

RG-T2495 - Accelerating Social Impact Enterprises in Latin America and the Caribbean
TC Document

I. Basic project data

▪ Country/Region:	Regional
▪ TC Name:	Accelerating Social Impact Enterprises in Latin America and the Caribbean
▪ TC Number:	RG-T2495 and RG-T2534
▪ Team Leader/Members:	Lourdes Gallardo (OMJ/OMJ), Nathaniel Jackson (OMJ/OMJ), Lina Salazar Ortégón (OMJ/OMJ), Brian Muraresku (LEG/NSG), George Rogers (LEG/NSG).
▪ TC Type	Client Support
▪ Reference to Request: (IDB docs #)	38969004
▪ Date of TC Abstract Authorization:	5/16/2014
▪ Beneficiary	Population at the base of the pyramid in LAC
▪ Executing Agency and contact name	Jose Molina. Shell Foundation - Jose-Jorge.Molina@shell.com. Shell Centre. London, SE1 7NA, United Kingdom.
▪ Donors providing funding	Infrafund (\$600,000), Sustainable Energy & Climate Change Fund (\$400,000)
▪ IDB Funding Requested:	\$1.0 million
▪ Local counterpart funding, if any:	\$1.5 million
▪ Disbursement period	36 months
▪ Required start date:	September 1 st 2014
▪ Types of consultants	Firm consultants
▪ Prepared by Unit:	OMJ/OMJ
▪ Unit of Disbursement Responsibility:	OMJ/OMJ
▪ Included in Country Strategy / TC included in CPD	No/ No
▪ GCI-9 Sector Priority:	PA 2: Infrastructure for competitiveness and social welfare. PA 5: Protection of environment, response to climate change, renewable energy and enhancement of food security.

II. Objective and Justification

- 2.1 The main objective of the TC is to identify, test and scale innovative market-based solutions in the energy and sustainable infrastructure¹ for the base of the pyramid² (BOP) population in Latin America and the Caribbean (LAC). Specifically, through an incubation/scale up methodology created and implemented by the Shell Foundation (SF) since 2000, the TC will leverage SF's resources and expertise to accelerate the development of commercially viable business models that increase access to energy and sustainable infrastructure solutions for the BOP in LAC (view examples in Annex 5), and to bring these to scale through financing from Opportunities for the Majority (OMJ). The SF will match the IDB's grant contribution over the same period of time along with active and ongoing business support to enterprises supported.
- 2.2 A key challenge companies serving the BOP in Latin America and the Caribbean with innovative products and services faces is the need to pilot their pre-commercial concepts in the market. Lacking such demonstrations, they cannot test distribution and consumer interest more fully before they could be considered by the IDB for debt financing. These companies must develop, iterate and refine their models by testing them in a risky and low-margin marketplace. Particularly in introducing new concepts among the BOP, these companies in the region also have to invest heavily in identifying distribution platforms, establishing strategic partnerships, developing a reliable network of suppliers, educating customers, among other aspects. Although these firms offer innovative solutions, investors need to carefully consider risk profiles, low initial returns, and to ensure that business models are commercially viable. This TC responds to these tough challenges that call for early stage technical assistance for these companies as they evolve from start-up to eventual scale. It also answers to the lack of funding for incubation and preparation of scalable energy and sustainable infrastructure projects that respond to the most common challenges of the region's BOP. According to the IDB, approximately 34 million people in LAC have no access to electricity and nearly 85 million lack access to clean modern cooking fuels. Moreover, LAC's high rate of urbanization (80%) and the prospect of 315 million people moving to the region's largest cities by 2025 pose infrastructure challenges related to transportation capacity, urban planning, technology for mobilization, among others.
- 2.3 A partnership with the Shell Foundation will allow the IDB to i) support business models with high probability of absorbing debt from OMJ; ii) have a catalytic effect by efficiently mobilizing early-stage resources for sustainable infrastructure; iii) support projects in sectors where traditionally there's been low degrees of private sector participation; and iv) support projects in smaller economies where entrepreneurs are less likely to have access to grant resources. Moreover, the IDB additionality through OMJ will be to refine the business models' focus on the BOP, the expertise in tracking performance, and to identify potential projects in Latin America and the Caribbean.

1 Business models in the energy and sustainable infrastructure sectors refers to market-based solutions that increase access to climate-friendly solutions in energy services (electricity and natural gas), mobilization, and urban development, for the base of the pyramid in Latin America and the Caribbean.

² We define the BOP as those with incomes of at most US 10 dollars per day (or US 3,650 dollars per person per year), measured in constant dollars of 2005. This threshold corresponds to the 69th percentile of the Latin American income distribution, which represents more than two-thirds of the population of the region population live below this income line.

- 2.4 This TC is aligned with the GCI-9 priority areas, in particular i) infrastructure for competitiveness and social welfare and ii) protection of environment, response to climate change, renewable energy and enhancement of food security.

III. Description of activities and outputs

3.1 **Component I. Replication and validation of business models in LAC**

- 3.2 The objective of this component is to support the replication of proven business models in the access to energy or sustainable infrastructure sectors and to validate the potential for replication of business models in need of capacity building. The projects to be supported will be selected jointly by OMJ and the SF. This specific component is aligned with Section 4.11 of the Infund Document. The validation and support for replication of the business models will require feasibility studies, transfer of know-how and strengthening local capacity, among others.

- 3.3 **Activity 1: Validation of business model.** The SF will help companies in the access to energy or sustainable infrastructure sectors with existing and successful business models (in other countries outside of LAC), validate the potential for replication in LAC and provide the corresponding support for replication by building capacity for market entry. Capacity building includes training, design of marketing strategy, feasibility studies, refining distribution channels, logistics, and human resources, among others.

- 3.4 **Activity 2: Support for replication.** The SF will support the replication of existing business models whose market viability (component 1) has been tested by building capacity for market entry. Capacity building includes training, design of marketing strategy, refining distribution channels, logistics, and human resources, among others. Support for replication will only happen once the appropriate market segments for entry are identified. The SF will be in charge of determining the readiness for replication of the business model.

3.5 **Component II. Incubation of new business models in LAC.**

- 3.6 Entrepreneurs with disruptive³ solutions in the access to energy and sustainable infrastructure sectors often face a first mover disadvantage in identifying and building a viable market for their solution. The objective of this component is to identify the market gap and launch the initial pilot for new business models in their early pre-investment stage. The SF incubation model aims at mitigating early stage market risk by providing business support beyond funding. Business support includes training, design of marketing strategy, refining distribution channels, logistics, and human resources, among others. This specific component is aligned with Sections 4.2 (a), particularly project identification activities, and 4.11 of the Infund Document. The identification of market gaps and initial pilot will require feasibility studies, transfer of know-how and strengthening local capacity, among others.

³ Disruptive market-solutions are those business models whose processes, products, or services have such unique characteristics that adoption may involve a “paradigm change”. Break-through innovation is of critical importance. Incremental innovation improves on an existing solution, but better alternative solutions arise through disruptive innovation efforts. Smart phones might be a good example of disruptive innovation, whereas an ultra-thin, lightweight cell phone is an incremental innovation. A project can be considered disruptive if it is the first time that such a business model is being replicated in LAC.

- 3.7 **Activity 1: Identification of market gap.** The SF will work closely with the entrepreneur to identify the consumer behavior and appropriate go-to-market strategy for the business model. This activity will include, among others, (i) building financial models and refining the BOP focus; (iii) determining the most cost-efficient and reliable procurement channels; (iv) developing and testing sales and marketing strategies; (v) refining inventory management and business processes; (vi) refining product portfolio for the local market and (vii) developing a methodology for tracking social and economic performance of final beneficiaries in the BOP market, (viii) building organizational capacity, legal structure, (viii) market research support to identify appropriate partners.
- 3.8 **Activity 2: Implementation of initial pilot.** The SF will work closely with the entrepreneurs selected in the implementation of the initial pilot, achievement of model validation milestones and building of initial capacity.
- 3.9 **Component III. Evaluation**
- 3.10 **Activity 1: Final evaluation of the TC.** OMJ will directly hire a consultant to produce a written qualitative independent assessment of how the grant resources were used and allocated in accordance with the components. The independent assessment will evaluate if the implemented activities fulfilled their expected outcomes and results. It will be done when the execution is complete.

Component - Activity	Expected Outputs	Expected Outcomes
C1. Replication and validation of business models		The IDB and OMJ will leverage the expertise and efficiency of the SF, resulting in at least three new clients in sectors with high impact potential. OMJ will build a pipeline for potential financing of at least three projects in the BOP access to energy or sustainable infrastructure sectors. All of these will have to meet the OMJ selection criteria and go through the IDB's regular filters and approval processes. OMJ will keep positioning itself as a pioneer and a thought leader in the field of BOP business models.
A1. Validation of business model	At least <u>two business</u> models that are validated for replication in the access to energy or sustainable infrastructure sectors in LAC.	
A2. Support for replication	At least <u>two business</u> models that are replicated in the access to energy or sustainable infrastructure sectors in LAC.	
C2. Incubation of new business models		OMJ will keep positioning itself as a pioneer and a thought leader in the field of BOP business models.
A1. Identification of market gap	At least <u>three new business</u> models that are incubated in LAC in the access to energy or sustainable infrastructure sectors.	
A2. Implementation of initial pilot		
C3. Evaluation		By supporting the replication and piloting of innovative business models focused on the BOP, the IDB will keep having a high development impact in the region.
A1. Final evaluation of the TC	An assessment of the TC and how the grant resources were used and allocated in accordance with the components.	

IV. Budget

- 4.1 This joint IDB-Shell Foundation program has been designed as a US\$3 million initiative. Shell Foundation has already committed \$1.5 million. Although the current TC was approved for \$1.0 million, the TC team will be able to request an additional US\$500,000 in 2015 or 2016, when disbursements of the current approved amount has reached 75% under Components 1 and 2.

Indicative Budget (US\$)

Activity/Component	IDB Funding		Counterpart	Total
	Infrafund	SCI		
C1. Replication and validation of business models				
A1. Validation of business model	\$300,000		\$300,000	\$600,000
A2. Support for replication		\$300,000	\$400,000	\$800,000
C2. Incubation of new business models				
A1. Identification of market gaps		\$100,000	\$500,000	\$600,000
A2. Implementation of initial pilot	\$275,000		\$300,000	\$600,000
C3. Evaluation				
A1. Final evaluation of the TC	\$25,000			
Audit**			\$0	\$0
TOTALS	\$600,000	\$400,000	\$1,500,000	\$2,500,000

*** The audit will be an in-kind contribution by the Shell Foundation (executing agency). It will follow the IDB policies. There will be two audits throughout the execution period.*

V. Executing agency and execution structure

- 5.1 The Shell Foundation was established by the Shell Group in 2000 as an independent charity and focuses on social issues linked to access to energy and sustainable infrastructure by developing and scaling innovative, entrepreneurial solutions that target the BOP. It has a mixed board of trustees and its funding goes up to US\$25 million per year. Though independent, the SF leverages its relationship with Shell where appropriate. The SF uses patient and flexible grant funding as its primary instrument and provides extensive hands-on business support to entrepreneurs with disruptive market-solutions. SF's model focuses on: i) a few well-targeted, long-term partnerships; ii) building disruptive market-based solutions; iii) targeting financial sustainability; iv) complementing resources with business support; v) monitoring progress and

vi) transparent reporting. SF intends to scale up its incubator model in Latin America and the Caribbean using its own funds and the IDB's support.

- 5.2 Since its creation, the SF has deployed \$170 million and leveraged an additional \$3.9 billion resulting in 17 million lives improved, 4.6 million tons of carbon offset, and 28,800 jobs created. SF also has an established track record in managing restricted funding from government bodies and DFIs. The SF is currently managing over \$14 million of grant funding from the UK's Department for International Development (DFID), and has worked with USAID and the OPEC's Fund for International Development. SF was featured as a case study on how to blend grant financing with investment capital to bridge the pioneer gap, in 'Blueprint to Scale' and was recognized for its role in building markets in 'Beyond the Pioneer', both Monitor Deloitte reports.
- 5.3 The SF incubation model focuses on six areas of business growth: i) catalyzing innovation; ii) piloting; iii) creation of pioneers; iv) support to scale-up; v) tackling market barriers; and vi) market building (See Annex 1). SF created its own in-house incubator program to help entrepreneurs identify and build a viable market for their proposed solution and ultimately gain financial viability. In these cases SF typically identifies a market gap and funds an initial pilot. Initial pilot grants (typically around \$300,000) are used to enable an enterprise to achieve carefully selected milestones needed to validate the model, which can be proving demand for their solution, early prototyping or building initial capacity. In specific cases where the identified models have a strong technology component, SF works with Factor(E), which it co-created with the Colorado State University (CSU) in 2013. Factor(E) works closely with early stage entrepreneurs to transform their ideas into innovations, covering technology advising and product development as well as business plan and fundraising efforts.
- 5.4 In cases where SF incubator grantees have completed initial validation of their models using grant funding, SF supports the capacity building and readiness for scale phases of an enterprise, blending its own grant financing with 'investment' capital at the appropriate time (see Annex 2). Core to the SF incubator approach to mitigating early stage market risk is to provide significant levels of business support beyond funding. SF incubators officers spend significant time helping entrepreneurs in-country and where external expertise is required, SF draws on its networks or on functional area experts within the Shell Group to support companies where possible.
- 5.5 Decision-making regarding companies' selection will be based on: i) Viability and scalability of the initiative to address a major development issue and increase the access to energy and sustainable infrastructure to the BOP; ii) credibility and competence of the company; iii) ability of SF to offer resources and business support; and iv) location (Latin America and the Caribbean) and target population (BOP defined as the population in LAC earning less than US\$10 per day (PPP, 2005). Annex 3 provides more detail on other criteria taken into account. The IDB and the Shell Foundation will select the companies jointly. OMJ will consult other areas and specialists of the Bank (e.g. INE/INE, INE/ENE, INE/TSP, IFD/CTI, VPS/ESG, etc.) on a project to project basis in order to leverage sector knowledge and disseminate lessons learned.
- 5.6 **Policies for the procurement of goods and works.** The procurement of goods and works will be carried out by the SF in accordance with appendix 4 of policies GN 2350-9 and GN 2349-9 approved by the IDB in April 2011. OMJ will perform due diligence to determine that SF's

procurement and financial management procedures follow established private sector or commercial practices that are acceptable to the IDB.

- 5.7 **Financial management.** Financial management comprises budgeting, cash management, financial accounting, managerial accounting, financial reporting, internal controls (audit), and external controls. The SF will execute the TC using the IDB's Financial Management Policy. The guideline will be policy OP-273-2.
- 5.8 **Execution.** Coordination with the SF will be led by Lourdes Gallardo, OMJ's Specialist (Email: mgallardo@iadb.org, Phone: 202-623-1821). The SF will act as the grant manager for IDB's contribution to the selected companies. The SF will monitor implementation to ensure that entrepreneurs or companies selected remain aligned to agreed milestones and targets and will defer/suspend installments if these are not met. The SF will be responsible for quarterly reporting to the IDB on financial and de-risking progress of the business models. Disbursements by the IDB will be made against reviewed and approved reporting. Among the IDB's tasks are: leading discussions with SF on the TC implementation; ensuring coordination of activities with IDB management and risk teams; coordination with IDB country offices where appropriate; guiding the annual and project completion reports; managing the project evaluation; and leading lesson sharing of with internal and external audiences. Others include financial management of the project; and ensuring appropriate IDB funds allocation.
- 5.9 **Governance.** The Shell Foundation, as Executing Agency, will deploy the resources to the various selected implementing partners which should all be incorporated in one of IDB's member countries. The Foundation will monitor implementation to ensure that partners remain aligned to agreed milestones and targets and will defer/suspend instalments if these are not met. It will be responsible for financial and progress reporting to IDB. The reporting will include a quarterly report on milestones by social enterprise and an annual financial report.
- 5.10 A project team, consisting of Shell Foundation's program managers and the IDB's team, will meet face-to-face semi-annually for progress updates (this may be more in the first 6-9 months of the partnership). A full narrative and financial report (i.e. the invoicing/payment requirements) will be provided by Shell Foundation as well as an overall update on individual implementing partners. Annually, IDB will complete an annual review based on reports and other data sources. A broader meeting with all implementing partners will be setup at the beginning of the annual review process with partners either joining by telephone or video conference.
- 5.11 Lourdes Gallardo, OMJ's Specialist, will supervise and monitor disbursements of this TC. Disbursements will be in US dollars as will be specified in the legal agreement and will be authorized by Gerhard Lair (GERHARDL@iadb.org), Lead Specialist (ORP/GCM) and Fund Coordinator (Infrafund and SECCI). A detailed disbursement schedule for the SF and the IDB will be included in the legal agreement. The IDB's disbursements are independent from those of the SF. See Annex 5 for details on disbursements.

VI. Project Risks and issues

- 6.1 There is a risk that there won't be enough business models or companies that fit the funding profile either for replication or incubation. In order to mitigate this risk, the project will be launched with an existing potential pipeline that includes companies already identified by both

the SF and the IDB. See Annex 4 for the potential pipeline. This and OMJ's and SF's network in the region and knowledge of current grant needs in the field should offset this risk.

- 6.2 There may be challenges regarding companies' sustainability in the long term and market consolidation. In order to mitigate this risk, the project's pipeline includes companies that have proven successful in other parts of the world. Piloting these models in Latin America and the Caribbean does imply certain risks typical of this kind of endeavors. Nevertheless, SF's methodology and experience (focused on strict due diligence and comprehensive market research and consumer identification), the selection criteria noted in the annex, as well as the IDB's know-how and knowledge of LAC will help tackle this risk.
- 6.3 There is a risk of coordination problems between OMJ and the SF. This risk will be offset by quarterly meetings between both parties as well as the formal commitment to keep permanent flows of communication and reporting on the accomplishment of the main milestones.
- 6.4 There is a risk that participating companies lack commitment or interest. In order to mitigate this risk, a part of the companies in the pipeline have developed a strong relationship with SF and are looking to replicate their business models in LAC. Additionally, as part of its role as an Executing Agency, the SF will establish legally binding relationships with each one of the different grantees under terms that secure their commitment and participation. The same scheme will be applied to new companies participating in the incubation phase. SF's good practices and know-how on grantee relationship will be applied.

VII. Exceptions to Bank policy

- 7.1 There are no exceptions to Bank policy and all Bank procurement policies and guidelines will be followed.

VIII. Environmental and Social Classification

- 8.1 There are no environmental and social risks. The TC has been ranked in category C by ESG.