greater than the social value that would be created by deploying the same amount of money as cash transfers – a bedrock element of best practice in social protection – to people who live on less than five dollars a day. Peer-reviewed research estimates the overall social return for all development assistance is about 11 percent.

The promise of innovation is that it is fundamentally catalytic, such that the most promising approaches can be scaled by others, whether local governments or through private investment. Because of this, it can be a highly leveraged use of scarce resources.

The benefits of innovations can best be captured by the application of two related policy principles:

- Measuring impact and using that information for investment decision-making; and
- Strategically structuring investment vehicles to create the right balance between flexibility and accountability in deploying capital.

I'll talk today about these two principles and recommendations for this subcommittee to consider as you reflect on what comes next for the innovation agenda in American development assistance.

Measuring impact

Let me illustrate an example of the importance of measuring impact when investing in innovation. In 2016, GIF provided a convertible loan to a company working in Uganda to take the idea of a safer, more professional motorbike taxi service to scale. This would be a new market, in a context where only informal taxis existed before.

The innovation here encompasses not only technology but also new business models and strategies for service delivery. The company was building a market while selling into it, uncertain that they could generate demand for their innovative solution. Commercial investors, interested only in risk-adjusted financial returns, might want to see more proof of traction before investing. Absent an investor like GIF, the promising new approach might have struggled to get past its pilot phase, as we often see in international development.

Just as commercial investors quantify their financial returns, innovation in development requires quantifying the social returns on investment when making a funding decision. In this case, the potential benefits were significant. Two hundred deaths, and many more critical injuries, would be prevented by 2020 if the company was successful. In practice, it generated some $9 million in discounted net social benefits between 2016 and 2020 and returned more than seven dollars in social benefits for every dollar initially invested. For the impact-minded, it is the potential for this social value that justified the investment in this early-stage company.

And while GIF was the first institutional investor when funding it was risky, we were able to exit in 2018 when commercial capital came to the table.

After the initial investment decision, measuring impact becomes a risk mitigation tool as the investment matures. If the evidence of impact is not what was expected, you can suspend the investment, just as a private investor would, based on market conditions. Positive evidence of impact can crowd in new funders. This is particularly the case with local governments, which often find experimentation challenging.

Taken together, estimates of social benefits allow you to assess the value of not just individual deals but portfolios at a time when innovation must address disparate but interrelated development challenges including pandemic recovery, climate change, and gender equality. At GIF, we've developed an impact measurement tool, that allows for such comparisons as one approach guiding investment decision-making in pursuit of the greatest potential for development impact. Similar approaches are being used at the DFC and MCC.

Structuring Investment Vehicles

Governments can create investment vehicles and innovation units strategically, to more easily unlock the value and social impact of innovation.

First, more development impact can be delivered through a financing vehicle with the flexibility to use a range of financial instruments. These instruments include equity, debt, grants, impact bonds, and blended instruments. The choice of instrument depends on the capital needs of the innovator or entrepreneur, their business stage and risk profile, and the route to growth and scale of the innovation.

One way to do this is by working through independent intermediaries that can engage directly with the private sector. This reduces the potential for politicization of investment decisions and makes it easier for capital to be deployed on the timescales of private investors. These outside entities can make smaller ticket investments, which is the kind of capital often needed by innovators, more effectively than government agencies can and can free up the U.S. Government's scarce human capital to focus on strategic oversight and governance of these partners.

Second, building in transparency mechanisms is essential for ensuring accountability. The DFI Transparency Initiative run by the non-profit Publish What You Fund is urging DFIs, aid funders, and intermediaries to clearly publish metrics around their investment priorities and performance, and data on impact, to drive better accountability and decision-making. U.S. aid agencies have an excellent track record in this regard in their core programming; the opportunity now is to push the boundaries on what can be expected in engagements with the private sector, sharing information on expected financial and social returns, at least at the portfolio level.

Third, governments can set parameters or other requirements around measuring and reporting impact and ensuring a clear mandate to crowd in private capital, not crowd it out. They can require strong environmental and social due diligence and a gender analysis of investments, without weighing in on any individual deal in particular. For example, when Global Affairs Canada joined GIF, they created the Innovating for Gender Equality Fund. This fund is specifically focused on finding and funding innovations to transform unequal gender relations

and increase the agency of the world's poorest women and girls. This means, in part, backing innovations that ensure freedom from violence for women and girls, which is of critical importance as COVID-19 has exacerbated the shadow pandemic of gender-based violence.

It is possible to prudently invest in a portfolio of high social return innovations by linking funding amounts to the probability of successfully delivering impact at each stage. Governance requirements can tie an investor's financial exposure to evidence of impact and potential for scale. This is critical to ensure the risk-reward ratio is balanced, as in the Uganda example. One way to do this is with a staged investment process where each stage is a test; if an innovation is effective at one stage it can be tested at a larger scale. If a market-based innovation is failing to scale, it can be revised or abandoned, and lessons can be learned by the innovator, by funders, and by the broader development community.

Fourth, funding for innovation requires flexible capital. An investment vehicle is not an implementing partner or a discrete development project. While finding flexible resources may be challenging, it has distinct benefits for the donor agencies. Flexibility allows for a pivot to respond to events, such as the pandemic. GIF, for example, was able to shift focus early in 2020 and devote resources to not only new deals related to COVID-19, but also provide current partners support to shore up the social impact we had worked with them to create.

GIF's donor partners commit to a compact in which flexible funding is provided in return for high levels of transparency and the commitment to measuring and reporting impact. Based on the successful track record of GIF, I believe it is possible for development agencies to provide ongoing oversight and flexibility to intermediary investors, in return for the social returns that innovation creates.

Finally, advance the American innovation agenda through multilateral partnerships. When like-minded governments come together to back innovation, each government has limited exposure to the portfolio's risk, relative to if they were to go it alone, while leveraging each other's funding. Working together creates opportunities to learn from each other as well. The US government has done so much to lead on innovation within its development agencies, now is a strategic time to lead on innovation internationally too.

Taking smart risk, protecting taxpayer dollars, and generating evidence can drive a virtuous cycle.

The question remains, what can be done to further encourage the government to advance development by derisking private sector investment, funding new pilots and, as importantly, scaling up those with evidence of success? Too often, we see innovations that never move to the next stage on the path to scale.

You have addressed some of this already, Mr. Chairman, in previous bills and I would wholeheartedly endorse your proposal from 2016 to provide challenge grants and allow for the hiring of new subject matter experts at USAID.

I would add that innovation should be a cross-cutting theme of post-pandemic development assistance at USAID and beyond and so submit these additional recommendations:

- Authorize funding mechanisms to normalize the flexibility needed to support innovation. At the same time, flexibility without transparency and evidence can invite serious problems. Marrying this flexibility with a focus on evidence and transparency is critical for accountability whenever using taxpayer dollars.
- Evidence generation is critical for mitigating this risk inherent with Innovation. USAID has already identified a number of shortcomings the agency has in this regard and are working to increase their capacity (https://pdf.usaid.gov/pdf_docs/PA00X78R.pdf). This effort should be applauded and accelerated.
- USAID could reinstate the Chief Innovation Officer role with responsibility for innovation design and integration, and accountability once the concepts are mainstreamed. This person should work closely with the Policy, Planning and Learning leadership to ensure proper evidence and feedback loops are institutionalized.
- The Millennium Challenge Corporation (MCC), which already has many of these evidence and feedback loops built in their programs, is constrained in its ability to support innovation by both the country-only focus and the rigid compacts negotiated years in advance of implementation. Their new regional compact authority should allow for regional innovation funds to which other donors could contribute. In addition, MCC could develop country-specific funds with an open window meant to derisk innovations. This would require mechanisms needed to maintain the capital deployment beyond their engagement in-country, as patient capital is what would be needed by the firms they will back.
- The Development Finance Corporation has a mandate for development and impact, and their promising Impact Quotient tool is similar to GIF's own impact measurement tool. Their desire to demonstrate impact could align with USAID's interest in sustainable, private sector led solutions by backing a new fund dedicated to impact, creating a bridge between grants and finance. USAID's expertise in government and regulatory capacity building aligned with the DFC's expertise in supporting the private sector would make a very powerful combination. Practically, thanks to the BUILD Act, USAID can provide grants for certain types of capacity building or to measure impact, alongside debt from the DFC.
- Building on the successful example of the 2X Challenge, born from OPIC and then the DFC, encourage the DFC to pursue more opportunities that leverage scarce development resources by pooling capital and risk to crowd in private capital. Pooled funds also deliver efficiencies in terms of cost-sharing and the development of strategic resources, such as impact analysis frameworks. You can imagine a scenario where investors, including development finance institutions, pool together in special purpose vehicles to pursue development impact that allow scarce taxpayer dollars to have more expected impact with lower risks.

Mr. Chairman, Ranking Member, and Members of the Sub-Committee, the case for the effectiveness in foreign assistance is made. Now is the time to ensure that the necessary authorities, influence, and resources are deployed towards backing innovation at the heart of the U.S. development assistance to support developing nations to recover from the pandemic while protecting America's prosperity, and security.

Thank you for inviting me to speak today and I welcome your questions.

Annex: About the Global Innovation Fund

The Global Innovation Fund is a multilateral non-profit innovation fund powered by governments, philanthropies and companies that invests in the development, rigorous testing, and scaling of innovations targeted at improving the lives of the world's poorest people.

Through our grants and risk capital, we help breakthrough solutions to global development challenges from for-profit firms, non-profit organizations, researchers, and government agencies to maximize their impact and affect meaningful change.

Across our portfolio, we support innovators who are committed to using and generating rigorous evidence about what works. We offer financing from USD $50,000 to $15 million, with the largest funding amounts reserved for innovations that can demonstrate evidence of success and that have potential to spread across multiple developing countries.

GIF's mandate is not constrained by sector or geography, but impact must benefit people living under $5 per day and have the potential to reach millions of people. GIF was designed to support innovators at all stages of their life cycle, from start-up and pilot-testing through to larger-scale refinement of implementation and evidence is at the heart of GIF's staged approach to investment. We take well-informed risks in pursuit of high social benefits and, as we do so, we embed learning into each investment we make.

Through grants, loans (including convertible debt) and equity investments ranging from $50,000 to $15 million, GIF's mandate is to support innovations broadly defined, whether they are new technologies, business models, policy practices, technologies, or behavioral insights.

GIF uses a tiered financing model, offering graduated funding. A stage is defined by how far along an innovation is in its development and by the level of evidence that supports its potential for success.

GIF has three stages of financing. The goal of stage one, the pilot stage, is to refine the basic concept or business model and establish the viability of an innovation at a small scale through testing in real world contexts. This stage could include initial research and development, introducing an innovation to target customers, assessing user demand and willingness to pay, or documenting social outcomes and costs of spreading the innovation.

The second stage, test and transition, is for innovators who require support for continued growth and for assessing the likelihood that the innovation can achieve social impact and/or market viability at a larger scale. During this transition period, innovators may require funding to test new business models or to make operational refinements.

The third stage, scale, helps innovators transition successful approaches to a large scale, usually with the goal of eventually achieving widespread adoption in one or more developing countries.