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Facilitation Tool: Small-Business Expansion Sub-awards

BACKGROUND

PRIME¹ targets a population that is in transition: in and out of food security between drought cycles, and gradual movement away from pastoral livelihoods. Fragmented market systems, specifically for agricultural and livestock production inputs and support services, inhibit households from investing in better production models. Output markets are under-developed and far from producers, resulting in high transaction costs and low opportunities for value addition. Weak vertical linkages, trust, and information flow offer few opportunities for knowledge transfer and embedded services, and limit the market’s reach to more rural producers. Yet, demand for livestock and livestock products on the domestic and international market continues to rise. Unlocking this potential towards more equitable growth of small scale producers, requires significant investment in improved policies, systems, private and public market infrastructure; an opportunity for PRIME to engage in market facilitation, technical service provision and funding.

THE SOLUTION

In this remote market, the likelihood of external investors moving in or businesses expanding on their own is low. A development agency such as Mercy Corps would ideally play a facilitator’s role here in helping businesses secure capacities and finance to spur their expansion. However this is not an option for most businesses serving pastoral areas, particularly those seeking no-interest loans². Mercy Corps adapted to the situation by engaging the private sector as development partners and using sub-awards³ as co-investment mechanisms. By “buying down” no more than 50% of the risk for businesses to expand and innovate in pastoral areas, PRIME is creating a pathway to profitability and growth for specific key value chain firms, and setting an example and incentive for other investors to crowd-in to the market. For this reason, PRIME approaches sub-awards as a risk-sharing partnership.



PRIME further buys-down the risk associated with new market entry and expansion by interlinking any business investments with other project activities, thus creating a more stable and healthy consumer and producer base for companies to tap into – and conversely, sustaining outcomes for program participants to secure jobs, access to new services and buyer-seller relationships.

¹ The Pastoralist Areas Resilience Improvement through Market Expansion project is a five-year, \$62 million USAID-funded Feed-the-Future effort implemented by Mercy Corps designed to increase household incomes and enhance resilience to climate change in Ethiopia’s dryland areas. Program impact is centered on livestock productivity and competitiveness, community adaption to climate change, alternative livelihoods, and household nutrition.

² To support businesses with Muslim shareholders, the Government of Ethiopia issued interest-free banking directives in 2011. However, loan products were not available until late 2013, leaving many businesses in Mercy Corps’ target regions in a funding gap.

³ Sub-awards are given in order to create a public good, such as access to veterinary services, renewable energy sources, and feed/fodder to pastoralist households, as well as milk to increase nutrition outcomes.

A RISK-SHARING PARTNERSHIP

Competitive cost-shared sub-awards to key market actors that transparently apply for such business expansion support are a critical vehicle for advancing PRIME's market development work. Small businesses in the livestock sector and related value chains compete for cost reimbursable grants provided by PRIME to strengthen and expand their services (e.g. milk collectors, private veterinary pharmacies). These small, nascent and usually rural businesses are, through this process (and based on individual vision for growth), lifted up, legalized and equipped with capacities for further growth.

SUB-AWARD SELECTION AND AGREEMENT

Building a Business Expansion Sub-award Roadmap

As PRIME's lead implementer, Mercy Corps explored all possible sub-awarding mechanisms within USAID before selecting the most suitable. The PRIME team then developed guidelines for staff through the design of a competitive, transparent solicitation process, evaluation of business applicants, and access to sample agreement templates. Deciding which type of sub-award to use (Fixed Obligation Grant (FOG) versus cost-reimbursable grant⁴) was a point of confusion, as regulations continued to evolve within USAID. As FOGs do not allow for cost-share, PRIME decided on using cost-reimbursable grants.

Finding the Right Businesses

To be eligible for PRIME support, businesses need to be legally registered and bankable (meeting all bank requirements to obtain loans) in Ethiopia, and not be affiliated with any religious, political or anti-democratic organizations or policies. PRIME funding is applied to fixed assets, training, marketing, technical assistance and other one-off business

expansion expenses, but not operational expenses.

Beyond those stipulations, PRIME crafts each sub-award solicitation to directly support its program goals – overlaid with businesses' profitability goals and market opportunities. A number of local solicitations have been issued to-date to satisfy different project objectives and attract different types of businesses. For example, some focused the eligibility criteria on veterinary services, dairy, and renewable energy sector businesses interested in expanding (and thus increasing profits) into regions where PRIME is active and competitors are scarce.

The screening process for small business expansion grants starts with verification of the eligibility of the applicant following the published eligibility criteria. Local review committees comprised of PRIME technical staff and technical representatives of local authorities are established to review, rank the applications against the published ranking criteria, verify and decide upon viability of support. The process also involves reviewing enterprises' history, momentum, and scale and field verification/due diligence.

Mercy Corps began seeing a trend of businesses that lacked the capacity to develop coherent business plans to be eligible for support. Rather than turning them down, Mercy Corps and other PRIME partners offered technical assistance and linked those applicants with additional help to strengthen their applications. Over time, a capacity building session was built into the review process to build the skills of motivated businesses on sub-award application, compliance and management.

Best-practices Toolbox: Selection Process

- Establish review committee early so that members are familiar with the concept, objectives of the awards and selection criteria;
- Committee members should be familiar with the sector and the local context;
- Committee members should not have any conflict of interest, should be reputable and not under pressure;
- Committee members must have genuine interest for successful implementation of the proposed projects;
- Best to have 4-5 members of which maximum 25% are external to the project.

Best-practices Toolbox: Developing eligibility and selection criteria

- It is best to have multiple criteria with appropriate points that sum up to 100;
- Do not apply more than 10 criteria;
- Set a minimum number of points an application must receive to qualify;
- Remember – HISTORY – MOMENTUM - SCALE

⁴ See USAID definitions of these two types of grant mechanisms: ADS 300.

Due Diligence

PRIME staff found the process of conducting due diligence and feasibility analyses to be part art and part science. Having a strong private sector background on the PRIME team proved useful in vetting applicants and understanding their business plans using sound technical and market information. Looking beyond the pre-award compliance checklist proved essential in understanding the company's structure and capacity, particularly in cases of strong leadership and weak middle management. The entire process unfolds without persuasion to make sure that the businesses received sub-awards are market-oriented, not NGO-oriented.

The subtler aspect of these assessments emerged as a "gut check". Since sub-awards are not procuring a service (like a contract would) but rather building a partnership, the gut check is about confirming that "you'll work with us in partnership" and that the applicant knows their industry as well as it claims. Numerous interactions and on-site interviews help significantly in this regard, as do building-in a cost-sharing mechanism. For example, PRIME requires all sub-award applicants to cover at least 50% of their expansion budget and 100% of the operational cost of the expansion from their own resources or other sources of investment. If businesses offer to cover more in terms of cost sharing, they score higher in the selection ranking. This requirement set the partnership tone in the selection process. Businesses have been able to adhere to this requirement, most surpassing the minimum limit with an average of 70% of their own funding.

Sub-award Implementation

Since inception, PRIME has issued 56 small-business expansions sub-awards leveraged by \$708,673 in co-financing to generate 293 jobs. This has included competitive small business expansion grants (\$1,700 to \$20,000) to milk collection centers, feedlots,

stockyards, private veterinary pharmacies, micro solar distributors and agriculture input suppliers for job creation and service delivery.

Implementation challenges for small-business expansion grants have come in the form of delays due to local policy and imperfect business expansion enabling environment, sub-awardees' need to improve the level of administration of their business, record keeping and financial discipline.

PRIME's implementation experience has served as a reminder that businesses expand at their own pace, which is not always aligned with a donor's fiscal year. The experience also illustrates the complexity of negotiations and coordination involved in getting the sub-awards off the ground.

LESSONS LEARNED AND BEST PRACTICES

Sub-awards are private sector partnerships - and need to share costs to yield sustainable gains. A refrain in the PRIME project is to "never fund 100% of a business expansion costs and never fund operational costs for the expansion". PRIME only engages those businesses with the demonstrated cash flow or ability to meet at least 50% of their expansion and innovation costs. This pre-selects businesses that are 'healthy enough' and 'hungry enough' to be able to see demand and seize the opportunity by expanding. A minimum 50/50 split encourages an equitable balance and removes Mercy Corps from the role as "funder" and into the role of "co-investor". An ideal 70/30 split further places Mercy Corps in a catalyst role, and anchors ownership of the business' operations and success firmly with the partner.

Sub-awards benefit from systemic analysis and integration within market development programs. PRIME pre-selected its sector focus and channels for market linkages and technical support, to target and

Best-practices Toolbox: Advertising a request for Application

- Advertising needs to be in simple and understandable language;
- Invite the potentially interested applicants for clarification sessions if needed
- Use all means possible: personal communication, e-mail, SMS, printed, electronic media, announcements on information boards;
- Be aware of the time and assistance the applicants will need to develop their application.

Do not:

- Depend on only potential applicants that were recommended by outside parties;
- Persuade people/companies to apply;
- Tell potential applicants anything that is outside the rules and principles of the sub-award. NO PROMISES.

attract businesses that would expand to pastoral regions or expand within value chains. By blending financial support with technical support, business linkages, and industry networking events, like trade fairs, PRIME helped new and improved players capitalize on their marketplace and forge new deals. An example of this is the small-business expansion grants given to private veterinary pharmacies: in addition to cost-shared grants, PRIME also facilitated linkages with Community Animal Health Workers and access to business skills training.

Sub-awards require substantial internal planning to keep up with business pace. PRIME thoughtfully planned and documented the entire sub-award process to ensure identification of those private sector partners most capable of advancing its program goals. And, rather than waiting until the sub-award agreement stage to involve stakeholders, PRIME engaged a range of staff (program, finance, compliance, procurement) throughout the sub-award design and implementation process. This ensured that internally, the organization's departments were looking for creative solutions and all were clear on the sub-award's purpose and intended outcomes.

Private sector partners require support in meeting USAID sub-award regulations. Using sub-awards to catalyze business expansion comes with "strings attached" in terms of donor compliance. The majority of PRIME's private sector partners had never operated under a USAID agreement and thus had limited capacity in program and financial reporting and procurement processes. The learning curve on what it means to be a sub-awardee has been very steep for many entrepreneurs, and Mercy Corps' time investment was greater than originally anticipated.

Way forward

PRIME's sub-award activities continue to evolve, taking into account the challenges and lessons learned of past and current partnerships. Closely monitoring, evaluating, and then adapting the approach ensures that incentives are correctly aligned and that business and development impact is maximized. Having built the capacity of its implementing NGO partners, Mercy Corps is confident that cost-shared sub-awards partnerships with the private sector, in combination with other training, linkage and capacity building activities, will continue to play an important role of the development in Ethiopia's pastoral communities for years to come.

To learn more, please visit us at <https://www.prime-ethiopia.org> or contact:

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