BRIDGING THE GAP

Unlocking Synergies between Private Sector Development and Development Finance

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British International Investment

Gatsby Africa

CONTENTS

FOREWORD

Donor-funded Private Sector Development (PSD) programmes and Development Finance Institutions (DFIs) often share similar development impact objectives but by their natures use different strategic and operational approaches. There is a lot of opportunity for the various tools used to complement each other to create better and more efficient outcomes.

As a major contributor to economic growth, innovation and job creation, the private sector has a key role in efforts to reduce poverty and achieve the Sustainable Development Goals (SDGs).

Within the sphere of private sector development (PSD), many organisations and actors pursue a mutual and overarching goal: namely, supporting poverty reduction and bolstering sustainable and inclusive economic growth in low- and middle-income countries. Yet despite this overlap, collaboration between development finance institutions (DFIs) and donor-funded PSD programmes could be improved. This report, jointly commissioned by British International Investment (BII) and Gatsby Africa, aims to help change that.

Our organisations share similar development impact goals but, by our nature, we have different strategic and operational approaches to achieving these goals. There is a lot of opportunity for the various tools we use to complement each other. For example, donor funded PSD programmes can help prepare markets and companies for DFI investment, whereas capital provided by DFIs can help businesses supported by PSD programmes to grow and contribute to driving broader sector transformation. On a positive note, this study finds evidence of development finance and donor funded PSD tools moving closer to each other. DFIs are becoming more involved in broader private sector development while donor programmes are moving closer to investors and sometimes include investment tools.

We have jointly commissioned this report to explore examples of collaboration and better understand the drivers of – as well as the barriers to – effective relationships between DFIs and the broader private sector development community. The report also provides recommendations for both sides to consider that could enhance collaboration moving forward.

We hope this report furthers an important dialogue between providers of development finance and funders and implementers of private sector development, and that the report's recommendations give rise to innovation and experimentation within and across these organisations. We look forward to building stronger bridges between these two complementary disciplines.

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Executive Summary

Private sector development (PSD) initiatives and the development finance community often share similar high-level goals around poverty reduction and sustainable growth in lower- and middle-income countries.

In recent years, approaches to achieving these goals have become less *transactional* and more *transformational* in nature, with growing interest from both sides in supporting lasting, sector-wide change.

The evidence shows that successful sector transformation relies on multiple enabling factors – such as markets, finance, investment, and policies – coming together to unlock growth[1]. As more development finance institution (DFI) and PSD strategies start to converge on transformational change, there is – in theory at least – scope for each side to support and complement the work of the other. PSD can play an important role in strengthening the underlying conditions for markets, firms, and investors; while DFIs and other investors can help seed and scale market-based innovations that contribute to systemic change objectives.

If in theory PSD and development finance can play a complementary role in driving transformational change within sectors, in practice there has been limited alignment between their strategies and activities to date.

This study aims to contribute to a body of evidence on how these two approaches – development finance and PSD – might be better applied in tandem. It focuses on exploring and mapping the factors that influence the level and quality of alignment, and making practical recommendations on what can be done to close the gap in future.

The work intends to provide a springboard for action, enabling PSD and development finance actors to access and benefit from the unique perspectives, skills, and resources of the other; and ultimately to meet shared transformational change objectives more effectively.

[1] Said, J., Vencatachellum, V. (2016) 'Lack of Competition as a Major Barrier to Structural Transformation in Africa'. Version: July 25,2016 Competition Policy Cluster, T&C GP, Tony Blair Institute for Global Change

CURRENT MODELS OF ALIGNMENT

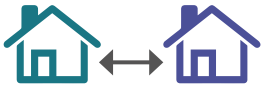
The study identified, and focuses on, **three broad models of alignment between PSD and development finance:** development of an in-house offer for both investment and PSD, structured coordination, and ad-hoc engagement.

Model 1

IN-HOUSE OFFER refers to DFIs building expertise in market shaping technical assistance (TA), and PSD initiatives expanding beyond grants to provide returnable capital. Recent examples include DFI-funded market shaping initiatives (e.g. BII Plus market shaping programmes), and PSD implementers launching investment arms (e.g. DAI Capital, Palladium Impact Capital, and ACDI/VOCA's AV Ventures). There are also organisations such as Gatsby Africa, the Wood Foundation Africa, Financial Sector Deepening Africa (FSDA), and Fundación Chile (FC) which invest alongside market shaping work.

Model 2

STRUCTURED COORDINATION refers to a deliberate approach to linking development finance with PSD, with pre-defined investors either incorporated at design stage or formally engaged during PSD implementation. Examples include the FCDO-funded IMSAR[2] programme in Rwanda and NU-TEC programme in Uganda[3] – both delivered in partnership with AgDevCo – and the Dutch Fund for Climate and Development, delivered by a funder-implementer consortium comprising FMO (the Dutch DFI), SNV (Netherlands Development Organisation), WWF (World Wildlife Fund), and Climate Fund Managers.



Model 3

AD-HOC ENGAGEMENT – which involves more opportunistic collaboration between DFIs and PSD programmes – is the most common model. Programmes such as USAID INVEST and FCDO's Manufacturing Africa are two examples of this model in practice, and have been successful in identifying investors for specific opportunities and closing transactions.

[2]Improving Market Systems for Agriculture in Rwanda (IMSAR), funded by FCDO, 2015–ongoing
[3]Northern Uganda – Transforming the Economy through Climate Smart Agriculture (NU-TEC), funded by DFID, 2015–2022

The research did not identify a single 'best practice' model. Each model has its advantages and disadvantages, and not all models are feasible for every actor interested in closer alignment.

Further to this, the study highlighted that closer alignment should not necessarily be a default aim for every PSD initiative and development finance-related investment. The recommendations are geared towards players and situations where closer alignment has the potential for mutual benefit, for example:

— PSD initiatives in design or underway with an interest in – and potentially specific targets around – attracting investment alongside market shaping work; and/or addressing specific functions or rules related to investment, such as access to finance – or working on the financial sector as a whole.

— Donor agencies looking to forge closer links with counterpart DFIs or in-country investors in support of country-level or thematic strategies.

— DFIs and other investors looking for new ways to grow their portfolios; deliver more transformational impact; better engage with the 'missing middle'; enter new – and potentially more challenging – markets; and mitigate sector-level risks.

SUCCESS FACTORS & CHALLENGES

The research identified 10 success factors and challenges that influenced whether and how successfully development finance and PSD collaborated, grouped into three over-arching themes that are relevant to all three models of alignment.

A. Strategy and Incentives

The chance of successful collaboration improves where there is a high degree of alignment between the strategy and incentives of DFIs and PSD initiatives. Key issues include:

— **Prioritising sectors and opportunities:** Both DFIs and PSD initiatives reported targeting similar types of impact, for example reduced poverty and the creation of decent jobs, but strategies to reach these aims differed. The study identified key points of divergence around views on the role of the firm, and the way in which sectors and opportunities are prioritised – driven in part by the financial imperative facing investors. Misalignments in strategy, in turn, make it more difficult for on-the-ground implementers to align tactically.

— **Timelines:** Sector transformation is a long-term, potentially multi-decade prospect. However, conflicting timelines between PSD and DFIs add to the challenges of alignment. The long-term sector transformation goals of many market shaping initiatives are simultaneously at odds with the typical five- to seven-year donor programming cycle; the needs of investors working to close transactions over the shorter-term; and the commercial realities of firms on the ground.

— **Programme- and transaction-level incentives:** A lack of incentives for alignment were identified on both sides. PSD initiatives tend to gear their efforts towards inclusive growth and often seek to build markets around MSMEs. DFIs, on the other hand, typically look for larger transactions, more sophisticated firms and quality management teams in established sectors, and as a result tend not to kickstart sector growth in nascent industries. The success of PSD initiatives is largely judged on sector-wide outcomes, whereas DFIs have traditionally focussed on firm-level performance. However, there are signs of change, for example through a shared focus on 'market shaping'; and as more DFIs adopt impact investing strategies, particularly through investments in General Partner (GP) funds with smaller ticket sizes.

B. Capacities

A range of capacity- and resource-related issues compromise the ability of both sides to understand, and meaningfully engage with, the other. Where unfavourable perceptions exist, these are sometimes built on limited real-world interaction. There have been a variety of innovative approaches to filling capacity gaps, but in general there is limited investment in building DFI-PSD alignment. Key factors include:

— **Knowledge and skills:** The research highlighted a lack of 'crossover' knowledge. PSD teams often do not include investment experience, and investment teams tend to be staffed with financial and business expertise. Internal training does not usually include a specific focus on the work of the 'other side'.

— **Awareness and perceptions:** Limited awareness of what both DFIs and PSD programmes can 'bring to the table', particularly in terms of approaches, value proposition, and the mechanics of engagement.

— **Investment facilitation:** There is increasing donor and programme recognition that expertise in investment facilitation can add value to PSD programmes, for example through defraying transaction costs and information asymmetries for investors; providing or sourcing the right specialist services (e.g. investment readiness support for businesses, due diligence for investors, and transaction structuring); and establishing investor networks.

— **Lack of dedicated coordination function:** A key resourcing challenge cited by interviewees was a lack of a dedicated coordination function. National development plans, industrial policies – and donor support strategies – articulate a government view of areas around which development assistance and development finance activities can align. However, there are few mechanisms to bridge the gap between policy and practice, and to help PSD initiatives and investors identify and follow through on opportunities for mutually beneficial alignment.

C. Operational Models and Tools

The research identified gaps in the compatibility of operational processes and tools between development finance and PSD, which creates challenges for implementation teams to align at a tactical level. Key issues are:

— **Real and perceived hurdles to engagement with PSD initiatives:** Investors and firms noted that engaging with technical assistance activities can be resource-intensive. Some regarded the costs (staff time, financial and in-kind contributions, and application and monitoring processes) as outweighing the potential benefits (impact, firm performance, funder relationships).

— **Investor fund structures can constrain investment ticket sizes and risk,** sometimes limiting investments into very early-stage ventures. PSD programmes, meanwhile, often work to pilot and develop opportunities in this space, resulting in a gap between "investible" opportunities from an investor versus a PSD perspective.

— **Limited 'toolbox' for collaboration:** Most PSD initiatives and investors each work with a limited tactical 'toolbox' (loss-making grants and technical assistance on the one hand, return-seeking capital on the other). The research highlighted low mutual awareness of the tools available to the 'other side' and limited discussion on joining up the two toolkits.

Where unfavourable perceptions exist, these are sometimes built on limited real-world interaction.

RECOMMENDATIONS

The 15 recommendations are grouped under three themes as follows:

1

Donors and DFIs should more closely align their strategies and incentives around common opportunities

For example sector transformation – to get the two groups pulling in the same strategic direction. Recommendations focus on aligning PSD approaches to sector selection and analysis with investor needs; both PSD donors and DFIs engaging with the 'other side' in setting strategy; building in smart performance metrics around investment and alignment; and maintaining momentum towards sector transformation through stronger exit strategies for donor-funded projects.

— **Quick win [For PSD donors]:** Develop and test a commercially oriented sector and opportunity selection toolkit, which supports PSD programmes to better leverage DFI interest in commercial opportunities, and DFIs to leverage PSD expertise in overcoming constraints to sector performance.

2

Build or buy crossover knowledge and coordination infrastructure

To make sure that efforts to align are more readily identified and followed through. Recommendations include upgrading ecosystem mapping; actively supporting good quality coordination efforts at country level; pooling DFI technical assistance around shared opportunities; piloting cross-organisational secondments; implementing 'crossover' training; and recognising the value of specialist investment facilitation expertise.

— **Quick win [For PSD donors/ programmes and DFIs]:** Identify and run targeted cross-organisational secondments.

— **Quick win [For donors and DFIs]:** Develop DFI-branded mini-CFA / Investment '101' training, delivered across a pilot PSD cohort.

3

Close the gap between product offers

To increase mutual relevance, and create clearer opportunities for alignment. Recommendations include building up the commercial relevance of PSD programme reports and analyses to appeal to an investor audience; experimenting with increasing use of results-based financing / pay-for-performance financing as part of PSD programmes; re-aligning systems change terminology to resonate with DFIs; and donors and DFIs supporting first-time local fund managers and piloting new fund models that can invest in earlier stage, smaller ticket size opportunities.

— **Quick win [For PSD donors/ programmes and DFIs]:** Work with a pilot group of PSD programmes to develop and test investor-targeted outputs.

— **Quick win [For donors and DFIs]:** Hands-on support to local fund managers working in under-served or nascent spaces, including piloting new fund models.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Success factors & challenges

A. Strategy & incentives

- Sectors and opportunities
- Timelines
- Incentives for alignment

B. Capacities

- Knowledge and skills
- Awareness and perceptions
- Investment infrastructure
- Resources for coordination

C. Operational models & tools

- PSD hurdles for investors
- Investor fund structures
- Collaboration toolbox

Recommendations

Theme 1

Align strategies and incentives around common opportunities

1. Develop common sector selection criteria
2. Engage the 'other side' in setting strategy
3. Increase use of smart investment indicators in PSD results frameworks
4. Increase emphasis on market shaping as part of investment screening
5. Strengthen handover and exit strategies to maintain momentum

Theme 2

Build or buy crossover knowledge, and coordination infrastructure

6. Strengthen ecosystem mapping
7. Support coordination at country level
8. Pool DFI TA around joined-up initiatives
9. Pilot cross-organizational secondments
10. Implement training (e.g. mini-CFA)
11. Utilise specialist investment advisory and facilitation expertise

Theme 3

Close the gap between product offers

12. Build commercial relevance of PSD offers
13. RBF / pay-for-performance financing
14. Re-align systems change terminology
15. Proactively support first-time local fund managers & experiment with new fund model

Represents quick-wins.

IMPLEMENTING THE RECOMMENDATIONS: WHO, WHEN AND HOW?

The recommendations represent a package of interconnected, mutually supportive measures, to be tested and built up over time. The approach is to provide a menu of options that stakeholders can take forward – alone or in partnership – based on their own needs, capabilities and interests. Follow-on work might start with a phase of pilot activities to test new ways of working and build the case for alignment, before building traction and deepening partnerships, and eventually taking successful initiatives to scale.

The recommendations provide a menu of options that stakeholders can take forward – alone or in partnership – based on their own needs, capabilities and interests.

Phasing follow-on activities: an indicative roadmap for how organisations might gradually build greater collaboration

Short term (Year 1)	Medium term (Years 2–4)	Long term (Year 5+)
Objectives: **Testing new ways of working and building the case for alignment**	**Objectives:** **Building traction and deepening partnerships**	**Objectives:** **Going mainstream and getting to scale**
— Launch pilot projects around specific recommendations to test relevance and feasibility. — Explore new partnerships – both with the 'other side', and around specific recommendations. — Build early awareness and identify interested stakeholders (e.g. through dissemination of this study). — Follow-on research to deepen the evidence base.	— Use pilot findings to further build awareness, strengthen partnerships, and expand successful pilot projects. — Explore the opportunity to launch standalone projects to support alignment at a wider scale. — Support high-level strategic alignment e.g. at donor, DFI, and inter-governmental levels.	— Support wide-scale implementation, potentially facilitated by one or more dedicated programmes and/or organisations. — Alignment has become a default consideration for actors of all types and sizes on both sides. — Support a deeper/richer ecosystem of development finance actors and facilitation services that channel capital into a wider spectrum of businesses and markets.

Introduction: The collaboration challenge

1

THE COLLABORATION CHALLENGE

Development partners working in private sector development (PSD) and the development finance community often aim to achieve similar goals, namely trying to contribute to poverty reduction and sustainable growth in lower- and middle-income countries.

In recent years, actors from both sides have moved to recognise their contribution to structural change, and introduce ways to ensure their programming and investment decisions are less transactional and more transformational in nature.

Donors and PSD practitioners have embraced more ambitious and holistic lens in the form of the market systems development (MSD) approach. A recent study[4] estimated that 85% of MSD programmes are now broadly aligned to transformational change objectives[5]. Development Finance Institutions (DFIs), in turn, were set up to finance private enterprise and contribute to greater economic stability[6] and growth. According to a study by ODI, DFIs have an implicit bias towards investments in more transformative sectors that can drive employment growth and bring about spill-over effects[7]. The same study cited evidence that the effects of DFIs on growth and labour productivity – a key measure of transformation – are both positive and significant.

While there may be overlap in terms of objectives, the fields of development finance and private sector development have markedly different incentives. On the one hand PSD programming is focused on achieving development impacts, whereas DFIs have a dual objective of financial and impact 'returns'. By design, development finance investors take a 'bottom-up' approach to channel capital directly to high-potential enterprises which have a pathway to profitability, but might not otherwise be able to access appropriate financing; to make a financial return, and then to reinvest the returns into more businesses. The private sector development community has increasingly adopted a 'market shaping' approach, with programmes aiming to facilitate change across whole markets by working with an array of public, private and third-sector actors. For these programmes, the success of any one individual company is important only in the sense of being able to 'crowd in' other competing firms around the business innovation, and thereby contributing to sector success as a whole.

[4] Impact Management (2019) 'Promoting Economic Transformation through Market Systems Development', Study Report, Donor Committee for Enterprise Development, Cambridge, UK.
[5] Sector transformation is characterised by shifts within and between firms towards higher value-added, higher-productivity activities and innovations, which creates opportunities for firm growth and job creation. See the DCED Policy Brief on Promoting Economic Transformation through Business Environment Reform and Market Systems Development.
[6] Gouett, M. and Attridge, S. (2021) 'BII–ODI webinar series on development finance institutions and the Covid-19 crisis', June 2021 Meeting Report, BII, in partnership with ODI and EDFI.
[7] Lemma, A. (2018) 'Measuring the Potential Contribution of Development Finance Institutions to Economic Transformation', London: ODI.

There is a pressing need to bridge the gap between private sector development and the world of development finance, and better leverage the unique perspective and set of skills, experiences, resources and networks of each community.

Yet these different points of entry have the potential to be mutually-reinforcing. PSD programming can strengthen the underlying conditions for markets, firms and investors to maximise the chances of long-term success; while DFIs and other investors backing innovative, productive, and responsible firms can help seed and scale the types of market-based innovations that PSD programmes aim to support in order to address their systemic change objectives.

If in theory PSD and development finance can play a complementary role in driving transformational change within sectors, in practice there appears to be relatively little alignment between their respective activities. There is therefore a pressing need to bridge the gap between private sector development and the world of development finance, and better leverage the unique perspective and set of skills, experiences, resources and networks of each community.

The challenge of benefitting from closer synergies is both an opportunity and a necessity, at least in terms of meeting transformational change objectives. Evidence on successful sector transformation shows how a number of enabling factors – such as markets, finance, investment and policies – need to 'come together' to unlock growth[8]. Such transformations require substantial investment capital which can be catalysed through strategically applied development finance, together with longer-term strengthening of financial systems. However, the benefits of development finance, even at the firm-evel, can be dampened if the policy and regulatory environment is not conducive, or if the business climate is subject to change due to political economy and other factors.

This present study aims to contribute to a body of evidence on how these two approaches – development finance and private sector development – may best be applied in tandem. Its main focus is on exploring the current gap, uncovering the underlying reasons behind the lack of alignment – and drawing practical recommendations about what can be done to close the gap in future.

There is cause for optimism around the timing of this study. PSD programmes have started to recognise the importance of capital to both firm- and sector-level growth. A new generation of more commercially-oriented PSD programming has started to generate demand for implementers to become more 'investment savvy'. At the same time, many investors are recognising the value of an approach that creates opportunities rather than just being opportunistic, such as the IFC's upstream activities which consist of pre-investment work that lays the foundation for future transactions. A number of impact investors connected to foundations and philanthropic initiatives have long played a prominent role in using an 'ecosystem' approach. This work is now being built on by DFIs as they put market creation at the centre of their strategic goals, and as impact investors (many of whom are funded by DFIs and represent an indirect DFI investment channel) continue to push into frontier markets with more limited deal-flow, the imperative to improve the performance of 'sectors' and not just 'firms' will only strengthen.

A new generation of more commercially-oriented PSD programming has started to generate demand for implementers to become more 'investment savvy'.

[8]Said, J., Vencatachellum, V. (2016) 'Lack of Competition as a Major Barrier to Structural Transformation in Africa'. Version: July 25,2016 Competition Policy Cluster, T&C GP, Tony Blair Institute for Global Change.

Methodology

2

METHODOLOGY

The research process ran between August and October 2021, comprising a literature review, 38 key informant interviews, and a rapid qualitative survey.

A cross-section of actors (see Appendix 1) was engaged, including DFIs, fund managers, donor agencies, PSD programmes and implementers, foundations, investment facilitators, and think tanks.

The team investigated the following research questions:

1. To what extent, and how, can alignment between development finance and market shaping PSD be mutually beneficial?
2. What are the key factors that influence the level and quality of alignment?
3. What are the lessons from successful cases?
4. What needs to change to enable more and better alignment?

Interviews were semi-structured, working to standardised interview guides to help ensure consistency, but emphasising open-ended questions to encourage organic discussion. Interview notes were captured for all conversations. Certain interviewees shared thoughts or documents on an anonymous or 'off the record' basis.

The rapid survey was disseminated through a selected group of institutions and networks (including BII, FMO, Gatsby Africa, and members of the DCED Market Systems Working Group) and focused on capturing examples of successful and unsuccessful alignment, together with open-ended questions on key barriers and success factors.

The research process sought to identify good quality case examples to strengthen the over-arching thesis, and to ground the recommendations in real-world experience. Examples were prioritised as follows:

— Initiatives with an explicit market shaping (i.e. 'beyond the firm') agenda were prioritised over initiatives working only at the firm level.

— Sectors with high employment potential took priority over those with lower employment potential.

— Positive outcomes (in terms of dealmaking, financial additionality and development impact), and unsuccessful examples with clear lessons learned, were prioritised over examples with less evidence of outcomes.

Findings were organised and analysed using a framework developed for this study (see Section 3.2), resulting in a set of 10 key success factors and challenges, each with a corresponding set of recommendations.

KEY CONCEPTS

The following definitions are used for key concepts covered in the study:

— **Private sector development (PSD) with a market systems / shaping focus:** Initiatives that work to address underlying, market-level constraints to inclusive economic growth, including barriers to catalysing greater investment flows. There is particular focus on initiatives that aim to transform high-impact (e.g. labour-intensive, higher-productivity) sectors. Targeted, sector-specific 'upstream' enabling environment work and 'ecosystem building' were also included.

— **Sector transformation** is characterised by shifts within and between firms towards higher value-added, higher-productivity activities and innovations, which creates opportunities for firm growth and job creation[9].

— **Development finance:** Both bilateral and multilateral DFIs making direct and/ or indirect investments; as well as fund managers receiving capital from DFIs or other concessional sources (commonly called General Partner, or GP, Funds), focusing on both impact and returns, with the ability to invest at "missing middle" ticket sizes.

— **Alignment:** Points of mutual benefit, intersection, or collaboration between PSD and development finance that can take a variety of forms. For example:

- PSD creating the underlying conditions for investment (or vice-versa);
- Project technical assistance (TA), and / or guarantees and other blended finance tools used to de-risk investment;
- Matchmaking, deal-sourcing, knowledge products to address information asymmetry (e.g. market studies, feasibility assessments, etc.), or similar arrangements.

CONSIDERATIONS AND LIMITATIONS

— **This study is exploratory.** Research on the core issue – alignment between market shaping PSD and development finance – is still nascent. This study aims to build understanding of the core issue, test initial hypotheses; better define the problem; and lay a foundation for further research and pilot work.

— **The research sample is not representative** by geography, size of deal, or type of PSD initiative or development finance investment. Interviewees and survey respondents were identified through existing networks and invited to participate on the basis of role / affiliation (i.e. to solicit views from each key stakeholder group), and availability. The original research design was broadened through addition of the rapid survey and an additional 18 interviews (38 versus an original target of 20) to help ensure a cross-section of views.

— **There were few examples of 'model' alignment** (i.e. successful investment alongside transformative market-shaping PSD). Lessons have been taken from cases of partial and attempted alignment, as well as promising early-stage initiatives, and prioritised according to the criteria outlined above.

[9] For more information see: Impact Management (2019) 'Promoting Economic Transformation through Market Systems Development', Study Report, Donor Committee for Enterprise Development, Cambridge, UK.

Current state of PSD-DFI alignment

3

CURRENT STATE OF PSD-DFI ALIGNMENT

This section draws on a combination of literature review and primary research findings to build a broad picture of the current state of alignment, using real world examples to illustrate and support key findings. Presented below is an overview of alignment models and trends, followed by analysis of success factors and challenges.

3.1 OVERVIEW OF CURRENT MODELS & TRENDS

The study identified, and focuses on, three broad models of alignment: development of an in-house offer for both development finance and PSD, structured coordination, and ad-hoc engagement.

Figure 1: Alignment models

Model	Characteristics	Examples
Model 1: **In-house offer**	Investor with market-shaping offer; implementer with investment offer; funder-implementer with combined offer	Gatsby Africa Aquaculture, Gatsby/ Wood Foundation Rwanda Tea, Nepal Invests, FSDA, IFC Upstream, Implementer fund arms
Model 2: **Structured coordination**	A mutually-agreed and deliberate approach to coordination between PSD and one or more predefined investor(s)	DFCD, IMSAR Rwanda, NU-TEC Uganda, EnDev, IPDEV2, Lighting Global, Partnerships for Forests, Nepal Hydropower
Model 3: **Ad-hoc engagement**	Opportunistic collaboration, with or without a pre-defined strategy. Includes investment facilitation programming	USAID INVEST, Manufacturing Africa, AINFP, AIP-PRISMA, SUED, ACE, SOBA, IPDEV2, Nigeria LINKS, Ghana JET, Invest Salone

There are recent examples from both sides of developing **in-house offers**, in the form of DFI-funded market shaping initiatives (for example recently-launched BII Plus market shaping programmes), and PSD implementers launching investment arms (e.g. DAI Capital, Palladium Impact Capital, and ACDI/VOCA's AV Capital). There are also examples of longer running combined in-house offers among funder-implementers such as Gatsby Africa, the Wood Foundation Africa, Financial Sector Deepening Africa (FSDA), and Fundación Chile (FC). As early as the late 1970s FC, for example, identified new sectors where Chile had a competitive export advantage and supported development of these sectors through technology transfer and business model incubation as well as investment from FC-launched accelerator, angel, venture capital (VC), and debt funds.

A second set of initiatives takes a **structured and deliberate approach to coordination,** with pre-defined investors either incorporated at the design phase or formally engaged during implementation. Examples include the FCDO-funded IMSAR[10] programme in Rwanda and NU-TEC programme in Uganda[11] – both delivered in partnership with AgDevCo – and the Dutch Fund for Climate and Development, delivered by a funder-implementer consortium comprising FMO (the Dutch DFI), SNV (Netherlands Development Organisation), WWF (World Wildlife Fund), and Climate Fund Managers.

[10] Improving Market Systems for Agriculture in Rwanda (IMSAR), funded by FCDO, 2015–ongoing.
[11] Northern Uganda – Transforming the Economy through Climate Smart Agriculture (NU-TEC), funded by DFID, 2015–2022.

The Dutch Fund for Climate and Development (DFCD) provides finance and Technical Assistance to projects with a focus on climate change adaptation, to mobilise external private sector funding at scale. DFCD funding is divided amongst three operating windows, each with a specific focus: the origination facility, the land use facility and the water facility.

The third, and most common, model was **ad-hoc engagement** between investors and PSD initiatives with explicit investment facilitation objectives. Programmes such as USAID INVEST and FCDO's Manufacturing Africa are two examples of this model in practice, and have been successful in identifying investors for specific opportunities and closing transactions, often leveraging the investment expertise and investor networks of intermediaries.

The FCDO-funded Manufacturing Africa, formerly known as Invest Africa, supports investment-led exports in agro-processing and light manufacturing, in Ethiopia, Kenya, Mozambique and Zambia.

The research did not identify a single best practice model, especially as each model has its advantages and disadvantages, and because not all models are feasible for every actor interested in closer alignment. However, some general observations are as follows:

1. **In-house models** appear to address some, but not all, of the challenges associated with cross-institutional collaboration. The key advantages are a greater ability to set a shared strategy and align some incentives than is usually possible between separate entities. Challenges include building the institutional buy-in required to launch an in-house offer; the scale of investment needed to build new, high-quality, in-house capacity; and a potential blurring of lines between the role of neutral facilitator and active market player.
2. There are examples of **structured coordination** bringing the two sides closer together around shared opportunities, each contributing specialist and complementary skills and resources. There may also be a risk of committing to partnerships that work in theory but not in practice, as well as limiting opportunities to engage with relevant partners outside the pre-determined structure.
3. **Ad-hoc models** tend to cast a wide net (in terms of partners and opportunities) and can focus resources on the areas of highest potential. These models sometimes face challenges in terms of trade-offs between deal-making and sector transformation, and in terms of building credibility and buy-in with investors.

Respondent views on alignment

In general, respondents expressed interest in closer alignment, but with mixed awareness of the full offer of the 'other side'. While there are considerable challenges to overcome – as presented in Section 3.2 – these underlying sentiments indicate potential collaboration. Selected views were:

On the abundance of capital chasing few opportunities, and the potential for market shaping to help build pipeline:

> *"Many people say that there is money everywhere, but not enough good opportunities. It seems like market shaping programmes would be key to creating more opportunities."*
> Africa-based Fund Manager

On a general recognition that market shaping PSD and development finance can but often do not – each play a necessary and mutually beneficial role in sector transformation:

> *"The development world focuses on enabling environment and capacity building, but doesn't have capital. DFIs have capital but aren't doing market shaping. Bringing them together is a dream outcome."*
> DFI Investment Manager

> *"The two worlds almost always miss each other. There are very few examples where efforts are joined up and aligned."*
> DFI Country Representative

A minority of respondents held the view that market shaping and investment should 'stay in their lanes' and treat opportunities for closer alignment with caution:

> *"Market systems work and investment are sequential things – the interventions are at very different levels. If market systems do their job, investors will naturally follow."*
> Impact Investor

> *"Market systems programmes shouldn't be operating at the micro level, trying to build business cases for individual opportunities."*
> PSD Implementer

3.2 SUCCESS FACTORS & CHALLENGES

The research identified 10 success factors and challenges that drive the level and quality of alignment, grouped into three over-arching themes that are relevant to all three models of collaboration:

— Aligning **strategies and incentives** between PSD and development finance.

— Building **resources and internal capacities** to allow for coordination and improve awareness and attitudes to engage effectively with the 'other side.'

— Increasing the compatibility and range of **operational models and tools** used by DFIs and PSD initiatives.

Successful examples tended to demonstrate elements of all three themes working in concert, for example, though a strategic focus on the same sectors and opportunities, appropriate resourcing for coordination, and compatible products and tools. There is at least a partially sequential element too, in that most opportunities for alignment seemed to stall before getting to the negotiating table, for example due to strategic misalignment, limited awareness, or unfavourable perceptions.

Figure 2: What drives alignment?

Models

In-house offer	Structured coordination	Ad-hoc engagement
Gatsby Africa Aquaculture, Gatsby/Wood Foundation Rwanda Tea, Nepal Invests, FSDA, IFC Upstream, Implementer fund arms.	DFCD, IMSAR Rwanda, NU-TEC Uganda, EnDev, IPDEV2, Lighting Global, Partnerships for Forests, Nepal Hydropower.	USAID INVEST, Manufacturing Africa, AINFP, AIP-PRISMA, SUED, ACE, SOBA, IPDEV2, Nigeria LINKS, Ghana JET, Invest Salone.

Success factors & challenges

A. Strategy & incentives	B. Capacities	C. Operational models & tools
• Sectors and opportunities • Timelines • Incentives for alignment	• Knowledge and skills • Awareness and perceptions • Investment infrastructure • Resources for coordination	• PSD hurdles for investors • Investor fund structures • Collaboration toolbox

A. STRATEGY AND INCENTIVES

Most opportunities for mutually beneficial alignment are missed before PSD initiatives and investors ever have the chance to engage. Strategic misalignment means that the case for collaboration is seldom made.

Three common challenges are:

1. Prioritising sectors and opportunities

Different views on the role of the firm presented a key point of divergence between PSD actors and development finance investors. For market shaping PSD, the firm is one actor, of many, through which to influence system-level change. The performance of an individual firm matters only to the extent to which it drives systems change. The key aim is to 'start races' – often across whole sectors – with the potential for large-scale impact. Many PSD programmes also have less focus on understanding firms in their entirety (across the balance sheet), and focus more attention on bounded innovations or parts of the business (specific revenue streams) that can be leveraged to bring about desired development impacts.

DFIs, on the other hand, must 'pick winners' that deliver both commercial performance and development impact. In addition, the development finance discourse has increasingly positioned firms as the principal drivers of large-scale, transformational change[12], resulting in growing pressure to back the 'right' firms and ensure their success. This difference in perspectives creates significant knock-on effects in term of where efforts are focused; the capabilities and tools deployed to drive change; and how success is measured.

Selecting common focal sectors has been an enduring challenge. Even the most concessional investors seek some level of financial return, which is reflected in a more commercially-oriented approach to selecting sectors and investment opportunities. For example, several investor respondents noted prioritising sectors based on export potential, running detailed analysis on regional competitive advantage; identifying specific high-potential target markets; and assessing the feasibility of developing higher-value products. Market shaping PSD generally took a lighter-touch approach, assessing commercial viability alongside other – sometimes competing – priorities (e.g. relevance and opportunity for target groups, and the feasibility of systems change[13]).

In addition to the sector selection challenge, it has proven challenging to align around opportunities for transformation[14], resulting from different diagnostic processes and different views on remit. Market shaping PSD concentrates analysis on identifying – and subsequently addressing – root causes of market system underperformance as it relates to the target beneficiaries (which may lie anywhere from R&D and input supply, through to policy and social norms). Often DFIs view these constraints as inherent to the operating environment, rather than challenges that can, or even need to, be solved.

[12] See, for example: Isaac, C. and Liesner, M. (2019) 'Seeking Impact Unicorns: Why Development Finance Institutions Should Set Their Sights on Transformational Change'. In Attridge S., Te Velde DW., and Andreasen, SP. (2019) 'Impact of Development Finance Institutions on Sustainable Development: An Essay Series'. London: ODI. p62–65.

[13] The Springfield Centre (2015) 'The Operational Guide for the Making Markets Work for the Poor (M4P) Approach – 2nd edition'. Swiss Agency for Development and Cooperation (SDC) and UK Department for International Development (DFID).

[14] Within sectors, accurately identifying economic opportunities was a common feature in all six cases of successful sector transformation, as presented in Balchin, N., Booth, D. and te Velde, D.W. (2019) 'How economic transformation happens at the sector level: evidence from Africa and Asia', London: ODI.

In practice:
Aligning around opportunities for transformation

In-house models (see page 22, above) offered some advantages in terms of aligned investment and PSD offers around the same sectors and opportunities:

— **Gatsby Africa[15] selected East African aquaculture** as a focal sector based on commercially oriented analysis, including assessment of specific market opportunities, investor mapping, and consideration of key business models. The analysis pointed to strong market demand, the availability of natural resources, and the potential to build on nascent comparative advantage[16]. From there, Gatsby Africa has deployed a combination of tools organised around a framework of 'Think' (e.g. commercially-driven analysis); 'Do' (market shaping, direct investment, and leveraging external funds); and 'Convene' (building consensus for action, demonstration, and building industry coordination).

There were also examples of strategic alignment from initiatives that focused on the cross-sectoral issue of access to finance – either at programme- or component-level, based on facing similar issues with similar partners, through teams more likely to have a shared financial background:

— **Invest for Impact Nepal** *formerly Nepal Invests* **(BII Plus, FMO, SDC)**[17] leveraged a shared interest in financial sector transformation to create strong engagement from BII and other DFI investment teams from the outset, including joint workshops to identify constraints and triangulate programme priorities. A key component looks at developing alternative financing channels for SMEs, with investment teams leading the design of this part of the programme.

— In Indonesia, **AIP-PRISMA (DFAT)** includes a specific access to finance component. An example of resulting alignment saw the programme linking Good Return, an Australian impact investor, with CROWDE, an Indonesian P2P lender. A loan guarantee facility provided by Good Return reduced risks in lending to women-owned agri-SMEs, resulting in new loans totalling $130,000 across 35 women-owned traders and agri-processors. PRISMA has deepened its support to CROWDE, for example by developing new, tailored agri-loan products[18].

An investor-led example is **Encourage Capital's 'Solutions Investing' approach,** which starts with identification of a social or environmental issue, followed by systemic analysis, and development of 'Solutions Strategies' to catalyse large-scale investment and multi-stakeholder collaboration. An example strategy, 'Investing for Sustainable Global Fisheries' – developed in partnership with Bloomberg Philanthropies and The Rockefeller Foundation – presents a series of 'blueprints' for bundling investments to address sector-level challenges[19].

[15] Gatsby Africa's aquaculture programme was implemented by Msingi between 2016 and 2022. Msingi was an independent organisation supporting sector transformation in East Africa, funded by Gatsby Africa and FCDO, which has now merged into Gatsby.
[16] Mulili, D. (2019) 'An investor-centric approach to industrialization', Presentation, Launch of the Kenyan Investment Policy and County Investment Handbook, Crowne Plaza Hotel Nairobi, November 6th 2019.
[17] Funded by CDC, FMO, and the Swiss Agency for Development and Cooperation (SDC), 2021–ongoing.
[18] Australia-Indonesia Partnership for Rural Incomes through Support for Markets in Agriculture (PRISMA) Progress Report: January – June 2021, Programme Team & Australian Department of Foreign Affairs and Trade (DFAT).
[19] Encourage Capital (2016) 'Investing for Sustainable Global Fisheries'. Supported by Bloomberg Philanthropies' Vibrant Oceans Initiative and The Rockefeller Foundation.

2. Timelines

DFIs often[20] have a short window in which to close deals. At transaction-level, investors source a pipeline of deals, conduct due diligence, and close transactions around cycles of investment committee (IC) meetings. DFIs are largely focused on companies that meet their investment criteria now, rather than 'priming the pump' for earlier stage companies – including those coming out of PSD programmes – that may be investment-ready in the future. Recognising that DFIs typically fund growth stage businesses that are already revenue-generating, resolving this would require coordination and alignment with investors across other stages of the business cycle, such as venture funds targeting early-stage companies. And although some DFIs and permanent or revolving capital vehicles can run long-term investment strategies[21], more General Partner funds have a set timeline, after which they must return capital to their investors and raise a new fund if they wish to continue investing. In practice, that means that funds generally have a few years during which they are actively making investments based on a strategy or thesis. After the fund capital is fully deployed, investors then turn to managing the portfolio and, in the case of equity funds, looking for exit opportunities. This means that serendipity comes into play in aligning investor time windows for actively seeking investment opportunities with when investment-ready opportunities emerge from PSD programmes.

By contrast, and although market shaping PSD sets a long-term vision for systems change, PSD programmes are traditionally delivered through five- to seven-year cycles, with success measured based on short-term (i.e. within programme lifecycle) results. Between cycles, programme approaches, strategies, and delivery models can change substantially, resulting in revised sector priorities, partnerships, results frameworks, and implementers. This stop-start model does not always align with the needs and timelines of investors and businesses. In addition to changes in direction, the realities of procurement can also lead to lags between successive programmes, resulting in disrupted partnerships and lost momentum.

In practice:
Lags between programmes

The gap between **GEMS4[22] and LINKS[23]**, two flagship UK government funded economic development programmes in Nigeria, was two and a half years. The former programme was gaining traction in the rice value chain, and by its contracted close had been engaging with a network of 70 investors to explore project opportunities in the sector. By the time the successor programme went live, momentum had been lost.

3. Incentives for alignment

The success of PSD initiatives is largely judged on sector-wide outcomes, whereas DFIs are more focused on firm-level performance. These mismatched incentives cascade down into how each side engages with businesses on the ground; with PSD often prioritising target group outreach and participation (e.g. through building more inclusive supply chains), while investors focus more on financial viability, management capacity, and driving long-term growth.

PSD initiatives are usually set up to deliver against predefined results frameworks, for example a logframe that specifies job creation or income change targets. As one implementer commented: "We deliver what we are reviewed against. What gets measured gets done. We are very risk averse when it comes to missing targets or breaching contracts". This is particularly relevant for contracts incorporating results-based payment. Investment-related metrics – particularly in relation to investment from external sources[17] – have not been routinely included in results frameworks.

Where investment metrics have been included, respondents noted that there can be room for interpretation, with programmes sometimes opting to take a path of least resistance. For example, some programmes have targets to leverage other sources of funding, but do not specify where this capital should come from. One implementer mentioned targeting additional grant funding rather than external investment, because the latter is perceived as more difficult to secure. Where external investment is specified, several respondents talked about the challenges of securing DFI capital, preferring to engage with investors with less stringent ESG and due diligence requirements, and more flexibility around ticket sizes and capital structures, e.g. equity, convertible debt, newer instruments such as SAFE notes and self-liquidating equity.

[20] There are exceptions, for example some of BII's infrastructure transactions took 3+ years to negotiate.
[21] For example, BII's recent Sustainable Forestry Investment Strategy has an outlook of 20+ years.
[22] Growth and Employment in States: Wholesale & Retail Sector (GEMS4), Nigeria, funded by DFID, 2012–2017.
[23] Catalysing Economic Growth in Northern Nigeria, funded by FCDO, 2019–2026.

Is it simply a case of adding more specific investment targets to results frameworks? Views were mixed, noting that more explicit metrics could create perverse incentives to work in ways that may be inappropriate for the context, such as facilitating expedient but less impactful types of investment; or drifting away from a systems change agenda in favour of a more hands-on, quasi-investment facilitation role. There are also challenges in terms of what targets to set. For example, the SUED programme in Kenya, aiming to generate investment in secondary cities across Kenya, is working in an unproven and high-risk context, which makes setting granular upfront investment targets particularly challenging.

The FCDO-funded Sustainable Urban Economic Development (SUED) initiative supports municipalities in Kenya to develop sustainable urban economic plans that attract investment for climate resilient infrastructure and value chain projects.

Incentive structures for investor respondents generally did not include market shaping considerations. Incentives are still largely based on closing and then exiting a deal successfully, reflected in investment screening criteria, personal and team performance metrics, and expectations around financial returns. There were tentative signs of beyond-the-firm considerations starting to play into investment decisions (see Recommendation 3 for more information on approaches) but this is not yet common practice.

Across both PSD and investment, there were few examples of specific performance criteria around alignment with the 'other side'. An exception was DFC and USAID, which do include criteria around coordination and engagement in their performance management for some in-country and HQ-based staff. This might be a legacy of DFC's previous positioning as a service provider to USAID missions and programmes. However, the research yielded little evidence as to the practical impact of performance management criteria around coordination on the strategic alignment between USAID and DFC, though the current DFC structure is still relatively nascent.

Understanding the incentives of the 'other side'

Findings indicated that understanding of the key incentives facing the 'other side' was limited. There appears to be a general tendency to over-simplify, for example thinking of PSD incentives purely in terms of impact, and investor incentives purely in terms of commercial performance. Other key incentives mentioned by respondents are outlined in the table below. Building a better understanding of what drives the 'other side' is an important step towards more effective alignment.

Table 1: Key pressure points

PSD Implementers	Investors
— Meeting and exceeding results targets (often a mix of impact and commercial motives) — External (donor/peer) perceptions — Meeting forecast expenditure — Financial incentives (implementers) e.g. hitting gross margins — Securing budget uplifts and follow-on contracts — Avoiding major risks (e.g. non-performance, safeguarding, etc.)	— Investment officers (DFIs & funds): Sourcing pipeline; successfully shepherding transactions through investment committee (IC) process; growth/impact performance of firms post-investment — General Partners (GPs) of funds: Closing transactions that align with investment theses, e.g. around sectors, business models, etc.; portfolio performance, leading to higher compensation through 'carry' on investment returns; generating track record to raise new funds — Limited Partners (LPs) of funds: Receiving returns on investments into fund, often above a certain 'hurdle rate'; meeting personal / institutional impact objectives

> “We deliver what we are reviewed against. What gets measured gets done. We are very risk averse when it comes to missing targets or breaching contracts”.
>
> *PSD implementer*

B. CAPACITIES

A range of capacity- and resource-related issues compromise the ability of both DFIs and PSD initiatives to understand, and meaningfully engage with, the other. Where unfavourable perceptions exist, they have sometimes been built on limited real-world interaction. There have been a variety of innovative approaches to filling capacity gaps, but in general there is limited investment in building alignment.

Key success factors and challenges include:

4. Knowledge and skills

Without speaking the language of investment, it can be difficult for PSD personnel to shape and communicate a compelling value proposition to investors, and to understand who they should be talking to for which opportunities:

— There is generally a low level of awareness of the investment process and investment criteria, such as asset classes, relevant ticket sizes, and what makes a firm commercially investable. DFI TA staff reported varying levels of financial training for non-investment professionals, and this type of training was rare across the wider respondent group. Some implementers reported recruiting investment professionals into central teams and programmes, but these examples were in the minority. Combined in-house models offered some advantages – most notably having investment and market shaping personnel under one roof – but there were reports of challenges around cultural fit.

— Some investor respondents had never been approached by PSD or market systems programmes looking to collaborate, even though they believe their portfolio companies would fit PSD impact criteria. On the other side, some PSD respondents noted that it can be difficult to identify the right investors and even harder to access relevant personnel. DFIs were noted as being particularly impenetrable.

This lack of understanding regarding investment criteria can lead PSD programmes to 'prime the pump' for the wrong opportunities. A programme implementer cited an example of a programme that developed a portfolio of "absolutely hopeless" opportunities that a bilateral donor organisation "pumped money into" because they thought these opportunities would generate a lot of impact. But from an investor perspective, these "investment opportunities" had no hope of commercial sustainability or scalability. From the PSD perspective, there can be a difficult balance to strike between recruiting general facilitation skills – important for a flexible and adaptive approach – and hiring in a level of technical expertise that carries weight with investors. Gatsby Africa notes the value of the latter, particularly where these advisers have experience of operationalising an investment in the sector (i.e. technical experts with experience of managing businesses).

Lack of awareness of investment stages also means it can be difficult for PSD programmes to identify where the best opportunities for collaboration actually exist. Several investor respondents noted being interested in PSD programme technical expertise in the pre-investment phase, to conduct feasibility studies or address information asymmetries. For example, the SUED initiative focuses significant resources on conducting commercial feasibility studies before trying to engage investors, to first demonstrate an investment opportunity before attempting to facilitate a transaction.

Mirroring the lack of investment internal capacity on the PSD side, DFIs also commonly lack understanding of what donor PSD programmes do or how a market systems approach works. As some PSD programme personnel cited, "investors' eyes glaze over when you mention market systems". A programme that brought together development and investment personnel noted that "it took a while to get (the investment side) to understand the development impact angle around which types of transactions should benefit from a subsidy" and why the answer wasn't always to invest in a business. There was emerging good practice, too, with Financial Sector Deepening Africa (FSDA) routinely training staff (including team members from investment backgrounds) on market systems approaches.

Lack of awareness of investment stages also means it can be difficult for PSD programmes to identify where the best opportunities for collaboration actually exist. Conversely, DFIs also commonly lack understanding of what donor PSD programmes do or how a market systems approach works.

5. Awareness and perceptions

Some of the respondents reported limited awareness of the 'other side', and where there were perceptions, these were mixed. In some cases, it appears that perceptions were formed on the basis of one, or at most a handful, of interactions, and in other cases opinions had been formed on even less substantive grounds. Based in experience or not, negative perceptions can shut down good alignment opportunities before they are ever explored.

One common theme was the perception that DFIs, and even DFI-backed funds with a mandate to invest in earlier stage businesses, can be too risk averse and overly focused on financial returns. Given that these investors receive concessionary capital, there is perception in some quarters that these actors should be willing to take more risks and invest in more early-stage opportunities. Fund managers counter that early-stage, small ticket size deals carry disproportionate transaction costs, and may require subsidy or other types of technical assistance.

Another theme was that some investors have not seen a clear value proposition from PSD programmes, and that donor support would be most impactful if channelled through them or their portfolio companies. One impact fund noted that "[Donors] don't need to overengineer sector support. Just give firms money – they know best how to spend it". Another investor noted, "Many of our agriculture portfolio companies have gone to a lot of trainings put on by market shaping programmes. These trainings may make them more well-rounded people, but don't really help grow their revenues".

There was also a lingering perception that market shaping was limited to macro-level, long-term interventions (policy change the most cited example) that were sometimes intangible at the level of the firm. PSD respondents noted that market shaping is an approach, rather than a prescribed methodology, and can operate at micro-, meso-, and macro-level (sometimes simultaneously) in pursuit of system-level change. Highlighting micro- and meso-level opportunities with direct links to investees was noted as a helpful way to demonstrate the value of market shaping work.

In practice: Investment facilitation

Yara, a global crop nutrition company, was struggling to penetrate markets in East Africa. They saw a potential market in serving smallholder farmers with their fertilizer products, but numerous obstacles stood in their way such as poor infrastructure (roads), slow systems (unloading at the port of entry in Tanzania took months) and a lack of credit and capacity among farmers. To overcome these systemic constraints, Yara pursued an 'ecosystem' approach, bringing together multinational companies, civil society groups, aid agencies, and the Tanzanian government in a partnership called the Southern Agricultural Growth Corridor of Tanzania (SAGCOT). Set up to develop a fully integrated agricultural corridor over a 20-year timeframe, SAGCOT has already boosted the incomes of hundreds of thousands of farmers. Yara only provided a small part of the funding (public sources provided one third of the funding, with the remaining amount coming from other private enterprises) – but it increased the company's sales in the region by 50% and its EBITDA by 42%, although a subsequent government policy shift towards bulk procurement of fertiliser threatened Yara's gains[25].

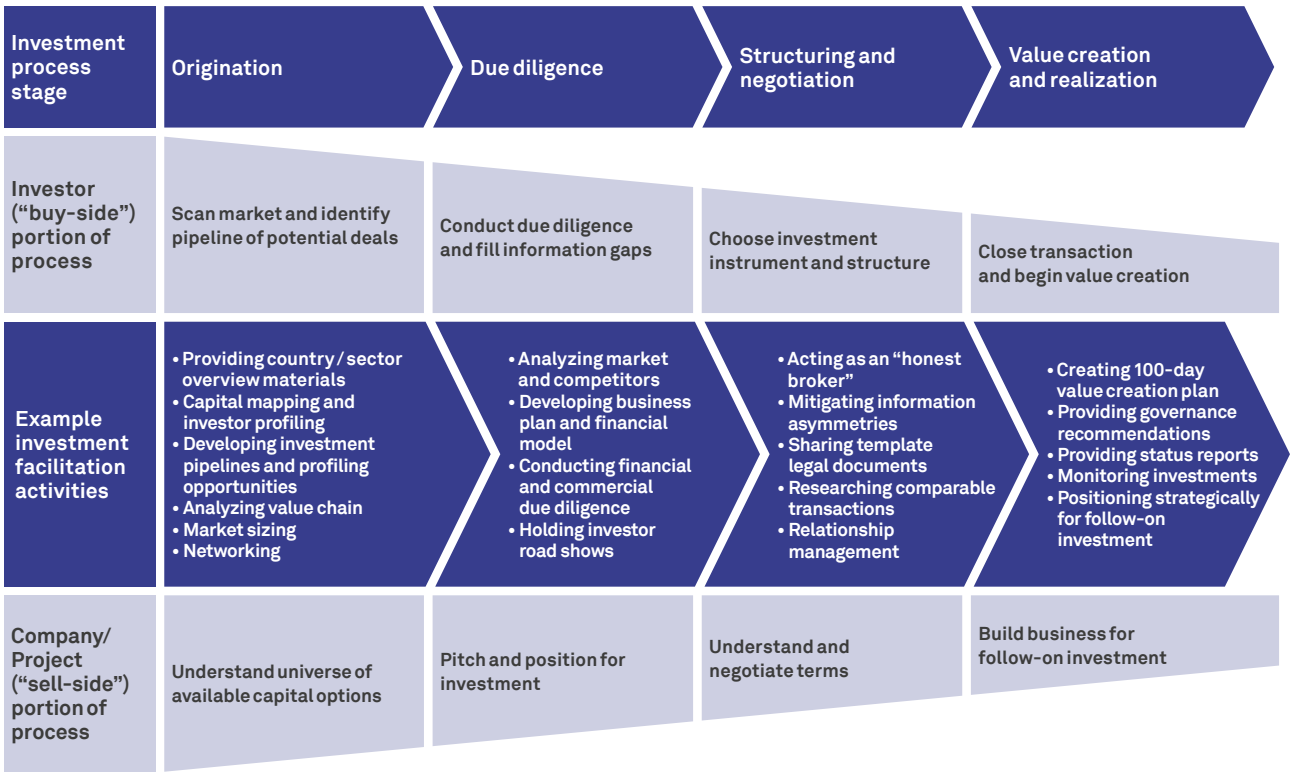
[25] Adapted from *The Ecosystem of Shared Value, Harvard Business Review October 2016.*

6. Investment facilitation

Respondents noted a relatively recent recognition that specialised 'infrastructure' is needed to facilitate investments and bridge PSD programmes, programme-supported firms, intermediaries, and investors. As one interviewee stated, "There's an assumption that transactions naturally move forward without intervention, when there are so many points where a deal can break down."

Investment facilitation can play a central role in coordinating the various actors involved at each stage of the investment process, and helps defray some of the transaction cost and information asymmetry barriers to successful investments. It can also provide or source the right specialist services at key points in the investment process – for example, pre-investment TA around investment readiness, pipeline sourcing (origination), due diligence, transaction structuring and negotiation, and post-investment portfolio support. These specialist services are valued by DFIs as well as other smaller funds. There are also benefits in terms of leveraging intermediaries' established investor networks and credibility with investors – both difficult to build quickly from scratch.

Figure 3: The role of investment facilitation through the investment process[26]



Investment Facilitation is using targeted firm-level assistance for investors and companies to reduce transaction costs and/or information asymmetries in order to catalyze developmentally beneficial investments, without the donor necessarily granting or investing directly into the company or project.

[26] Taken from Runde, F., Cusack, J. and Tilleard, M. (2019) 'Investment Facilitation Revisited', Centre for Strategic and International Studies and The CrossBoundary Group, p.10.

In practice: Investment facilitation

The **USAID INVEST**[27] programme operates across a multitude of different geographies with the recognition that "building financial market systems is an important part of our work" and "USAID should fund bringing the puzzle pieces together." The first prong of INVEST is to address the information asymmetry challenge by funding commercially-focused feasibility studies and business cases to lay the groundwork for investment. INVEST also provides investment readiness technical assistance at the firm-level; and to investors themselves to build funds that can provide catalytic capital. To implement these three prongs, INVEST relies on intermediaries with the relevant competencies to execute many of the investment facilitation activities summarised in Figure 3 above. What started as an informal network of intermediaries has since evolved into a **formal network of 400 intermediaries globally**. INVEST views intermediaries, especially underutilised firms in challenging markets such as Haiti, as part of the systems-change work around building robust financial markets. An investor also specifically cited that they appreciate the involvement of these intermediaries to help them navigate working with PSD programmes.

7. Resources for coordination

The research identified very few cross-function coordination initiatives, with several respondents noting that coordination of this type is often under-prioritised and under-resourced. As one respondent noted, "Collaboration isn't just people willing to work together. It's a system of people who have different capabilities, and [someone needs to fund] those people to be the bridge".

In the absence of dedicated coordination functions, some activity is driven by informal networks within and between organisations. This can be a powerful driver of coordination and there is scope to support and leverage these networks alongside more structured coordination initiatives. Movement of staff between PSD and investment organisations and functions (a symptom of organisations increasingly seeking to expand their internal capacity) has helped in recent years to build more personal bridges across the two sides.

Movement of staff between PSD and investment organisations and functions has helped in recent years to build more personal bridges across the two sides.

[27] Sierra Leone Opportunities for Business Action (SOBA), funded by DFID, 2013–2017.

In practice: Informal networks

The **SOBA programme in Sierra Leone** engaged early on with Cordaid, an international development organisation with an investment management arm that was relatively new to making impact investments in Sierra Leone. In-country programme staff developed informal relationships with Cordaid Investment Management staff that led to regular touchpoints and opportunities for collaboration. There are also several other lessons from this programme that relate to success factors and barriers identified earlier in this section. For example, in a case of serendipitous timing, Cordaid was actively sourcing pipeline while SOBA had developed a portfolio of investable opportunities, partially due to programme staff with commercial backgrounds. Cordaid also had flexibility around smaller ticket sizes in the $150K to $500K range and was willing to disburse local currency and long-term loans suitable for SOBA's pipeline of opportunities.

The potential downside of informal coordination is that sometimes a personal connection or endorsement can carry more weight than the quality of the underlying opportunity. For example, an investor stated that they rely on informal referral networks for pipeline opportunities, but see that this approach is susceptible to bias. There were also reports of a general level of positive investor bias towards international management teams and ownership – created and reinforced through informal networks, language and culture, and trust in people's experience – that concentrate capital in a narrow set of businesses.

The number of players and programmes within a country, region, or sector also make it more difficult to identify partners and coordinate efforts. The interviews highlighted perceptions of a 'patchwork' of overlapping investment and PSD initiatives in many countries, which were noted as difficult to track, understand, and engage with by potential collaborators on both sides. On the DFI side, this is particularly challenging where funds are sector-agnostic.

In theory, national development plans, industrial policies – and donor support strategies – articulate the government's view of areas around which development assistance and development finance activities can align. In practice, however, both PSD initiatives and DFIs do not seek to actively align with these sector transformation visions, and the lack of a dedicated coordination function means that the responsibility falls on the shoulders of individual staff and country teams to navigate any alignment of the systems transformation vision with 'on the ground' decision-making. For example, an investor noted that many development partners are doing mapping and support of agricultural value chains in a specific country, but that all have their own strategies and KPIs, which makes identifying the right actor and opportunity challenging.

Interviews highlighted perceptions of a 'patchwork' of overlapping investment and PSD initiatives in many countries, which were noted as difficult to track, understand, and engage with by potential collaborators on both sides.

C. OPERATIONAL MODELS AND TOOLS

The research identified gaps in the compatibility of certain operational models and processes, and in the complementarity of each side's tools and products. Without the right tools, implementation teams on both sides struggle to align at a tactical level.

Key issues were:

8. Real and perceived hurdles to engagement with PSD initiatives

Some DFIs had perceptions of extensive 'strings attached' to partnerships with PSD initiatives, e.g. complicated application processes and reporting requirements, and pressure to demonstrate results in a specified timeframe. Some investors noted that they did not always understand donor requirements and that it could be difficult to find information on project criteria. As one fund manager noted, "It can be a bit of a pain to design the programmes for donors[28]". Another asserted that "Managing donor relationships require a lot of senior time. Junior capacity doesn't always work – it needs a certain level of professional to manage it well."

There was also a prevailing view that PSD initiatives could be prescriptive regarding the focus of technical assistance and accompanying financial support, and that the PSD 'offer' was not always aligned with the target firm's current needs. For example, an investor sought PSD programme support for a healthcare company, but the PSD donor had a strict focus on HIV infection prevention and contraception and required the TA focus exclusively on those topics. The company's business model included HIV prevention and contraception but also a broader array of products and services, which meant that the prescriptive TA did not fit the company's support needs.

[28] This referred to a perception that although donor support is usually provided free of charge, there can be high transaction costs and significant expectations around the role of the fund partner.

9. Investor fund structures constrain investment ticket sizes and risk

DFIs can be constrained in terms of ability to make risky, small ticket size direct investments into early-stage ventures. With investment minimums that range from $5M to $15M, and there is often no clear path from PSD programme support for a nascent sector to DFI investment. Given the large amounts of capital that DFIs have to disburse and the high transaction costs of individual deals in emerging markets, doing 100 $1M deals is less cost effective than doing 10 $10M deals. The transaction costs for a $1M deal are not meaningfully lower than those for a $10M investment, which means transaction costs will be higher as a proportion of a smaller ticket size investment. There was also a perception from some interviewees that DFIs had tended to be more interested in 'safer' brownfield investments over riskier, but potentially more additional, investment in greenfield opportunities.

Non-DFI (but often DFI-funded) investors can make smaller ticket size investments relative to DFIs because they also tend to be smaller funds, but they still have to meet the return expectations of their own investors [Limited Partners (LPs) for equity funds], while keeping operating costs below the fixed management fee that the fund managers [General Partners (GPs)] receive on assets under management. The challenge is that the risk / return expectations and management fee structures for impact investors operating in emerging markets are often comparable to VC funds operating in developed markets, when transaction costs are higher and ticket sizes are smaller in emerging markets. As one interviewee stated, "We hold emerging markets to ludicrous standards that we don't even apply to our own markets".

For example, GPs in many impact investor funds receive a 2–4% management fee on assets under management, with a 20% "carry" on fund returns after a certain "hurdle rate" is met. The developed world VC fund standard is a 2% management fee and 20% carry. Often, the only structural differences between an impact investor operating in challenging markets versus a Silicon Valley VC is a small bump in the management fee and a lower hurdle rate.

This structure works for Silicon Valley VC firms making multi-million-dollar seed round investments, into companies that can scale quickly and then IPO or be acquired, generating significant fund returns upon exit. But for smaller funds investing in higher-transaction-cost markets into firms that will likely not become unicorns or have an easy pathway to an exit, it can be difficult to make the fund economics work for small ticket size, riskier deals. Hence, even impact funds that want to target the missing middle still go after easier opportunities. This contributes to the average VC investment size in Africa being $2M[29], when many define the "missing middle" as investments below $500K. Some PSD programmes have started to address this by subsidising transaction costs. For example, USAID INVEST recognises the challenging ratio of ticket sizes versus transaction costs for missing middle deals and subsidises investor transaction costs by funding intermediaries to do investment facilitation.

10. Limited "toolbox" for collaboration

For PSD initiatives equipped to offer direct financial support, this was often viewed as a tool of last resort[30]; deployed in situations where a clear market shaping opportunity was identified but 'softer' facilitation tactics (such convening, information sharing, or TA) were deemed insufficient alone to drive the desired change[31]. However, recent studies on the role of PSD programming in driving sector transformation have called for an 'opening up' of the facilitation toolbox[32]. This would allow them to get more hands-on and provide transactional support to work directly with firms to help 'kick-start' the development of modern sectors, especially in thin markets.

In addition, direct financial support often focused on reaching proof of concept for an innovation, rather than getting that innovation to scale, e.g. by joining up with external investment. Other PSD initiatives have limited, or no, ability to use direct financial support. This can be strategic, i.e. to avoid market distortion, or contractual, i.e. the use of certain tools, such as returnable grants, being restricted due to donor accounting rules.

There may therefore be a rationale for PSD programmes to become a temporary player in the market system. This may seem to go against the maxim set out in the Operational Guide for PSD implementers to "remain outside of the market system they are intervening in" – but in practice PSD programmes can build in guardrails to mitigate the risk that they become a permanent market player, such as by tapering off support over time, and by having clear and agreed-on exit strategy. As noted by one respondent in a study for the DCED MSD Working Group, "Market systems ideology should be interpreted flexibly, balancing long term systemic change with more hands-on or direct support to prove a business model or market opportunity"[33].

[29] African Private Equity and Venture Capital Association (2021) 'Venture Capital in Africa: Second Edition'
[30] See, for example, the 'Have You Tried Everything Else? Test', available at: seepnetwork.org/files/galleries/EWB_Have_You_Tried_Everything_Else_Test.pdf
[31] The underlying logic – driven by the core market shaping principles of sustainability and scale – is that providing finance risks distorting the market, for example by crowding out local financial institutions.
[32] Impact Management (2019) 'Promoting Economic Transformation through Market Systems Development', Study Report, Donor Committee for Enterprise Development, Cambridge, UK
[33] Ibid., p.43

In practice:
Using financial tools to promote systems change

Power Africa, a USAID-coordinated partnership, aims to connect 60 million homes and businesses to power by 2030. The initiative takes a transaction focus, working to address barriers to specific deals and in the process unlocking bottlenecks for wider development of the sector. Alongside technical and political solutions, Power Africa provides direct financial support with the aim of de-risking investment and driving wider systemic change. Financing models include a repayable grant that catalysed a 30-times return on $1.3M renewable energy fund; loan guarantees; and financial support to launch the Kenya Pension Fund Investment Consortium (KEPFIC)[34].

Gatsby Africa and the Wood Foundation made the leap from facilitator to investor through acquiring two tea factories in Rwanda in 2011, seeing an opportunity to demonstrate the commercial viability of smallholder-owned factories as part of a wider programme of sector transformation. The work has resulted in direct benefits to 14,000 farmers; follow-on investments of ~$50m including greenfield projects by Unilever and Luxmi; and tea exports on track to reach $209m by 2024 (up from 93m in 2019-20). Lessons from the process include that making direct investments built greater credibility with industry and government, and resulted in more tangible, on-the-ground impact. Challenges included being conflicted out of certain roles that a 'pure' facilitator could play – some areas of policy work for example – and potentially less focus on sector-wide challenges as energy and resources are pulled into making the investments successful. The approach is also noted to be long-term and high-risk, with £20m+ committed and a 15+ year time horizon[35].

For investors, commercially-relevant, firm-level TA and financial contributions were noted as providing the clearest incentive to align with PSD initiatives. There was generally limited awareness of, and interest in, 'softer' market shaping tactics and TA that was perceived to be 'too far away' from the deal. The two areas of greatest interest were:

1. Specialist technical expertise, particularly when directed at a genuine business need. The quality of delivery – both technical knowledge and the ability to operationalise this knowledge – was highlighted as critical. PSD implementers noted that delivery of TA can be hit-and-miss: the flexibility inherent in market shaping work often calls for generalist full-time teams with subject experts contracted in to deliver TA at firm-level. Selection of these specialists, and definition of their roles, is sometimes done without input from the partner (recipient) firm and with variable levels of vetting by programmes. Furthermore, it can be challenging for non-specialist programme staff to validate the quality and relevance of specialist technical inputs.
2. Blended finance and grants, assuming manageable transaction costs. For example, Root Capital, a debt provider for agricultural SMEs, collaborates with PSD donors in two ways: 1) through development organisations and foundations providing grant capital as an equity, first-loss layer into its capital structure, and 2) through use of traditional capacity building PSD programmes for smallholder farmers.

[34] Power Africa (2020). Annual Report. USAID.
[35] Gatsby Africa and The Wood Foundation Africa (2020) 'In it for the Long Haul: Transformative impact from The Wood Foundation Africa and Gatsby Africa's investments in the Rwandan tea sector'

Figure 4: What types of PSD support were investors most interested in?[36]

Investor interest: High → Low

PSD input	Investor feedback
Direct financial support (e.g. grants, blended finance)	— Streamlined application and management are key — Greatest interest in flexible, non-prescriptive terms
Specialist firm-level TA	— High quality advisers and co-designed TORs important — Tangible outputs aligned with genuine business need
Feasibility assessments	— Credibility of service provider is critical — Perceptions of complicated intellectual property issues (who can access and benefit from donor-supported feasibility studies?)
Linkages / Co-ordination	— High interest where there is a direct firm-level benefit e.g. access to new buyers
Information / Demonstration	— Depends on the relevance and quality of information provided – does it serve a genuine need or highlight a genuine opportunity?
Market-level TA	— Sometimes unclear on aims, approach, and firm/investor role — Free-rider issues: why invest in helping the competition? — More interest where clear value demonstrated over the short term
Generalist firm-level TA	— "Why would I want advice from somebody who knows less than me?" — TORs that do not meet a clear need or respond to real opportunity

[36] This ranking is the authors' interpretation based on responses from investor interviewees. It is qualitative and non-representative and is intended to give a broad sense of investor interests.'

In practice:
Investor and firm-relevant support

In the East African aquaculture sector, **Gatsby Africa combines both direct financing and specialist TA** targeted at individual firms in key value chain gaps such as fish feed and fingerlings. The intended outcome was to create a demonstration effect for other actors to enter the market and catalyse overall sector growth by addressing upstream value chain gaps. This approach helped de-risk investments into a nascent sector, and Victory Farms, a fish farm on Lake Victoria that benefitted from Gatsby Africa investment and TA, was able to raise tens of millions of dollars in equity and debt from several impact investors, following an initial debt investment from Gatsby Africa.

DFCD is another example of combining TA and financial support in a way that is relevant to investors. FMO's involvement in design and implementation means that there is a DFI investor perspective guiding the deployment of finance and TA. For example, DFCD provides grant funding at the origination stage so that NGOs working on climate mitigation opportunities can hire the necessary financial expertise to develop business cases, and then utilises blended financing at the piloting and scaling stages. In terms of TA, FMO and external consultants also provide financial expertise and investor perspective to WWF and SNV, which leverage local presence to provide the TA. There are currently 18 projects in the origination / development phase, with a target of 9 projects moving into the piloting and scaling investment stage over the next 2 years.

Recommendations

4

4.1 PUTTING THE RECOMMENDATIONS INTO CONTEXT

Building closer PSD-DFI alignment is a substantial and multi-faceted challenge, driven by a spectrum of issues from the deeply structural to the highly granular. Further to this, the concepts of "development finance" and "PSD initiative" over-simplify vast variety and nuance within each stakeholder group. As such, the recommendations presented below are made with the following parameters in mind:

1. First and foremost, the recommendations were developed and prioritised with feasibility and real-world relevance in mind. This means steering clear of grand, theoretical solutions to the most deep-rooted structural challenges, in favour of practical recommendations with the potential to deliver value to both sides over the short- to medium-term. Each recommendation links back to one or more of the success factors and challenges discussed above.

2. Second, the research highlighted that closer alignment should not necessarily be a default aim for every PSD initiative and development finance-related investment. The recommendations are geared towards players and situations where closer alignment has the potential for mutual benefit, for example:

   - PSD initiatives in design or underway with an interest in – and potentially specific targets around – attracting investment alongside market shaping work; and/or addressing specific functions or rules related to investment, such as access to finance – or working on the financial sector as a whole.
   - Donor agencies looking to forge closer links with counterpart DFIs or in-country investors in support of country-level or thematic strategies.
   - DFIs and other investors looking for new ways to grow their portfolios; deliver more transformational impact; better engage with the 'missing middle'; enter new – and potentially more challenging – markets; and mitigate sector-level risks.

3. Third, the recommendations recognise that a growing number of organisations are building the 'other' function in-house. While some of the points below address cross-institutional alignment specifically, most apply regardless of institutional setup.

4. There is a good opportunity to move forward with an initial set of pilot activities and start building momentum for this wider change. These 'quick-win' opportunities are highlighted below with an icon.

Theme 1

Align strategies and incentives around common opportunities to get DFIs and market shaping PSD pulling in the same strategic direction.

Theme 2

Build or buy crossover knowledge, and coordination infrastructure to make sure that efforts to align are more readily identified and followed through.

Theme 3

Close the gap between product offers to increase mutual relevance, and create clearer opportunities for alignment at a tactical level.

Figure 5: Summary of findings and recommendations

Success factors & challenges

A. Strategy & incentives

- Sectors and opportunities
- Timelines
- Incentives for alignment

B. Capacities

- Knowledge and skills
- Awareness and perceptions
- Investment infrastructure
- Resources for coordination

C. Operational models & tools

- PSD hurdles for investors
- Investor fund structures
- Collaboration toolbox

Recommendations

Theme 1

Align strategies and incentives around common opportunities

1. Develop common sector selection criteria
2. Engage the 'other side' in setting strategy
3. Increase use of smart investment indicators in PSD results frameworks
4. Increase emphasis on market shaping as part of investment screening
5. Strengthen handover and exit strategies to maintain momentum

Theme 2

Build or buy crossover knowledge, and coordination infrastructure

6. Strengthen ecosystem mapping
7. Support coordination at country level
8. Pool DFI TA around joined-up initiatives
9. Pilot cross-organizational secondments
10. Implement training (e.g. mini-CFA)
11. Utilise specialist investment advisory and facilitation expertise

Theme 3

Close the gap between product offers

12. Build commercial relevance of PSD offers
13. RBF / pay-for-performance financing
14. Re-align systems change terminology
15. Proactively support first-time local fund managers & experiment with new fund model

Represents quick-wins.

THEME 1: ALIGN STRATEGIES AND INCENTIVES AROUND COMMON OPPORTUNITIES

Recommendation #1: Develop mutually-relevant criteria to prioritise sectors and opportunities

An overlapping sectoral focus – by chance or design – was a prerequisite for alignment in the examples covered in this study. For initiatives with an explicit sector transformation agenda, there was also alignment around a shared set of targeted constraints and opportunities. Reaching a point where investors and market shaping initiatives more routinely agree on focal sectors and opportunities would be a significant step towards closer alignment. The most immediate opportunities lie in aligning wider efforts around a shared view of sector transformation, and in building up the commercial relevance of PSD sector and opportunity selection. Specific recommendations are:

— **For market shaping PSD programmes:** Build a clearer commercial focus into sector selection and analysis alongside the wider impact mandate, making greater use of resources such as the 'Pre-intervention investment toolkit'[37], which is specifically geared towards PSD programmes. Depending on the sectoral focus and programme goals, this may include deeper analysis of growth and productivity, comparative advantage, and economic complexity; mapping the investment ecosystem, including specific opportunities; and understanding key enabling environment constraints from a firm-level perspective.

— **For PSD donors:** Build commercial focus into both internal guidelines (e.g. for staff developing new programme business cases), and external guidelines (e.g. for market shaping implementers). A donor could take a leadership role in drawing on existing best practices across PSD programmes, e.g. in sector selection criteria that combine both an impact and commercial perspective, to draft and disseminate standard guidelines.

— **For all:** Build interest in, and consensus around, models of sector transformation to serve as a point of alignment for future investment strategies and PSD programme designs. Ensure approaches consider host government economic development strategies, and consider providing targeted coordination and technical support to relevant bodies to strengthen planning and delivery.

In practice: Prioritising sectors and opportunities based on impact and commercial viability

Manufacturing Africa – delivered by a consortium of both impact- and commercially-oriented partners – is an example of a PSD programme that considered both impact and commercial viability in sector and country selection. Key considerations were the potential for job creation; complexity (as part of a wider economic transformation agenda); and the investor perspective (e.g. global market trends and import substitution potential).

The **IFC and World Bank** run joint Country Private Sector Diagnostics that take a commercially oriented approach to identifying priority sectors and specific opportunities to support inclusive growth. Based on the findings of these diagnostics, Country Strategies provide joint action plans for coordinated intervention[38].

[37] Blewett, J., Keddie, J., Van Hummelen, S. (2016) 'Pre-intervention investment toolkit: The challenge of achieving impact at scale in market systems development (M4P) interventions', BEAM Exchange.
[38] International Finance Corporation (2020) Annual Report 'IFC 3.0: A Strategy for Creating Markets'

Recommendation #2: Engage the 'other side' in setting investment strategies and designing programmes

In addition to aligning on sector selection, there is scope for closer engagement throughout the programme and investment cycle. Incorporating the perspective of the 'other side' can drive up the commercial relevance of market shaping work, and add value to investment strategies in terms of sectoral knowledge; analysing scope for direct and indirect impact; and market-level barriers to firm growth.

— **For market shaping PSD programmes:** Engage with investors from the outset to test assumptions and ensure relevance versus investment strategies (where they exist) and individual deal-level opportunities. Mechanisms include investor consultations as part of the intervention planning process; inviting a panel of investors to attend strategy review meetings; and long-term investor roles on programme advisory boards.

— **For investors:** Invite relevant donors or PSD programme representatives to contribute to investment strategy-setting exercises for specific sectors or geographic areas. Opportunities to leverage the key strengths of multiple initiatives e.g. knowledge of the political economy; policy analysis; impact pathways; and sectoral expertise. Scope for 'investor-led' TA approaches (see DFCD example, alongside).

— **For donors and DFIs:** Proactively identify and coordinate opportunities for engagement at country level. Consultation on programme business cases with DFIs, and investment strategies with donors and programmes, as a default.

In practice: A joined-up approach

The Dutch Fund for Climate and Development (DFCD) was designed with the joint input of FMO, the WWF, SNV, and Climate Fund Managers. The role of each partner was defined at the outset, with FMO bringing the investor lens and the three partners contributing specialist technical assistance and an on-the-ground presence. FMO guides the work of the other partners from the investor perspective, for example helping to ensure selection of partners with the potential to attract investment in future, and developing commercially-relevant interventions.

Recommendation #3: Integrate targets related to commercial viability and capital raising into PSD programme results frameworks

Collaboration with investors must be properly incentivised. This is not collaboration for its own sake – but in order to help deliver on the core objectives of PSD programmes. A 2016 study funded by the BEAM Exchange found the reason that half of the reviewed projects failed to scale was because of "low profitability for partners or competitors"[39]. In other words, PSD-supported innovations may benefit target groups, but the business model is not viable for the private sector. Even commercially viable innovations are unlikely to lead to a replication effect unless private sectors partners can access finance, for example working capital to allow the 'adoption' of new business practices, or growth capital to 'expand' service provision.

However, simply including investment objectives in results frameworks can lead to perverse incentives. For example, performance metrics related to the number of investment opportunities, or the volume of investment mobilised may lead to PSD implementers encouraging the private sector to take on inappropriate finance – and risks over-leveraging smaller companies[40]. Absolute targets may be difficult to set up front, and lead to programmes de-prioritising smaller and riskier deals in favour of big-ticket, less risky, and less additional transactions.

[39] 12 out of 26 sampled projects failed to reach scale. See Blewett, J., Keddie, J., Van Hummelen, S. (2016) 'Pre-intervention investment toolkit: The challenge of achieving impact at scale in MSD (M4P) intervention'. In the same vein, a Monitor Group review of more than 270 market-based ventures aimed at alleviating poverty found only a "handful" that were commercially viable.

[40] Default rates can be high, especially where there are government policies mandating a certain proportion of a bank's loan book to specific sectors such as agriculture. In addition, some smaller companies may not fully understand the implications of asset-backed loans and what happens to them in the case of default.

Specific recommendations are:

— **For PSD donors:** Set targets that reflect well-designed investment objectives and shape incentives for programmes to purpose appropriate financing solutions. As one programme implementer said, "We deliver what we're measured against". Instead of absolute US$ targets, focus performance indicators on measures such as the number of private sector partners able to access growth capital, for example, recognising that many PSD initiatives may be helping to 'prime the pump' and put businesses on the long-term path to investment readiness – but not yet be 'bankable'. Targets can encourage programmes to examine the commercial viability of the innovations they are supporting, not just their 'impact viability'. This may involve tracking, for instance, the number of private sector partnerships where the innovation being supported is a) cashflow positive, b) returns a gross profit (sales minus variable costs), and c) is returning an investment profit (a project's overall return on investment which weights gains against the investment's original cost).

— **For market shaping implementers:** Results frameworks should be sensitive to the sector and country, and leave programmes the flexibility to adapt as they learn how the sector and geographical context influences investment needs. Programmes should also ensure that results frameworks are not overly prescriptive on the financing instrument or source of financing – as that will vary, and may come from local sources of finance (e.g. bank lending) rather than through foreign investment (DFI or otherwise).

Recommendation #4: Increase emphasis on market shaping as part of investment process and tie it to performance incentives

DFIs are increasingly seeking ways to magnify the economic and social development impact of their investments. But these measures often still limit investor views of impact to the performance of a single transaction rather than that transaction's role in a more holistic view of sector growth or systems change. More investors are now considering aligning compensation to the realisation of impact, especially as this is enshrined in the IFC-led Impact Principles where all major DFIs are a signatory. Impact-linked carry – where GP carried interest is contingent on achieving specific ESG and impact metrics – is becoming an emerging practice even among more commercially oriented private equity funds[41]. This provides the opportunity to integrate KPIs that move beyond individual transactions to favour investments that contribute to sector transformation.

— **For investors:** To incentivise more investor alignment with market shaping objectives, and hence more opportunities for collaboration with PSD programmes, investment criteria can be further expanded or adjusted to include broader market shaping factors. LPs play an important role in shaping dynamics and could take the lead in incentivising their own deal teams to push towards wider transformational change objectives, especially when making direct investments. Innovative approaches to aligning incentives with GPs could be considered that provide 'carrots', such as carry kickers or lower hurdle rates, rather than 'sticks' such as forfeiting a portion of carry if targets are not met.

— **For PSD donors and implementers:** Incentives are only effective with clear and agreed-on criteria for measuring and verifying performance. Measuring systems change has proved notoriously tricky even for PSD programmes with often extensive 'monitoring and results measurement' resources. However, there is now general acceptance that systems change cannot be boiled down to a single number or binary measure, but is best measured using rubrics-based methodologies. These aim to create a shared language for describing and assessing change by drawing on both quantitative and qualitative evidence[42]. Donors can help ensure these lessons learned are shared with investors by PSD implementers, and the often more practical focus of development finance practitioners could even help PSD programmes to further refine their own approaches to systems change to ensure they remain more 'actionable' rather than 'academic'.

[41] See, for example Trill Impact (www.trillimpact.com) and EQT (eqtgroup.com).
[42] See, for example, the Laudes Foundation: www.laudesfoundation.org.

In practice: Ecosystem mapping

BII considers the indirect, systemic effects of a potential investment in terms of "economic enablers" and "catalysing markets." Investments meeting economic enabler and catalysing markets criteria will result in additional points being awarded during the due diligence scoring process. The economic enablers point is designed to prioritise investments "most likely to have the largest indirect impacts on productivity at a market, sector, or economy level." The catalysing markets point is designed to incentivise investments that have spillover effects in developing a market, through increasing competition, demonstrating replicable models and lowering market risk, developing skills and capacity, and / or improving enabling environment.

The **UN Capital Development Fund (UNCDF)** uses a 'dual key' analysis to help decide whether an investment opportunity will move ahead. The first step of the analysis is the "Impact Key" that determines whether the selected project will deliver local impact in line with the specific goals of the programme. The second step of the analysis is the "Financial Key" that focuses on the financial performance of the projects, evaluating the business model with a range of financial tools. This second key is not only about bankability, but also looks for the financial impacts in the form of sustainability and follow-on investment potential.

Omidyar Network assesses its investments using a 'Returns Continuum Framework' that first confirms scope for direct (firm-level) impact and then considers each investment in terms of expected financial returns and expected market impact, tailoring screening criteria and financial instrument accordingly. Investments with higher expected returns require less evidence of market impact, while investments forecasting sub-commercial returns must make a strong case[43].

Recommendation #5: Strengthen market shaping exit strategies to maintain strategic alignment, including handovers of key investment-related activities

Aligned strategies and incentives can still fail if that alignment is not maintained across cycles of programme implementation. The Success Factors & Challenges section above highlighted how the lag between successive PSD programmes can limit the momentum of investor and private sector partnerships. While the traditional programming cycle is largely a structural issue, there are options to mitigate the impact of project changeover:

— **For market shaping PSD programmes:** Build an exit strategy into interventions and partnerships from day one. Map and manage exit risks, particularly over the final year of an initiative. Hand over key activities to other programmes, the donor directly, suitable market players, or investors themselves in the closing phases of a programme.

— **For PSD donors:** Consider a specific performance metric on the robustness of a programme's exit strategy. Offer bridging support to high-momentum investment activities between programme phases, including a minimum viable level of relationship management with key investors and private sector actors.

Aligned strategies and incentives can fail if that alignment is not maintained across cycles of programme implementation.

[43] Bannick, M., Goldman, P. Kubzansky, M. and Saltuk, Y. (2017) 'Across the Returns Continuum', Omidyar Network

THEME 2: BUILD OR BUY CROSSOVER KNOWLEDGE, AND COORDINATION INFRASTRUCTURE

Recommendation #6: Assign responsibility and resources for economic development ecosystem mapping in priority countries

Research respondents highlighted the challenge of navigating the patchwork of economic development initiatives (PSD, development finance, and government-led) at country- and sector-level. Investment strategies and PSD sector diagnostics have tended to focus on a narrow slice of the wider economic development ecosystem. Standalone ecosystem mapping has sometimes struggled to find practical relevance. There is scope for a revamped approach to ecosystem mapping at country- and sector-level to better highlight opportunities for alignment:

— **For PSD donors and DFIs:** Pool resources to map the economic development ecosystem by region, country, or sector to increase mutual awareness of overlapping efforts and opportunities to collaborate. Consider sustainability (i.e. who will do and pay for updating, hosting, dissemination) at the outset. Where mapping has been undertaken, disseminate this proactively among investors and PSD initiatives, identifying specific opportunities for alignment and brokering introductions between relevant teams.

— **For market shaping programmes and investment teams:** Strengthen mapping of the wider economic development ecosystem, including the 'other side', drawing on (and building on) pooled efforts (as above) where possible.

In practice: Ecosystem mapping

Regional bodies such as the East Africa Venture Capital Association **(EAVCA)** or the African Private Equity and Venture Capital Association **(AVCA)**, as well as groups like **ANDE**, have experience running investor ecosystem mapping. Industry associations such as **GOGLA**, the global off-grid solar energy association, have convened companies, donors, investors, and policy makers working in the same sector.

Global Steering Group for Impact Investment (GSG) has a network of 28 National and Regional Advisory Boards (NABs) working to catalyse impact investment in their markets. Where present in a country, NABs can provide the building blocks for collaboration and a principal mechanism for mobilising collective resources, ideas and action towards developing robust systems for impact investing that bring together co-ordinated private and public sector action.

Recommendation #7: Recognise and support effective investor-PSD coordination initiatives at country level

Coordination is often expected to happen organically within and between investors, market shaping initiatives, and other actors in the wider economic development ecosystem. In reality, coordination is resource-intensive (and often under-rewarded) work that is critical in identifying and driving forward opportunities for alignment. There is scope to increase both resourcing and recognition of good quality coordination as follows:

— **Country-level staff on both sides:** To replicate more effective country-level coordination tactics, country-level staff could be given access to more support, e.g. time allocation for coordination efforts, and recognition, e.g. internal best practice forums specifically to share pilots and experimentation related to coordination tactics.

— **DFIs:** Make key DFI contacts more accessible to relevant donor and programme teams, for example by sharing contact information in-country (together with guidance on investment criteria); inviting programmes to relevant events; and engaging with donor country teams to understand where opportunities for alignment might lie.

— **Donors and DFIs:** Recognise the importance of 'backbone support'[44] for good quality coordination. For current or planned coordination initiatives (e.g. delivered through associations), consider including a specific mandate for aligning investors and market shaping initiatives.

— **All:** Recognise that the quality of coordination matters more than the form, and find and support initiatives that are working in practice – formal and informal; large- or small-scale; and top-down or bottom-up.

In practice: Experimenting with more action-oriented approaches to coordination

At the country-level, individual programme implementers and investment personnel have often been proactive in trying to facilitate more coordination and collaboration. For example, the Manufacturing Africa team in Ethiopia has introduced a new communications channel for all programmes working on investment into agricultural processing in Ethiopia.

Rather than providing generic progress updates as in other forums, participants are asked to share specific investment opportunities and others respond with any support they can provide to the particular investment opportunity.

Recommendation #8: Pool DFI TA around joined-up initiatives

DFI technical assistance offers – both standalone, and packaged as Technical Assistance Facilities – have proliferated over the past five years, many targeting improved performance and development at the investee level. There is growing scope for DFIs interested in transformational approaches – but without the ability to launch major programmes alone – to pool funding and expertise into jointly-run market shaping initiatives.

— **For DFIs:** Identify high-potential opportunities (e.g. around the launch of new investment strategies or country plans) and engage with DFIs and other investors with TA offers to explore opportunities for joint projects. Explore co-funding or co-implementing opportunities with relevant donors, particularly agencies with shared thematic interests, a strong country-level footprint, or well-tested programme delivery infrastructure. Actively disseminate guidance and lessons from live joint projects to demonstrate the model in action and to inform future practice.

In practice: Pooling DFI TA

BII, FMO, and the Swiss Agency for Development and Cooperation (SDC) partnered on a market shaping programme in Nepal Invest for Impact Nepal *(formerly Nepal Invests)* to direct combined resources and technical capacity towards influencing regulations governing DFIs in Nepal, building the capacity of investment professionals, and increasing demand for growth capital amongst Nepalese businesses, among other initiatives.

Joining forces resulted in the 'critical mass' required to design and implement a multi-year market shaping initiative, something that may have been out of reach for any individual partner. The programme now provides a platform that can be grown over time as new opportunities arise.

[44] Collective Impact – a leading model for driving social change at scale – emphasises the key role of 'Backbone support organisations' (i.e. centralised coordination bodies with dedicated staff) as a critical success factor for coordination. See ssir.org/articles/entry/collective_impact.

Recommendation #9: Pilot cross-functional or cross-organisational secondments

The research highlighted gaps in investment awareness and expertise within PSD initiatives and, vice versa, a lack of market shaping expertise within DFIs. Cross-functional secondments offer an opportunity to build knowledge on both sides, and to strengthen linkages and networks.

— **For donors and DFIs:** Launch a pilot project matching five to ten applicants with opportunities that offer mutual benefit. The secondments could take various forms: cross-team; between government departments (e.g. between FCDO and BII); or between DFIs and PSD organisations (e.g. FMO investment team member seconded into a FCDO in-country programme). If pilot secondments are successful, there is scope to jointly fund a wider secondment programme that proactively identifies opportunities; matches relevant applicants; monitors progress and outcomes; and disseminates success stories and lessons learned.

Cross-functional secondments offer an opportunity to build knowledge on both sides, and to strengthen linkages and networks.

In practice: Cross-functional secondments

USAID is experimenting with seconding foreign service officers into DFC teams. The organisational and recruiting infrastructure has been established to enable these placements, but another challenge has emerged – recruiting to fill the positions. The first recruitment process yielded few suitable candidates, perhaps hinting at the difficulty of finding candidates with both the right skillsets and the willingness to work within organisations that are culturally and operationally different than their core experiences.

The **Kuza youth employment programme**[45] seconded a series of investment professionals from Open Capital Advisors with the dual objectives of a) building commercial capacity within the core team, and b) scoping new investment opportunities in Mombasa. Alongside assessing opportunities for investment, and supporting the setup of Mombasa Invest (one of the first county-level investment attraction bodies in Kenya), the secondments played into Open Capital's subsequent decision to set up Arcadia[46], a talent service which has gone on to run 120+ secondments with over 40 clients.

The USAID-funded **Alliance for Inclusive and Nutritious Food Processing (AINFP) programme**[47] works to strengthen the food processing sector in East and Southern Africa. Part of the programme's offer is to connect agro-processors with appropriate forms of financing from local banks and regional impact investors. To support this aim, ISF has embedded a commercial agriculture banker into the programme team, working alongside the technical assistance provided by TechnoServe and Partners in Food Solutions. To-date, the project has been able to mobilise $5M in financing for East African agro-processors.

[45] Kuza (2014–2017) was an urban youth employment programme focussing on the most marginalised young people in Mombasa County, Kenya. Funded by DFID and implemented by Adam Smith International.
[46] Arcadia embeds Open Capital staff with clients for 3–6 months to support finance, operations, and strategy. See opencapital.com/services/arcadia
[47] AINFP (2018–2023) works to develop a more competitive food processing sector in East and Southern Africa. Funded by USAID, implemented by a TechnoServe-led consortium. See www.ainfp.org.

Recommendation #10: Implement training for donors, implementers, programme teams, and investment personnel (investment 101, mini-CFA, market systems in practice)

There is an opportunity to build a base level of 'crossover' knowledge on both sides through streamlined training products, both an immediate opportunity for a 'mini-CFA' or 'Investment 101' course for non-investment audiences; as well as targeted market shaping training for investment teams.

— **For DFIs:** There is clear demand from across non-investment audiences for a concise, targeted training offer that introduces key investment concepts. This includes donor PSD personnel; PSD implementers and programme teams; and DFI and fund-level technical assistance units. Key content might include a briefing on the investor ecosystem; key investment terms and processes; investment instruments; and investment management. It might extend into practical tools like basic financial modelling and due diligence assessments. The training would be tailored to reconcile some of the key gaps that limit alignment. There is potential for a group of interested DFIs to jointly fund and co-brand the training offer. The package could be delivered through a combination of online content, interactive workshops, simulations and other experiential approaches.

— **For DFIs and donors:** There is scope to develop a 'market shaping for investors' training offer that could be included as part of new joiner inductions and offered on a standalone basis. This could be piloted with a cohort of investors interested in the concept of market shaping and looking for guidance on putting it into practice. The offer would need to make a clear case for market shaping that resonated with an investment audience; present clear and tangible examples of the approach in action; and translate market shaping terminology into familiar terms.

In practice: Crossover training

All **Financial Sector Deepening Africa (FSDA)** staff, including investment personnel, receive market systems training as part of a wider professional development programme delivered through the FSD Academy[48]. The market systems training is tailored to the needs of FSDA, with content designed to be relevant and engaging for personnel with both private sector and traditional development backgrounds.

IFC has significantly expanded its Upstream offer as part of its 'Strategy 3.0' approach. Led by a specially-created Innovation and Upstream Implementation Task Force, this included recruiting 233 new Upstream personnel and rapidly integrating this group into the organisation through structured onboarding and training[49].

Recommendation #11: Utilise investment advisory and facilitation expertise

As a complement to building internal capacity through secondments and training, PSD programmes could also a) increase use of investment advisory and facilitation intermediaries, and b) recruit high-quality investment personnel into programme teams, to fill gaps around transaction expertise and access to investor networks. The findings section cited several examples of programmes such as USAID INVEST and Manufacturing Africa that successfully leverage intermediaries, and initiatives like Nigeria LINKS that combine internal and outsourced investment expertise.

— **For DFIs:** Recognise the role that specialist investment advisers can play in tuning the offer of a market shaping initiative to resonate with investors, and review budget thresholds to cater for the related specialist fee structures. Consider offering pay-for-performance models (e.g. a fixed fee for each deal closed) noting the points on perverse incentives under Recommendation 3, and recognising that hybrid contracting models (i.e. those mixing input-based and pay for performance aspects) are not always attractive for investment intermediaries.

— **For market shaping PSD programmes:** For programmes and implementers targeting investment outcomes but 'going it alone' (i.e. without specialist internal or outsourced investment advisory) consider reviewing the available options – for example in-country or regional facilitation service providers – and piloting a joint intervention on a small scale. For investment-related tenders, explore mutually-beneficial partnerships with specialist advisory outfits.

[45] See elearning.fsdafrica.org for more information.
[46] International Finance Corporation (2020) Annual Report 'IFC 3.0: A Strategy for Creating Markets'.

THEME 3: CLOSE THE GAP BETWEEN PRODUCT OFFERS

Recommendation #12: Build up the commercial relevance of the PSD 'offer'

Aligning around sectors and opportunities (see Recommendation 1) creates the conditions for PSD initiatives to develop offers that add genuine value for investors, while keeping focus on the wider market shaping and impact mandate.

— **For market shaping PSD programmes:** Develop tools and products that provide direct value to investors and firms:

- **Address pre-investment information asymmetries:** PSD programmes can build the business case for investment into focal sectors and firms, for example, through targeted feasibility studies. Programmes can also address other information asymmetries around industry standards and best practices, e.g. by defining and / or verifying those standards. This is especially important for nascent sectors with short business track records and industry data. Incorporating investor guidance on areas of intervention helps ensure feasibility and other analyses are relevant.
- **De-risk investments through post-investment portfolio support:** Programmes can use high-quality technical and commercial expertise (in-house or outsourced) that focuses on tangible, value-adding activities for firms and investors. Co-develop terms of reference with investors and target firms to build buy-in and help ensure relevance. Devote sufficient senior time to recruitment, vetting and management of consultants to ensure high quality outputs.
- **Provide sector-specific regulatory linkages and support:** Investors often do not have the resources or scope of operations to address the policy environment, which can adversely affect firms' performance. PSD programmes with the scope to engage on sector-specific policy environment can help decrease investor risk perceptions and increase the scale of productivity-enhancing investments into a sector. PSD programmes could also help investors understand the importance of incorporating political economy considerations into portfolio company strategy, as gaining political 'licence to operate' through alignment with national development priorities could significantly boost company performance post-investment.
- **Recognise that investors and investees are more likely to engage with a streamlined setup and management process.** Look for ways to simplify processes without creating unacceptable levels of risk.

In practice: Commercially-relevant PSD support

Gatsby Africa and the Wood Foundation Africa's work in the Rwandan tea sector relied on hiring staff with strong industry technical and commercial experience, e.g. experienced tea professionals with commercial factory experience; senior hires from major consumer goods companies; and top-level tea branding and retail specialists[50].

Gatsby Africa funded an initial feasibility study in the **East African aquaculture** sector to reduce barriers of entry for Victory Farms and to de-risk early-stage investments. As mentioned in an earlier section, Victory Farms has since raised tens of millions of dollars in equity and debt.

The **World Bank Group** has played a key role in setting industry standards for the off-grid solar sector through the Lighting Global Quality Standards and verification process. During the early growth of the off-grid solar lighting and solar home systems sector, cheap and counterfeit products flooded some markets, eroding consumer trust in products and increasing investor risk perceptions. Lighting Global introduced industry-wide quality standards and a testing and verification process for products that addressed what could have been a serious threat to continued growth investment into the sector.

The African Clean Energy (ACE) initiative was another programme cited by investors as adding value. It embedded staff with technical expertise in the Senegal Ministry of Energy, providing a link between businesses and investors and policy formulation, and helping to create a friendlier regulatory environment for the off-grid solar sector.

Recommendation #13: Experiment with increasing use of RBF (results-based financing) / pay-for-performance financing as part of PSD programmes

There is an opportunity to further the discussion on using donor-provided financial support to strengthen PSD-investor alignment and generate results at both the firm- and market-level. The dual aims would be a) to identify financial tools that are additional, non-distortionary, and do not compromise a wider market shaping agenda, while b) offering a clear incentive for investor engagement and tangible value to the investee.

— **For donors and market shaping programmes:** Review the facilitation 'toolkit' with a view to building a nuanced and pragmatic view of how to deliver financial support in a way that can directly unlock additional capital, i.e. beyond a simple challenge fund or traditional grant scheme.

- Consider using results-based financing (RBF) to incentivise investor engagement in under-served geographies and sectors, alongside market-shaping work.
- Build understanding of tools like blended finance and credit guarantees to enable informed decisions on what to include.
- Package the offer – including elements of direct financial support alongside TA and other tools – in ways that resonate with investor partners.
- Consider engaging directly with investors in outcomes-based contracts such as Impact Bonds, where PSD programmes could play the role of 'outcome payer' in order to incentivise upfront funding from investors.

[50] Gatsby Africa and The Wood Foundation Africa (2020) 'In it for the Long Haul: Transformative impact from The Wood Foundation Africa and Gatsby Africa's investments in the Rwandan tea sector'.

In practice: Using direct finance to support sector transformation

The **Uganda Sawlog Production Grant Scheme (SPGS)** (2004–date) has been cited as an important contributor to development of the commercial forestry sector in Uganda[51]. The scheme offered conditional grants alongside technical assistance to medium-scale commercial growers, with key requirements including growing trees primarily for timber and meeting certain production standards. Grants of up to 50% of establishment cost were paid retrospectively following a site inspection.

An impact investor cited the success that donor funding has had in incentivising solar home systems companies to enter new markets that are not yet commercially viable to serve, such as **D.Light's** market entry into Zambia with Swedish International Development Cooperation Agency (SIDA) support.

Recommendation #14: Re-align systems change terminology to resonate with investors

The investment and market systems worlds use two distinct vocabularies. Each is useful and relevant in its own world, but has the potential to confuse when transplanted into the other. There is a particular opportunity to reframe market systems terminology to resonate more strongly with an investor audience, and to more clearly articulate the real-world value that market shaping approaches can offer:

— **For donors and market shaping programmes:** Develop an investor-friendly glossary of key market systems terminology. Include examples of the approach in practice that 'bring it to life' for an investor audience; highlight the short-, and longer-term value proposition (i.e. around creating and protecting value); and dispel the myth that market shaping is just about long-term, intangible change. This could later be packaged as part of a future training on market systems for investment (see Recommendation 11).

In practice: Misaligned terminology and a clear opportunity

The research process highlighted that certain market systems concepts and terminology carry little meaning for the average investor. For example, the concepts of **'supporting functions'** and **'rules and norms'** – everyday terms for market systems audiences – often needed to be re-framed in terms of specifics, e.g. better quality and cheaper seeds that boost farm outputs; better and cheaper irrigation services; or more efficient export processes that improve market access.

More effectively communicating what market shaping is, and isn't, presents the opportunity to leverage investor interest, as the general principles of sector transformation and systems change increasingly resonate within the business community. This is particularly the case due to the growing recognition of the link between long-term financial success and non-financial impacts – such as on climate change. Work by William Burckart and TIIP founder Steve Lydenberg is offering institutional investors guidance and tools to broaden their sustainable investing approach to the system level[52].

[51] Calabrese, L. (2021) 'Promoting Commercial Forestry in Uganda: The Experience of the Tree Biotechnology Programme', ODI and Gatsby Africa.
[52] Burckart, W., Lydenberg, S. (2021). 21st Century Investing: Redirecting Financial Strategies to Drive Systems Change. United States: Berrett-Koehler Publishers, Incorporated.

Recommendation #15: Proactively support first-time local fund managers and experiment with new fund models

A well-documented financing gap exists for the "missing middle" – firms requiring investment ticket sizes that are too small for DFIs yet too big for donor grant programmes such as USAID's Development Innovation Ventures or other grant challenge funds and microfinance institutions. Some believe that existing impact investors should fill this gap, but as discussed in the Success Factors & Challenges section, most impact investors are also unable to make small ticket size, early-stage investments due to fund economics constraints. There is an opportunity to support the creation of more funds that can fill this gap:

— **For DFIs and donors:** First, to fully understand the fund economics challenge, conduct research that generates open-source data on the operating costs and compensation for different types of fund models. For example, gather benchmark data on due diligence and other transaction costs for equity versus debt transactions at missing middle ticket sizes, along with data on other fixed fund operating costs and revenues for different fund models, e.g. from management fees or other sources of operating budget. DFIs could draw on data from their own transactions and investee funds. This data could then inform the design and piloting of fund models with different investment processes and management fee (and carry) structures that balance striving for operational efficiency with the recognition that early stage, emerging market investors often face higher transaction and operating costs.

In practice: Supporting first-time fund managers

Investisseur & Partenaire (I&P)'s IPDEV2 initiative will sponsor 10 first-time fund managers in addressing the financing gap for African SGBs (small and growing businesses), by experimenting with new early-stage investment structures, creating permanent capital vehicles, supporting launch process and fund design, and providing anchor investments to help the fund managers close additional capital.

IPDEV2 is targeting the $50K–500K ticket size range that is underserved by existing investors. Since 2014, fund managers supported by IPDEV have raised Euro 15M and made 45 equity investments along with 43 smaller ticket size seed investments. In addition to securing DFI financing to invest in first-time fund managers, IPDEV2 also secured Euro 22M in grants from donors to provide capacity building and technical assistance to the early-stage local investment fund ecosystem.

4.2 IMPLEMENTING THE RECOMMENDATIONS: WHO, WHEN AND HOW?

The recommendations in the previous section represent a package of interconnected, mutually supportive measures, to be built up over time to drive change at scale. The intention is that stakeholders take recommendations forward – alone or in partnership – based on their own needs, capabilities and interests. This could take a variety of forms, for example adjusting day-to-day ways of working, launching pilot projects, forming new partnerships, or exploring new approaches and strategies.

This report and the subsequent dissemination activities are as much about identifying (and facilitating) opportunities for this follow-up work as they are about sharing the findings. To support this, an example high-level phasing of activities and recommendations is presented below. This is intended to put some structure behind the menu of recommendations without imposing a centralised agenda. These phases may not be strictly sequential, and some recommendations may be fast-tracked – for example in cases of particularly strong interest or institutional buy-in.

Figure 6: Example phasing of follow-on activities

Short term (Year 1)

Objectives:
Testing new ways of working and building the case for alignment

— Launch pilot projects around specific recommendations to test relevance and feasibility.

— Explore new partnerships – both with the 'other side', and around specific recommendations.

— Build early awareness and identify interested stakeholders (e.g. through dissemination of this study).

— Follow-on research to deepen the evidence base.

Specific activities:

— Quick win 1: Build stronger commercial focus into guidelines (see Rec 1).

— Quick win 2: Pilot staff secondments (see Rec 9).

— Quick win 3: Pilot crossover training (see Rec 10).

— Quick win 4: PSD develop commercially-relevant tools (see Rec 12).

— Quick win 5: Explore fund economics challenge (see Rec 15).

Medium term (Years 2–4)

Objectives:
Building traction and deepening partnerships

— Use pilot findings to further build awareness, strengthen partnerships, and expand successful pilot projects.

— Explore the opportunity to launch standalone projects to support alignment at a wider scale.

Specific activities:

— Support discussion on high-level strategic alignment among major players on both sides (see Rec 2) and joined up activities (see Rec 8).

— Build closer alignment into strategies and results frameworks (Recs 3 and 4).

— Explore opportunities for industry-wide good practice standards.

— Resources and tools further developed and disseminated (see Rec 1).

— Deepen and expand training offers and secondment schemes (see Recs 9 and 10)

— Strengthen information-sharing and coordination at country-level (see Recs 6 and 7).

Long term (Year 5+)

Objectives:
Going mainstream and getting to scale

— Support wide-scale implementation, potentially facilitated by one or more dedicated programmes and/or organisations.

— Alignment has become a default consideration for actors of all types and sizes on both sides.

— Support a deeper/richer ecosystem of development finance actors and facilitation services that channel capital into a wider spectrum of businesses and markets.

Specific activities:

— Support rollout of good practice standards and certifications.

— Support follow-on/organic innovation around new products/models on both sides.

— Assess impact of closer alignment based on data from the previous five years.

— Further mainstream results-based financing and performance metrics.

Appendices

1. Consultation list

Interviewee	Category	Contact name	Date
BII	DFI	Rehan Rashid	07-Sep-21
BII	DFI	Sarah Marchand	15-Sep-21
BII	DFI	Rabi Rayamajhi	21-Sep-21
FMO	DFI	Abi Thomson	22-Sep-21
BII	DFI	Vivianne Infante	27-Sep-21
BII	DFI	Habib Yousuf	30-Sep-21
BII	DFI	Alex Kucharski	30-Sep-21
BII	DFI	Joe Huxley	05-Oct-21
BII	DFI	Dirk Holshausen	05-Oct-21
IFC	DFI	Neil Gregory	18-Oct-21
DFC	DFI	Jesse Corradi	20-Oct-21
FCDO	Donor	Tom Sanderson	09-Sep-21
USAID	Donor	Sharon D'Onofrio	15-Sep-21
Ceniarth LLC	Private foundation	Harry Davies	08-Sep-21
LeapFrog Investments	Fund	Mike Jelinske	27-Aug-21
Triple Jump	Fund	Marnix Mulder	27-Sep-21
Root Capital	Fund	Katie Naeve	16-Sep-21
AgDevCo	Fund	Chris Isaac	20-Sep-21
Novastar	Fund	Sapna Shah	21-Sep-21
Phatisa	Fund	Robert Jenkins	22-Sep-21
Acumen	Fund	Kate Montgomery	28-Sep-21
Injaro	Fund	Mirabelle Moreaux	01-Oct-21
Dutch Fund for Climate and Development	Fund	Aart Mulder	13-Oct-21
Gatsby Africa	Funder-implementer	Justin Highstead	01-Sep-21
FSDA	Funder-implementer	Kevin Munjal	29-Sep-21
DAI	Implementer	Luqman Ahmad	28-Jul-21
Palladium	Implementer	Will Attfield	01-Sep-21
Chemonics	Implementer	Garron Hansen	02-Sep-21
Tetra Tech	Implementer	David Joiner	07-Sep-21
INVEST project (USAID/DAI)	Project	Robin Young	17-Aug-21
Market Systems and Partnerships (USAID/DAI)	Project	Daniella Maor	14-Sep-21
Business Engagement Support Unit (DFAT)	Project	Tim Stewart	23-Sep-21
Manufacturing Africa (FCDO)	Project	Julia Kraetke	06-Oct-21
Open Capital	Service provider	Annie Roberts	25-Aug-21
Tandem	Service provider	Gareth Davies	13-Sep-21
CrossBoundary	Service provider	Paul Ouma	01-Oct-21
ISF Advisors	Service provider	Dan Zook	26-Oct-21
ODI	Think Tank	Alberto Lemma	24-Sep-21

2. Long list of case examples

Case example	Sector	Geography
Aceli Africa	Agriculture	Africa
African Clean Energy (ACE)	Energy	Africa
Alliance for Inclusive and Nutritious Food Processing (AINFP)	Agriculture	East & Southern Africa
Australia-Indonesia Partnership for Rural Incomes through Support for Markets in Agriculture (AIP-PRISMA)	Agriculture	Indonesia
Catalysing Economic Growth in Northern Nigeria (LINKS)	Multiple	Nigeria
BII's "Economic Enablers" & "Catalysing Markets" frameworks	Multiple	Global
Encourage Capital's 'Solutions Investing'	Multiple	Global
Gatsby Africa aquaculture programme	Aquaculture	East Africa
Gatsby Africa & the Wood Foundation's Rwanda Tea Sector programme	Tea	Rwanda
Growth and Employment in States: Wholesale & Retail Sector (GEMS4)	Multiple	Nigeria
IFC and World Bank Country Private Sector Diagnostics	Multiple	Global
Improving Market Systems for Agriculture in Rwanda (IMSAR)	Agriculture	Rwanda
Investisseur & Partenaire's I&P Développement 2 (IPDEV2)	Financial	Africa
Kuza Youth Employment Programme	Multiple	Kenya
Manufacturing Africa (formerly Invest Africa)	Manufacturing	Africa regional
Nepal Invests	Multiple	Nepal
Northern Uganda: Transforming the Economy through Climate Smart Agribusiness (NU-TEC)	Climate, agriculture	Uganda
Omidyar Network's 'Returns Continuum Framework'	Multiple	Global
Partnerships for Forests (FCDO)	Forestry	Global
Power Africa	Energy	Africa
Sierra Leone Opportunities for Business Action (SOBA)	Multiple	Sierra Leone
Sustainable Urban Economic Development (SUED)	Multiple	Kenya
The Dutch Fund for Climate and Development (DFCD)	Climate / energy	Global
Uganda Off-Grid Market Accelerator (UOMA)	Energy	Uganda
Uganda Sawlog Production Grant Scheme (SPGS)	Forestry	Uganda
UN Capital Development Fund (UNCDF)	Multiple	Global
USAID INVEST	Multiple	Global
WB Lighting Global / Global Off-Grid Lighting Association (GOGLA)	Energy	Global
Yara & the Southern Agricultural Growth Corridor of Tanzania (SAGCOT)	Agriculture	Tanzania

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