



HPG Commissioned Report

New financing partnerships for humanitarian impact

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Contents

Boxes, tables and figures	v
Acronyms	vii
Glossary	ix
Foreword	xi
Executive summary	1
1 Introduction	3
2 The humanitarian challenge	5
2.1 Humanitarian crises in the 21st century	5
2.2 Key players in humanitarian system	6
2.3 Humanitarian phases and activities	6
3 Introduction to innovative finance	9
4 Humanitarian financing challenges and investment solutions	11
4.1 Not enough funding	11
4.2 Funding arrives too late	15
4.3 Inefficient funding	17
4.4 Short-term solutions	20
4.5 Lack of economic opportunities	20
4.6 Research and development costs are too high	22

5	Legal and practical considerations for working in humanitarian contexts	25
5.1	Humanitarian principles	25
5.2	Legal considerations	26
5.3	Voluntary initiatives for corporate responsibility	27
5.4	Operational challenges of humanitarian contexts	27

6	Building a market for humanitarian investments	29
6.1	The state of the innovative finance market	29

7	Conclusions and recommendations	33
7.1	Recommendations to increase investment	33
7.2	Opportunities for investment	34

	Bibliography	35
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Boxes, tables and figures

Boxes

Box 1: What defines a humanitarian crisis?	6
Box 2: Example: African Agricultural Capital Fund	13
Box 3: Humanitarian crisis example: Ebola, West Africa	15
Box 4: Example: ICRC Humanitarian Impact Bond (HIB)	19
Box 5: Humanitarian principles	26
Box 6: Protection threats: data breach or disclosure of personal information	27
Box 7: Refugees and displaced people	28

Tables

Table 1: Who's who in investment	10
Table 2: Existing challenges and the financial instruments that could be used	11

Figures

Figure 1: International humanitarian assistance, 2013–2017	5
Figure 2: Illustrative diagram representing the international humanitarian system, showing key entities and many of their funding connections	7
Figure 3: Spectrum of financing	9
Figure 4: Financial instruments mapped against end recipient and timing	10
Figure 5: Mapping financing type against crisis phase	12
Figure 6: Resource mix in the 20 countries receiving the most international humanitarian assistance, 2016	13
Figure 7: Co-operative insurance with subsidised premiums	16
Figure 8: Swapping debt for premiums	17
Figure 9: Displacement insurance	17
Figure 10: Impact bond structure	18
Figure 11: Pricing illustration for vaccine development	22

Acronyms

AACF	African Agricultural Capital Fund
AMC	Advanced Market Commitments
ARC	African Risk Capacity
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CRS	Catholic Relief Services
CSR	Corporate social responsibility
DFI	Development Finance Institution
DWM	Developing World Markets
EOF	Africa and Middle East Education Outcomes Fund
FAM	Famine Action Mechanism
FDI	Foreign direct investment
GCOFF	Global Concessional Financing Facility
HIB	Humanitarian Impact Bond
IASC	Inter-Agency Standing Committee
ICESCR	International Covenant on Economic Social and Cultural Rights
ICRC	International Committee of the Red Cross
IDA	International Development Association
IDP	Internally displaced person
IFC	International Finance Corporation
IHL	International humanitarian law
IHRL	International human rights law
IRC	International Rescue Committee
MDTF	Multi-Donor Trust Fund
MSF	Médecins Sans Frontières
NGO	Non-governmental organisation

NRC	Norwegian Refugee Council
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PEF	Pandemic Emergency Facility
ROI	Return on investment
SDG	Sustainable Development Goal
UDHR	Universal Declaration of Human Rights
WEF	World Economic Forum
WFP	World Food Programme

Glossary

Blended finance	A range of instruments that use grant funding to attract further private sector investment in emerging markets.
Capital	Assets that enhance the ability to create goods and services. In financing, capital usually refers to money invested to start a business and produce the products to offer consumers. More broadly, it can refer to a range of assets such as buildings, roads, software, or patents.
Concessional financing	Loans provided at sharply reduced interest rates than usually available, and/or with long ‘grace periods’, intended for customers who would not otherwise be able to repay.
Equity investment	Funding that supports business development through buying a stake in a private enterprise, with the promise of financial returns later.
Humanitarian system	The network of entities that receive funds from public donors and private sources, to enhance, support or substitute for in-country responses in the provision of humanitarian assistance and protection to a population in crisis. This includes local and international non-governmental organisations, UN humanitarian agencies, the International Red Cross and Red Crescent Movement, host government agencies and authorities, and donor agencies.
Impact bond	A means of financing whereby a funder pays a service provider a pre-agreed price once agreed upon outcomes have been achieved. Investors lend the upfront capital that allows the providers to operate, and are repaid with a financial return at the end of the contract.
Impact investing	Financing that is intended to generate a positive social or environmental impact, as well as a financial return. In exchange, investors may accept a lower rate of financial return than expected in other investments.
Innovative financing	A range of mechanisms intended to raise more money from capital markets for development and humanitarian aid, leveraging and supplementing the grants from governments, foundations and private donations that currently provide the bulk of resources for aid responses.
Parametric insurance	An insurance scheme where a payout occurs when a pre-agreed trigger is reached, currently used for disaster response. These are made possible by complicated data models, and are intended to reduce the time between the event and payout.
Patient capital	Investment from investors who are willing to finance enterprises without expecting a quick profit and instead wait longer before they see financial benefits from their investments, in exchange for blending social, environmental and financial returns.

Protection

In humanitarian responses, ‘protection’ usually refers to activities that seek to protect, respect and fulfil individual rights in accordance with the relevant bodies of humanitarian, human rights and refugee law. This includes advocating for the protection of affected populations as well as integrating a rights-based approach in the provision of goods and services.

Protracted crisis

An environment in which a significant proportion of the population is acutely vulnerable to death, disease and disruption of livelihoods over a prolonged period of time. The governance of these environments is usually very weak, with the state having a limited capacity to respond to, and mitigate, threats to the population, or provide adequate levels of protection.

Return on investment (ROI)

A means of relating profits to invested capital. In business, ROI is a measure that is used to compare the efficiency of different potential investment options.

Foreword

We are never far from images of communities affected by conflict and disaster in different corners of the globe. As climate change threatens to worsen the toll of disasters, and continuing conflicts lead to millions of people being driven from their homes for years on end, we all share a responsibility to support the basic needs of those worst affected by crisis. Yet, this is not where it ends. At the IKEA Foundation we want to pre-empt disasters by using forecast-based financing and cash, for instance, whilst also helping families to rebuild their futures after experiencing crisis.

Our programmes to unlock the potential of key partners working in support of these communities have been ongoing for many years. We are doing this in various ways: from investing in unseen emergencies, undertaking initiatives to promote the inclusion of refugees – for example by bringing renewable energy to refugees and their host communities – supporting businesses, civil society and governments to reduce carbon emissions, as well as our recent efforts to structure a Development Impact Bond. Our experience with strategic grant-making has shown that joining forces with new partners and working in innovative ways can be truly transformative. Embarking on this

research with ODI and Numbers for Good marks our desire to support the wider ecosystem of new approaches to fundamentally shift the way that humanitarian response is carried out.

We hope this research will mark an important step in the journey towards transforming humanitarian response to harness the power of the markets to do what they do best, while making the best possible difference to communities affected by crisis around the world.

As the report notes, this is the beginning of that journey for what is an emerging and still uncertain market – but one we fully want to nurture so that it can develop into a complementary force to the tireless work that humanitarian agencies and their teams in countries affected by crisis undertake. Only through breaking down barriers and perceptions can we see a brighter future for the growing number of communities living in crisis.

Per Heggenes

CEO, IKEA Foundation

Executive summary

A humanitarian system under pressure

The humanitarian system and its financing are under immense pressure from ongoing crises affecting over 200 million people in Syria, Yemen, South Sudan and beyond. While traditional donors – governments, foundations and private funders – are increasing their grant funding to traditional emergency responders such as the United Nations, Red Cross Movement and non-governmental organisations (NGOs), the gap between needs and funding continues to grow – in 2018 only 58.5% of requested funding needs were covered.

Appetite from investors, funders and humanitarians for new approaches

Current reform efforts to make crisis funding faster, more consistent and more cost-effective are addressing some of the longstanding funding and efficiency problems of the humanitarian sector. Beyond these efforts, there is a sense that we need to move from grant-making toward employing a wider range of financial tools and scaling up investment in poor countries under the Sustainable Development Goals (SDGs) financing frameworks – and that private finance has a part to play. There is growing interest from the capital markets in investing in so-called ‘frontier markets’, where risks have been perceived as too high. There is also growing acknowledgement of the need to incorporate a social return alongside a potentially reduced market return on investment. This comes from a sense that socially responsible businesses need to do more than discrete corporate social responsibility (CSR) activities and build social objectives into their core business model.

Traditional donors and foundations also have an appetite for exploring different uses of grant funding to attract greater capital input from investors – dubbed ‘innovative financing’ or ‘humanitarian investing’.

Challenges in growing the market for investing

Humanitarian contexts offer some of the greatest challenges to investors looking for returns where risks are high, and who need evidence of a pipeline of investible products to justify engaging in these markets. Currently, these initiatives are new and little-tested, but there are increasing numbers of pilots and products that are testing viability and market demand, often benefitting from catalytic foundation or government funding to reduce start-up risks.

The potential and limits of humanitarian investing

This is an emerging and rapidly changing area, so firm conclusions are premature. Grant-making to traditional humanitarian actors will continue to account for the lion’s share of response; while growing, blended finance opportunities are not going to comprise a major proportion of public funding or foundation grant portfolios. But, particularly in more stable settings, in preparing for crises and where there is scope for longer-term and development solutions, investment approaches could make a difference. Private finance is best placed to deal with the longer-term consequences of crisis and fragility, rather than short-term, acute needs.

While innovative financing cannot be expected to fill the gap in funding humanitarian needs singlehandedly, it is clear that the scale and duration of today’s emergencies require creativity, ingenuity and a wider set of partnerships, alliances and solutions.

This report makes linked sets of recommendations regarding how to increase investment, and where to invest.

Increasing investment

To achieve growth in the investment market, the following are needed:

- **New strategic alliances:** donors, agencies and investors need to adapt to take advantage of this opportunity; further use needs to be made of different partnerships, including intermediaries who can provide expert advice across the humanitarian/investor divide. Greater focus is needed on engaging and developing local fund managers to direct investment using appropriate contextual knowledge.
 - **Humanitarian agencies:** rather than building in-house expertise, leverage external experts at an early stage.
 - **Funders:** partner with experienced fund managers and use capital to attract more external investment; this could be done by seeding new funds or providing first loss capital.
 - **Investors:** build partnerships with investors in affected countries/regions to create a more supportive investment ecosystem.
- **Focus on the need:** grant-based (concessional) financing should be focused on facilitating products in areas where investment might be feasible and doing what other funding cannot do in supporting frontline humanitarian action in the worst-affected places. It should only be used when the nascent market needs a catalyst, to avoid moral hazard and mitigate concerns that humanitarian funding is being used to subsidise private business rather than help people in need.
 - **Humanitarian agencies:** clearly define the challenge you are seeking to address and how and why an investment would be better than a traditional grant-funded approach.
 - **Funders:** develop business cases for investment approaches.
 - **Investors:** wherever possible, reduce complexity to ensure the instrument meets

the market need and reflects the changeable nature of humanitarian contexts.

- **Shared learning and greater transparency** over current investments and humanitarian agencies being more open about their budgets would provide evidence to encourage further investment, along with greater flexibility from funders on procurement, which can allow more creative financing approaches.
 - **Humanitarian agencies:** share deal terms, impact metrics and lessons from investments.
 - **Funders:** include funding to support the dissemination of learning and the creation of a repository of investments and a directory of stakeholders; ensure procurement processes do not undermine the potential for partnerships and more creative approaches to funding.
 - **Investors:** share deal terms, impact metrics and lessons from investments.

Opportunities for investment

Investment approaches to funding response may be best placed to solve a specific set of financing problems beyond the funding gap, through the following priority opportunities:

- Anticipatory risk financing for disaster preparedness and response.
- Job creation and entrepreneurship targeting refugees, internally displaced people (IDPs) and host communities. Health, education and water supply opportunities should also be explored.
- Investments in enterprises or assets that support the wider market for humanitarian impact in social sectors, such as temporary housing, portable or renewable energy or other infrastructure investments, or products that could be adapted to this market, such as microfinance lenders or companies concerned with financial inclusion.

1 Introduction

This report responds to a demand for a balanced assessment of the potential and opportunities – but also the challenges – of expanding the market for investing in humanitarian contexts to address the problems faced by the international humanitarian system in responding to growing levels of suffering and crisis. A number of high-level events and workshops over the past two years have raised the profile of private investment approaches to humanitarian action. Pilots are underway and there is a window of opportunity in which investors are looking for new ways to invest while public funders and foundations see a way to tackle challenges differently. The risk is that the willingness to look at new approaches will not last for long, and unless the market for private investment for humanitarian impact starts to build momentum, the current alignment of interests may pass.

This report aims to do three things:

1. Identify which challenges in humanitarian financing can be best solved using investment approaches harnessing capital markets.
2. Explain the different innovative financing mechanisms and how they can be applied to different challenges.
3. Set out specific proposals for (a) expanding the market for humanitarian investing and (b) building momentum around specific types of investment.

The report is aimed at both the humanitarian and finance communities. Each will find parts that are

familiar to them, but we hope to break down some of the siloes that have impeded effective partnership and communication between the two sectors to date.

This report was jointly developed by ODI, a leading think tank on humanitarian and development policy issues, and Numbers for Good, a social investment consultancy, both located in London. It is based on a review of policy reports, investor documentation, academic and think tank analysis, and current or planned investment deals; interviews with representatives of 25 humanitarian agencies, government donors, private foundations and investors; and the research team's participation in workshops and discussions.

It is structured as follows. Section 2 outlines the challenges the humanitarian system is trying to address and provides an introduction to how it operates. Section 3 describes how international private finance operates. In Section 4 we discuss the particular challenges facing humanitarian financing and which instruments may be best suited to addressing them, with examples. Section 5 then considers the difficulties faced by the different motivations and norms of the finance and humanitarian worlds, both in cultural and legal terms, and the operational challenges of working in humanitarian contexts. Section 6 sets out the ingredients of an effective market and assesses the current state of the market for products in humanitarian contexts. Section 7 draws together recommendations for specific action by different stakeholders.

2 The humanitarian challenge

2.1 Humanitarian crises in the 21st century

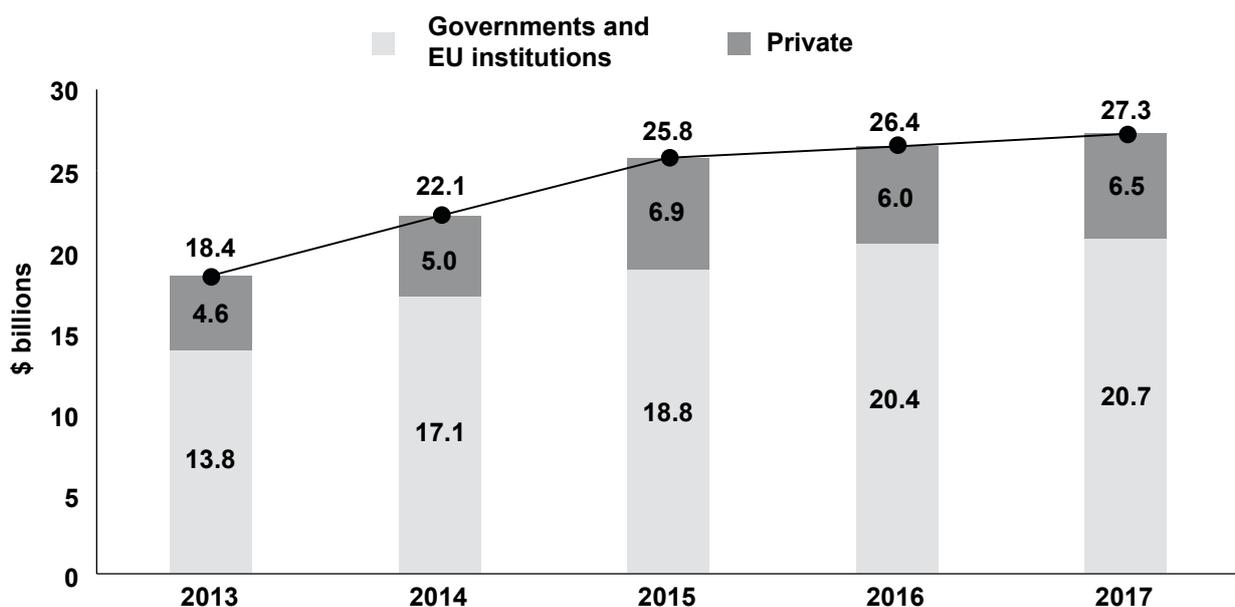
Humanitarian crises today are more frequent, last longer and affect more people than before. Over 201 million people needed some form of humanitarian assistance in 2017. The causes of these needs often comprise a mix of conflict, internal displacement, refugee movements and disasters, such as typhoons, earthquakes and drought. Those hit hardest tend to have pre-existing vulnerabilities stemming from poverty, gender and ethnic discrimination, and governments unable or unwilling to respond.

These emergencies are increasing in their scale and intensity. The number of people forcibly displaced reached over 68 million people by the end of 2017, a figure unmatched since the end of the Second World War (UNHCR, 2018). Yet there is also a growing concentration of need in contexts affected by conflict and displacement, and over a quarter of these people are in Iraq, Syria or Yemen.

The average conflict now lasts almost twice as long as in 1990 and there are now 23 protracted refugee situations lasting over 20 years; this concentration of those in need in the poorest and most fragile countries is only set to increase (HPG, 2016; UNHCR, 2016; Development Initiatives, 2018). Of the 20 countries receiving the most humanitarian aid in 2016, 16 had been in crisis for eight or more years (Development Initiatives, 2018: 22). A lack of political solutions to these protracted conflicts and crises is the primary reason for humanitarian aid and emergencies becoming 'normal' rather than exceptional in many places. This not only raises difficult questions around the role of humanitarian relief, but places a considerable burden on a system that was initially designed to respond to single, sudden onset events.

As of 2017, total international humanitarian assistance has been estimated annually at \$27.3 billion (see Figure 1). Comprising government and private donors, these contributions are the highest they have ever been, but the increase is slowing down, threatening to be eclipsed by the growing cost of responding to humanitarian needs.

Figure 1: International humanitarian assistance, 2013–2017



Source: Development Initiatives (2018)

2.2 Key players in humanitarian system

Responding to these emergencies is the humanitarian ‘system’, the network of entities that receive funds from public donors and private sources to enhance, support or substitute for in-country responses in the provision of humanitarian assistance and protection to a population in crisis. This includes local and international non-governmental organisations (such as Save the Children and Mercy Corps), UN humanitarian agencies (e.g. World Food Programme (WFP), UNICEF, UNHCR, and the World Health Organization), the International Red Cross and Red Crescent Movement, host government agencies and authorities, and donor agencies (see Figure 2) (ALNAP, 2018). These entities are driven by the fundamental principles of human rights and humanitarianism (see Section 5).

In a crisis these actors form only part of the true scale of the response. Religious groups, military actors, the private sector and affected populations rescue people, deliver relief supplies, and seek to maintain normality through a crisis. These actors have only recently been recognised by the ‘traditional’ system as key players in their own right, with their own agency and interests (HPG, 2016). They are increasingly being incorporated into the various coordination and funding mechanisms of the humanitarian system, but have less access to much of its resources.

2.3 Humanitarian phases and activities

The humanitarian system is highly reactive and is often mobilised only when needs have become acute. In crises that occur repeatedly or last a long time with varying bouts of intensity, responses have often been seen as working to a ‘cycle’ comprising different phases from preparedness through response, recovery and reconstruction.

This cycle may correspond to people’s experience in responding to a rapid onset shock such as an earthquake, but the ‘cycle’ approach to response is generally seen as simplistic, since the division between life-saving relief and longer-term development is blurred in practice. While such distinctions may be useful to humanitarian agencies and donors, they do not accurately reflect the needs of affected people. Those caught up in protracted displacement, conflict

Box 1: What defines a humanitarian crisis?

A humanitarian crisis can be described as occurring ‘when the human, physical, economic or environmental damage from an event, or series of events, overwhelms a community’s capacity to cope’ (World Vision, 2018). Often associated as being the consequence of a singular, disastrous event such as an earthquake or hurricane, contemporary humanitarian crises are usually a consequence of conflict and state fragility that drives the most vulnerable populations to become displaced or in need of humanitarian aid. Defining, or declaring, a humanitarian crisis is not without controversy, as long-standing chronic poverty and marginalisation often leave huge numbers of people permanently in a position of vulnerability regardless of ‘disastrous’ events.

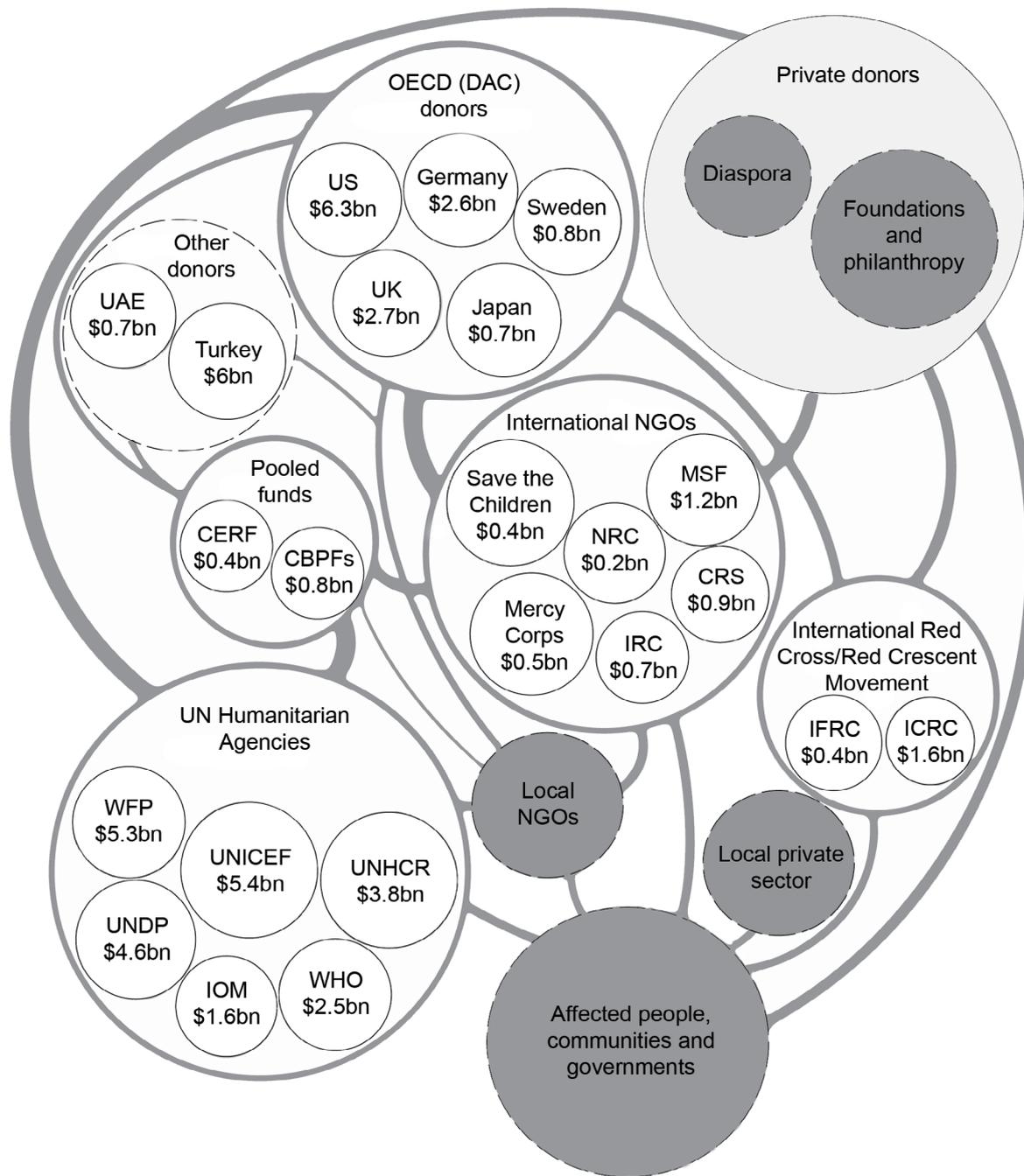
or poverty may have been struggling with day-to-day survival for years. *Slow onset* and *protracted* crises such as famines and conflict result from longer-term political, environmental and economic factors without specific shocks that mark the ‘start’ of the crisis.

The reality of complex responses, particularly in conflict, requires non-linear, simultaneous humanitarian and development interventions. Organisations such as the International Committee of the Red Cross (ICRC) argue for an approach that seeks to meet people’s basic needs regardless of the length of time passed since the ‘crisis’ occurred (ICRC, 2016).

Types of activity that are carried out in this complex and concurrent way include:

- a. Risk reduction and resilience activities that involve improving the ability of responders (either government, organisations, communities or individuals) to understand, prevent, anticipate and respond to future crisis events. Better preparedness can effectively reduce mortality and suffering, and is also highly cost-effective when compared with reactive humanitarian responses. Yet it constitutes a small minority of total humanitarian funding (Harris, 2013).
- b. Response in the immediate aftermath of a crisis event, such as a disaster, usually initially carried out by affected people, local organisations and the affected government. In cases such as the 2015 earthquake in Nepal, nearby governments will follow over the coming days, with international

Figure 2: Illustrative diagram representing the international humanitarian system, showing key entities and many of their funding connections



Note: The thicker the line, the greater the amount of (recognised) funding is travelling through the system. Grey circles indicate a lack of understanding regarding the true scale of these entities or the role they play in crises.

This diagram is illustrative and does not represent the full extent of the humanitarian system or the relative importance of its various actors. Financial figures represent 2016 total expenditures for UN agencies and INGOs and reported humanitarian funding for 2016 for donors. Some entities have a scope of work beyond humanitarian relief, which may mean larger expenditures.

Sources: International Rescue Committee (IRC) (2016); Norwegian Refugee Council (NRC) (2016); UN (2016); Catholic Relief Services (CRS) (2017); Save the Children (2017); World Vision (2017); Médecins Sans Frontières (MSF) (2018); OCHA (2018)

responders gearing up activities. In situations such as disasters or acute conflict, there will be immediate needs such as freeing trapped people from rubble and providing critical medical care.

- c. The recovery period, which could last from several hours to months, years or decades after the shock. Life-saving relief is still provided by international and national humanitarian actors but this is a more stable period, where life-saving needs are addressed but everything else may be delivered in an improvised or incomplete manner. Markets, schools and jobs are the priority. In the case of conflicts, affected people may move from crisis to stability and back rapidly and unpredictably.
- d. In displacement crises, whether involving refugees crossing borders or people internally displaced in their own country, there can be acute waves of mass displacement, multiple displacements, and, as seen in many crises, protracted displacement where people are in crisis for years.
- e. Reconstruction, which sees a shift in emphasis from relief to development. Wider social and economic issues can begin to be addressed and displaced people may consider it safe enough to return to their homes. Development actors such as the World Bank, rather than humanitarian ones, become more prominent.

3 Introduction to innovative finance

Innovative finance applies to using market-based investments – which generate a financial return – rather than grants. Approaches can be innovative when new financial products (or instruments) are designed or when well-established financial instruments are used to operate in new situations, in this case fragile, humanitarian contexts.

Financial inputs can range from non-repayable donations for social good to purely commercial, return-seeking funds for financial gain (see Figure 3). In between these two extremes lies social investment, which looks for both financial and social returns. The importance of each type of return can vary within this category. Some investors are willing to make smaller returns to achieve (social) impact (impact investing) and others are keen to achieve market-level returns by investing in proven industries delivering social or environmental good (e.g. renewable energy).

Investing in the alleviation of humanitarian needs is likely to evolve in a similar way to the impact investing market. It is therefore useful to consider the ecosystem for impact investors in their terms. Actors fall into four broad categories: asset owners (those

with funds that can be distributed), asset managers (those who manage the funds), demand-side actors (those who absorb investment), and service providers (see Table 1). In the humanitarian sector the most important asset owners – in terms of where resources originate – are governments, and the most important demand-side actors are international agencies including the UN and NGOs. The type of capital, the level of risk and the cost of capital varies greatly across asset owners and asset managers. Equally the ability to absorb capital and in what form and for what duration will vary greatly among demand-side actors. As one would expect in a market as nascent as humanitarian investing, there are very few specialised asset managers and service providers.

Investors refer to ‘frontier’ markets – where risks are high and there are few examples of successful deals, meaning where a return can be made. These will often overlap with humanitarian contexts, but would also include stable but developing countries with no significant humanitarian crises. With innovative finance, the role of grant funding from government donors or foundations will therefore be to reduce risk to help catalyse a new market

Figure 3: Spectrum of financing



by demonstrating that investors can make returns, or to help determine what the market price for a particular instrument is.

Private finance has a range of types of financial instrument that are commonly used, from insurance to equity investments and bonds. These instruments can be applied to humanitarian contexts to provide solutions to different problems, whether it is a shortage of money to build or operate a business (capital), or inefficient mechanisms for achieving outputs that can be incentivised by payment by results.

These financial instruments can have a range of end recipients, which affects how they are deployed. Some instruments can be used on a macro level to address a country-wide issue and others can be more targeted to directly reach individuals. Figure 4 maps various instruments against their end recipient and the timing of implementation relative to a crisis occurrence.

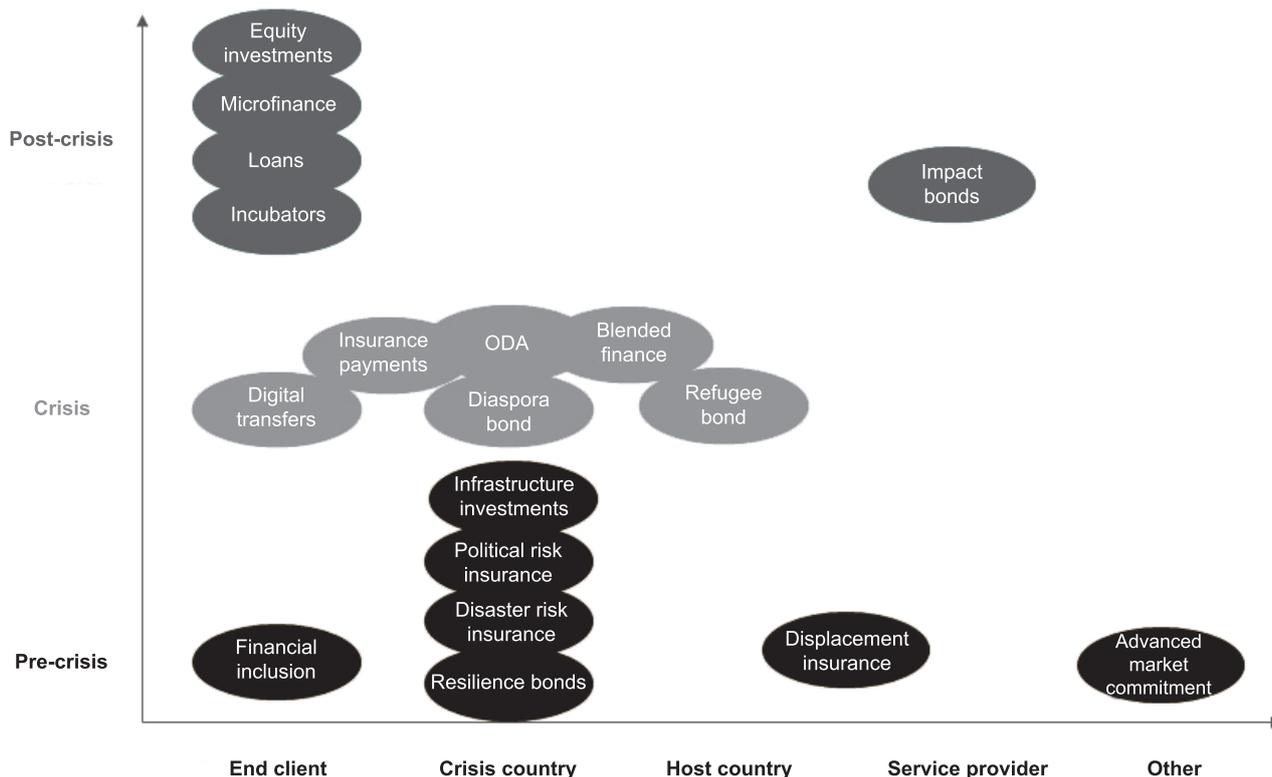
The structuring of each instrument also has implications for its potential use. In the following section we explore a range of financial mechanisms that could address specific humanitarian financing problems.

Table 1: Who's who in investment

Asset owners	Asset managers	Demand-side actors	Service providers
<ul style="list-style-type: none"> High net worth individuals/families Corporations Governments Employees Retail investors Foundations 	<ul style="list-style-type: none"> Investment advisors Fund managers Family offices Foundations Banks Corporations Venture funds Impact investment funds/intermediaries Pension funds Sovereign wealth funds Development finance institutions Government investment programmes 	<ul style="list-style-type: none"> Corporations Small and growing businesses Social enterprises Cooperatives Microfinance institutions Community development finance institutions 	<ul style="list-style-type: none"> Networks Standards-setting bodies Consulting firms Non-governmental organisations Universities Capacity development providers Government programmes

Source: Accelerating impact achievements, challenges and what's next in building the impact investing industry, E.T. Jackson and Associates and commissioned by The Rockefeller Foundation

Figure 4: Financial instruments mapped against end recipient and timing



4 Humanitarian financing challenges and investment solutions

Innovative financing has generated considerable interest within the humanitarian community. However, the size of the opportunity is hard to quantify given the early state of the market. Current research suggests that it would be more meaningful at this point to gain better understanding regarding which financing instruments could be an opportunity, rather than generating questionable estimates of the market size. What is apparent is that certain financial instruments are better suited to solving specific financing challenges, whether it is the shortfall against international funding appeals or the speed with which funds can be deployed, for example. Applying the wrong instrument could be less effective and more expensive than existing grant mechanisms.

Not all humanitarian financing challenges are suited to innovative finance solutions. In particular, inflexibility in terms of grant earmarking and the narrow range of funders are problems that are not obviously amenable to the injection of private capital. Instead, existing processes such as the Grand Bargain and post-World Humanitarian Summit reforms are best placed to address these longstanding challenges (Metcalf-Hough and Poole, 2018). It is key to find ways for innovative funding to complement existing grant funding.

This section maps the most significant financing challenges to the type of instrument to consider, as summarised in Table 2. These are discussed in greater detail below, describing how they operate and their respective advantages and disadvantages.

Different instruments are also suited to different crisis-related activities – preparedness, response, recovery and reconstruction. Figure 5 maps existing financial instruments against this cycle and the spectrum from purely grant-based to purely commercial investment. The aim of this report

is to identify opportunities to shift – in the right circumstances – further up the graph towards more commercial, market-based investments.

4.1 Not enough funding

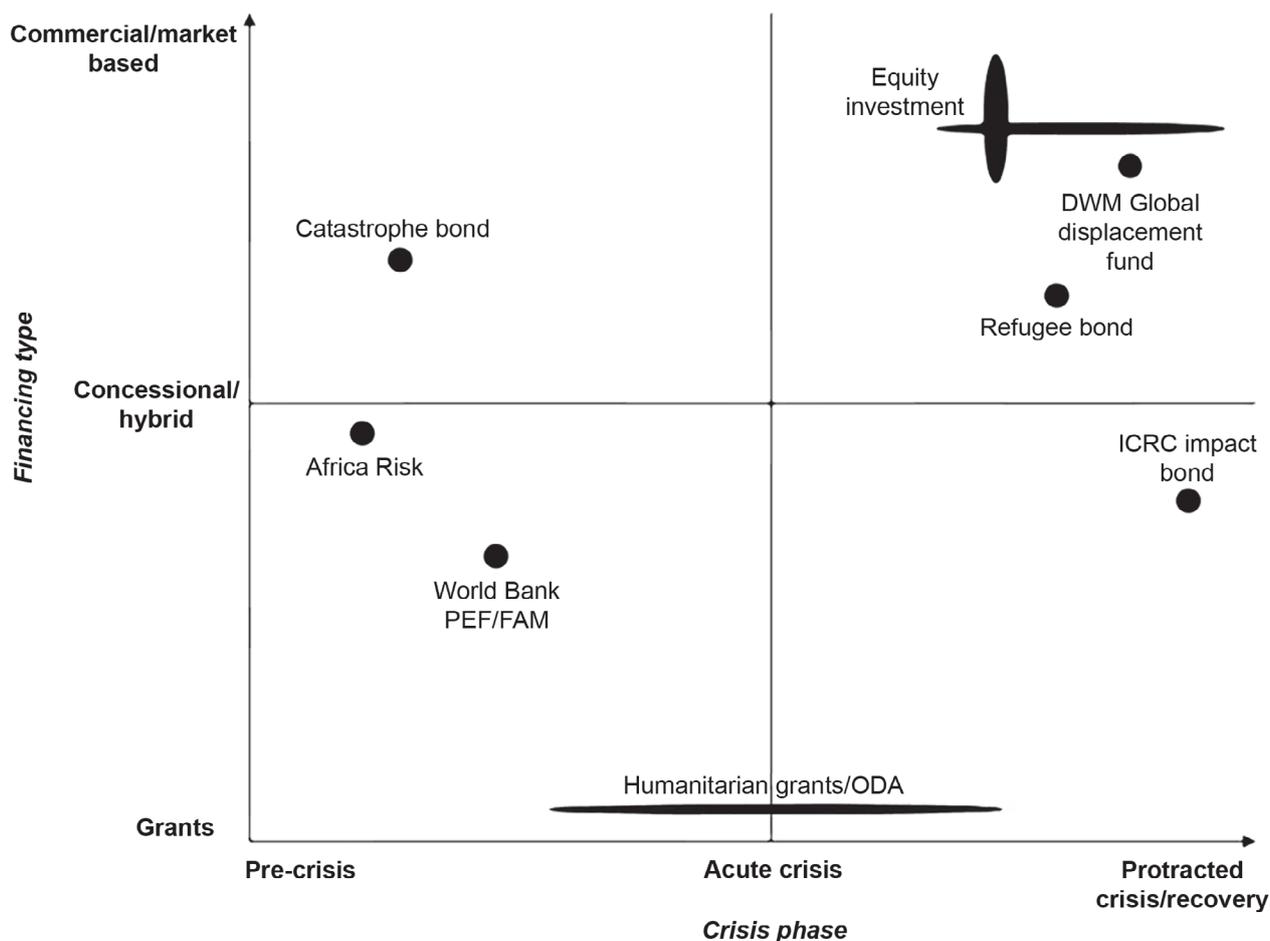
Despite receiving more money than ever before in 2017, UN-coordinated appeals experienced a shortfall of 41% on requested funding (Development Initiatives, 2018: 9). This is the largest such shortfall to date, and illustrates how donor funding, while increasing, is not keeping up with rising needs. For many humanitarian organisations, this is their most pressing challenge.

Financing is also increasingly concentrated in a small number of conflict-affected contexts: in 2016, Syria, Yemen, Iraq and South Sudan received over half of all humanitarian funding (Development Initiatives, 2018: 60). Persistent underfunding continues to limit responses in a myriad of ‘forgotten crises’, including Libya, the Central African Republic and the Gambia, which regularly receive less than 20% of their required funding.

Table 2: Existing challenges and the financial instruments that could be used

Challenge	Possible financial instruments
Not enough funding	Blended finance, equity investments
Funding arrives too late	Disaster risk insurance, displacement insurance
Inefficient funding	Impact bonds
Short-term solutions	Renewable investments
Development costs are too high	Advanced market commitments
Lack of economic opportunities	Job creation, microfinance, incubators

Figure 5: Mapping financing type against crisis phase



However, the assertion that the system is ‘broke, not broken’ has been increasingly called into question in recent years, with some humanitarians arguing that the solution is not simply to raise more money (OCHA, 2017a). The High-Level Panel on Humanitarian Financing’s 2016 report proposes that more money without reform would ‘not solve all the problems, and may entrench some of the current dynamics’ (Belanger et al., 2016). Instead, the processes and timing by which humanitarian funding is raised, managed and spent has been of increased focus – to make funding work more efficiently and flexibly, in an anticipatory way in advance of crises, but also to increase and diversify the resource base.

There has been a focus on increasing philanthropic contributions, but additional resources could be brought in via market-based financial instruments leveraged where needed by grant inputs. As Figure 6 illustrates, humanitarian and development assistance represents only a quarter of international resource flows into humanitarian contexts, with foreign direct investment (FDI), commercial debt and equity representing significant proportions.

The challenge is directing this investment to benefit those most in need.

4.1.1 Applicable instruments

1. Blended finance

Blended finance is the use of philanthropic and donor grant funds to attract private sector investment to frontier markets. The funding is used to prove untested markets or to subsidise deals that might not otherwise go through. The grant funding lowers the investment risk for the private sector and brings the overall risk more in line with the potential rewards of investing in new, untested markets. This arrangement can benefit all investors/stakeholders – donors achieve greater social impact through increased funding and the private sector benefits from financial returns.

Blended finance can be structured in different ways:

1. First loss capital, meaning that any losses on investment come from the grant funding until it has run out.
2. Grant financing can be used as a soft loan, with more lenient and flexible repayment terms,

therefore enabling the private funding to achieve higher returns so that the deal is feasible.

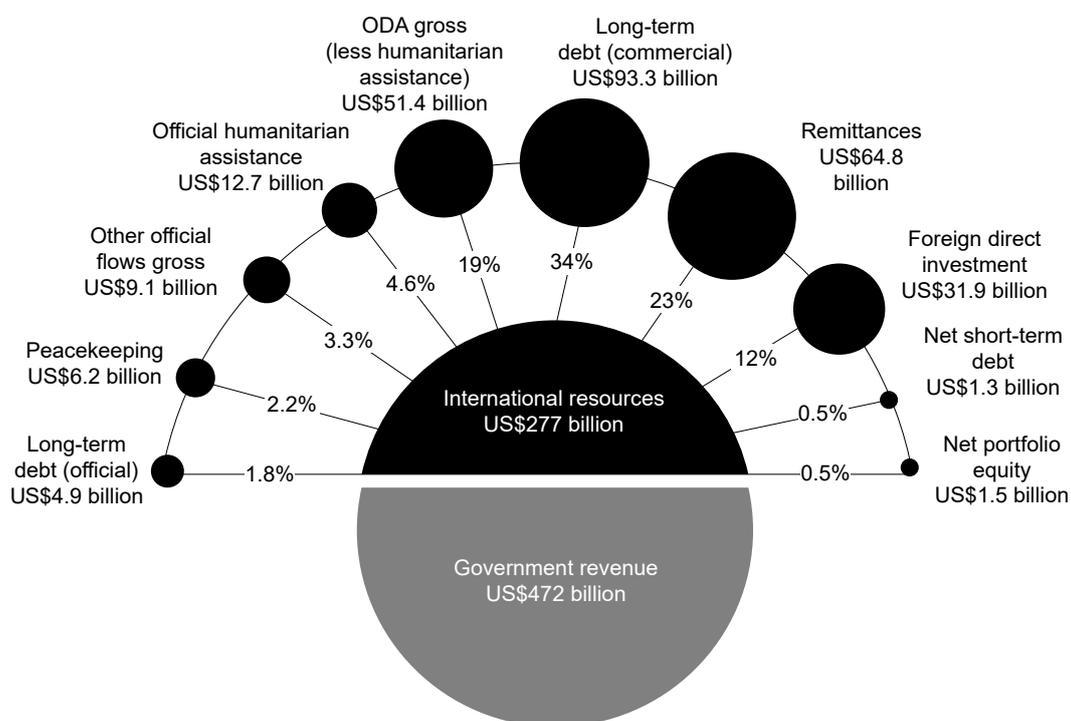
3. It can also be used as a guarantee or insurance for payments of bonds that have been issued to fund specific projects (often infrastructure projects).
4. Or it can fund technical assistance/design and development work for new structures that could attract private sector investment.

The term ‘blended finance’ covers a range of financial instruments that we explore further in this report. In the example from a more stable context below, targeting farmers rather than people affected by crisis, the blended finance draws in an additional loan of \$8 million alongside \$17 million of

investments from philanthropic foundations. The JP Morgan loan is 50% guaranteed by USAID, meaning USAID will repay 50% of the loan if the borrower defaults. The foundations are taking a higher risk on their investments but are willing to do so for social returns while JP Morgan is partially protected from risk due to the guarantee from USAID.

However, both philanthropic and public donors may be hesitant to subsidise commercial capital and there are concerns that private investors could take advantage of grant financing, knowingly using it to minimise their risk and increase returns (rather than it being a prerequisite for entering the market). There are also tight restrictions

Figure 6: Resource mix in the 20 countries receiving the most international humanitarian assistance, 2016



Source: *Development Initiatives (2018: 30)*

Box 2: Example: African Agricultural Capital Fund

Summary:	The African Agricultural Capital Fund (AACF) is a \$25 million investment fund that injects risk capital into agricultural supply chains in East Africa to support smallholder farmers and leverage additional financial and human capital in the sector. \$17 million from various foundations is blended with an \$8 million commercial loan from JP Morgan.		
Geography:	Uganda, Kenya, Malawi	Date launched:	September 2017
Investors and investment size:	Rockefeller Foundation, Bill and Melinda Gates Foundation, Gatsby Charitable Foundation, JP Morgan Chase Social Finance \$25 million		

on what counts as aid (official development assistance (ODA)) and how it can be used for private investment, to avoid aid money intended to alleviate poverty being diverted to support businesses (Convergence, 2018).

Advantages and disadvantages:

- + Blended finance creates the ability to draw in new funds to test new geographies. As well as having a potential positive humanitarian impact, these deals will set a precedent and will begin to seed a market, making way for future deals that potentially require less blending.
- + Funding technical assistance at pilot stage will ensure sound products are designed for long-term usability.
- There is a risk that commercial investors could take advantage of this first loss capital by profiting from these investments while incurring minimal risks. To mitigate this, caution needs to be exercised to ensure both investor and grant funder goals are aligned.
- Negative perceptions of using aid funding to subsidise commercial funding could arise.

2. Equity investments

Another way of attracting more funding to new markets is through enterprise investment. This means buying a stake in a business with the promise of future financial returns on that investment as the business grows. An example is Mercy Corps' Social Venture Fund, which offers early stage equity investment into businesses working across agriculture, financial inclusion, distribution and logistics and education and employment, including in Kenya, Colombia and Indonesia.¹ Investment can range from \$50,000–\$250,000 for a stake in these new companies. Alongside this funding, the Mercy Corps team act as facilitators to offer hands-on technical support and strategic advice to these nascent companies to help them grow and achieve positive social impact.

On a larger scale, Development Finance Institutions (DFIs) such as the UK's CDC, US OPIC and other national DFIs, as well as the International Finance Corporation (IFC), the investing arm of the World Bank, make equity investments into private companies to stimulate development of new capital markets, often accompanied by advisory services. As they are owned by governments, they can be more flexible

in how they invest compared to private investors (in terms of expectations of return or loan conditions), and can help stimulate or test frontier markets by building new partnerships.

For example in 2018, IFC made \$1.3 billion of equity investments (IFC, 2018c). They typically take a 5–20% stake in enterprises and encourage public listings to diversify company stakeholders. IFC also offers profit-participating loans and loans which convert to equity. These methods can fund nascent companies without burdening them with loan repayments before they are profitable.

There have been concerns about the performance of DFIs in directing investment to the poorest and most fragile settings because of structural incentives and constraints tending towards risk aversion and safer markets (Kenny et al., 2018). Over the course of 2018, IFC has reportedly increased its investments in more fragile countries significantly, responding to its shareholders' desire to focus resources on reaching the poorest and most vulnerable (IFC, 2018b; World Bank, 2018a).

Relating specifically to refugee contexts, Developing World Markets (DWM), an emerging markets impact investor, and Innovest Advisory have partnered to develop a Global Displacement Fund, which will make equity investments in refugee and migrant inclusive businesses. The fund will target ventures operating in regions affected by and at risk of experiencing displacement, both host and source countries. The fund will seek both social and financial returns and will offer additional technical assistance to investees.

Advantages and disadvantages:

- + Potentially brings new money into businesses that directly or indirectly have humanitarian impact.
- + Equity funding is long-term. Investors only receive returns once the business is profitable, allowing ventures time to prove their businesses without worrying about loan repayments.
- There is a lack of investors and/or capital due to the high-risk nature of investments, inadequate or unknown returns and the absence of trading track record.
- Without precedents, businesses could be undervalued by commercial investors.

¹ Mercy Corps interview.

4.2 Funding arrives too late

Most funding received by the international humanitarian system is reactive; the bulk of fundraising happens following the outbreak of a crisis against a humanitarian response plan.² While this allows donors to support specific areas and activities of the humanitarian response, the progress of this fundraising is often inefficient, slow and heavily earmarked. For sudden-onset, large-scale crises such as the 2015 earthquakes in Nepal, donors pledged most of the funding at a conference held more than two months after the event. Following the rapid influx of Rohingya refugees to Bangladesh, beginning at scale in late August 2017, responders waited more than two months for a donor-pledging conference, many of whose commitments remain unfulfilled today (Backhurst, 2018). And notably, despite early warning alerts of famine in Somalia in 2011, the response by the international system was delayed.³

The impact of funding arriving too late is that in the initial phase of a crisis, the window in which critical needs should be met is missed. Among other effects, this leaves local authorities, many of whom may not be functioning and lack the access to funding that international responders have, to provide immediate relief. When funding arrives late, this can result in the largest flows of resources landing when the absorption capacity of the state and affected communities are at their lowest. This means a major presence of the international humanitarian system, often with a focus on measurable, short-term humanitarian programmes at the expense of approaches that may actually address the underlying causes of the crisis.

Late funding also means deteriorating situations, such as food insecurity that is not yet a famine, are underfunded. Early responses are also shown to have an average cost saving of 40% compared with a late response (Poole, 2016). Assessments of a 2015 drought in Ethiopia suggested that people began to be affected two years before the crisis was recognised (Wilkinson et al., 2018). Attempts at addressing food insecurity prior to the intensity of a famine would have saved lives, livelihoods and money.

4.2.1 Applicable instruments

Insurance instruments are well suited to responding rapidly to foreseeable future events. They have been

Box 3: Humanitarian crisis example: Ebola, West Africa

The rapid spread of a contagious disease can constitute a humanitarian crisis, particularly when it intersects pre-existing development challenges such as a weak healthcare system and persistent poverty. Despite this, epidemics may only attract the attention of donors in the global North once the spread threatens to expand globally. In the case of the Ebola outbreak in West Africa in 2014, the framing of the crisis as one of health rather than humanitarian need meant that the surge capacities and emergency funding of international donors arrived late and the response did not take into account the adverse effects on livelihoods, education and other development issues (DuBois and Wake, 2015). Partly as a result of this, the most recent estimate for the economic and social cost of the outbreak is \$53.2 billion (Huber et al., 2018). Countries such as the Democratic Republic of Congo continue to grapple with further outbreaks of Ebola and these responses are also currently underfunded.

used for many years for disaster risk and political risk insurance, but have not been used in higher risk, conflict-related crises.

1. Disaster risk insurance

Disaster risk insurance mechanisms have attracted increased attention and large-scale funding from donors and development communities (Weingartner et al., 2017). Insurance presents opportunities to improve disaster risk management, adapt to climate change and reduce poverty by generating broader benefits and providing financial security against disasters, including geophysical and climate-related events such as droughts or floods. A common form of disaster risk insurance is parametric insurance, meaning it triggers a payout from the insurer when a disaster occurs based on agreed triggers, built on complex data-driven models. The insured party pays a fixed amount at regular intervals (a premium) for this coverage. Both the size of the payout and trigger criteria (e.g. when a tsunami hits or rainfall falls below a certain threshold) are pre-agreed. Because there is no need to provide proof, there is no time lag between the incident and the payout.

2 Rapid response mechanisms such as START Fund and UN-managed pooled funds including CERF and Country-Based Pooled Funds are designed to act more quickly by having funds and systems already in place for rapid disbursement.

3 Some lessons have been learnt. For example, the UK response to the potential famine in Somalia in 2017 was assessed to have helped avert famine through better prevention and early action (see DuBois et al., 2018).

Disasters stall agricultural and industrial productivity, destroy infrastructure and homes, disrupt business and increase the spread of disease. Payment delays often exacerbate these effects. Unfortunately, many of the countries regularly affected by disasters have limited means to pay insurance premiums for coverage, so donor contributions are needed to subsidise or cover the premiums. There are several methods to subsidise the cost of premiums as shown in Figures 7 and 8.

The Caribbean Catastrophe Risk Insurance Facility (CCRIF) was formed in 2007 as the first multi-country risk pool in the world. It was designed as a regional catastrophe fund for Caribbean governments to limit the financial impact of devastating hurricanes and earthquakes by quickly providing financial liquidity when a policy is triggered. The CCRIF was developed by the World Bank and was capitalised through contributions from a Multi-Donor Trust Fund (MDTF) as well as membership fees paid by participating governments. Since the inception of CCRIF in 2007, the facility has made 36 payouts to 13 member governments totalling \$103 million.

A similar structure, the African Risk Capacity (ARC), was launched in Africa in 2012 to spread the risk of weather-driven crises across the continent (ARC, 2018). The organisation comprises two entities – a specialised agency of the African Union, to support and provide capacity building to individual countries, and the ARC Insurance Company, which pools risk and delivers the core insurance function, providing over \$400 million in drought coverage since inception. ARC Replica is currently being piloted as a mechanism to extend ARC coverage through partners including WFP and Start Network. Part of the ARC

initiative included a 9–12-month capacity building segment to enable each member state to better understand the financial structure of the insurance product and the implications of risk modelling.

The enthusiasm for disaster risk insurance does, however, need to be tempered by the lack of financial infrastructure, regulatory frameworks and high-quality risk data in developing countries, and the fact that insurance programmes often struggle to cover the most vulnerable, and are not suited to certain types of extreme weather or slow onset effects such as rising sea levels.

Advantages and disadvantages:

- + Disaster risk insurance prevents the need for a huge cash outlay when disaster strikes.
- May not reach most vulnerable; inadequate financial infrastructure, regulation and risk data.
- Best suited to rapid onset, relatively infrequent disasters such as floods. Less suitable for slow onset or extreme weather events, and hard to apply to conflict.
- The countries that need the most coverage are unable to pay for premiums.
- As this is a relatively new market and there are limited providers offering this type of insurance, there is a risk that premiums could be overpriced.

2. Displacement insurance

Displacement insurance has not yet been implemented but is currently being developed by the IRC to alleviate the pressure on resources in host countries when there is a sudden inflow of refugees (IRC, 2018). As with disaster risk insurance, it is also

Figure 7: Co-operative insurance with subsidised premiums

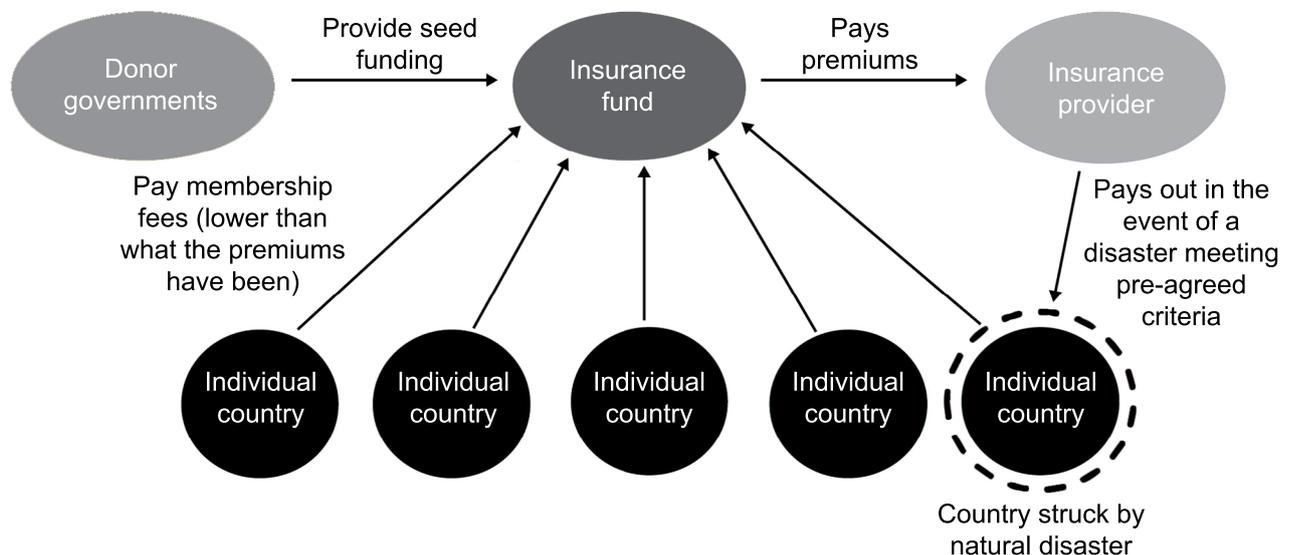
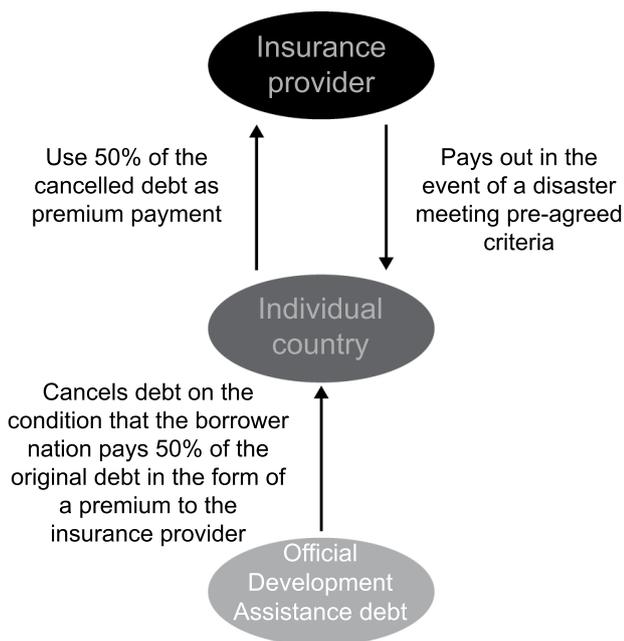


Figure 8: Swapping debt for premiums



a form of parametric insurance with the trigger being a pre-determined threshold of refugees entering the country (it is not currently being developed to address internal displacement). This mechanism eliminates the delay of humanitarian agencies on the ground assessing the level of need, applying for funding and then receiving the funds. At present, two models have been proposed:

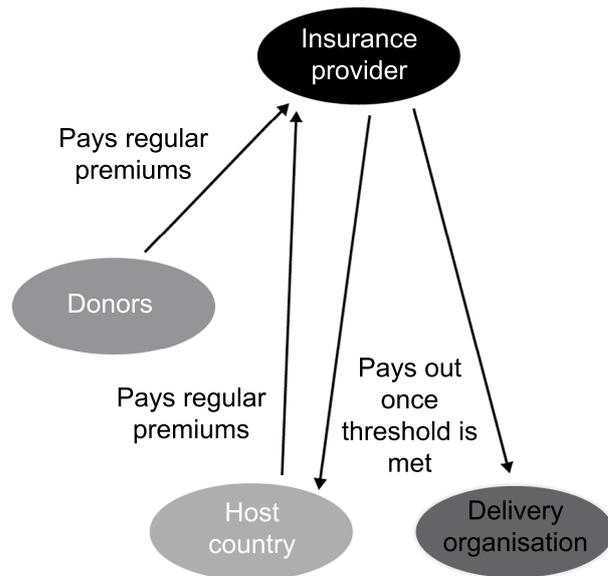
1. Donors pay insurance premiums and payouts go directly to delivery providers for pre-agreed service provision.
2. Both host country and donors pay insurance premiums and payouts are split between host country and delivery providers.

Key issues must be considered before this instrument is put into practice. Insurance premium prices are determined by calculating the probability of the event occurring, which is not straightforward in the context of conflict. Agreeing on a suitable trigger point will also require discussion and input from multiple stakeholders – the insurance provider, the host country, humanitarian agencies and donor countries. Care should be taken to ensure that perverse incentives to attract refugees to a host country to trigger payouts are managed.

Advantages and disadvantages:

- + This new instrument will improve host country preparedness for incoming refugees.
- As with disaster risk insurance, there is a risk that premiums could be mispriced due to the niche nature of the market.

Figure 9: Displacement insurance



- Perverse incentives could arise to attract refugees into countries to trigger payouts.

As the pricing of risk becomes increasingly sophisticated, the insurance framework will become applicable to more situations. At present, the World Bank is developing a grant- and insurance-based Famine Action Mechanism (FAM) to predict the occurrence of famine and trigger a response to counteract its effects; this is being developed with a number of partners including ICRC and the UN and combines public and private finance to respond more effectively to famine risks (World Bank, 2018b). The IFRC is also exploring a catastrophe bond for volcanic activity (Artemis, 2018). A specific level of volcanic ejection would trigger a payout to respond to the potential effects of a full-scale eruption. There is clearly ample scope for insurance to be utilised to manage crisis situations but there are challenges such as the costs of insurance becoming unaffordable and/or the subsidies required being too high.

4.3 Inefficient funding

Humanitarian funding tends to be inefficient as a way of producing required outputs/outcomes (Stoddard et al., 2018). Donor preferences for large INGOs that can fulfil complex reporting requirements tend to result in multiple steps in transaction chains through sub-contracting to partners with a stronger presence in the crisis itself. This results in only a small proportion of total donor funding reaching affected people. A study

of 28 EU-funded humanitarian projects found that 38% of the total €302 million for the projects reached beneficiaries directly. The rest was spent in procurement, logistics and other support costs – some of which are clearly essential for successful operation, but this is where donors are looking for savings by reducing multiple levels of overhead (Willitts-King et al., 2018).

Inefficiency is also a consequence of the highly reactive nature of humanitarian funding and responses, arriving when needs have already become acute. This is largely the case with most responses to even protracted crises, where financing requirements can often remain similar over many years but where funds are usually mobilised on an annual basis, ‘as if it were not possible to foresee demand’ (Poole, 2016). This puts avoidable cost inefficiencies on aspects of the response like procurement, transport, warehousing and recruitment. WFP has estimated that more multi-year financing would cut its costs by approximately a third through improved procurement practices (Belanger et al., 2016).

Prevention and mitigation programming remains a small minority of total humanitarian spending: just 1% of total ODA is spent annually on disaster risk reduction (Sparks, 2012). However, these approaches have been demonstrated to be cheaper, less resource intensive and more effective than post-crisis responses.

The Grand Bargain agreement made between donors and agencies at the World Humanitarian Summit in 2016 aims to address many of these

issues, and donors have committed to changing their practices in exchange for greater transparency (Metcalf-Hough and Poole, 2018), but there are also financial instruments – particularly impact bonds – that could be used to improve efficiency by focusing on outcomes and providing longer-term financial certainty.

4.3.1 Applicable instruments

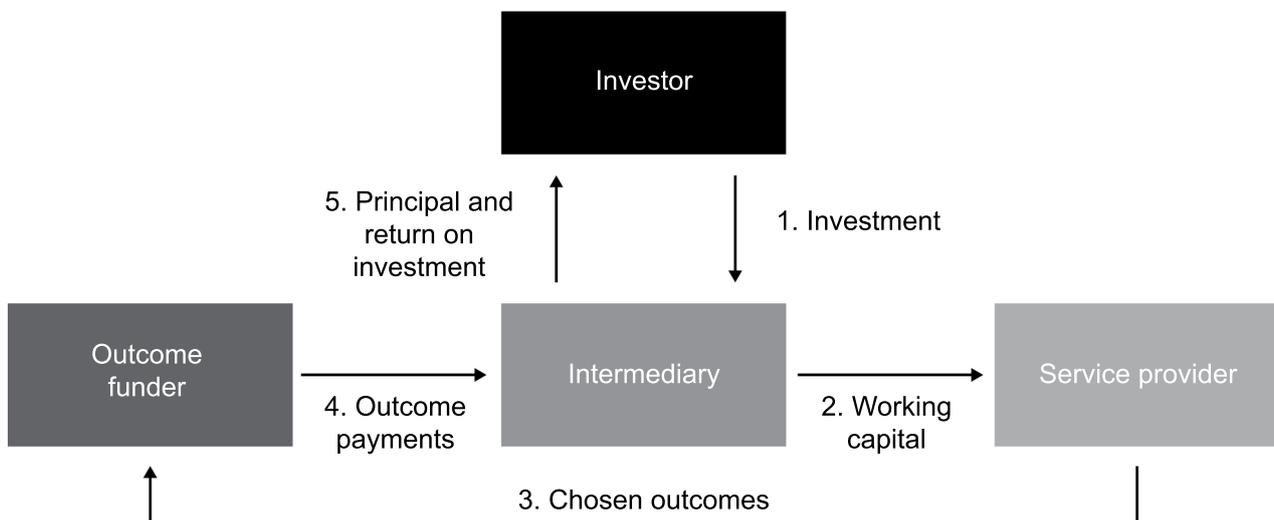
1. Impact bonds

Impact bonds are a form of results-based or payments by results funding where an investor pays a provider to carry out a specific set of tasks with pre-agreed outcomes, and when these outcomes are agreed the investor’s capital is returned using money from an outcome funder. Outcomes can vary but should be simple, measurable and specific. Examples of outcomes are increased school enrolment, achievement of education qualifications and reduced unnecessary hospital admissions.

Investors typically lend the upfront capital needed for providers to set up the intervention (e.g. mentoring and guidance in schools) and are repaid at the end of the contract by outcome funders with the income generated from outcomes achieved. This does not bring in new money to the crisis but provides upfront funding and a mechanism that incentivises success.

Instead of funding a specific intervention, this structure enables outcome funders to only pay when desired outcomes are achieved whilst giving providers the opportunity to innovate as to how they will achieve the chosen outcomes. The investors take on the financial risk of the provider failing to deliver on outcomes.

Figure 10: Impact bond structure



Box 4: Example: ICRC Humanitarian Impact Bond (HIB)

Summary:	ICRC HIB launched in 2017 to address services for people with physical disabilities in conflict-affected countries. The investment raised has funded the building of three new rehabilitation centres and training of staff. After five years, outcome funders will pay ICRC an undisclosed amount if the centres run more efficiently than existing centres.		
Geography:	Nigeria, Mali, Democratic Republic of Congo	Date launched:	September 2017
Length of contract:	Five years	Target outcomes:	Improved efficiency (the ratio of how many people receive mobility devices per physical rehabilitation professional) vs. existing centres
Investors and investment size:	New Re (Munich Re), Bank Lombard Odier 26 million CHF	Outcome funders:	Belgium, Switzerland, Italy, UK and La Caixa Foundation

Impact bonds require evidence and data to function. Evidence is needed to prove that the outcomes can be attributed to the intervention and data is vital to regularly monitor success. Issues with impact bonds can arise when providers cherry-pick the members of the cohort with whom they work. For example, with an education-based impact bond, a provider could choose to work with a child already excelling at school instead of one that is struggling to achieve a qualification outcome and thereby receive funding. To counteract this, outcome funders can define the cohort to meet specific criteria.

Given the multiple stakeholders involved and complex payment mechanisms, impact bonds often require external expertise for structuring and can be time and resource intensive to design and execute.

All impact bonds follow the same structure but can have different names when they are applied to different contexts. Impact bonds in developed countries operate as ‘social impact bonds’ and are used to improve the efficiency of government contracts while delivering savings to the public purse. ‘Development impact bonds’ are used to finance development work and recently the first ‘humanitarian impact bond’ was launched by the ICRC – see Box 4 (Gustafsson-Wright et al., 2017; ICRC, 2017).

There has been significant innovation and development in the field of impact bonds, mainly in developed economies and development contexts.

However, more experimentation is underway: KOIS are presently fundraising for the first Refugee Livelihoods Development Impact Bond to fund programmes by the Near East Foundation and possibly Spark in Jordan and Lebanon (Convergence, 2017; Gustafsson-Wright et al., 2017). The outcomes for this bond will be based on indicators of improved livelihoods for refugees and host populations, including sustained enterprise creations and increased household spending on basic needs. The bond is looking to raise up to \$20 million of investor money and \$25 million donor money, and will generate an internal rate of return of up to 8% for investors.

Advantages and disadvantages:

- + Impact bonds mean funders only pay for success, reducing their risk.
- + The structure allows for flexibility in delivery and promotes innovation, improving efficiency of the operation.
- + The data tracking required strengthens the intervention and gives greater visibility on impact.
- High set-up costs (up to 10% of total outcome payments) to cover contract design and development, performance management, data tracking and legals.
- External expertise from intermediaries is needed, thereby increasing development costs.
- It can take over a year to structure an impact bond. The development time is out of step with the fast-changing nature of fragile contexts.

4.4 Short-term solutions

Humanitarian grant funding tends to be provided in either annual or even shorter cycles, regardless of the nature of the crisis. This is both inefficient and not conducive toward appropriate planning. A lack of long-term investment also means that responses remain expensive, a common example of this being the widespread use of diesel generators in humanitarian settings, rather than investing in the high up-front costs of alternative energy options that would be cheaper in the long run.

The ICRC, for instance, is increasingly adopting an approach whereby humanitarian teams work to both a short and long timeframe in their programmes, combining elements such as immediate food relief with seed supply, livestock vaccinations with cash distribution, and emergency medical care with the training of hospital staff and ensuring their incomes (ICRC, 2016). Ultimately, to save costs and allow for longer-term responses at scale, donors need to provide multi-year funding, which can help foster medium-term planning and greater links between the humanitarian and development sectors (Belanger et al., 2016).

4.4.1 Applicable instruments

1. Renewable energy investments

Renewable energy is increasingly seen as a sector that offers tangible examples of non-grant-funding models working in humanitarian contexts. The need is clear: without long-term certainty on funding, humanitarian agencies can only focus on shorter-term solutions for providing power in refugee camps, which are often expensive, inefficient and environmentally damaging. Most camps rely on diesel generators for electricity, wood or charcoal cookstoves, for example the refugee camp in Dadaab, Kenya, which first opened in 1991, spends \$2.3 million per year on diesel alone (Lahn and Grafham, 2015). Simple solutions such as the introduction of solar lanterns would cost \$335 million but would lead to annual savings of \$323 million in fuel costs. Most of these savings would accrue to benefit refugees and IDPs directly, as they often have to spend the majority of their household income on energy.

Displacement contexts usually present an unattractive prospect for a potential investor, so many financing mechanisms seek to leverage first losses and ‘prepare the market’ for more commercial investment, as well as build support through gathering evidence. To that end, the Moving Energy Initiative, with a focus on displaced contexts in Burkina Faso, Kenya and Jordan, has conducted studies in camps to find that a

significant proportion of refugees are willing to pay for clean and reliable energy.

Such schemes would provide further benefits. In 2017 UNHCR, funded by the IKEA Foundation, built a solar plant in the Azraq refugee camp for Syrian refugees in northern Jordan (IKEA Foundation, 2018). The building of the plant created training and employment for 50 refugees as well as ongoing employment. Electricity is expensive in Jordan but through the plant UNHCR can provide free electricity in the camp, meeting half the camp’s needs. The plant saves UNHCR \$1.5 million dollars per year in energy costs.

Despite early enthusiasm and some emerging for-profit entities supplying equipment for aid providers and residents, most financial mechanisms used in energy have yet to scale up. This is due to a range of factors: energy is rarely seen as a priority, owing to the current configuration of humanitarian coordination structures, but there is also a lack of technical expertise on the installation and maintenance of these systems. There is also a more fundamental barrier: energy systems that accrue their benefits over a long period of time require an admission from governments and humanitarian agencies that displaced populations and camps will be a more permanent presence than is often acknowledged.

Advantages and disadvantages:

- + Renewable products offer both savings and positive environmental impact.
- High up-front costs mean savings are only generated over a longer period of time.
- Instructions and repairs training required to prevent users reverting to diesel.

4.5 Lack of economic opportunities

All contemporary conflicts have an element of forced displacement and this now constitutes one of the primary challenges of humanitarian response. The total number of people forcibly displaced reached 68.5 million in 2017, the sixth consecutive annual increase (Development Initiatives, 2018). Only some populations cross international borders and become refugees. The majority become IDPs and, without any form of legal protection, are highly vulnerable to further violence and persecution. Most displaced people, around 70%, are currently in middle-income countries, with just 7% in high-income countries, and crucially most do not live in camps – the

majority find shelter by renting or living in improvised shelters in urban areas. Many displaced people leave their homes for many years and will often never return, necessitating longer-term approaches that go beyond immediate relief.

Due to humanitarian aid being unpredictable and focused on short-term needs, many employment approaches tend to be small in scale, uncoordinated and have poor links to local markets (Crawford et al., 2015). Some reasons behind the lack of opportunities for refugees are, however, beyond the control of humanitarian responders. Restrictions placed on refugees by host governments that limit their movement, income-earning activities and integration with the aim of discouraging permanent settlement mean some programmes would not be permitted. Conversely, some humanitarian organisations, with a strict interpretation of their mandate as being restricted to life-saving activities, may not see it as their responsibility to implement programmes seeking to improve ‘opportunities’ for displaced people. It is also important to consider the impact of refugees on the host community who may be in similar levels of poverty and need despite being citizens – effective responses take into account opportunities to work with and support refugees and host communities.

4.5.1 Applicable instruments

Different kinds of instrument address different avenues for improving prospects for refugees. Supporting job creation can help provide a steady income, microfinance gives refugees the financial freedom to potentially start their own businesses, and incubators work to upskill refugees so that their ventures are more sustainable and investible. Access to financial services is an essential prerequisite to all these instruments. The importance of financial inclusion for refugees is more thoroughly explored in the 2017 CGAP report *The role of financial services in humanitarian crises* (El-Zoghbi et al., 2017).

The World Bank has incentivised host governments to support refugees and host communities through national systems by providing low interest loans. These come through the World Bank’s International Development Association’s (IDA) \$2 billion facility for low-income countries (World Bank, 2017) and the \$6 billion Global Concessional Financing Facility (GCFF) for middle-income countries (currently Jordan and Lebanon, where large numbers of Syrian refugees are hosted) and are

subsidised by donor contributions to the facility (GCFF, 2018).

1. Funds to incentivise job creation for refugees

Refugees frequently cite employment as critical to normalising their situation and giving financial and broader stability. However, government restrictions and limited opportunities can create barriers to employment and job creation. The 2018 report by the Refugee Investment Network on ‘How investment can unlock the potential for refugees’ cites lower turnover rates for refugee workers when they are given access to the job market. Hindering refugees’ ability to work increases their dependence on aid and the probability of them joining illegal trades. Other investments are planned or underway (Price, 2018).

One approach has been the development of refugee compacts which align governments’, funders’ and refugees’ interests to overcome such barriers. For example, the UN launched the Jordan Compact in 2016, which offers humanitarian and development financing in the form of grants and loans as well as favourable trade agreements with Jordan in return for creating legal employment opportunities and education for Syrian refugees. Similar compacts have now been signed by Turkey and Lebanon, and are being developed for Ethiopia (Barbelet et al., 2018b). In the Jordan Compact, funding is assigned to meeting targets on issuing work permits to refugees in specified sectors, providing school places to Syrian children and granting the establishment of Syrian businesses.

While positive steps have been taken and the situation is improving, reviews of the Compact state that its design should have been more refugee-led and that the focus on work permits has had limited improvement on the daily lives of refugees. Work permits were restricted to certain sectors, which did not necessarily reflect the qualifications of the refugees. In some instances, lack of transport links near the camps made attending both school and work impossible (Barbelet et al., 2018a).

Using a different approach – and still vulnerable to such drawbacks – impact bonds can also be used to promote job creation by using employment as a specified, paid-for outcome. Alternatively, equity investments can help businesses grow, which in turn provides jobs or services for refugees. The KOIS refugee bond described earlier uses enterprise creation and sustainment as a metric to indicate improved livelihoods. The DWM Global Displacement Fund (see above) will make equity

investments mainly in inclusive finance institutions for displaced and host populations.⁴

Advantages and disadvantages:

- + Employment provides long-term financial security and independence for refugees and host communities if designed well.
- Fund design needs to be highly context specific; political considerations can also complicate implementation.
- Lack of opportunity for host communities, lack of government policy and regulatory frameworks.

2. Microfinance

Investors, both retail and commercial, can invest in microfinance funds through finance institutions such as Triodos, Deutsche Bank and SEB (SEB, 2018). These funds invest in local financial institutions who then provide loans to individuals. This offers refugees and others in crisis contexts financial freedom and the opportunity to invest, although caution must be taken to ensure that interest rates are fair and loan recipients do not take on unsustainable debt.

An example of a microfinance fund supported by both individuals and foundation investors is the online lending platform Kiva, which runs a World Refugee Fund offering loans to refugees through its network of Kiva Field Partners (Kiva, 2018). Since 2016, the fund has lent \$6.6 million to 7,800 refugees and IDPs. The

average loan is \$855, and Kiva has reported a 96.6% repayment rate (almost the same as their repayment rate from non-refugee borrowers at 96.8%). In Rwanda, Kiva Field Partners have reported a 100% repayment rate within refugee camps.

Between 2017 and 2018, most of these loans were issued in Lebanon, Colombia and Jordan, with funds being used for a range of causes including personal use, agriculture, food and health. Kiva has tailored its offerings for refugees by decreasing the minimum loan size and widening the acceptable forms of identification.

Advantages and disadvantages:

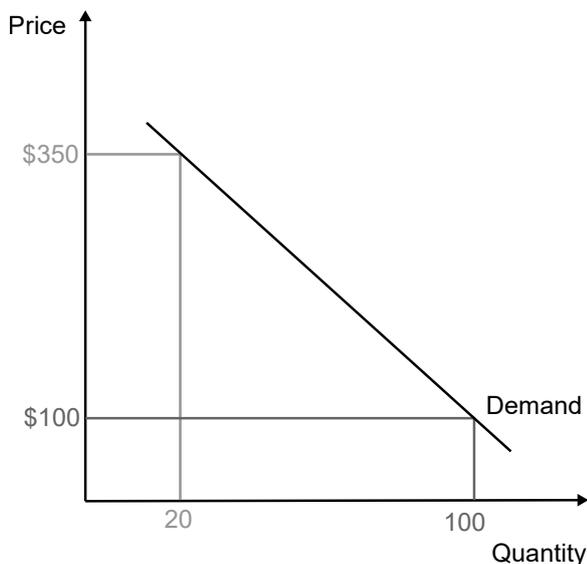
- + Microfinance offers businesses and individuals funding when they are too small for commercial lending but have outgrown their direct resources of savings or family funds.
- Interest rates can be very high, leading to continuing cycles of debt.

3. Incubators

Incubators offer equity investments alongside more intensive support in running and developing the business. Gaza Sky Geeks, founded in 2014 as a partnership between Google and Mercy Corps, is one such example. This tech hub offers a 16-week accelerator programme for Palestinian start-up founders in Gaza during which they test and refine their product offering and meet potential venture capital investors. The hub also offers a coding academy for students looking to graduate as full-stack developers who will then be able to work remotely for clients around the world (GazaSkyGeeks, 2018).

- + Incubators provide both patient capital and intensive training at the crucial early stages of the business, giving it the highest chance for success.
- + Ventures can access extensive networks.
- Content of the training can be driven by the funder's own branding. This may not necessarily fit the targeted cohort.

Figure 11: Pricing illustration for vaccine development



4.6 Research and development costs are too high

The expense of research and development of a product must be justified by the potential revenue from that product. In some sectors, these costs are out of balance meaning that products are not

⁴ Prior to this, in 2016 the philanthropist George Soros pledged to invest \$500m in businesses in order to address the needs of migrants, refugees and host communities, which is still being deployed (see Soros, 2016).

developed despite there being a need. There is therefore a deficit of incentives for a private sector company to produce the product as there is likely to be little financial return. Advanced market commitments (AMC) are a way of manipulating a market where demand is high from people who cannot afford a product but low from those who can. This model has been used to help develop vaccines that would otherwise not be financially feasible.

In 2010, an AMC was launched to fund development of a vaccine for pneumococcal diseases (meningitis and pneumonia), which are responsible for 1.6 million deaths each year (DFID, 2014). \$1.5 billion of donor funding was committed to purchase 2 billion doses of the vaccine. Without this funding, low-income countries would have only had access to the vaccine nine years after its introduction into the market in developed nations; the AMC was therefore able to prevent significant numbers of deaths.

However, the AMC model has not been replicated since, a key challenge being lack of donor appetite to enter legally binding commitments to future expenditure. There are additional risks involved with pharmaceutical companies overpricing vaccine

development. Oversight of the pharmaceutical companies is needed to monitor this.

A potential area for future AMCs could be in addressing diseases mainly affecting fragile contexts. For example, the quantity of Ebola vaccine needed in developing countries is high, but they can only afford to purchase the vaccine at a low price and there is little demand for the vaccine in developed countries who can afford to buy it. To address this misalignment, donors can enter a legal agreement with pharmaceutical companies to purchase a fixed number of vaccines at a price high enough to incentivise companies to invest in research, thereby subsidising the cost for developing countries. However, if the vaccines do not work, the donors pay nothing.

Advantages and disadvantages:

- + This is an effective mechanism to channel donor funds into long-term, high impact solutions.
- + This instrument could be used to fund non-medical research and development, for example specialist technologies for use in refugee camps.
- It is difficult to secure legally binding, future funding from donors.
- There is a risk of mis-pricing vaccine development.

5 Legal and practical considerations for working in humanitarian contexts

Building new and effective partnerships between humanitarian agencies and investors requires building bridges between two very different worlds, both in terms of how they operate – the principles that underpin their approaches – and where they operate – i.e. the geographies and types of operation with which they are familiar.

The humanitarian community has traditionally been sceptical towards private sector interventions in humanitarian contexts and reluctant to build partnerships. Much of this apprehension stems from the assumption that the private sector’s profit-driven model is fundamentally incompatible with the humanitarian principles that guide humanitarian organisations in addressing need wherever it is found, irrespective of cost.

Investors, however, are not all the same. There has been a growing movement to balance market and social returns, and transform business practices in a way that reflects and goes beyond CSR standards and human rights-based approaches to build a business model in which a socially responsible ethos permeates the entire organisation while still returning a profit. Partnerships between humanitarian organisations have enhanced the understanding of some private sector actors on how to approach such considerations and helped humanitarians to understand how these partnerships can work to the benefit of crisis-affected people. This section outlines the legal and ethical considerations for private investment opportunities in humanitarian settings along with potential human rights and protection⁵ concerns and due diligence mitigation measures. It also summarises the

practical operational considerations that are familiar to humanitarian agencies working in conflicts and disasters, but which investors are less aware of.

5.1 Humanitarian principles

Central to humanitarian assistance is that it must be delivered in line with four key principles: humanity, neutrality, impartiality and independence (UN, 1991; 2004) (see Box 5). These humanitarian principles are cited by humanitarian organisations as the guiding framework for all activities and operations,⁶ but they may not be readily understood by those outside the sector.

A significant obstacle for private sector–humanitarian engagement and collaboration has been the exclusionary and specialist vocabularies used by their respective sectors (Zyck and Kent, 2014: 18). Any private investment in humanitarian settings, therefore, should at the outset ensure businesses properly understand humanitarian principles. It is also essential to recognise what these may mean in practice, what they can or cannot do as well as how business activities could potentially contravene these principles (see Box 5 for some recommended approaches).

5.1.1 Approaches to humanitarian- and conflict-sensitive investment⁷

Companies seeking to invest in humanitarian contexts need to consider conflict sensitivity as well as cultural norms. This section offers some guidance for businesses

5 Protection in the humanitarian context is defined by the humanitarian coordination body the Inter-Agency Standing Committee (IASC) as ‘activities aimed at ensuring full respect for the rights of the individual in accordance with the letter and spirit of the relevant bodies of law (i.e. human rights law, international humanitarian law and refugee laws).’ This includes protecting human rights, delivering life-saving goods and services, and promoting the respect for rights and the rule of law (GPC, 2015: 2).

6 In reality, these principles and their application have been the subject of much critical debate across the sector since their formulation. Many organisations interpret them in different ways, leading to contrasting stances on contentious issues – particularly on when to ‘go public’ and ‘name and shame’ parties responsible for human rights violations.

7 This section is modelled on and guided by the UN Guiding Principles on Business and Human Rights (UNHRC, 2011).

Box 5: Humanitarian principles

Humanity: Human suffering must be addressed wherever it is found. The purpose of humanitarian action is to protect life and health and ensure respect for human beings.

Neutrality: Humanitarian actors must not take sides in hostilities or engage in controversies of a political, racial, religious or ideological nature.

Impartiality: Humanitarian action must be carried out based on need alone, giving priority to the most urgent cases of distress and making no distinctions on the basis of nationality, race, gender, religious belief, class or political opinions.

Independence: Humanitarian action must be autonomous from the political, economic, military or other objectives that any actor may hold regarding areas where humanitarian action is being implemented.

Source: OCHA (2012)

to adjust their work in line with humanitarian principles, based on guidance from the UN on business and human rights.

Private sector actors must review their proposed interventions to examine whether they might directly or indirectly contribute to local tensions. Those aiming to align their business activities and operations with humanitarian principles will need to undertake a due diligence review prior to or at the outset of implementation, particularly when operating in disaster-prone or conflict-affected areas. Given the dynamic and fluid nature of most humanitarian environments, such due diligence reviews will need to be regularly reviewed to determine whether the appropriateness for private sector interventions has changed.

Identifying and assessing actual or potential adverse impacts

Identifying potential adverse impacts of private sector investment requires an examination of not

just direct activities, but also indirect impacts caused by personnel, contractors, suppliers or partners and the unintended, negative consequences as a result of direct or indirect actions. When undertaking the humanitarian risk assessment, businesses should consult regularly with humanitarian actors in addition to local communities.

Humanitarian policies need to be as inclusive as possible, including meaningful consultations with affected groups to understand their concerns fully and accurately. Such consultations must be in a language that communities understand and in a culturally and socially appropriate manner.

Integrating findings from impact assessments across relevant business functions and processes

If the decision is made to proceed with private investment, the business needs to ensure that any findings from the impact assessment are properly incorporated into both strategic and operational planning. Private sector commitments supporting humanitarian principles must be integrated and embedded in all levels of a business enterprise.

Communicating on how impacts are being addressed

Private sector commitments must be communicated and accountable to all stakeholders, including affected communities, through accessible, transparent and rights-based reporting mechanisms.

5.2 Legal considerations

An increasing number of voluntary corporate standards reference the relevant international legal framework, which provides an appropriate starting point for considering legal issues related to business projects in humanitarian contexts (Hansson, 2013: 12). The international legal standards derive primarily from international human rights law (IHRL), international humanitarian law (IHL) and international labour law.⁸ An IHL-sensitive investment approach recognises the need for greater sensitivity and resources when operating in high-risk areas with weak governance structures.

⁸ This would include, at a minimum, the International Bill of Rights consisting of the Universal Declaration of Human Rights (UDHR), the International Covenant on Economic Social and Cultural Rights (ICESCR) and the International Covenant on Civil and Political Rights along with the International Labour Organization's eight core conventions as set out in the Declaration on Fundamental Principles and Rights at Work (Human Rights Council, 2011: Principle 12). Separate but complementary to IHRL, IHL applies exclusively in the context of armed conflict or occupation and includes the four Geneva Conventions of 1949 along with their Additional Protocols of 1977.

Box 6: Protection threats: data breach or disclosure of personal information

Private sector financial investment in humanitarian responses could potentially involve the collection of personal information of displaced or conflict-affected communities. Individuals have the right to know what information is being collected about them, with whom and in what ways this information may be shared and the need for their consent in doing so. In high-risk environments and conflict settings, the sharing of this information could potentially expose communities to protection risks to their safety and security. For example, in February 2018, the IFC announced a partnership with IrisGuard, a Jordanian company focused on iris-scanning technologies, 'to help boost financial inclusion and improve the lives of Syrian refugees in Jordan and the region' (IFC, 2018a). The commendable goal of improving financial access for Syrian refugees must at the same time consider the protection risks to refugees if their personal information is inadvertently shared. Companies looking to invest in humanitarian and emergency settings should ensure that an operational strategy that will protect confidentiality is in place before the collection of any personal information.

5.3 Voluntary initiatives for corporate responsibility

Over the past two decades, a number of international and regional initiatives have sought to develop standards on corporate responsibility and obligations. Launched in 2000, the UN Global Compact outlines ten key principles for socially responsible practices, including in the areas of human rights, labour, the environment and anti-corruption, and today includes more than 12,000 signatories in over 160 countries. While non-binding, the Compact provides private sector actors with an opportunity to formalise their commitments to operationalise the standards at all levels. In 2011, the UN Guiding Principles on Business and Human Rights set forth the most significant standard on the application of human rights to the sector, emphasising the legal obligations of business to respect human rights and the need for appropriate and effective remedies where breaches occur (UNHRC, 2011).

Additional voluntary initiatives include the *Organisation for Economic Co-operation and Development (OECD) due diligence guidance for responsible supply chains of minerals from conflict-affected and high-risk areas* (OECD, 2016) as well as private initiatives such as Certified B Corporations, which is administered by the non-profit B Lab and involve 'third-party validation, public transparency, and legal accountability' (Certified B Corporation, n.d.). Corporations which seek B Corporation certification must also achieve a minimum B Impact Assessment score and amend their corporate governance documents to explicitly provide for balancing profit with social purpose. Related to B Corporations are Benefit Corporations, which expressly require that the corporate mission and business objective include a social benefit element, which allows corporate executives to consider these benefits along with profits in carrying out and discharge of their fiduciary duties to stakeholders (Neri, 2017).

5.4 Operational challenges of humanitarian contexts

Humanitarian programmes are often faced with a number of logistical and other challenges that can raise costs and slow down their work, but which they have considerable experience in overcoming or mitigating. Delivering aid or operating in costly, remote and insecure settings will likely be a feature of many investment-type approaches, and may entail a number of obstacles for a timely humanitarian response:

- Regulations by both host and donor governments, including those intended to stop financing to terrorist organisations, have meant banks and humanitarian organisations are faced with delayed or blocked transactions and account closures (Gordon and El Taraboulsi-McCarthy, 2018). Bringing money into countries on the scale required for humanitarian programmes is often a major challenge, including to finance sub-contracting arrangements with local NGOs or businesses.
- Infrastructure is often a major challenge for humanitarians seeking access to remote locations. Roads and airports may be in poor condition even before disaster events, and often lack the capacity to transport large amounts of goods as part of a humanitarian response. Electricity supply may be limited or erratic and prone to outage, making back-up generators an expensive necessity in many contexts. Digital and

financial infrastructure, similarly essential for the functioning of increasingly common debit card responses, may also be limited, with few affected people having access to bank accounts.

- A weak regulatory environment hinders the protection of businesses and humanitarian responders alike. This reduces legal opportunities or protections for workers including refugees and an inefficient or non-existent judicial system may mean a heightened risk of corruption. Conversely, a highly constrained regulatory environment may mean authorities creating prohibitively complex or intimidating practices to impede aid delivery or employment. A lack of regulations regarding digital and financial sectors may also expose affected people to theft and fraud, as well as the use of data for purposes other than what was intended.
- Political uncertainty is a universal feature of humanitarian contexts. Violence around elections, changes of government leading to hampered bureaucracies, strikes and industrial action disrupting infrastructure, and rapidly shifting political objectives could all present challenges. Being seen as tied to or distanced from the ruling government may become a sudden benefit or hindrance that could hamper businesses and humanitarian operations.
- Above all, insecurity significantly constrains humanitarian operations – the higher the levels of violence, the more uneven the coverage (Stoddard et al., 2017). A risk of violence also limits technical complexity and targeting, meaning responses may have to distribute straightforward in-kind aid rather than invest in more sustainable approaches.

Box 7: Refugees and displaced people

Forced displacement often as a result of conflict is a major source of humanitarian needs – whether within a country's borders (IDPs) or crossing a border (refugees). Displacement is increasingly an urban, dispersed phenomenon, with at least 59% of all refugees now living in urban settings rather than refugee camps, which are often situated in rural locations where land is available. More than 80% of refugee crises last for ten years or more, with two in five lasting 20 years or more. Once displaced for six months, refugees have a high probability of finding themselves in displacement for at least three years (Crawford et al., 2015).

Host governments faced with a displaced population have adopted a range of policies that impact the scope and nature of humanitarian and business responses. Many governments currently enforce a strict refugee camp policy on displaced people, with some placing restrictions on movement, employment and access to certain goods and services. This is currently the case in the Rohingya refugee camps of Bangladesh, where cash responses and livelihood projects are severely limited. Conversely, Uganda has a relatively open policy that has seen many of its 1.2 million refugee population provided with small plots of land, being allowed to work and move freely. Such refugee 'camps' may be indistinguishable from villages of citizens of the host country.

6 Building a market for humanitarian investments

Fully functioning financial markets, operating at scale, are critical for the effectiveness of any economy. Humanitarian investing has a long way to go before it can realistically be called a market in the same way as green investments, which have grown significantly over the past decade, with green bonds worth \$389bn in 2017.⁹ However, it is possible to accelerate progress by having a clear understanding of what it would take to scale. This includes:

1. **Returns:** effective financial markets generate a return for investors. In the case of humanitarian crises this return could be purely social (i.e. through improving social indicators) or could be a mixture of social and financial. If financial returns are targeted, operating models need clear revenue streams that can generate a surplus over and above operating costs.
 2. **Visibility on risk:** the flipside of potentially generating a return is that any investment carries an element of risk. For well-developed markets such as government bonds, the risks are clear and industry benchmarks exist for tracking and quantifying that risk. For less developed and more closed markets, such as those presented here, challenges exist in understanding the risks let alone quantifying them. This prevents many investors from entering the market and pushes up the cost of capital.
 3. **Timing symmetry:** it is essential that the duration of investments match the profile of the underlying operations. This can be a challenge for some business models, particularly those targeting a social return, that take longer to mature and has led to the evolution of what is known as ‘patient’ capital.
 4. **Liquidity:** the ease with which capital can be released from an investment is a key consideration for many investors. Public markets such as stock exchanges offer an opportunity for investors to trade; however, in nascent markets the lack of scale, transparency and regulation makes the trading of investments difficult. There are also
- important ethical considerations that any investors into humanitarian crises need to abide by that limit the ability to create an open market.
5. **Transparent pricing:** markets that have clear pricing structures are far more effective than those in which prices are decided on a case-by-case basis. This is because both sides of the trade know that they are getting a fair deal and less time is spent determining and negotiating price.
 6. **Proportionate transaction costs:** these are the costs associated with delivering funding. They include the cost of assessing the investment, due diligence, valuation, risk assessment and impact assessment. For pioneering investments these can be very high; however, it is critical the market moves to reduce them over time through data and best practice sharing.
 7. **Investible opportunities:** one of the biggest challenges faced by impact investors is the lack of investible opportunities, particularly for large investors such as pension funds who deal in tens or hundreds of millions. Creating a pipeline of deals will be essential to the enduring success of the market.

6.1 The state of the innovative finance market

Against this benchmark of the ingredients for a market, what is the current state of the innovative finance market? Based on our research we have grouped this into three broad categories: the appetite for new financing models, the ability of the market to absorb these instruments and gaps in what is needed to achieve this.

6.1.1 Appetite

Early evidence of success

Since 2010, 129 impact bonds have launched, of which 122 have been social impact bonds in developed countries. 25% of these have come to conclusion and

9 Filkova, M. 2018. *Bonds and climate change: the state of the market*. Climate Bonds Initiative. <https://www.climatebonds.net/resources/reports/bonds-and-climate-change-state-market-2018>

the majority have paid out or have been extended, showing a positive precedent of success for these new financial mechanisms. The impact investing market is growing, with an investor survey showing \$228 billion invested in impact investments (Global Impact Investing Network, 2018).

In frontier markets, however, we are seeing only limited evidence of innovative finance being piloted, and mainly in insurance products. Examples of this include:

- The ARC, developed to manage the effect of weather shocks across the continent by pooling sovereign (i.e. governmental) insurance risks (see above).
- The World Bank's Pandemic Emergency Facility (PEF), created in 2017 in response to the Ebola outbreak in West Africa in 2014–2016 to address the funding gap between initial disease outbreak and reaching pandemic thresholds. The facility combines both insurance and cash grants (for when insurance criteria are not met).
- Building on its experience with PEF and responding to the threat of 'four famines' in 2017, the World Bank is developing the FAM (see above) – the first global mechanism dedicated to supporting upstream interventions in famine prevention, preparedness and early action (OCHA, 2017b). This initiative will use data to predict the probability of famine to trigger payments to manage food security (World Bank, 2018b).

Other high-profile investments include the ICRC humanitarian impact bond described above. The challenge is that none of these mechanisms has either reached the outcome payment stage (for the ICRC bonds) or had major payouts triggered (for the insurance approaches), so evidence of their success is still too early to determine, and there is a limited track record of successful investments producing a return that can encourage further investment.

Existing funders and willingness to experiment

A range of funders have expressed interest in innovative financing. Government aid departments from developed countries have traditionally funded humanitarian agencies with grants to deliver essential supplies and services to crisis situations. They are now exploring innovative financing methods to maximise the impact of this financial aid, but face challenges in finding evidence or in making the business case for innovative financing compared to grant-based approaches. They are also constrained by procurement norms focused on grant-making, which are not suited to working with different partners such as investors.

Partnerships are essential. The growing engagement of the World Bank in fragile countries is important in bringing additional support to ultra-fragile situations through its strong influencing and convening power. There is increasingly additional support from corporate and private foundations through finance, technical assistance and specialist skills, for example technology. Partnerships between funders can also work to achieve real results, such as the Mastercard Financial Inclusion Lab, which brings together funding from the Bill and Melinda Gates Foundation with MasterCard's resources to increase access to financial services in developing countries (Mastercard, 2018). As mentioned above, IKEA Foundation has seeded investment in solar energy plants for refugees in Kenya, working with UNHCR.

There is, however, some sense of increasing frustration with the pace at which the innovative finance market is developing. There is intellectual interest in the space and a willingness to engage but insufficient willingness to act collectively. To accelerate this process, donors need to develop ways to catalyse or subsidise financial innovation, while investors need to consider different approaches and partnerships.

6.1.2 Ability

On both sides of the transaction, humanitarian and investor, there are differing skillsets and comprehension of operating constraints of various stakeholders. Investors lack an understanding of crises and local contexts and humanitarians have limited knowledge of structuring financial instruments. Before any financial instrument can be implemented, there needs to be an awareness of the real logistics of operating in a crisis context – the ease of getting money in and out of the region, the existing communications infrastructure and local capacity to deliver.

To bridge the knowledge gap, external expertise is needed as well as development of enhanced internal capacity to engage across the humanitarian/investor divide. There needs to be a willingness and trust to partner with intermediaries to develop solutions and act as financial translators, and for organisations to develop new partnerships, for example between development finance institutions and humanitarian agencies, as the IFC is doing with UNHCR in Kenya (Ndege, 2018).

6.1.3 Gaps

Stakeholder convening

Humanitarian agencies/donors and investors still form two largely separate camps. From the investor side, we

hear how they are keen to invest in these markets but that there are not enough ‘investible’ deals. And from the humanitarian side, it appears investors have little interest in their projects. Both are speaking different languages and operating in different spheres. Private capital may need to adjust its due diligence and risk criteria if they really want to invest and humanitarian agencies/donors need to change how they operate in terms of procurement rules (which make it hard to contract different partners) and track metrics to make themselves more attractive to the commercial sector. With more stakeholder convening, all sides should be present to co-design products that both suit financial markets and adhere to the operational structure of aid agencies. Initiatives such as the World Economic Forum’s (WEF’s) High Level Group and Community of Practice on humanitarian investing are needed to narrow the gap and build new partnerships (WEF, 2017).

Transparency and data

Despite impact bonds being tested in various geographies and other instruments being piloted, we are seeing very little publicly available data on key bond components such as outcome prices, or the value of other instruments. When interviewing aid agencies, the consensus was that impact bonds are complicated and expensive to develop, making them less attractive. If metrics such as outcome prices were readily available, organisations would have a starting point from which to develop their own impact bonds without having to heavily invest in resources for development.

The Africa and Middle East Education Outcomes Fund (EOF) is currently under development by the global Education Commission initiative and the Global Steering Group for Impact Investment (Devex, 2018). This entity will pool funds from governments, corporate and private donors to fund successful education interventions on an outcomes basis. EOF will work with governments to identify suitable outcomes and the appropriate local providers capable of delivering them. More initiatives like EOF will create a market for impact bonds with precedent transactions, thereby lowering set up costs.

Markets need data to understand and price risk. As new, more sophisticated financing mechanisms are

introduced, increased data collection will be required. This data will show returns, costs and quantitative evidence of impact and will serve to draw in new funds – both philanthropic and return-seeking. For other types of financial investments, investors called for greater access to investment propositions in frontier markets.

Most investors in developed economies have limited interactions with entrepreneurs in emerging markets but that doesn’t reflect their appetite for investing. A roadshow would be one way for international investors to gain exposure to ventures operating in post-conflict regions. Such measures could transition these investments from being niche to commonplace.

Funding certainty

At present, humanitarian aid agencies mostly receive funding on an annual (or shorter) basis. One-off financing in 12-month cycles means that funding arrives late in the year and needs to be spent by year-end. This short-term financing can therefore only be used for quick fixes that are ultimately more expensive. Sustainable long-term interventions require multi-year investment. We need to see resilience funding, financing to rebuild, and financing to create sustainable businesses.

Since refugee camps may last for many years, implementing durable, energy-efficient solutions is worthwhile. However, there is a danger that investing in long-term infrastructure could be seen as creating a permanent settlement, when camps are meant to be temporary.

While humanitarian agencies have developed workarounds such as WFP’s internal advance financing mechanisms, and the Grand Bargain commits donors and agencies to work together to develop more multi-annual funding approaches, increasing funding certainty is also an opportunity to harness investment approaches (WFP, 2017). The ICRC impact bonds provide five-year funding certainty to the agency to build and run physical rehabilitation centres. Other approaches could provide new or upfront investment finance which then provides a return for investors and funding certainty for implementers.

7 Conclusions and recommendations

Investment approaches to financing humanitarian impact represent a new model that could influence positive behavioural change among important stakeholders and drive better outcomes for those most in need. While they are not the catch-all solution to mounting pressures on the humanitarian system that many hope for, this research evidenced a growing appetite for greater investment in the humanitarian system, as well as the need for more time to put in place the relationships, data and tools to realise the ambitions of both social investors and humanitarian organisations to complement grant funding with financing approaches.

Two sets of recommendations below capture steps that must be taken to build the sector's ability to absorb and deploy investment, as well as highlighting areas where the research identifies the greatest scope for investment.

7.1 Recommendations to increase investment

Recommendation 1: New strategic alliances. Donors, agencies and investors all need to adapt to take advantage of this opportunity; intermediaries have a critical role to play in facilitating the growth of the market. This includes both advisory firms, which can help structure deals and support organisations in the process of taking on investment, and fund managers based in the fragile markets they seek to serve. Such players would be well equipped to navigate the complexities of investing in crisis situations and would bridge the cultural gap between humanitarian agencies and larger private investors. While such intermediaries exist, they tend to be small businesses that are not particularly visible. Foundations and investors should promote and support these organisations, connect them to interested

stakeholders and grow their number. Similar approaches have been taken with social investment in the UK through the Big Potential programme and Big Society Capital, which have provided seed funding to fund managers across the country and internationally in innovative financing for development.¹⁰

- **Humanitarian agencies:** rather than building in-house expertise, leverage external experts at an early stage.
- **Funders:** partner with experienced fund managers and use capital to attract more external investment; this could be done by seeding new funds or providing first loss capital.
- **Investors:** build partnerships with investors in affected countries/regions to create a more supportive investment ecosystem.

Recommendation 2: Focus on the humanitarian financing need. The need must drive the investment approach and not vice versa if this market is to successfully evolve. Given the nascent nature of the market there may be a tendency to over-engineer solutions or, worse, focus on a particular instrument rather than the underlying problem. This will require a deeper understanding of challenges and should include the role of investment in driving behavioural change among governments and communities. If we take the example of emergency responses to disasters resulting from natural hazards, preventative insurance has a critical role to play not just in ensuring access to funding at the point of the disaster but also in driving changes in behaviour that would reduce the impact of the disaster on citizens.¹¹

- **Humanitarian agencies:** clearly define the challenge you are seeking to address and how and why an investment would be better than a traditional grant-funded approach.
- **Funders:** develop business cases for investment approaches.

¹⁰ See www.bigpotential.org.uk.

¹¹ The UK's Centre for Global Disaster Protection is exploring ways to do this – but we should also look at how insurance and risk financing need to be complemented by other financing and programming approaches (see Weingartner, 2017).

- **Investors:** wherever possible, reduce complexity to ensure the instrument meets the market need and reflects the changeable nature of humanitarian contexts.

Recommendation 3: Shared learning and greater transparency. Greater incentivisation to share learning and, more critically, data would significantly improve the market's ability to engage with investment and accelerate the flow of capital for humanitarian impact. The dissemination of best practice, deal templates, deal terms, returns and other such resources would reduce the perception of risk and drive down the costs of putting together investment deals. However, the significant capacity constraints faced by the sector may mean that external funding and leadership are required to push this forward.

- **Humanitarian agencies:** share deal terms, impact metrics and lessons from investments.
- **Funders:** include funding to support the dissemination of learning and support the creation of a repository of investments and a directory of stakeholders; ensure procurement processes do not undermine the potential for partnerships and more creative approaches to funding.
- **Investors:** share deal terms, impact metrics and lessons from investments.

7.2 Opportunities for investment

Investment has a role to play across the spectrum of activities undertaken within a humanitarian context, mainly in the pre- and post-crisis phase rather than the acute phase of humanitarian crises. Over time, as stakeholders become more attuned to the role of investment, there will be a greater proliferation of approaches and instruments. However, at this stage this report recommends that the market focus on a small number of areas in order to achieve critical mass more quickly and with the least development capital. The focus areas selected are based on a combined understanding of the challenges faced by humanitarians, the context within which they work and what would be needed to attract significant investment capital to the market.

Opportunity 1: Preventative investment approaches. There is already increasing activity in insurance driven by both commercial insurance companies and donor governments. Insurance offers significant social and financial benefits as it ensures money is available at the

point of greatest need and can be used to encourage investment in reducing the impact of disasters resulting from natural hazards. With the growing impact of climate change globally and the benefits of risk pooling we see this as a promising form of innovative financing; at the same time it is important to recognise the limits of its applicability to conflict situations, and even for disasters it is better suited to predictable, rapid onset events rather than, for example, the slower-onset impacts of climate change.

Opportunity 2: Investments in job creation and social sectors for refugees and host communities. While the recently agreed Global Compact on Refugees seeks to achieve more equitable burden-sharing as poor countries disproportionately host the greatest number of refugees, many governments continue to limit opportunities for legal working and refugees remain dependent on aid. A focus on job creation for refugees and investment to stimulate economic growth in host communities could attract significant financial and human capital to the growing global challenge of forced displacement and change host governments' views on refugee employment. Not only is this a promising investment opportunity, as there are many precedents within impact investing that could be built upon, but it can also create a more integrated approach by generating jobs and economic prosperity for both refugees and host communities. Similarly, investments in sectors such as health, education and water supply are underexplored.

Opportunity 3: Investments in enterprises or assets that support the wider market for humanitarian impact are an effective route to improving humanitarian responses. For most humanitarian actors, taking on investment for service delivery would be a fundamental departure from existing operating norms. It is therefore unlikely they would be able to take on capital investments successfully for the next few years. Focusing instead on operators who serve or could serve these markets would be a more realistic medium-term goal. This could involve enterprises that have an existing focus on this market, such as providers of temporary housing, portable or renewable energy or other infrastructure investments. Or it could focus on companies with products that could be adapted to this market, such as microfinance lenders or companies with financial inclusion solutions. In either case, it is likely that investors or interested third-party funders, such as foundations and governments, would need to provide technical assistance alongside investment to help enterprises grow.

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