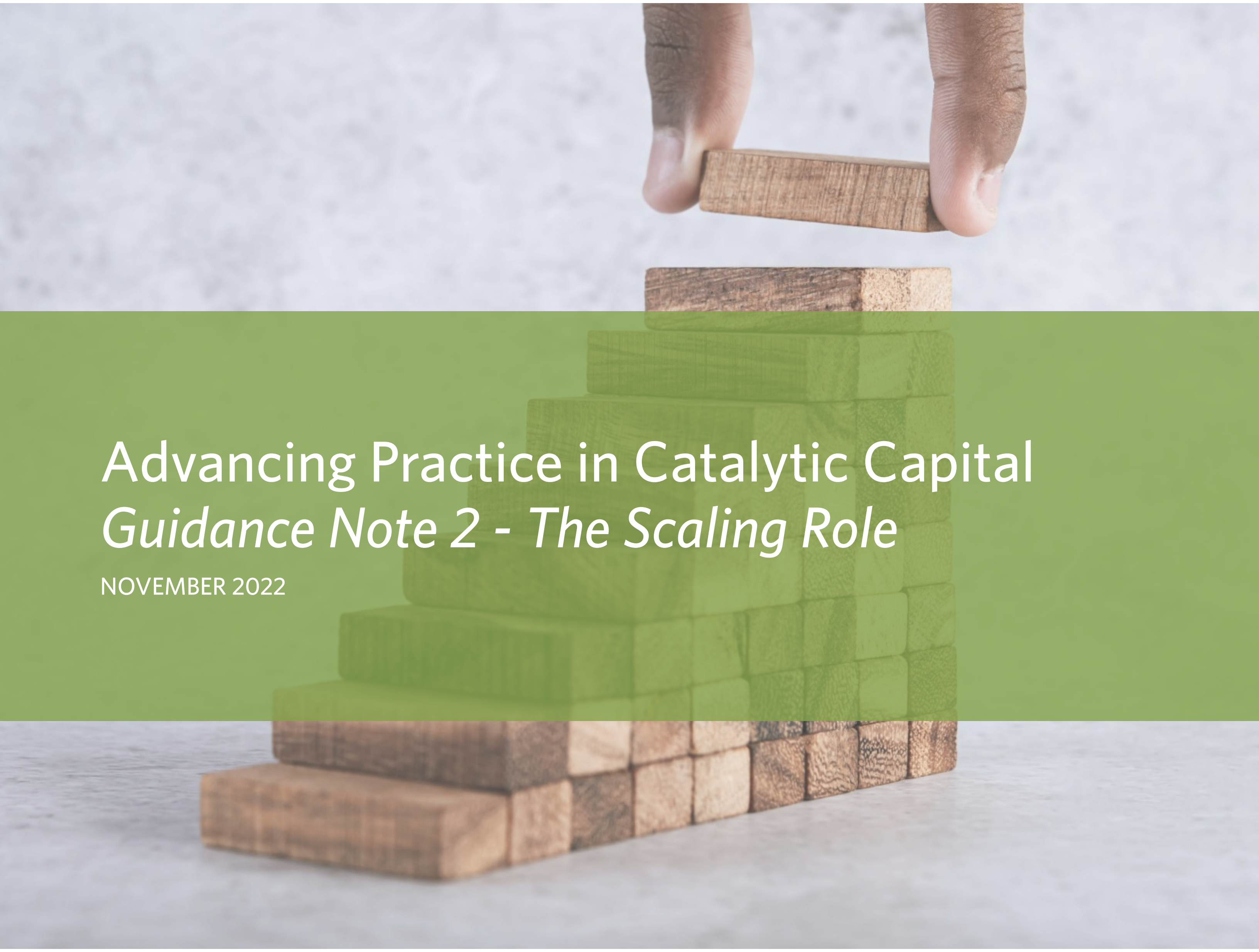
Catalytic Capital Consortium

COURAGEOUS CAPITAL ADVISORS



Advancing Practice in Catalytic Capital
Guidance Note 2 - The Scaling Role

NOVEMBER 2022

Guidance Note Series

SEEDING SCALING SUSTAINING

About Courageous Capital Advisors

Courageous Capital Advisors is an impact investing advisory firm. We believe that financial capital should be used to build a just, equitable, sustainable, and resilient society for all, our North Star. Recognizing that one size does not fit all, we tap a range of financial tools and instruments to combine different types of capital to achieve the impact objectives we seek in order to move us closer to our North Star.

Learn more at www.courageouscapitaladvisors.com.

This work has been commissioned and funded by the Catalytic Capital Consortium (C3), an investment, learning, and market development initiative to promote greater and more effective use of catalytic capital, in recognition of its essential role in realizing the full potential of the impact investing field and achieving the Sustainable Development Goals.

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FOREWORD

The Catalytic Capital Consortium (C3) is excited to continue its partnership with the Courageous Capital Advisors team on the development of this guidance note, which we hope will provide valuable information and insights to both new and experienced catalytic capital investors. C3 is an investment, learning, and market development initiative to promote greater and more effective use of catalytic capital, in recognition of its essential role in realizing the full potential of the impact investing field and achieving the Sustainable Development Goals. Together, the C3 Strategic Partners - The Rockefeller Foundation, Omidyar Network, and the MacArthur Foundation - are supporting field-building work through the C3 Grantmaking Program, housed at and managed by the New Venture Fund.

C3 Grantmaking works to advance learning and market development related to catalytic capital and helps to answer critical questions about the scope of the need for catalytic capital, when and how catalytic capital can be most effective, and what tools and practices are needed. It does this through activities aimed at strengthening the evidence base, advancing the practice in the field, communicating and facilitating engagement among investors, and fostering solutions and infrastructure. Learn more about the various C3 Grantmaking workstreams here.

This is the second in a series of three publications, emerging from conversations with experienced catalytic capital providers (styled as "Learning Labs") and fund managers, all of whom generously shared their insights, experiences, and expertise with us over several months. This document attempts to capture many learnings pulled out of these conversations relating to creative approaches for navigating implementation challenges and crafting success strategies when deploying catalytic capital. Each publication focuses on one of the three "roles" catalytic capital can play when supporting an investee, as delineated by Tideline in 2019: Seeding, Scaling, and Sustaining. This second document focuses on the Scaling role, wherein catalytic capital is deployed to funds or enterprises to help them realize economies of scale and reach new geographies and population segments, creating "multiplier effects". In this role, catalytic capital can also de-risk and leverage investment from other investors.

We hope this offering helps catalytic capital providers incorporate some of these practices into their own investment activities. We also aspire to drive greater awareness and understanding of catalytic capital in action and spur additional conversation in the field to surface other ways catalytic capital can be utilized more effectively, efficiently, and in service of deeper impact.

The last guidance note in this series, focusing on the Sustaining roles, will be released later in 2022. It comes in the midst of considerable activity on various projects as C3 Grantmaking's Evidence Base partners begin to work on final reports to share with the field, as well as ongoing engagement around the third Learning Lab which will yield our final guidance note. We launched our LinkedIn presence this summer and are steadily sharing updates and news with our growing online community. We are also looking forward to engaging with the broader catalytic capital community in different ways through the coming months. To stay in the loop as these additional resources are released and to learn about future opportunities to connect with C3, please sign up to receive updates and announcements through our newsletter. We are excited to see the momentum in efforts all around us, and encouraged to partner with others that are taking on this important work in pursuit of a more just, equitable, and resilient world.

Urmi Sengupta

Urmi Sengupta

Chair, Project Advisory Board

INTRODUCTION

Impact investing is now part of the investing mainstream. Major financial services institutions have entered the field, and size estimates of the sector range from $715 billion[1] to $2.3 trillion[2]. Yet while much has been achieved, numerous opportunities to deliver impact still fail to attract investment.

Significant capital gaps remain, particularly for opportunities that are new and unproven, are sub-scale, or entail more challenging risk-return profiles - often targeting particularly poor and marginalized communities and geographies. Capital gaps such as these, and the underserved impact opportunities they represent, are where catalytic capital plays a critical role in advancing the frontiers of impact.

Catalytic capital, as defined by Tideline, is capital that "accepts disproportionate risk and/or concessionary return to generate positive impact and enable third-party investment that otherwise would not be possible".[3] **Catalytic capital is needed to ensure that impact investing pushes farther, harder, and faster to help build a more equitable and sustainable future.** Put another way, continuing to grow impact investing without catalytic capital runs the risk of leaving those who are most vulnerable behind, reinforcing societal inequities, and failing to deflect the current trajectory of catastrophic climate change.

Taking up this important challenge is a growing community of catalytic capital investors that are striving to advance the practice. How can catalytic capital move more quickly and effectively into impactful opportunities? How can it best mobilize other capital in that process? How can it better meet the real needs of people and planet in pursuit of impact that could not otherwise be achieved? These are some of the questions we seek to address through this guidance note, with the aim of strengthening and accelerating the catalytic capital investing practice across the field.

About This Document

This guidance note is intended as a practical resource for catalytic capital investors to reflect on and advance their practice in deploying catalytic capital. The guidance note is not primarily intended to make the case for catalytic capital, nor to describe the many ways in which it has been deployed in the past or could be in the future. **The central focus of this work is to help investors who are already active in deploying catalytic capital (or have set an intention to do so) to**

1 Global Impact Investing Network (2020) 2020 Annual Impact Investor Survey

2 International Finance Corporation (2021) Investing for Impact: The Global Impact Investing Market 2020

3 Tideline (2019) Catalytic Capital: Unlocking Investment and Impact

address and overcome the practical challenges of catalytic capital deals, in order to improve the effectiveness, efficiency, and integrity of catalytic investment activity.

It is the **second of a series of three** such notes, each of which focuses on one of three roles of catalytic capital - Seeding, Scaling, and Sustaining - as set out by Tideline[4] and explained further in this document. Although this second guidance note specifically addresses the **Scaling** role, many points made in this note have wider relevance beyond Scaling (or even beyond catalytic capital).

While this series focuses on **indirect investment** (i.e., investors deploying capital into funds and other indirect investment vehicles or platforms), we expect that much of the discussion is also relevant to direct investment.

Each note in the series seeks to unearth key challenges and barriers to the effective deployment of catalytic capital and lays out several practical responses, accompanied by **examples** of approaches and tools used by experienced catalytic capital investors. In this second guidance note, we also introduce a number of tangible **ideas** that have surfaced in response to the challenges, and the beginnings of an annotated term sheet with a catalytic capital lens. We invite the reader to engage with the content in the spirit of advancing the practice of catalytic capital investing.

This note has been developed based on invaluable input from and discussions with leading practitioners in the Scaling role of catalytic capital. Specifically, the authors wish to acknowledge the significant contribution of the following individuals and organizations who participated in the **C3 Scaling Learning Lab Series**, a sequence of in-depth peer-learning discussions among a group of experienced catalytic capital investors organized and led by Courageous Capital Advisors, in early 2022:

- **Adam Connaker**, *former* Director, Innovative Finance, The Rockefeller Foundation
- **Dia Martin**, Managing Director, Office of Development Credit, DFC
- **Gareth Zahir-Bill**, Director of Operations, Shell Foundation
- **Greg Neichin**, Managing Director, Ceniarth
- **John Balbach**, Director, Impact Investments, John D. and Catherine T. MacArthur Foundation
- **Kevin McGahan**, Chief Financial Officer, Sierra Club Foundation
- **Mireille Perrin**, Global Program Manager, Good Energies Foundation
- **Osaruyi Orobosa-Ogbeide**, Senior Vice President, Project Development & Investments, Africa Finance Corporation
- **Pranab Ghosh**, Principal Investment Officer, IFC
- **Ronie Mak**, Managing Director, RS Group
- **Stefan W. Hirche**, Principal Portfolio Manager, KfW
- **Ward Nusselder**, Investment Officer Energy - Eastern and Southern Africa, FMO

We also thank the following investment managers for providing vital input and perspective to this process in order to ensure that the challenges discussed reflect the experiences of managers:

- Africa Finance Corporation
- Azolla Ventures
- BlueOrchard
- CrossBoundary
- International Housing Solutions
- NatureVest
- New Forests
- responsAbility
- SIMA
- SunFunder
- Triple Jump

We would note that the C3 Scaling Learning Lab Series adopted a "climate action" theme to provide a focal point for discussions, and readers will see this reflected in certain parts of this guidance note, in particular with respect to deal examples used. At the same time, we believe that the transaction challenges and responses illustrated can be extrapolated beyond this theme to any investments, funds and managers that seek to scale through the effective use of catalytic capital.

[4] Ibid

THE SCALING ROLE OF CATALYTIC CAPITAL

Setting the Scene: the Roles of Catalytic Capital

This guidance note addresses **Scaling**, the second of the three roles of catalytic capital as outlined in Tideline's 2019 report[5]. It is important to note that the three roles of Seeding, Scaling and Sustaining were used as a tool in framing our Learning Lab discussions and to organize this guidance note series.

We encourage the reader to review each guidance note in this series. To help the reader navigate the series, we include in this second note the following icons to highlight how specific challenges compare to the ones discussed in the first Seeding guidance note (*see* Advancing Practice in Catalytic Capital: Guidance Note 1 - The Seeding Role):

=	≈	≠
Largely the same	Difference in nuance	Different in kind

= The challenges are **largely the same** (allowing the reader to see patterns; please note that the discussion may draw out particular features for Scaling and include different examples)

≈ The challenges are similar but have a **difference in nuance** or point of emphasis

≠ The challenges are **different in kind**.

The ***Scaling*** role comes into play after pioneering fund strategies and investment managers demonstrate early success. Scaling funds or investment vehicles aim to achieve significant "multiplier effects". These multiplier effects can apply both with respect to progression and growth of the underlying investees or the manager itself; they can also be associated with the maturation of the investment strategy and the mobilization of capital within a blended capital structure (*see below under The Multiplier Effects*). As the track record of Scaling funds may be limited, their size subscale, and the markets they play in relatively underdeveloped, they often struggle to attract general impact as well as commercial capital. Catalytic capital is needed to help strategies and managers expand, with the aim of achieving the necessary size and track record so that further catalytic capital support is no longer required.

[5] Ibid

The previous guidance note in this series addressed the ***Seeding*** role, which precedes Scaling. Seeding is often the starting point where catalytic capital is deployed in investment vehicles that have novel aspects to their pursued strategies, innovative structures or instruments, or that are run by a new investment manager (so-called “first-time fund manager”, or a manager with limited track record). These vehicles typically involve a high level of uncertainty - in particular lack of performance data, comparables, and proof points with respect to the new aspect of the transaction - which makes it difficult to attract investment. Here, catalytic capital enters where others fear to tread, supporting nascent solutions and thereby seeding a range of impact opportunities for the future.

Meanwhile, the ***Sustaining*** role of catalytic capital (to be covered in the third guidance note in our series) responds to an ongoing (i.e., long-term) need for investments that accept concessional returns or disproportionate risk to serve hard-to-reach people and places and strategies for which full commercial viability cannot be envisaged within the foreseeable future.

In the Seeding and Scaling roles, the need for catalytic capital is considered **transient** - that ultimate success is about closing the capital gap at the market level so that mainstream impact or even fully commercial investors can pursue similar opportunities down the line without the involvement of catalytic capital (*for more see below in the following chapter*).[6] In contrast, the Sustaining role typically assumes that the capital gap is **structural**, meaning that it is anticipated to persist in the longer term.

OVERLAPS BETWEEN SEEDING, SCALING AND SUSTAINING

Transaction design and execution often blur the lines between the three roles of catalytic capital - Seeding, Scaling and Sustaining - and many transactions **integrate elements of more than one role** in the same structure. For example:

- There could be a follow-on fund (Scaling) that adds novel elements to a strategy (Seeding), for example the Access to Clean Power Fund (*described below on p. 12*); or
- A fund could integrate both transient and structural capital gaps, the first expected to be reduced over time as the strategy matures and track record increases (Scaling), but with a remaining structural gap to persist in the long term due to underlying risk-return elements (Sustaining).[7]

Similarly, **many catalytic capital investors invest across the roles** and do not explicitly delineate between them; to illustrate the point, two of the investors in our Seeding Learning Lab have also participated in our Scaling Learning Lab.

While acknowledging these limitations, we suggest that the delineation of these three roles continues to provide a set of convenient entry points for investors to join the catalytic capital discussion and for insights to be shared in the interests of advancing the practice of catalytic capital investing.

6 The need to bridge these transient capital gaps in impact investing has been documented significantly over the past decade, including work by Monitor/Acumen on the challenge of the pioneer gap, and by Omidyar Network on priming the pump by taking a sector-based approach. More recently, Omidyar Network, FSG and ImpactAlpha have curated perspectives from leading impact investors (including the Ford Foundation, Prudential Financial, Big Society Capital and Blue Haven Initiative) articulating why and how they deploy flexible capital to bridge these gaps.

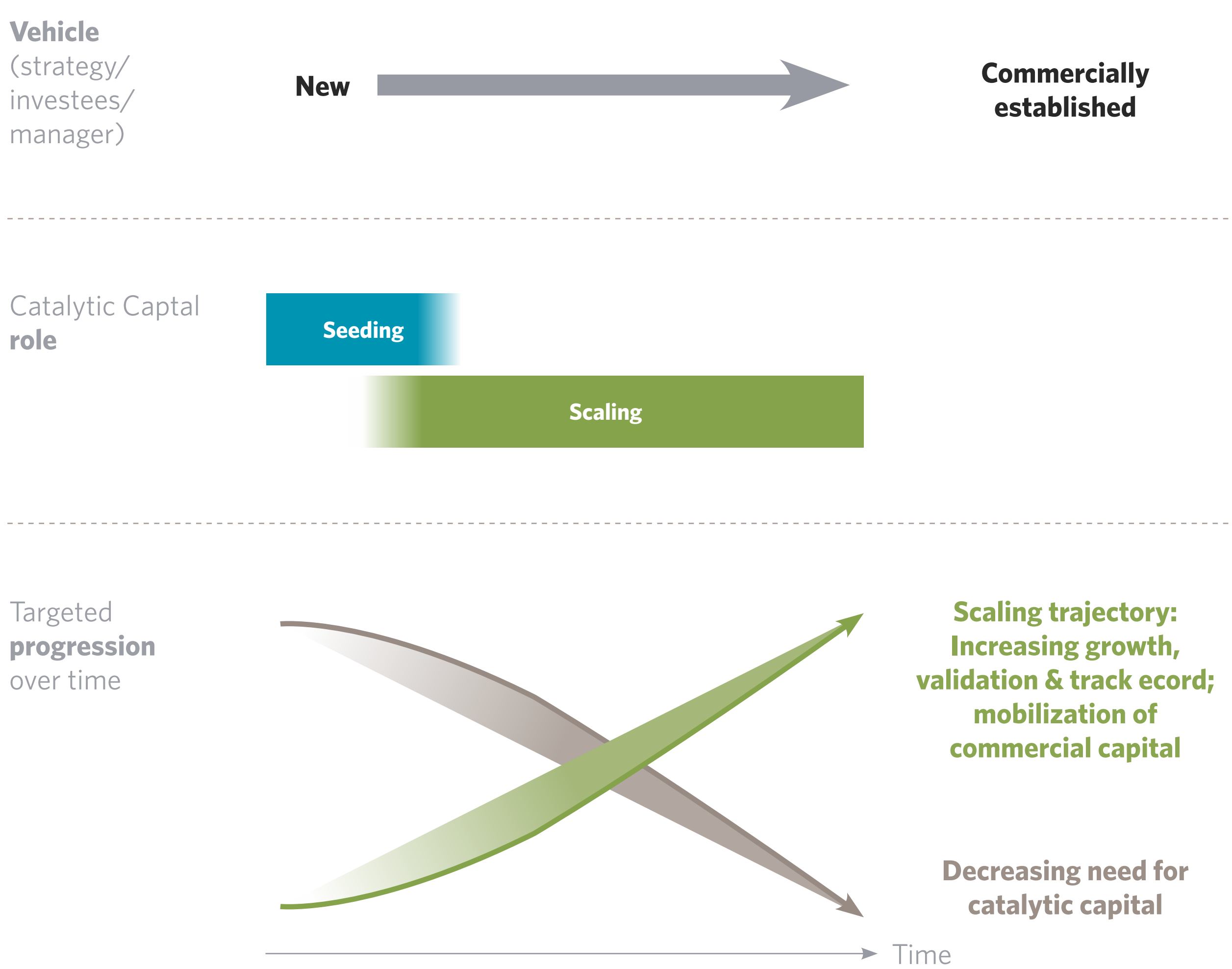
7 This delineation is often found in the evolution of financial inclusion strategies, be it in the US with CDFIs or internationally with microfinance institutions.

Closing the Transient Capital Gap

The progressive closing of a transient capital gap is a key expectation in the Scaling role. Over the course of what might be described as the "**Scaling trajectory**", an impact vehicle would ideally transition from being nascent to being commercially viable. Along the Scaling trajectory, vehicles will be able to raise increasing volumes of private commercial capital, while gradually reducing their reliance on catalytic capital.

It is a central thesis of Scaling that once com-mercial investors engage and become familiar with investment strategies, sectors and geographies, and once there is sufficient available track record and performance data to support their underwriting, funds active in these areas - or at least segments thereof - are expected to ultimately no longer need catalytic capital support. This progression is illustrated in Figure 1 below.

FIGURE 1: PROGRESSIVE CLOSING OF THE TRANSIENT CAPITAL GAP



As shown in Figure 1, both the increasing Scaling trajectory and the decreasing catalytic capital trajectory (both being merely illustrative) unfold over time and involve multiple steps. Solutions do not suddenly blossom into commercial maturity as soon as they have been tried once. The slope of both trajectories varies from case to case, (*for more detail see Appendix 1: Explaining the "Scaling trajectory"*) and they do not follow immutable laws or fundamental forces: there are numerous obstacles along the path and there is no guarantee that a progression will take place. In particular, managers at the beginning of the Scaling progression often struggle to attract capital to their funds, whether catalytic or commercial, even where they have demonstrated initial success. Key reasons include:

- ✓ Their **track records** may still be limited in the eyes of investors, with only a few years of performance data available. While Scaling vehicles typically benefit from the existence of some performance data, the availability of comparables and proof points tends to increase as funds move along the Scaling progression;

- ✓ Their **fund sizes** may be still subscale, below or just at the threshold where private institutional investors start showing interest; or

- ✓ The targeted **market** (in terms of geography, sector and/or segment) may be perceived as relatively underdeveloped, with a focus on unfamiliar and emerging sectors and/or relatively early-stage enterprises within a market.

The lack of smooth and predictable progressions highlights the **need for catalytic capital beyond initial signs of success and viability and the importance for it to continue through the Scaling process.** The need for such support should be expected to decline, not overnight but by degrees over time. Catalytic capital investors in the Scaling role should adopt a reasonable view of the timeframe for this trajectory and the factors that affect its slope. This may require a willingness and stamina to participate in multiple transactions and funds to help advance solutions, sectors and markets through to commercial maturity.

The Multiplier Effects

Scaling vehicles aim for significant *multiplier effects*, with the clear intention to:

1. Replicate and scale **enterprises and business models at investee level**;

2. Replicate and scale (somewhat) **tested investment strategies** (e.g., follow-on funds);

3. Scale **fund managers** as they expand their existing or venture into adjusted or adjacent strategies (e.g., target geographies, target population segment, instruments used, etc.); and/or

4. **Mobilize private commercial capital** for the vehicle and an underlying strategy or sector.

These four multiplier effects are *not* mutually exclusive, and many Scaling vehicles combine elements of more than one. In particular, the fourth effect, capital mobilization, is a key enabler within many funds that intentionally pursue multiplier effects at the enterprise, strategy or manager level, often through **blended finance structures**. These play an important bridging role in progressing strategies, vehicles and managers beyond Seeding to ultimately a scaled, mainstream vehicle.

> "
> The lack of smooth and predictable progresssions highlights the need for catalytic capital."

	MULTIPLIER EFFECTS			
	ENTERPRISES AND BUSINESS MODELS	INVESTMENT STRATEGIES	FUND MANAGERS	MOBILIZATION
WHAT IS BEING SCALED	Enterprises and business models are progressed from early to growth stage or even maturity. This progression could also be viewed at a sector or market level	Strategies are progressed from innovative or niche to tested and familiar. This progression could also be viewed at a sector or market level	Managers are progressed from new to established and viable	Crowding in private commercial capital, in particular through blended finance structures
HOW SCALE IS ACHIEVED	Allowing enterprises to prove their strategies and business models, increasing performance track record and proof points; Debunking risk perception; Allowing enterprises to grow to size	Allowing strategies to build performance track record and proof points; Debunking risk perception; Proving opportunity and market demand for the product or service	Allowing managers to build performance track record; Increasing manager's assets under management (AUM)/ size and economic sustainability	Attracting increasing amounts of commercial capital into fund strategies, sectors and fund managers
TARGETED OUTCOMES (OVER TIME)	Enterprises that can attract commercial funding	Robust and familiar strategy that is investable by mainstream investors	Sustainable and experienced manager that mainstream investors can underwrite	Significant participation of private commercial capital
DEAL EXAMPLE	**Energy Entrepreneurs Growth Fund:** Triple Jump's fund pursues explicitly the "missing middle" funding gap faced by second-generation access to energy (A2E) enterprises to help them scale in size and to a level of maturity at which they become investable by commercial investors. Progression of the overall A2E sector is an explicit aim for EEGF	**InsuResilience Investment Fund Private Equity II:** the BlueOrchard-managed follow-on fund builds on IIF PE I's experience, leveraging the continuous support of KfW on behalf of the BMZ[8], as junior capital provider, expanding the adoption of the strategy. Scaling the insurance segment within climate adaptation is an aim for IIF PE II	**IHS Fund II SA:** next to scaling its affordable housing strategy, the fund also allows International Housing Solutions to grow as a specialist manager, addressing a market gap for affordable housing in Southern Africa	**SunFunder Gigaton Empowerment Fund:** SunFunder's fourth fund is seeking significant scale with a target size of $500 million and introduces a new "super-senior" notes tranche (~50% of the targeted fund size) that specifically targets private institutional investors

[8] KfW being the Kreditanstalt für Wiederaufbau, the German DFI, and BMZ the German Federal Ministry of Economic Cooperation and Development.

These multiplier effects are the pathways to significantly amplify the magnitude and reach of impact solutions that can respond effectively to key challenges faced by people and planet, and the corresponding need to mobilize the volumes of private commercial capital required to fuel those expansions. **Without the support of Scaling catalytic capital, many effective solutions are doomed to remain niche.** They will not be able to generate the magnitude of positive impact ultimately needed to build a more inclusive and sustainable world for all.

Example Sector: Access to Energy

One example of a sector that is Scaling within the climate action theme is the access to energy (A2E) market. This sector has been an important impact theme for the last several years, particularly in Africa, where the energy access challenge is acute: across Sub-Saharan Africa, about 580 million people lacked access to electricity in 2019. During the last decade, the off-grid solar (OGS) A2E industry has been steadily on the rise, achieving a $1.75 billion market turnover in 2019.[9] According to GOGLA, the off-grid industry association, OGS revenues grew at 30% annually from 2017 to 2019, and at present the sector serves 420 million users.

Despite this growth, there remains a substantial untapped market opportunity, "with 840 million people without electricity access, over 1 billion connected to an unreliable grid, and over 70 million farmers who could leverage OGS for productive use".[10]

Though the A2E sector has evolved considerably, it includes only a handful of relatively sizable and mature companies, which attract a substantial part of the available investor funding. Most enterprises in the sector remain early-stage, and they continue to struggle to find suitable financing.

For example, in 2020, 75% of all commitments went to the top three A2E recipients.[11] This concentration demonstrates the need for catalytic capital to close the prevalent financing gap and allow the sector to scale. Catalytic capital can allow earlier-stage enterprises to grow to a maturity level that makes them investable by impact and commercial capital without further need for catalytic capital.

responsAbility and SIMA are two examples of managers that started more than five years ago with their first A2E debt funds and are now scaling their strategies with follow-on funds.

9 EA (2020) World Energy Outlook 2020

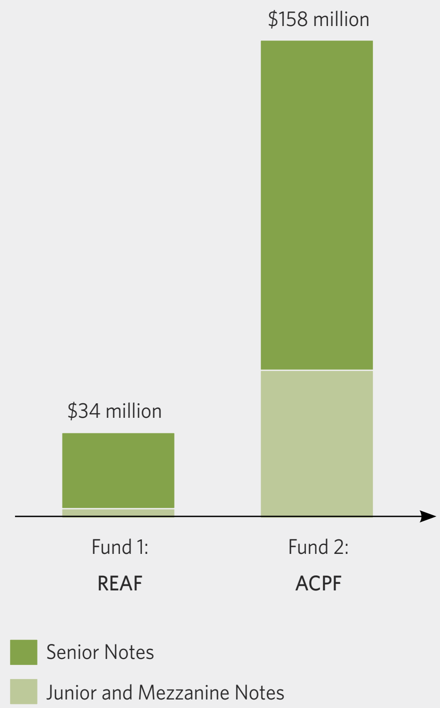
10 GOGLA (2020) Off-grid solar investment trends 2019-2020

11 Ibid

responsAbility – **SCALING ITS A2E STRATEGY**

responsAbility started engaging in the A2E sector in 2015 with its first debt fund, the **responsAbility Energy Access Fund** (REAF). The $34 million fund provided working capital to companies selling access to clean energy solutions to underserved populations across Sub-Saharan Africa and Asia Pacific. The aim was to bridge the gap toward more universal access to modern energy by providing debt financing to entities operating across the entire value chain. REAF had a blended layered capital structure, with 12% of junior first-loss and mezzanine capital supporting 88% of senior debt.

responsAbility's second fund in the sector, the **Access to Clean Power Fund** (ACPF), raised $158 million. Launched in December 2019, the fund pursued the same core strategy as REAF but with an extended scope, including also the commercial and industrial (C&I) market segment as well as other energy value chain segments and addressing the evolution of the overall sector and of market demand. Further, while keeping the primary focus on Sub-Saharan Africa and Asia, the manager extended the second fund's geographic scope to opportunistically include other emerging markets. ACPF also has a blended structure, whereby a higher percentage (compared to REAF) of junior first-loss and mezzanine support is provided to the senior layers, the increase in credit enhancement being driven by many factors, including the increased scale of the fund and how the overall risk profile of the investment strategy was perceived by selected investors.



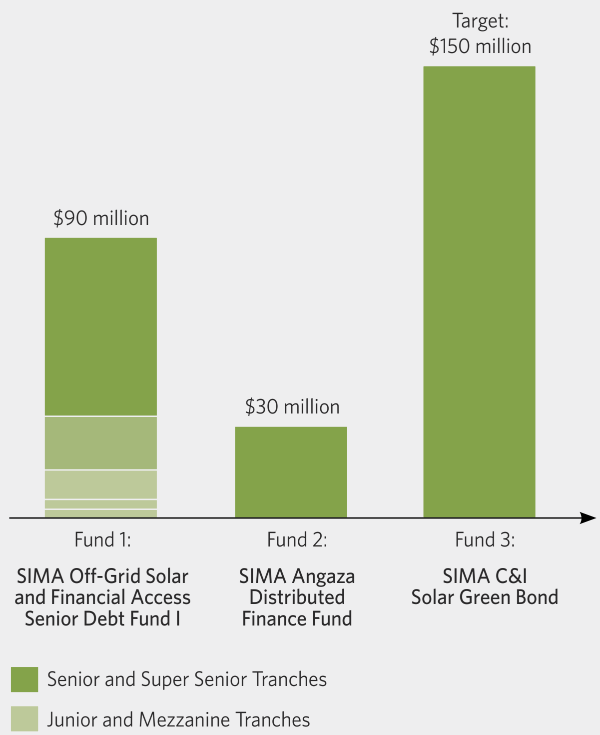
SIMA – **EXPANDING ITS A2E STRATEGY AND SCALING THE MANAGER**

SIMA has been active in the A2E market since 2017, when it closed its $90 million **Off-grid Solar and Financial Access Senior Debt Fund**. At the time, it was one of the largest in the OGS market, providing senior debt to solar home system enterprises and investing in financial access for end-users to purchase energy products. The fund had a blended structure, providing credit enhancement to senior tranches.

The manager followed its first fund with the $30 million **SIMA Angaza Distributed Finance Fund** in 2019, a cooperation with Angaza, a software developer. The fund provides debt financing to clean energy distributors across emerging markets, leveraging Angaza's PAYG[12] software and proprietary score cards.

SIMA also won the mandate for the **Energy Access Relief Fund**, a $90 million fund which has already approved 85 loans, some as low as $100k. SIMA expects to make more than 100 loans through the use of an innovating underwriting approach.

SIMA's recent endeavor in the A2E space is its **C&I Solar Green Bond** (Green Bond), currently in the market. It advances and extends SIMA's A2E investment strategy to solar commercial & industrial projects, the fastest growing sector within the solar industry. SIMA's Green Bond is focused on creating a sub-sector that caters to smaller projects and local developers with the objective of making systemic change focusing on local developers. The intention is to provide them with relevant funding, covering both shorter-term needs (like working capital, inventory finance, or the bridging of equity) and longer-term project finance capital. The credit profile of the bond is expected to be strengthened by a reserve fund, guarantee support and a clawback on part of the management fees.



The Energy Entrepreneurs Growth Fund (EEGF) is pursuing a slightly different multiplier effect. Managed by Triple Jump and advised by Persistent Capital, the fund is focused on scaling investee enterprises. The strategy explicitly targets second-generation, earlier stage enterprises, supporting their growth into investable businesses and, ultimately, the development of a healthy and sustainable sector.

[12] Pay-as-you-go

Triple Jump – **SCALING 2ND GENERATION A2E ENTERPRISES**

The **Energy Entrepreneurs Growth Fund** (EEGF) was initiated to address the funding gap experienced by Shell Foundation A2E partner grantees and by FMO. It was designed together with fund manager **Triple Jump** and its advisor **Persistent Capital** to offer the full range of financing solutions to second-generation A2E companies, with a focus on mezzanine capital to provide non-dilutive flexible financing and a cushion for senior debt. In addition to capital, the fund offers hands-on "engine room support"[13] to address investees' operational pain points typical to A2E businesses, seeking to optimize efficiency and allowing for data-driven decision making. The fund's holistic offer of tailored patient growth capital plus engine room support intends to enable early-stage enterprises to grow to the next level of maturity.

EEGF also illustrates how a fund can integrate several catalytic roles: while the fund seeks to Scale enterprises, its flexible combination of instruments with a particular focus on mezzanine structures, is relatively new in the sector, adding a Seeding element.

All three example funds have faced - and continue to face - strong headwinds in raising capital. Being assessed as too small, too risky, and too early-stage are just some of the challenges reported by the managers on their fundraising journey. The fact that they only have limited track records, both with respect to their strategies and the underlying enterprises and sector, is a major challenge. And while there is data available, it is often in the hands of a few investors and not available to the wider market.

These examples reflect broader continuing hesitation from most private commercial investors to commit to such funds, underscoring the need for more catalytic capital to help propel these funds along their Scaling trajectory.

[13] With its "engine room support", Triple Jump and Persistent Capital provide hands-on support to investee companies in areas of day-to-day operations, including, amongst others, strategy and business development, financial management, IT and data systems, internal processes, governance and human resources.

Getting Catalytic Capital Flowing

Catalytic capital investors in the Scaling role have the potential to mobilize the quantum of capital needed to achieve meaningful and lasting change in the world, with the theme of climate action as one of the most visible near-term opportunities. They have a window of opportunity to seize current momentum and move commercial capital off the sidelines and toward impact, whether in climate action or across the many other sustainable development themes and sectors.

While the potential scale of investment and impact is truly exciting, there are many challenges in the way of its realization. To begin with, managers often struggle to attract capital, and scarce catalytic capital in particular. As many Scaling vehicles have a blended structure, managers face the amplified challenge of finding and attracting the right investors for each of the capital tranches. It is by and large left to them to do the heavy lifting in forming an investor group that works, from the initial outreach down to plugging the last gaps in their respective structures.

Even once investors have been gathered, weaving them together through structuring, due diligence and legal negotiations can end up being a long and convoluted process. As a result, managers face delays and often fail to achieve their target fund size. They are unable to deploy their capital with the speed and urgency required and frequently fall short of their original Scaling objectives. Delays in Scaling funds - getting them off the ground or getting them to the size intended - ultimately means that the large amounts of money held by commercial investors continues to sit on the side lines.

It is vital that the catalytic capital community addresses these challenges and works to get capital flowing as it should: effectively and efficiently. This recognition - and the motivation to break through challenges - is the common spark that fostered collaboration among the investor participants in the C3 Scaling Learning Lab.

In the next four sections, we will set out some key challenges, suggested responses and possible approaches, informed by our in-depth discussions with Learning Lab participants and Scaling fund managers. As such, these materials are grounded in the experience of practitioners and reflect a shared ambition to work better, faster, and smarter going forward.

The challenges and responses are grouped under the following headings, which we organized by specific investment process elements. They describe aspects of investor behavior that demonstrate the intention and spirit of catalytic capital:

A. STRATEGY: determining strategic objectives and parameters for the use of Scaling catalytic capital and building a community of practice

B. UNDERWRITING: approaching underwriting of Scaling transactions effectively and efficiently for all

C. CAPITAL-RAISING: supporting the Scaling capital-raising process toward a successful and timely conclusion

D. STRUCTURE & TERMS: designing an efficient Scaling structure and enhancing terms negotiations

"While the potential scale of investment and impact is truly exciting, there are many challenges in the way of its realization... This recognition - and the motivation to break through challenges - is the common spark that fostered collaboration among the investor participants in the C3 Scaling Learning Lab."

A STRATEGY

CHALLENGE SUMMARY

Investors often fail to clearly articulate their objectives for Scaling catalytic capital, either internally or with respect to clear communication to the market. Similar to the discussion in the Seeding guidance note, this can result in internal process frictions, external market confusion or both.

Uncertainty about risk-return appetites and decision-making parameters forces fund managers to spend unnecessary time and effort finding the right investors for their funds' risk proposition, even more in situations that involve a layered blended structure. Even when clear, investor objectives and underlying parameters are often too narrowly defined and applied.

In addition, many catalytic capital investors are searching for "new" strategies or propositions, and there is often diminished interest in follow-on investments that promise scale.

And investors tend to operate in individual siloes, with limited strategic coordination and cooperation with other investors and little transparency to the market. This lack of open engagement is a consistent experience, as set out also in the Seeding guidance note.

In summary, these challenges slow down individual deals, the development of emerging strategies and the general advancement of the catalytic capital community.

1 CLARITY IN STRATEGIC OBJECTIVES AND PARAMETERS ≈

Specific Challenge

There is often a lack of clarity on the strategic objectives and parameters of investors for their catalytic capital investing, as also explained in the Seeding guidance note. With respect to catalytic capital deployed to advance Scaling, a clear articulation of the multiplier effect(s) sought by investors is often missing. *Internally*, such lack of clarity can lead to a disconnect within an investment team and also, importantly, between teams of an organization (e.g., investment team, impact team and risk / investment committee). It may also exist *externally* with respect to communication or publication of the institution's objectives and parameters to the market.

Approaches

Effective deployment of catalytic capital begins with a **clear articulation of objectives**: *what* is the catalytic capital seeking to achieve? This question should be asked for all catalytic capital activity across the three roles (Seeding, Scaling and Sustaining), providing clarity on whether an investor pursues all or a subset of roles, and specify potentially different objectives depending on the role (e.g., is there a particular interest in Seeding new managers? Or are there Scaling capital mobilization targets?). Specific questions that need clarifying in the context of Scaling transactions and the multiplier effects are *outlined in the box below.*

QUESTIONS CLARIFYING SCALING OBJECTIVES

What specific questions need clarifying for Scaling transactions within the **framing of the multiplier effects**?

- What is the catalytic capital supposed to scale: a business model, a sector, a manager universe?
- Does the investor seek to lead a particular sector to scale, driving the development and evolution of a sustainable market or theme (e.g., A2E sector or gender theme)?
- Is the objective to scale a certain enterprise type (e.g., tech companies or simply SMEs) or a certain manager universe (e.g., local managers or managers representing underserved communities)?
- Is the investor's main scaling driver attracting private commercial capital, and if so, is there a certain leverage multiple expected?
- Or is it a combination or all of these?
- And how is the catalytic capital trying to scale: by replication, by expansion into adjacent markets, by mobilizing commercial capital?

> "It would be useful to know who the investors are, those that are willing - and most likely to - participate in a particular kind of deal, so as to avoid wasting fund managers' time and resources in discussions with organizations that have no appetite to invest."
>
> Osaruyi Orobosa-Ogbeide, AFC

Once objectives are defined they need to flow through into **specific investment parameters**, i.e., *how* are the objectives put into action? Relevant parameters (including, ideally, clarity on "must-have" requirements, preferences and "no-go's") that can help managers understand investors' focuses, priorities and constraints are (parameters particularly pertinent to Scaling deals, due to the Scaling objectives or the fact that many Scaling vehicles apply blended structures, are marked with*):

- ✓ *Financial instruments (e.g., equity, mezzanine, debt, guarantees);
- ✓ *Financial parameters (e.g., risk appetite/loss tolerance, return expectations);
- ✓ Sector/thematic and geographic focus areas;
- ✓ Target enterprises' profile (e.g., SME, post-seed, early-stage, growth-stage, second-generation, social, tech, cooperatives, position in value chain);
- ✓ *Multiplier effect sought (what should be scaled);
- ✓ *Requirements around crowding in of other (e.g., private commercial) investors;
- ✓ Requirements around impact additionality; or
- ✓ Preferred "role" in deals (e.g., investor, sponsor, or co-creator).

Africa Finance Corporation’s ARISE Platform – OBJECTIVES AND THEIR TRANSLATION INTO INVESTMENT PARAMETERS

Why: Africa’s industrial potential needs to be unlocked by shifting from a global commodity supplier to a global manufacturing powerhouse. To achieve that, the **Africa Finance Corporation** (AFC) and its partner Olam International sought to identify infrastructure gaps where they can unlock value and create new industries. To stimulate the emergence of industrial ecosystems, they design tailor-made solutions to enable a sustainable local transformation of raw materials, boost exports, and promote trade.

What (objectives)**:** the ARISE Platforms seek to industrialize key sectors by creating local transformation, maximizing production, efficiency and cost, which in turn generates local value addition. They seek to strengthen the African climate infrastructure, led by African developers.

How (parameters)**:**

- *Cornerstones*:
  - strategic partnerships with governments and investors, allowing the platforms to establish tailor-made economic zones;
  - integrating the IFC’s eight environmental and social performance standards (PS);
- *Target projects*: large-scale infrastructure and logistics projects (including ports, airports, power, water and wood projects);
- *Instruments*: equity (ARISE and AFC) and debt (AFC and other third-party lenders); as well as provision of early-stage development equity funding in project developers, seeking to catalyze:
  - additional equity;
  - debt financing from local and international financial institutions;
- *Sector-specific parameters*, e.g., power projects must show:
  - bankable power purchase agreements;
  - construction contracts that follow market bankability criteria; and
  - environmental impact assessment following the IFC PS.

Sierra Club Foundation – EXPLAINING ITS FOCUS

Sierra Club Foundation (SCF) has developed an "**implementation memo**" that establishes overall objectives (*why*) and strategic focus areas (*where*) but also, importantly, concrete criteria (*how*) that provide tangible guidance to its team for the deployment of funds.

Objectives

The SCF Catalytic Capital portfolio strives to accelerate the shift of trillions of dollars from fossil fuel investments to climate solutions that also advance racial, economic, and environmental justice. It seeks to have a catalytic effect by supporting Sierra Club's policy advocacy and public education efforts on climate justice and clean energy solutions, and engaging other investors and financiers at the state and federal levels. The portfolio's investments are deployed in consultation with leaders, particularly BIPOC (Black, Indigenous and people of color), to support communities most affected by climate impacts. It also strives to support innovators' efforts to create a future that is more economically just and environmentally safe.

Strategic focus areas

Two distinct strategies for deploying catalytic capital are emerging. They will be guided by the same policy and impact measures related to the five United Nations Sustainable Development Goals (SDGs), but implemented in distinct ways:

- Invest in entities (with strong preference for those that are BIPOC-led/founded) that are focused on advancing economic justice and climate solutions. Such entities could be companies, tribal organizations, non-profits, or funds;
- Identify collaborations with other impact investors to invest in climate solution projects that prioritize BIPOC leaders and increase economic justice in under-resourced communities (as identified by the Biden Administration's Justice40 initiative[14]).

Criteria

As a portfolio, this fund leverages SCF capital by:

- Helping to catalyze a just, clean energy transition;
- Attracting capital into Justice40-identified communities;
- Supporting early-stage BIPOC-led entities (companies, tribal organizations, funds, or non-profits);
- Creating and deepening relationships with peer investors;
- Achieving significant and lasting impact;
- Complementing Sierra Club's charitable advocacy efforts on climate justice and clean energy solutions by deploying catalytic capital in service to frontline communities and in collaboration with Sierra Club programs where appropriate;
- Building on the shared brand recognition with the Sierra Club as a trusted and effective environmental organization.

[14] The U.S. federal government made it a goal that 40% of the overall benefits of certain federal investments flow to disadvantaged communities that are marginalized, underserved, or overburdened by pollution; see also link.

Specificity is useful when defining parameters and decision criteria for strategic objectives. It helps align investment teams and investment committees and ensures efficient interactions with other actors in the market. Relevant criteria should not only articulate the focus areas and preferences, but also what an investor *cannot* do. To be clear, specificity should not be confused with overly narrow parameters, which can grind investment action to a halt, frustrating internal professionals as well as managers and fellow investors (*for more see below on p. 21*).

Some investors seek to **delineate their catalytic capital investments** explicitly from their other impact investing activities (or other impact investing in the wider market). There is no "right" way of delineating and the preferred approach can differ depending on the investor type, size or overall impact strategy. Delineation can include clearly stated objectives and parameters and, at times, separate teams for particular catalytic capital activities. The relevance of specificity and impact delineation are both also discussed in the Seeding guidance note.

For example, to further its ambitions with respect to observed capital gaps for early-stage social enterprises, the U.S International Development Finance Corporation (DFC) established a separate window - its Portfolio for Impact and Innovation (PI²) program - which applies to direct and indirect Seeding and Scaling transactions.

> Being crystal clear internally allows for effective collaboration: you have to get your story straight in house before you can go out and be a more effective partner externally."
>
> Kevin McGahan, Sierra Club Foundation

DFC – A DEDICATED PROGRAM TO PURSUE HIGHER RISK

DFC (U.S. International Development Finance Corporation), the US government development finance institution (DFI), through its predecessor Overseas Private Investment Corporation, established a new pilot program in 2014 to support higher impact projects that entail higher risk: the Portfolio for Impact. The successful Portfolio for Impact program was made permanent by DFC in 2019 and expanded to become the **Portfolio for Impact and Innovation** (PI²). The portfolio, managed by three core team members, can be accessed across different DFC teams.

DFC established distinct parameters for the program, allowing the DFI to take more risk in the pursuit of impact, including, for example:

- *Investment amount:* up to $10 million;
- *For direct investments:*
  - provision of debt;
  - at least $1 million in revenues or $1 million in assets;
  - a pathway to profitability (breakeven) within 24 months; and
  - lighter requirements on collateral in case of debt investments;
- *For indirect investments:*
  - provision of debt; and
  - accessible to more established and first-time fund managers.

In addition to the parameters that delineate the program from the DFI's other activities and enable it to take higher risk, DFC also introduced a simplified approval process.

PI² projects are diverse in nature. They include early-stage enterprises and funds, but also, the first development impact bonds pursued by DFC, leading to a diverse portfolio with respect to innovation, types of company, risks, and concessionality. Increasingly, investees "graduate" from PI² to DFC's other funding and private-sector funding over time.

[14] The U.S. federal government made it a goal that 40% of the overall benefits of certain federal investments flow to disadvantaged communities that are marginalized, underserved, or overburdened by pollution; see also link.

Another example is British International Investment's (BII, formerly CDC Group) catalytic capital "Catalyst" portfolio that was established with clear delineation from the institution's "Growth" impact investments, with respect to risk appetite, return hurdles and impact expectations (*for more information see the Seeding guidance note*).

In summary, while there is no uniform or correct way to articulate objectives and parameters for a catalytic capital strategy, it is important to be as clear and specific as possible, both internally and externally.

2 STRATEGIC FLEXIBILITY AND MARKET RESPONSIVENESS

Specific Challenge

One issue for Scaling vehicles is that some catalytic capital investors tend to look for the next "new" thing rather than supporting something that has been tested yet requires additional catalytic capital to achieve full market adoption. As such, some investors may not participate in a follow-on fund by the same manager, even where performance is on track to deliver as expected.

A more general issue is that investors' catalytic capital investment strategies at times seek to address a very specific subsegment of a market and thus have a narrow strategic focus area. Further complicating the situation is that strategies are often inflexible, meaning investors struggle to react swiftly to dynamic and evolving markets. This can lead to some unwanted consequences:

- ✓ **Certain market needs are left unaddressed**, as investors pursue narrow strategies that focus on sub-segments of a market and do not support a market holistically, are too inflexible to adjust to evolving markets over time or at times ask managers to bend their investment strategies away from market-demonstrated demand to fit their capital-driven objectives and parameters; or

- ✓ **Capital sits idly**, as investors remain on the sidelines waiting for the "perfect" opportunity in a narrow sweet spot.

Both potential consequences can stifle the development of sustainable and thriving sectors and delay private capital mobilization, resulting in catalytic capital being required for a longer period of time.

Approaches

Catalytic capital investors are generally motivated to **ground their strategies in market realities and market demand** to ensure that as far as possible they are fit for purpose upfront. That said, markets evolve and demand changes. Therefore, the following considerations may help catalytic capital (and other) investors ensure that their money goes where (and when) it is needed:

- ✓ **Flexible strategies:** develop sufficiently broad strategies and underlying parameters with built-in flexibility (*see example box on the following page*);

> "Developing the courage to move now is very important, because the need for this work is now - not tomorrow."
>
> Kevin McGahan, Sierra Club Foundation

KfW – **FOLLOWING THE MANAGERS' MARKET EXPERTISE**

KfW (Kreditanstalt für Wiederaufbau), a German DFI, is considering a new **request for proposal (RFP) to fund managers that pursue a carbon sequestration fund strategy**.

This approach allows KfW to benefit from the managers' proximity to the market and range of solutions, inviting them to demonstrate how they will best use the DFI's concessional capital in pursuit of CO_2 reduction. By running a flexible window, KfW hopes to support the best available strategies and ideas.

The RFP will outline the institution's offer and select requirements (*must-haves*) and a number of preferences (*nice-to-haves*), leaving room for a broad range of market-driven solutions and creativity. Criteria may include the following:

- Clear carbon sequestration objectives (*must-have*);
- Secondary objectives, such as biodiversity or community inclusion (*must-have*);
- Maximum fund life (*must-have*);
- Expertise in carbon finance (*must-have*);
- Regional focus (*nice-to-have, global approach also possible*); or
- Target fund size and mobilization ambition (*nice-to-have*).

KfW is planning to select one to three funds for catalytic equity first-loss support and grant-funded technical assistance (e.g., for impact measurement and reporting, and development of community outreach strategies).

It aims to help build the market, accelerate innovation and encourage the emergence of public-private partnerships. The DFI hopes that future similar RFPs will integrate the learnings from this first window and reflect further market evolution, pushing the boundaries of what is possible.

- ✓ **Holistic strategies:** where relevant, consider and analyze the entirety of a market or sector and prevalent capital gaps when establishing your strategy; consider which parts can and should be in the focus of your capital and where you may play a role, even if minor, to achieve systemic change;
- ✓ **Actionable strategies:** recognize the importance of *moving* capital; this means that capital should go to the best available option and not wait for the perfect one. This includes the willingness to accept investable strategies that go beyond your actual target areas, i.e., where your target area is only a subset of the vehicle strategy; and

Sierra Club Foundation – **WINNING WHILE MISSING THE BULLSEYE**

Sierra Club Foundation (SCF) initially looked for the perfect catalytic capital deals that ticked all its objectives and criteria boxes. But the market was not (yet) where SCF's ambition was - and, as a result, only a few deals were being executed. The foundation recognized the impasse and now **looks for deals that hit multiple catalytic capital investment criteria**, if not all, so it can move *toward* its ambition. The hope is that later transactions will be able to tick all SCF's boxes - but that hope should not cut off progress today.

- ✓ **Perseverance and stamina:** persevere - often more than originally anticipated - to cross the bridge between the "new" and commercial investability, where catalytic capital is no longer required.

3 COMMUNITY OF PRACTICE

Specific Challenge

Investors often act in isolation. Market efficiencies and synergies that can flow from effective cooperation on a strategic level between like-minded investors remain untapped (cooperation on a deal level is *discussed on p. 39)*. In Scaling vehicles, which often feature blended structures that require bringing together and aligning multiple parties, a disconnected investor universe translates into greater effort, longer time horizons and additional complexity.

Where investors do cooperate, such cooperation (or the products and results of such cooperation) is often not communicated to the market. Other practitioners remain unaware of and consequently fail to leverage, useful networks, products or tools in their work.

Approaches

For strategic cooperation to be relevant, there must be coherence between the parties. For high-level initiatives the fact that investors are focusing on catalytic capital may be sufficient. However, in most instances when seeking to "get things done" and creating relationships or platforms of action-oriented collaboration, such engagement needs to be **grounded in a joint interest in a particular sector or theme**, such as A2E or gender. Depending on the breadth of the sector or theme, an additional geographic or sub-segmental focus can be helpful to make collaboration relevant. There are multiple cooperation approaches:

- ✓ On ***how*** investors can effectively form communities of practice, this can be done bilaterally or in groups, formally or informally (whereby there is a fluid spectrum) – *see Appendix 2: Creating Communities of Trust*.

- ✓ Looking at ***what*** can be covered by partnerships, there are again many possible subject matters that can be addressed. Formal partnerships or platforms and informal relationships can target multiple topics as set forth in the following paragraphs.

Pipeline sharing

Investors report spending too much time finding suitable deals - and on the flipside, managers confirm spending too much time finding suitable investors. Therefore, a strategic and regular pipeline exchange between investors - across types - that share a Scaling ambition, and are, for example, active in a certain sector or geography, can work wonders to accelerate the capital-raising process for managers. Two examples of groups that formed to share pipeline are the Climate Justice Investor Collective and the Climate and Conservation Working Group.

> "Close collaboration between investors and between investors and fund managers is crucial as it allows each party to continuously understand some of the nuances of other investors' mandates and their changing policy-driven priorities."
>
> Osaruyi Orobosa-Ogbeide, AFC

The Climate Justice Investor Collective and Mission Investors Exchange – **PURSUING PIPELINE COLLABORATION**

The **Climate Justice Investor Collective** is a forum established to identify and collaborate on investment opportunities with the dual purpose of addressing the climate crisis and increasing racial, gender, and/or economic equity. It is managed by **Candide Group** and its members include a number of foundations and family offices (*see Seeding guidance note for further information on the Collective*).

The **Climate and Conservation Working Group** - an investor group interested in climate-related investments, assembled by the **Mission Investors Exchange** - meets on a regular basis to share and discuss each other's pipeline with a view to enhancing the participants' deal-sourcing, benefiting from each other's networks and sourcing capabilities. As a welcome side-effect, this also indirectly extends the managers' network and access, giving their deals enhanced visibility beyond their direct connections.

During our Scaling Learning Labs, practitioners voiced two specific ideas to enhance deal flow and execution timelines (*see idea boxes*).

ESTABLISHING SPACES FOR SHARING AND CREATION

One Learning Lab participant, Gareth Zahir-Bill from Shell Foundation, proposed the creation of a **platform** where a (manageable) group of investors active in a certain sector or market segment meets regularly to discuss a number of topics, such as:

- Who is doing what/who is interested in what **market-building initiatives**?
- Who is doing what/who is interested in what **research projects**?
- Who is doing what/who is interested in what **investments** in what **market subsegments**?

The **objectives** of these discussions are threefold:

1. Avoid duplication of work/initiatives;
2. Find partners to do work/pursue initiatives jointly; and
3. Gain clarity on strategic areas of priority and areas of "no interest" by investors to accelerate deal execution and unearth co-creation opportunities.

Other ideas that the platform could consider are:

- "Speed-dating" events between active investor types; or
- Learning events for "newbies" in the space.

Action step: could a few catalytic capital investors with shared interests and active in a certain sector or market segment hash out a useful and simple design for such a platform and pilot a new "space for exchange"?

A DFI CAPITAL GAP DASHBOARD TO FIND THE MISSING PUZZLE PIECES

Similar to the above, but with a different angle, another Learning Lab participant, Greg Neichin of family office Ceniarth, suggested setting up a "**DFI capital gap dashboard**" - a dashboard that the catalytic capital investor would consider very helpful. Such a dashboard would:

- Allow participating *non*-DFI catalytic capital investors, such as foundations and family offices, to efficiently source deals where their catalytic capital can unlock larger amounts of DFI funding; and
- Allow participating DFIs to shorten the time that it often takes managers to find suitable catalytic capital that can provide the missing piece that is needed for the DFI to invest.

How could such a dashboard look in reality? Some key parameters to consider include:

- **Relevance:** the dashboard would benefit from a sectoral or thematic focus, ensuring coherence of the participating investor group and resulting relevance to participants (there could of course be different dashboards covering different topics);
- **Longevity:** the dashboard should be kept relatively informal, avoiding legalistic red tape, heavy processes and onerous administration; it should be more like a collaborative workspace;
- **Timeliness:** funding gaps and underlying deals should be presented early enough to allow an incoming catalytic capital investor to still influence the investments and key terms; they should be put forward when acutely relevant (in order to really accelerate deals);
- **Regularity:** the group should establish regular calls to ensure that there is a timely throughput of relevant deals (one could allow DFIs to circulate deals and funding needs also between meetings, if need be, in the interest of timeliness).

What could be the next steps to bring the dashboard to life?

- A working group of interested catalytic capital investors, including both DFIs and non-DFIs, could come together to hash out details, including on the substance and deal types within focus (e.g., sector/thematic, direct/indirect, asset class etc.), and also on the form and how the dashboard would function (e.g., cadence of meetings, form and initial content of requests, targeted group size etc.);
- Thereafter, an initial pilot could be launched to test relevance and improve the proposition; a pilot should include at least two or three DFIs and be organized around a sector or theme strongly in the focus of the DFIs, with sufficient deal flow and current momentum.

Action step: could a small group of engaged catalytic capital investors come together in a workshop to design and kick-start the creation of the first collaborative dashboard?

Data sharing

Scaling vehicles usually benefit from some level of track record information derived from prior funds as well as strategy-specific and market/sector data, both typically increasing along the Scaling trajectory. It is important to share available data, to the extent possible (acknowledging limitations due to confidentiality, liability and institutional constraints), in order to scale a market. This is particularly true if the intention is to widen the investor universe in a particular sector or strategy - including attracting new commercial investors as well as more catalytic capital investors.

In the Learning Lab sessions, practitioners pointed out that DFIs, in particular, have access to large amounts of data across many strategies, sectors and geographies, often going back for years. However, this data remains largely inaccessible to other investors. The GEMs database[15] is one attempt to gather that data. While useful to the participants contributing the data, it remains spotty and is closed to non-participating investors.

That said, it is important not to stop with DFIs when discussing data-sharing. Other catalytic capital investors also benefit from an increasing collection of data that could be helpful to the wider industry.

During our Learning Lab sessions, one idea was voiced regarding an initiative that could help the gathering and dissemination of data with a view to accelerating the Scaling trajectories across all four multiplier effects (see idea box).

MAKING DATA ACCESSIBLE THROUGH TARGETED INITIATIVES

A question surfaced in the Learning Lab as to whether a group of engaged catalytic capital providers could identify one or two **targeted data gaps** that, if filled, would help accelerate the deployment of catalytic capital - in general or in a certain sector or thematic area?

Shell Foundation has voiced interest in leading such an effort, provided the gap is within its strategic realm, working with a group of investors to:

- Identify the core questions that need answering;
- Identify the information that is needed to answer those questions; and, importantly,
- Provide the necessary resources to fund such endeavor.

That said, while the foundation can lead the effort, the holders of the information (most importantly DFIs) need to share the required data.

The objectives could include:

- Catalyzing **new investors** into a market, in particular private commercial investors;
- Helping **catalytic capital investors** allocate, apportion more and justify their catalytic capital; and
- Supporting **managers** within a sector in their funds, providing them with a "neutral" source of data they can use to make the case for their strategies and structures.

One manager suggested an "annotated benchmarking" review of management fees to address one concern in investor discussions. It would unearth (i) what fees are paid in the market across funds, and, importantly, (ii) the rationale behind fee levels, i.e., what justifies higher fees?

Action step: could a group be formed - including investors and managers with a few specific questions and relevant data - for an initial research project?

[15] https://www.gemsriskdatabase.org/

Strategic alignment and co-investments

In our Learning Lab discussions, catalytic capital investors consistently highlighted the value of inter-investor relationships, as the familiarity, understanding, and trust that are engendered through these interactions can accelerate deal-making. In particular, in Scaling vehicles, which often feature a complex blended structure, close cooperation was repeatedly described as crucial to get deals across the finish line.

"The Learning Lab participants generated a number of concrete ideas that have the potential to advance a vibrant community of practice."

Laurie J. Spengler, Courageous Capital Advisors

Shell Foundation – **MEMORANDA OF UNDERSTANDING**

In recent years, **Shell Foundation** has increasingly pursued **memoranda of understanding** (MOUs) with likeminded investors and practitioners across types. The important feature is that they are *active* in Shell Foundation's target markets and *interested* in enhancing collaboration and accelerating joint investment activity in the targeted sectors.

One example is the collaboration between Shell Foundation and DFC, announced in February 2021:

> *"Shell Foundation intends to deploy more than $45 million in grant funding by 2025 to build a pipeline of fast-growing, high-impact businesses that deliver distributed renewable energy (DRE) to households, farmers and businesses in off-grid areas. DFC hopes to approve up to $100 million early-stage debt and equity to support the growth of these businesses and leverage capital for further scale, subject to these projects meeting DFC's eligibility criteria."*

Other Shell Foundation MOUs include FMO (*as mentioned in Appendix 2*), The Rockefeller Foundation and, most recently, Nuveen, a global asset manager.

Standardization and harmonization

Increased efforts to standardize and harmonize materials used across a deal cycle can support managers in their execution efforts, e.g., joint due diligence lists, harmonized reporting or aligned policy requirements can accelerate processes significantly. One area where investors largely seem to agree on harmonized forms is investor reports. Increasingly, investors are ready to acknowledge the efficiency of a single reporting template to be used over the life of the investment.

Knowledge-sharing and learnings

As in any area, knowledge-sharing and learning from others - their wins and losses - is crucially important if the field is expected to evolve and advance. Initiatives like our Learning Labs, where small groups of practitioners are brought together to resolve real challenges, are important to create such cross-learnings and develop best practices. More such initiatives - from engagements to publications - are needed to enhance a catalytic capital community of practice.

FMO – **SHARING ITS EXPERIENCE WITH THE MARKET**

Every year, **FMO's** evaluations team conducts an **in-depth in-house evaluation** of one of the DFI's strategic sectors or impact themes. Based on this internal review, FMO publishes a report to share its findings and learnings with the broader field.

The reports include, amongst others, an overview of FMO's investment activities over time (including case studies); a review of the sector development and opportunities; and an in-depth review of FMO's impact contributions to the sector and mobilization efforts. Each report also features a client survey, where the clients assess FMO's non-financial role.

The reports further include detailed recommendations by the evaluations team to FMO's management (and responses from management thereto) on how to improve the institution's investment activities, portfolio and impact management, and non-financial services in the future.

FMO's aim is to "learn from past experiences and identify ways to increase FMO's development impact and additionality." By publishing the reports and making findings available to the wider market, FMO lets others participate in its learnings, enhancing the field and the capabilities of fellow investors.

One idea of a useful knowledge-sharing tool came out of our Learning Lab sessions around a blended finance playbook (*see idea box*).

A BLENDED FINANCE PLAYBOOK TO DEMYSTIFY BLENDED DEALS

Based on a Learning Lab participant's recurring experience of practitioners - both investors and investees - struggling with blended finance structures, the group discussed the value of a hands-on "**playbook**" to demystify the concept, design and implementation of these vehicles, guiding the reader through relevant considerations and questions when designing or assessing a blended structure.

Brainstorming with Dia Martin from DFC, some of the areas and underlying considerations could be:

- **Design:** what are the key questions that need answering when designing a blended structure? → underlying considerations could include threshold questions on the purpose of the blending and a discussion of possible blending and risk-mitigation tools and structures;
- **Capital ratios:** what are the right capital ratios? → underlying considerations could include a discussion on the forms of analysis (e.g., benchmarking, loss analysis), possible drivers in addition to analysis (e.g., investor requirements, "no-brainer," capital scarcity) or tactical considerations of setting capital ratios;
- **Pricing:** how to look at pricing? → underlying considerations could include how to consider commercial versus concessional pricing for different tranches, how to determine why a tranche is concessional, and what the right level of concessionality is;
- **Capital-raising:** how to bring in investors? → underlying considerations could include suitability of investors or investor types for certain blending elements, the sequencing of outreach or the dynamics and potential tensions between different tranches; and
- **Capital powers:** how to identify an investor's catalytic capital powers (terms, timing, quantum - which came to be referred to as the catalytic capital "superpowers" in the Learning Labs; *for more see p. 36*)? → underlying considerations could include how to best use the powers or how to understand their limitations.

The playbook could be modular with respect to certain topic areas and target audiences (investors, managers, other). The idea is not to be prescriptive but to guide practitioners on how to think about blended finance and what questions to ask themselves (or others) in the context of deploying catalytic capital.

Action step: would a funder be interested to commission the development of such a playbook that allows market participants to get guidance on open questions?

In summary, catalytic capital investors' strategic contribution to the field can go beyond the deal-specific impact of their capital and towards the progression of the catalytic capital universe itself, supporting the development of a catalytic capital community of practice.

B UNDERWRITING

CHALLENGE SUMMARY

For Scaling vehicles, there is already some data and track record with respect to previous, similar vehicles and to the relevant sector or market related to the investment vehicle's strategy - increasingly so as funds move along a Scaling trajectory. That said, such data remains limited when compared to more mature markets and is often in the hands of a few investors.

Also, underwriting processes can be long and convoluted. Lack of upfront and ongoing clarity is a recurring problem, as investors often offer only minimal guidance on their information needs, processes, timelines, and criteria. Without candid and timely feedback throughout the process, managers may have to guess at investors' intentions.

When combined with the vehicles' often-bespoke strategies and frequently complex blended structures, this can extend underwriting timelines, often spanning more than a year, leading to frustrations and ultimately delaying the arrival of funding.

1 SHARING OF DATA

Specific Challenge

While Scaling vehicles benefit from at least some relevant data points, such data may be limited both with respect to breadth (quantity) and depth (time). This is particularly true for vehicles that are at the beginning of their Scaling trajectory, where data is typically confined to what is available from the first (Seeding) fund; moreover, this often serves only to validate the opportunity set and does not yet speak to actual performance.

Further, in the case of Scaling, much of the data is often concentrated in the hands of the catalytic capital investors that engaged at the Seeding stage or that are investing in similar Scaling transactions, and is not widely available. New investors, from catalytic to commercial, that would consider entering in order to scale a proposition often struggle with this lack of data availability, leaving them unable to assess and underwrite a vehicle.

Information gaps can have significant consequences, from a heightened perception of a risk, in particular by newcomers, to extended underwriting periods; in some cases, they could result in complete failure even to engage an investor.

Approaches

Similar to the discussion around strategic sharing in building a community of practice, catalytic capital investors, including repeat investors and those that participated in similar funds, should be prepared, at a deal level, to **share their experience and data**, analysis and due diligence materials, to the extent possible. This can happen between investors but may also be achieved by working with the manager, with investors volunteering their data to strengthen the manager's proposition and available benchmarks. Although it is important to treat such data with nuance, making clear what elements are the same and what are different to allow for a fair comparison and use of the data, the contribution and aggregation of more data was widely recognized in our Learning Labs as much-needed. On the flipside, it was also stressed that receiving parties should be open to use such data. Data sharing is generally important to get more investors into Scaling vehicles, and particularly pertinent when seeking to crowd in the larger tickets needed from commercial investors, who tend to be inexperienced in Scaling markets.

FMO and Ceniarth – SHARING AS ACCELERANT

FMO (a Dutch DFI) and **Ceniarth** (an impact-focused family office) are examples of two very different catalytic capital investors willing and able to **share deal-level information** with fellow investors in order to make deals more efficient and with a view to accelerating transactions and getting them across the finish line:

- At **FMO**, the team is typically able to share its underwriting materials - from credit papers to financial models - subject only to a non-reliance letter by the receiving party to protect the institution from any liability issues and approval from the (prospective) client; the only material constraints are around deal-specific performance data (both for funds and corporates) as that is typically subject to confidentiality.
- Similarly, at **Ceniarth**, the team is encouraged to share its internal underwriting materials with prospective co-investors, including deal-level information from portfolio investees, subject to information where they are bound by confidentiality agreements.

Such sharing can happen early in an investor's review, as a trigger to progress to screening or due diligence, or at the due diligence stage, enabling the investor to benefit from the provider's analysis and views.

2 CLARITY ON UNDERWRITING INFORMATION NEEDS

Specific Challenge

Underwriting information requirements are often unclear. Managers cite a tendency for investors to "drip feed" requests with long intervals between, thereby stretching efforts over lengthy periods punctuated by intense bursts of activity. Additionally, critical points are at times communicated toward the end of the process, leading to late-process interruptions and potentially late-stage terminations after the expenditure of significant amounts of time and energy from managers.

In addition, the capital gap that is being addressed through the use of catalytic capital is at times unclear and needs to be bottomed out as part of the underwriting.

Approaches

The approaches include *internally*:

- ✓ Catalytic capital investors should be **clear on their information needs** (with the caveat that certain questions only come up as the investors get to know more details of a transaction, e.g., with respect to specific risks);
  - Such clarity includes the information the investor needs to assess the capital gap that is being addressed by the catalytic capital;
- ✓ Investors should be rigorous in **identifying their must-haves** (i.e., threshold needs), and delineate those from their nice-to-haves; and
- ✓ Investors should have regular **internal feedback loops** including relevant teams and committees to ensure alignment on information asks; one participant in the Learning Labs pointed out that risk perception gaps between investment professionals and the investment committee often contribute to delaying transaction processes.

Turning to the *outside*, i.e., communication with the manager, the following actions and behaviors can achieve a more streamlined and less frustrating process:

- ✓ **Prepare the manager upfront on information needs along the underwriting journey** by decision step, delineating must-haves from nice-to-haves and including specific information required due to the catalytic nature of the capital, e.g., discussion supporting the framing of the capital gap being addressed by the vehicle, or information needed by private foundations to show adherence to their charitable purpose when investing through their PRI[16] arm;
- ✓ **Communicate key needs and asks early in the process;** due diligence should be confirmatory (to the extent possible), and threshold issues should have been cleared in advance, at least in principle;
- ✓ **Be prepared to explain your information requests,** making clear why the information is needed; where relevant, clearly delineate general market intelligence discussions from information needed for the decision process;
- ✓ To avoid unnecessary loops, where needed **provide templates, forms, and concise examples** to the manager, if possible using common, standardized formats shared by other investors; and
- ✓ **Coordinate information requests with other investors** where appropriate and feasible.

Sierra Club Foundation – ESTABLISHING THE STRATEGIC FIT AT THE OUTSET

SCF has developed an "**Introductory Questionnaire** for Investment Managers or Advisors" to help assess if goals and values are aligned. The document asks for:

- Overview of the firm;
- Investment philosophy and impact goals (to assess the manager's impact objectives, management and experience, including also how they relate to financial return objectives and asset classes);
- Diversity, equity and inclusion (DEI) (to establish the manager's internal commitment and its investment strategy's commitment to DEI, in particular communities of color);
- Investment terms (to understand the capital requirements, key terms and, importantly, how SCF may play a catalytic role); and
- Potential for other investors to participate (to see who they may collaborate with).

> "[Specific] actions and behaviors can achieve a more streamlined and less frustrating process."

[16] For foundations in the United States, Program-Related Investment (PRI) refers to mission-driven investments that meet a three-part test: a) The primary purpose of the investment must be to further one or more exempt purposes of the foundation; b) the production of income or the appreciation of property may not be a significant purpose of the investment; and c) no electioneering and only very limited lobbying purposes may be served by the investment. For more information on PRI and how it is to be distinguished from Mission-Related Investment (MRI), see this resource from the law firm Adler & Colvin, from which the above explanation is summarized.

3 CLARITY ON PROCESS, TIMELY COMMUNICATION, AND TRANSPARENT FEEDBACK

Specific Challenge

Investors' underwriting and decision processes are often opaque from the outside - including for managers and other investors. Changes over time may not be effectively communicated, leading to uncertainty and frustrations.

Moreover, feedback provided along the way can be patchy and limited, and important investor concerns are at times only unearthed late in the process. Investors' hesitation to say "no" as clearly or as early as they could often leaves managers stuck in limbo, not knowing whether they should keep pushing ahead or call off the pursuit.

Approaches

Beyond clarity on information needs, it is helpful if investors:

- ✓ **Are clear on the envisaged process**, including timing and lead contact person(s), upfront or as early as possible. Aspects of this could include:
  - an outline of the internal decision-making process, milestones, and important time parameters, e.g., only intermittent committee meetings or internal budgetary processes that can have a significant impact on timing;
  - clarity on key people and investor teams involved; and
  - disclosure of any capacity constraints;
- ✓ **Share updates regularly and transparently** on status and envisaged timeline as things progress;
- ✓ **Provide transparent, detailed and constructive feedback** throughout the process. Feedback should be specific and clear and include (to the extent possible) where in the investor institution a particular concern arises and what is needed to address it; this includes a clear communication of any need for substantive changes to the fund's investment proposition. Transparent feedback allows the manager to sharpen the proposition - and also to be more effective in future outreach;
- ✓ **Clarify - and seek to align - processes with other investors** where feasible;
- ✓ **Drive momentum towards a yes/no decision as early as possible** by addressing threshold questions early. To do this, investors need to put key needs and areas of concern on the table as soon as is feasible; also, it is important to engage respective investment or risk committees early in order to avoid late surprises. Once yes/no decisions have been reached, there should be timely communication, including the rationale behind them; and
- ✓ **Respond in a reasonable amount of time** to manager communications, even if it is only to manage expectations. Always seek to be **judicious with the manager's time,** given high effort and cost implications.

In Scaling transactions, and particularly those that involve blended structures, finding effective ways to confront and address these challenges is vital to achieve the multiplier effects that yield real and lasting impact.

> "There is a lack of transparency regarding prioritization for potential co-investors (e.g., strategic priorities, timing, budget etc.). Each DFI has its own planning, budget cycles and priorities, but it seems difficult to understand and navigate these constraints for other investors. This oftentimes causes difficulties and adds time and complexity to the capital-raising process."
>
> Gareth Zahir-Bill, Shell Foundation

YOUR OPINION MATTERS

Managers often face an uphill battle during underwriting processes, where timelines are continuously delayed, responsiveness is spotty and feedback is thin. Could investors' behaviors be improved and process efficiency enhanced if institutions introduced **client feedback surveys** asking prospective investees for feedback on their experience during an underwriting process?

To brainstorm, such a survey could include **questions around topics** such as:

- Upfront preparation of the manager on process;
- Clarity of communication;
- Clarity of information needs by decision step;
- Timeliness of responses;
- Provision of status updates; and
- Depth of feedback, measured, as applicable, on scales of satisfaction levels, time units, or similar.

A survey could, and perhaps should, seek feedback from not only the eventual investees but also from managers or companies where the institution ultimately decided not to invest. Ensuring anonymity for the respondents - both those that succeeded in securing commitments from the investor as well as those that did not - would be essential to capture accurate and honest feedback.

Such surveys could allow the institution to introduce learning loops, seeking to improve the throughput of deals and internal efficiency, or could even form (a small) part of a professional's annual review as one KPI to be considered.

Action step: could investors submit themselves to be assessed on the quality of their client services?

CAPITAL-RAISING

CHALLENGE SUMMARY

For managers, capital-raising tends to be a time-consuming and expensive process. In Scaling deals, which often feature blended structures, it can be challenging to find the right investors for each capital structure component. There tend to be many unanswered questions in the market: who can play where? When can they come in? And at what amounts? The ways in which an investor's capital can catalyze a transaction is often not sufficiently clear, making it difficult to find scarce funding and optimize its use in a structure.

Furthermore, similar to the lack of cooperation on a strategic level discussed above, investors often act in siloes at a deal level, with each running its own due diligence process and leading its own negotiation without leadership by or any meaningful coordination with other investors. This creates fraught processes whereby the manager spends a great deal of time and energy shepherding investors individually toward a closing.

For the manager, all this means a high burden of work and unnecessary negotiation loops, with often suboptimal results. For investors, this means drawn-out processes and often a significant investment of time to close a deal.

Certainly, effective coordination and cooperation are easier said than done. Investors can just as easily trip over each other if this is attempted without clarity around roles (based on each investor's preferences and constraints) as well as processes.

New Forests – TAFF2'S LONG WAY TO A FIRST CLOSE

Overview: **New Forests' Tropical Asia Forest Fund 2** (TAFF2) is its second-round sustainable forestry fund focusing on Southeast Asia, following the first TAFF fund, which closed in 2013 with $170 million of commitments. TAFF2 had its first close in March 2022 at $120 million, with an overall target size of $300 million. The fund has a blended finance structure, whereby the blending element does not provide risk mitigation support but is an impact equity tranche that sits structurally alongside (pari passu) the commercial equity tranche, allowing for increased social and environmental impact outcomes, in addition to scaling up institutional ownership of the Southeast Asian sustainable forestry sector.

Capital-raising: New Forests started the fundraising process for TAFF2 in 2018, achieving its first close in March 2022. New Forests provided a number of reasons for the extensive fundraising period, including the disruptive impact of Covid-19. In response to the pandemic, many investors paused new investments and temporarily moved their focus to their existing portfolios; it also made due diligence processes challenging. That said, even accounting for Covid-19, the process was very long due to investors' extended due diligence processes and negotiation cycles. Further, it was challenging to find investors willing to commit early in the process to jump-start the fund.

1 CLARITY ON CATALYTIC CAPITAL POWERS: TERMS, TIMING, AND QUANTUM

Specific Challenge

Investor capital can catalyze deals through flexibility on terms, the ability to commit early to a deal (i.e., timing), or the capacity to provide a significant quantum of capital that changes transaction dynamics. As introduced already in the Seeding guidance note, one might think of these as **"catalytic capital (super)powers"**.

CATALYTIC "SUPERPOWERS"

Terms | Timing | Quantum

These powers - and clarity on who has which - are critical as managers often need to raise junior capital with flexible terms in order to leverage the significant amounts of senior capital that allow for envisaged Scaling, *and* need to get to the all-important first close to actually get going at all.

Without clarity, managers cannot use the powers efficiently, leading to delayed timelines and suboptimal structures.

Approaches

To be clear upfront: in a blended deal *every* chair can help catalyze transactions, not just junior capital. When talking about catalytic capital, discussions most commonly revolve around the catalytic use of **terms**, in particular in blended structures, where catalytic capital investors provide subordinated capital (i.e., equity or junior debt) or guarantees into a capital stack. However, our Learning Labs discussions have pointed to additional catalytic capital levers: **timing** (i.e., being a first-mover) and **quantum** (i.e., helping managers to reach the envisaged scale of the fund, or a viable first close, or attract further investors that cannot invest below a certain size threshold - importantly in Scaling, commercial investors).

Different catalytic capital investors have different powers. One of our Learning Lab participants from a DFI described their primary power to be *quantum*, i.e., the ability to provide significant leverage on top of first-loss capital, with the secondary power being *terms*. Another one called *terms* their primary superpower, as they enjoy a clear catalytic capital mandate with far-reaching flexibility and a wide range of tools at their disposal (including first-loss capital, guarantees and also grants); that is followed by timing and the ability to come in early or even first to commit to a vehicle.

Ceniarth - **CREATIVELY APPLYING ITS COMBINATION OF POWERS**

Ceniarth once provided **short-term funding** to a vehicle that "**bridged**" to a prospective investor's finalization of its underwriting process and investment execution, thereby allowing a fund to begin its investment activities. Subsequently, Ceniarth's short-term bridge was to be refinanced upon the investor's closing.

Such bridge financing allowed the manager to get going, effectively accelerating the time to the all-important first close.

> "If you are a catalytic capital investor, why would you not be a first-mover? It should be the default assumption for a catalytic capital investor to participate in the first close of a deal."
>
> Ronie Mak, RS Group

EEGF – USING THE FULL SET OF POWERS

As described earlier, the **Energy Entrepreneurs Growth Fund** (EEGF) was jointly initiated by **Shell Foundation** and **FMO**. Both initiators were willing to use all three powers in and for the fund:

- **Timing:** as initiators, both institutions stood by the fund from the beginning, allowing fund manager Triple Jump to use their commitment in the capital-raising process; importantly, they jointly committed to a first closing, allowing the manager to get started;
- **Terms:** while Shell Foundation committed the crucial equity tranche, FMO added a commitment to junior notes, jointly providing credit enhancement to senior noteholders; and
- **Quantum:** both institutions contributed significant amounts of funding to the targeted $120 million fund size - Shell Foundation committed $30 million of equity and FMO $15 million of junior notes, together providing more than a third of the overall targeted amount.

> "Clear and early communication of an investor's catalytic capital powers helps all participants in a deal, but especially the manager."

Clear and early communication of an investor's catalytic capital powers (in a specific deal situation, but also on a strategic or portfolio basis) helps all participants in a deal, but especially the manager. Such **clarity on powers does not only include what investors *can* do, but importantly also what they *cannot* do**, or where their powers come with certain constraints or conditions attached.

Questions that should be answered on investors' limitations on catalytic capital powers include:

- ✓ **Timing:** is your ability to participate in a first close subject to certain conditions, e.g., do you require other investors' participation in general, or even someone providing junior capital, before you can commit?
- ✓ **Terms:** are there limits to your flexibility on terms? Or are there conditions attached, e.g., do you have certain minimum return requirements you need to meet? Or, can you invest in open-end structures and if so, what are your redemption requirements?
- ✓ **Quantum:** are there limits to the amounts you can provide, e.g., institutional size limits, maximum deal percentage, strategic limits for a certain sector or strategy type?

All **specificity** that can be provided helps the market assess an investor's powers and use them effectively.

2 CONTINUING INVESTOR SUPPORT

Specific Challenge

Scaling is work and requires patience. Some catalytic investors hunt for the "new" and some expect (or need) to see a rapid Scaling pathway - both leading them to move onto "the next fund".

When investors fail to commit to follow-on funds, it makes capital-raising that much harder for managers, not only because new investors need to be found and more capital raised, but also for the (often unintended) signals such change sends to prospective investors.

Approaches

Managers consistently highlight the importance of **continued catalytic capital investor support** in follow-on fund situations, particularly the second fund. Scaling trajectories require solid grounding in order to accelerate towards attracting private commercial capital. When embarking on the marketing of a second fund, there are valuable proof points validating the strategy, market demand and manager ability to deploy the capital; however, the important portfolio performance data has mostly not yet crystallized.

Continuing investor support in the second fund and beyond usually enhances the manager's ability to raise private capital, as:

- ✓ The original investors have gained experience in the targeted market and strategy, enabling them to bring an **independent peer voice** to the table, by sharing their views and knowledge; and
- ✓ The confidence and level of satisfaction that continuing participation **signals** is not to be underestimated, providing new investors with implicit comfort.

It is important to note that the type and amount of catalytic capital support may change in follow-on funds, specifically with respect to risk-mitigant capital: investors could certainly alter the amount of capital support or take a different chair even as they demonstrate their continuing investment commitment.

3 INVESTOR ROLE: LEADERS AND FOLLOWERS

Specific Challenge

The blended nature of many Scaling transactions can increase the complexity of investor relationships and the prevalence of differing voices. Still, investors tend to pursue investments in isolation from due diligence to legal negotiations without anyone taking the lead. In contrast, mainstream syndicated loan facilities are typically led by the arranger or lead bank, which heads the discussions among prospective lenders. Why is that leadership approach not followed (at least to some extent) in catalytic capital fund and fund-like deals?

Approaches

Investors have different **positions** in a deal due to the capital layers they can commit to, the terms they can provide, the size of their investment, and the timing of their commitment. This, plus their objectives, investment needs, capacity, capabilities and prior knowledge, should enable each investor to identify the role or roles they want to play in a deal (or elements thereof): **leader or follower**.

Deal "leaders" on specific transaction elements or topics can help drive efficiency and prevent unnecessary discussion loops with multiple parties to find alignment. In practice, leaders are often one of the following: large investors in the deal; "conservative" investors; or investors with the most relevant experience, be it with respect to a particular manager or to a certain sector, theme or geography.

To be clear, leadership by no means needs to be a formal and documented arrangement as seen in the case of syndicated loans. To the contrary: for catalytic capital transactions, informal agreements are more appropriate. They are more dynamic and allow for a more fluid and at times implicit arrangement. The leader/follower approach does not need to include all participating investors but can be limited to just a few investors, e.g., investors in a certain tranche or even just parties that often do deals together.

Further, different investors can lead on different topics within a deal: e.g., an impact-driven investor that is highly flexible on terms may want to take a lead on the review of a fund's impact strategy and systems, while a larger senior debt provider with conservative legal requirements may be most suitable to take the lead on the negotiation of detailed legal terms (post agreement of key terms at term sheet stage) and may take a backseat on the impact review.

For an effective leader/follower approach to improve efficiency it is important that:

- ✓ **Leaders create momentum**, coordinating effectively and moving the process forward; this includes regular involvement of the followers, ensuring that their voices are heard and needs considered, looping them directly into relevant discussions;
- ✓ **Followers follow with discipline**, being clear and specific on their must-haves and needs, but explicitly allowing the leader to take the helm; and
- ✓ **Managers are on board**, being the driver throughout the capital-raising process and dialogues, and involved in and aligned on the investors' arrangements.

One investor in our Learning Labs mentioned that a relationship of trust between investors, often grounded in prior co-investment experience including both investors and the manager, is very helpful to ensure an effective leadership model. Further, it was pointed out that an effective leader can also be a third-party **intermediary**, in particular with respect to structuring and terms, legal negotiations and documentation.

4 EFFECTIVE COOPERATION WITH FELLOW INVESTORS

Specific Challenge

Similar to the challenge of leadership, general collaboration (or the lack thereof) is often a barrier to an efficient process. Again, in contrast to syndicated loan deals where lenders work together on the overall loan facility, investors in fund deals - notably in blended transactions, where different capital layers often pursue different interests - tend to focus on themselves without constructive cooperation with other investors.

This single-party orientation contributes to inefficiencies and long transaction processes, leaving managers to square the circle with different and often rigid investor "asks". Also, smaller investors and those new to a particular sector or strategy (importantly including commercial investors, who are needed for Scaling) often lack the necessary data to allow them to assess risks efficiently or at all. For these players, collaboration around the investor table is tremendously valuable.

Further, many investors act without a sense of urgency, leading to drawn-out processes where the work is done over months. One investor pointed out that the "real work" on a deal could be done in a few weeks, if greater focus was applied by investors.

Approaches

Early engagement with potential co-investors to find common ground and workable solutions can drive toward an efficient closing of the transaction.

There are several cooperation considerations and approaches that can make a capital-raising process more efficient. Highlighting just a few:

- ✓ **Importance of *who* is around the table:** in our investor Learning Labs, participants repeatedly pointed out the importance of the "*who*", i.e., assembling aligned investor groups with relationships of trust that tend to foster constructive cooperation with a view to getting a deal done; as such, it may be beneficial for investors to engage actively in finding aligned investors for a deal;

- ✓ **Early engagement with a sense of urgency:** investors should join forces early and jointly drive towards solutions; this includes coordinated timeframes with fellow investors to get a deal done;
- ✓ **Driving towards a first closing:** catalytic capital providers are critically important to participate in and drive towards a first close. Most investors cannot do that on their own; therefore, coordination and joint effort is required to address concerns and find a way to get to the all-important first closing;

> "One key challenge in capital raising stems from a lack of clarity of processes: everyone ends up running in circles waiting for each other - leading to significant timing delays. This underscores the importance of clearly laying out your investment process to the manager and seeking early alignment amongst co-investors, as possible. It also underscores the importance of who is around the table as familiarity and past joint investment experience can enhance collaboration and accelerate timing."
>
> Ward Nusselder, FMO

FORMING FOCUSED AND COORDINATED UNDERWRITING GROUPS

One of our DFI Learning Lab participants, Ward Nusselder from FMO, pointed out the benefit of the manager (ideally backed by at least one key prospective catalytic capital investor) corralling an **initial group of interested investors** early in the capital-raising process to instill a sense of urgency, in particular those that can come in at a first close. They could **jointly commit** to:

- Agree on a **compressed underwriting timeline** - committing to prioritizing the transaction in the coming X weeks and with coordinated processes;
- Provide the manager with **concise due diligence asks** - enabling the manager to provide the necessary information in an efficient and timely way; and
- **Join forces** in the underwriting process - seeking to align due diligence requests and sharing materials, including transaction reviews, analyses and committee papers.

Ward pointed out that for most deals the brunt of the underwriting is done within three to eight weeks and could be performed in a compressed timeline to accelerate towards the important first closing.

Action step: could a manager, together with one or two key aligned catalytic investors, lead a group to commit to a concentrated and concerted underwriting effort?

Shell Foundation and FMO – CREATING A "FIRST CLOSE PLAN B"

A typical **stumbling block to a first close** is concern about the viability of the fund if there is no further investor interest.

In the case of the **Energy Entrepreneurs Growth Fund** (EEGF), **Shell Foundation** and **FMO**, the fund's joint initiators and first-close investors came together with the manager, Triple Jump, and established restrictions on the fund for the period from their first to the aspired second closing, to be completed within a year. The safeguards they put in place were the following:

- **Limitation on drawdowns:** while committing the full intended amounts of \$30 million and \$15 million, respectively, in order to allow Triple Jump to (i) market the fund at a \$45 million first-close level, and (ii) earn fees that made the management of the fund economically sustainable, the investors limited drawdowns until a meaningful second closing was achieved; and
- **Limitation on instruments:** while the fund benefits from the availability of flexible instruments (from senior debt to mezzanine to equity), Triple Jump was restricted to debt investments until the second closing was achieved.

These guardrails allowed the investors to get comfortable with a subscale first closing, allowing for a wind-down contingency Plan B in case the "what if" scenario became reality.

- ✓ **Keeping the bar low:** as already discussed earlier, investors should seek to focus on a number of must-haves and be flexible beyond, with respect to their own underwriting and terms requirements, to increase the chances of success in getting the deal over the finish line; and

- ✓ **Sharing available performance and market data** (*see also earlier under Underwriting*).

Specific deal-level cooperation should **make things move faster and towards a closing**, avoiding behaviors that effectively extend processes, create delays and add complexity. This often occurs when investors adopt "me too" concerns and challenges from others, adding them to their own lists. Streamlining processes requires discipline from investors and a willingness to actively engage - sharing how they managed to get comfortable on certain topics or terms. It also taps a willingness among investors to listen and learn, in particular from more experienced counterparts.

Collaboration can benefit from designated support resources - either from one or more participating investors or a professional intermediary - to facilitate the activities central to the intended cooperation.

5 SUPPORT BEYOND CAPITAL

Specific Challenge

Managers typically carry the brunt of the capital-raising process, from finding investors to managing underwriting processes and leading legal negotiations. These are time-consuming activities that require significant effort.

Approaches

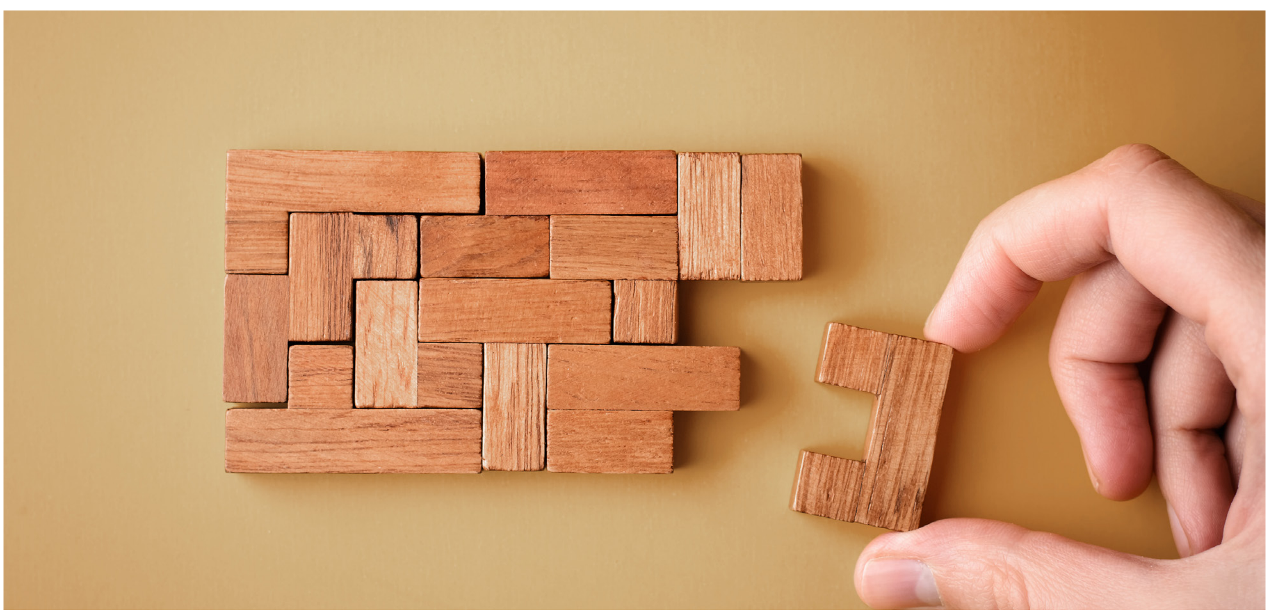
As Scaling managers are usually more established than those in Seeding transactions, the required breadth of support can be expected to be less extensive and more focused on structuring and capital-raising.

That said, **support from catalytic capital investors using their expertise and influence** is usually a beneficial contribution to a deal.

Areas of investor contribution that can help catalyze a transaction include the following:

- ✓ **Allowing the manager to use the investor's name** (e.g., referencing the investor as an engaged first mover);
- ✓ **Providing introductions or reaching out to other prospective investors;** in particular with respect to
  - making connections to a *new* set of investors, especially larger investors such as DFIs or private commercial investors, which may have been less relevant at Seeding stage; this also includes advice on the challenges of navigating those bigger institutions; and
  - finding *aligned* investors, which benefits not only the fund but also the investors (*see also above on the importance of an aligned investor table*);
- ✓ **Providing structuring support** (including possibly legal support) as Scaling deals often entail blended capital structures;
- ✓ **Improving the investment proposition** by providing detailed feedback on fundraising materials, especially regarding the messaging to investors that the manager is less familiar with, or engaging on operational set-up (such as policies and systems or staffing); or
- ✓ **Providing grant funding to cover pre-closing costs or enable pre-closing improvements** to the investment proposition.

> "From Seeding to Scaling, investors' additional support moves from mentoring to coaching."
>
> Greg Neichin, Ceniarth



D STRUCTURE & TERMS

CHALLENGE SUMMARY

One of the core catalytic capital powers discussed previously is flexibility on *terms*. However, negotiation of capital structures and terms, particularly in blended Scaling transactions, is often painful and long. With greater flexibility in terms and risk-return expectations comes greater ambiguity and complexity: if the different participants in a transaction are departing from conventional norms, there is a greater need to be explicit about each one's priority terms and risk-return appetite. While there are precedents in Scaling transactions, vehicles still tend to be highly bespoke and hard to compare.

Prolongated discussions on structure and terms exacerbate the already familiar problem of wasted time and effort, but crucially they can also lead to wasteful use of scarce catalytic capital.

CrossBoundary Energy Access Platform
– APPLYING A BLENDED STRUCTURE WITH MEZZANINE AT ITS CORE

Overview: **CrossBoundary Energy Access Platform** (CBEA Platform) is a project finance facility focused on using project finance to invest in mini-grid infrastructure across Africa, targeting communities that are unconnected to the grid or are not receiving adequate service from it. The facility, which announced its first close in June and is currently in the market, builds upon its pilot facility that launched in 2019 and has since committed $14 million to mini-grid portfolios in Africa - seeking now to scale the development of solar-based mini-grids.

Structure: The fund has a three-layered capital structure: senior debt (target ~50%), mezzanine (target ~20%) and equity (target ~30%). While the senior debt and equity have commercial terms, the mezzanine layer offers blending support "upwards and downwards" by providing (i) subordination support to the senior debt due to its position and (ii) return enhancement to the equity layer due to its concessional returns.

1 CLARITY ON RISK-RETURN APPETITE ≈

Specific Challenge

Investors' risk-return appetites and preferences are often unclear. This lack of clarity makes it difficult for managers to assess up front the right fit of investors to the investment opportunity at hand. Key questions include: is an investor focused on risk protection or return upside? Where in a capital stack can an investor play? What is an investor's experience and resulting view on key risks? The search for scarce junior and flexible catalytic capital is often particularly challenging.

Approaches

To allow managers to structure and efficiently close a deal, it is important for investors to:

- ✓ **Be clear internally** on their institution's catalytic capital risk-return positioning, appetite and parameters. This defines the "chairs" an investor can take: are you a **risk mitigant "giver"** or **"taker"**, or **both** (in a deal or at times on a strategic or portfolio basis)? For example, FMO can occupy multiple chairs, whereby capital at times comes from different funding pots, e.g., investments in a mezzanine tranche are often funded from government capital, while investments in senior tranches are usually funded from the institution's own balance sheet;
- ✓ **Communicate their risk-return parameters**, preferences and constraints with as much specificity as possible, including differentiating by asset class, geography, and manager type. For example, Sierra Club Foundation expects its catalytic capital investments to return the capital on a portfolio-wide basis. This capital preservation target implies that some of these investments may result in financial losses, accepting a higher level of risk to support significant impact in terms of climate solutions and climate justice; and
- ✓ For risk-mitigant capital-takers, **be clear on the primary need:** loss protection or return enhancement.

2 EFFICIENT CAPITAL STRUCTURE AND RATIOS ≠

Specific Challenge

Catalytic capital is a scarce resource. However, it is often used without a rigorous analysis and well understood rationale. Some investors in our Learning Labs explained that they often reverse engineer capital structures based on the envisaged or stated need of the senior tranche, without clarity on underlying fundamentals around the table. Catalytic capital is often overused and the data and assumptions behind the sizing of credit-enhancing capital layers can be unclear. Similarly, Scaling follow-on funds often do not demonstrate the reduction of, say, first-loss capital that one might have expected at the outset.

Approaches

Given its scarcity, there is a real need to optimize the use of catalytic capital. Investors should do their homework to size the needed capital ratio. Those around the table should seek alignment, amongst themselves and with the manager, to optimize the structure:

- ✓ *Internal:* each investor should be clear and specific on the drivers behind a proposed capital structure. This is particularly true for investors asking for risk-mitigant capital, i.e., the takers. The **drivers** are usually certain risks (real and/or perceived) embedded in the investment opportunity, but can also be regulatory requirements. When sizing a transaction's capital ratios, data should be used to the extent available to ground any need;
- ✓ *External:* beyond internal clarity, it can be beneficial to **share internal analyses and benchmarks**. Sharing can enhance a transaction on several levels as it:
  - increases the pool of available data for all, allowing for a transparent discussion

between the manager and all investors;

- encourages less experienced investors to come in, through the availability of additional data;
- helps the manager overcome the perception that their views are tainted by marketing bias, through the availability of co-investor viewpoints;
- enables risk-mitigant capital-*takers* to review their positions, getting more comfortable with certain risks; and
- supports risk-mitigant capital-*givers* to make a case internally, justifying their use of scarce catalytic capital. For example, MacArthur Foundation pointed out that it is required to make a case for the best use of its capital.

A COMPILATION OF ANNOTATED TERM SHEETS

The market benefits from many helpful case studies, not least due to Convergence's valuable efforts; yet, structuring remains bespoke. Could a set of **deal comparisons or case studies on structures, their evolution and the rationale behind them** be a helpful tool?

In addition to structures being displayed in case studies (*what*), we envisage a compilation (e.g., by sector) of funds that explains the **rationale behind the development of the respective structures** (*why*). This can include, for example, a risk-driven scenario analysis informing the sizing of capital layers; the use of benchmarks; an investor's regulatory requirements; or the manager's intention to accelerate capital-raising by providing "generous" credit enhancement.

It should also discuss the *who* - who was driving the sizing or was at least involved - e.g., the manager, certain investor types, single investors?

And it could include a depiction of the development of similar funds by a manager and a **discussion of how the funds' structures have evolved and why**. Reasons for change can include more track record and performance data; a change in the investment strategy (such as the inclusion of other segments within a sector or inclusion of new geographies); or general increased investor interest in a sector or theme.

A more detailed discussion of capital structures may offer investors and managers better insight into the rationale behind the structures, making a comparison and potential benchmarking exercise more relevant and nuanced.

Action step: could an interested party sponsor an initiative to compile, analyze and present such annotated structures?

Based on the data available and clarity around specific drivers, a transparent discussion on the sizing of the capital ratio can be had, and each identified driver should feed into the sizing of an appropriate capital ratio.

These analyses should seek to **identify the *minimum* amount of risk-mitigating capital** needed to get the deal over the finish line. The capital ratio analysis should be data-driven, to the extent possible, and use any available track record (e.g., historic returns or default rates/losses), similar transactions and benchmarks, and other relevant data (see also below on sharing of data).

That said, the process of right-sizing the risk-mitigating capital layer remains challenging, often bespoke, and as much an art - and a process of negotiation - as a science.

Also, there is at times a powerful argument for a "no-brainer deal" where catalytic capital is provided generously to accelerate discussions and mobilize new investors into a deal.

InsuResilience Investment Fund Equity Sub-fund – **ACCELERATION THROUGH PROTECTION**

BlueOrchard faced two major capital-raising challenges with respect to the first **InsuResilience Investment Fund Equity Sub-fund**:

- The fund was a first, seeking to establish a new and untested strategy; and
- While being an experienced and respected debt manager, this was BlueOrchard's first venture into a distinct private equity strategy.

As a consequence, besides setting a conservative target amount of $80 million, **KfW** provided (through a prior public tender) senior investors a relatively high first-loss tranche of 40%, seeking to accelerate capital-raising by making other investors' participation particularly attractive.

"Even if a perfect model would have only needed 30% of first-loss protection and not 40%, sometimes too much is the right answer."

Greg Neichin, Ceniarth

In our Learning Lab discussions, catalytic capital investors pointed out some further aspects of capital ratio design, including:

- ✓ Any capital ratio sizing exercise, in particular when adding further terms - importantly returns - should include the consideration of **wider effects on the market to avoid market** distortion;
- ✓ It can help if risk-mitigant capital-takers invest not only in the senior but **also the junior capital** layer (if only to a modest level) to align interests with the junior capital providers;
- ✓ The importance of not losing sight of **simplicity**; as managers seek to get deals across the finish line they often give in to investors' many requests, resulting in complexity (that can again put others off); and
- ✓ At times it would be helpful to engage early with managers in the **"white-boarding"** of a structure, rather than "duct-taping" at the end.

3 REDUCING USE OF CATALYTIC CAPITAL OVER TIME

Specific Challenge

The capital gap in Scaling is typically transient. Once a certain scale is achieved (to be clear, this often means a viable trajectory of multiple funds), the hypothesis is that at some point no further catalytic capital is required (*see also Scaling trajectory discussion on p. 8*). Several of our Learning Lab participants pointed out the importance of making a case in their internal committees for a credible reduction pathway over time. However, there is a tendency for capital ratios not to change as expected or even to stay flat as funds are transferred over to the next deal. As such, there is little or no progressive reduction in usage of scarce catalytic capital over time.

Approaches

Catalytic capital investors should ask themselves: what is a reasonable **Scaling trajectory** for this fund, strategy, sector, or manager? What private commercial capital is needed over time to scale the proposition? And what is needed to attract such commercial capital - a threshold size, certain performance data, de-risking, or the promise of returns? As a consequence, what is the role of the catalytic capital over time? And, importantly, what is the investor's willingness to continue supporting this trajectory to Scale?

A few considerations that may enhance reduction efforts include:

- ✓ **Set out reduction pathways early:** envisaging the next deal at the outset of discussions with the manager and co-investors can be a valuable starting point. Set a pathway for reduction, acknowledging that things change and will look different if and when the next fund is structured; and, furthermore, that the perspective might differ, e.g., between a manager focused on its funds, and an investor focused on the wider sector development. This should clarify and align on what is to be expected, over what timeframe, and what might be good indicators of progress toward this goal;
- ✓ **Consider influencing factors:** as laid out in *Appendix 1: Explaining the "Scaling trajectory" and its Influencing Factors*, there are many influencing factors to a reduction trajectory. Relevant factors should be considered carefully to arrive at a credible reduction pathway;
- ✓ **Leverage data:** reduction should be based on increasing amounts of data over time. Increasing amounts of data over time can be used to fill information gaps initially plugged by conservative assumptions;
- ✓ **Be transparent on drivers:** transparency and specificity regarding all risk-mitigating and return-enhancing elements in a structure (not only the capital layers but also any guarantees or technical assistance support, as applicable) and, importantly, regarding the underlying drivers and the rationale behind a structure and capital ratios enables a more thoughtful and effective sizing of the next fund; and
- ✓ **Put in the effort:** someone needs to do the work (beyond "copy-paste") of a thoughtful analysis.

That said, despite the desire for clarity in reduction trajectories and the importance of developing such pathways early, catalytic capital investors also acknowledged in our discussions the difficulty of precisely predicting upfront how such reductions will actually unfold over time. Accordingly, as investments are made and a track record is built, investors need flexibility - and stamina - to adapt to reality and use lessons learned.

> "
> Negotiation is only valuable on things that are negotiable."
> Greg Neichin, Ceniarth

InsuResilience Investment Fund Private Equity II – **ON THE WAY**

The first **InsuResilience Investment Fund Equity Sub-fund** (IIF PE I) provided senior investors with a **40%** cushion, *as already described on p. 46* above.
For the second private equity fund, **InsuResilience Investment Fund Private Equity II** (IIF PE II), KfW is providing to senior investors only an initial subordinated tranche representing **15-20%** of the target fund size, given:

- Proof points on strategy implementation, achieved with IIF PE I (while the verdict is still out on exits, the opportunity and demand have been showcased);
- Strengthened manager track record, whereby the manager was able to show their ability to find and execute equity deals with the deployment of IIF PE I funds; and
- Increased investor interest in climate adaptation and resilience solutions.

IIF PE II sports an additional noteworthy feature, in that the first-loss support, provided by KfW, is mainly available to private investors.

4 LANDING A DEAL THAT WORKS FOR ALL

Specific Challenge

Investors across types, including many catalytic capital investors, typically seek the "best deal" for themselves. This tends to result in extended negotiations and is made worse by a "me-too" attitude, where investors seek to have the same terms others have, even if not needed or requested at the outset. Moreover, the tendency of issues to arise at the last minute often impedes efficient deal timelines - in particular, when side letters are pulled up unearthing new legal requirements and terms. The often-complex and bespoke nature of Scaling transactions makes a narrow self-focus by investors particularly challenging, leading to lengthy negotiation loops.

Approaches

It is important for catalytic capital investors to rise beyond such behaviors. There are a number of actions they can take and behaviors they can adopt that can enhance the efficiency of transactions:

- ✓ **Early clarity on priority (must-have) terms**: catalytic capital investors should be clear on their priority areas - and areas of flexibility - with a view to finding a workable for all; this hopefully avoids:
  - late surprises (often arising in side letters, such as, for example unilateral enforcement or stop-funding rights in relation to DFI policy requirements);
  - unnecessary discussions of terms that are effectively non-negotiable; and
- ✓ **Flexibility beyond:** catalytic capital investors should seek to be as flexible as possible in order to close a deal. They should recognize the importance of a first close to establish market momentum and put the manager into investment mode. This includes being willing to adopt a "less favored nation" mindset, whereby investors accept that others may receive more advantageous terms in accordance with their particular must-haves. These flexible behaviors may enhance:
  - the manager's ability to align terms with others; and
  - the resistance to complexity as fewer particular requirements need to be accounted for.

5 AGREEING ON TERMS THAT ALLOW FOR DELIVERY OF IMPACT AND INVESTEE-LEVEL SUSTAINABILITY AND SCALING

Specific Challenge

At times investor negotiations seem to proceed without clear connectivity to the impact of certain terms on the objectives and strategy of a fund - and the underlying investees and ultimate end-customers or beneficiaries.

Approaches

Catalytic capital investors **should consider each term with impact in mind**, including any negative effect a term may have on the delivery of a strategy. Whatever the needs and preferences, catalytic capital investors should always weigh any ask and concern against the effect it may have on the ultimate delivery of impact, including the ability of the vehicle to achieve the Scaling targets. By applying a rigorous catalytic capital lens in term sheet negotiations, investors can more directly build the connection and tease out effects on underlying investee dynamics (market need, sustainability, market distortion). One obvious term is returns, but this also applies to other terms, for example tenor or flexibility on currency and hedging requirements.

Bottom line, the shared priority should be to **put together a deal that works for all** - the investors and the manager - and ultimately achieves impact objectives for investees and beneficiaries. This involves not only the negotiated terms per se, but also the **timely closing** of the deal to get the money rolling.

> "Aligning investors in a blended deal can be challenging and lead to a 'death by a thousand cuts' - you go in wanting what the market needs and you end up bringing together what the investors want."
>
> Gareth Zahir-Bill, Shell Foundation

AN ANNOTATED TERM SHEET ADDING A CATALYTIC CAPITAL LENS

In the Learning Lab sessions, we discussed the design of an **annotated term sheet** that reflects considerations a catalytic capital investor may bring to the table when reviewing transaction terms. To be clear, the term sheet is not different; what is added are questions specific to catalytic capital investors. Select terms and considerations are shown below:

1. **Objectives** *(in particular, why is this a CC deal?)*
2. **Closings** *(in particular, threshold requirements for a first close)*
3. **Capital structure** *(including rationale for the structure, in particular for blended structures)*
4. **Target returns** *(risk-return considerations, particularly in multi-layer structure; concessionality?)*
5. **Investment strategy** *(strategy alignment with thematic, geographic, CC or other priorities)*
6. **Impact objectives** *(specific CC impact objectives?)*
7. **Investment/eligibility criteria** *(specifying the must-have criteria)*
8. **Investor rights** *(specifying the must-have rights while providing room for accommodation)*
9. **Reporting** *(room for harmonization across investors including CC expectations)*
10. **Management fee** *(is the fee realistic to deliver the CC Scaling objectives?)*

In Appendix 3 *(Select Considerations for Catalytic Capital Deal Term sheets)*, we take a closer look at six of the terms listed (1. Objectives, 3. Capital structure, 4. Target returns, 5. Investment strategy, 6. Impact objectives and 10. Management fee), providing a starting point for relevant questions.

CONCLUSION

The Scaling role of catalytic capital and its multiplier effects - seeking to scale business models and enterprises, strategies, sectors or managers, and seeking to crowd in commercial capital - are vital to financing the needs of people and the planet. **Failure to scale ideas from seedling to full bloom will stymie the reach and positive results of numerous strategies, managers and solutions**. There is no magic wand that can transform innovative financing solutions into sizable game-changers. Scaling needs focused attention and patience. In particular, progressing through the initial stages on the Scaling trajectory - where data remains limited, market information patchy and deal sizes small - is a vulnerable process. This part of the Scaling journey is where catalytic capital investors need to be particularly attentive.

Our Scaling Learning Lab series provided rich content and **constructive, actionable ideas for the field of catalytic capital investor**s, which we have endeavored to capture in this guidance note. Some of the key messages from this paper for Scaling catalytic capital investors include:

1. **1+1=3.** Constructive cooperation and transparent sharing of knowledge and data are key, especially as regards complex blended Scaling transaction, weaving together different investor types with diverging intentions, needs and experience. If we want to achieve meaningful change, investors, led by catalytic capital investors, must get better and smarter in working together, both on a strategic level and on a deal level.

    a. **Deal level:** increased constructive collaboration on structuring, under-writing and term negotiation, following the examples set by syndicated loan deals, leads to *shortened investment timelines.* It helps avoid unnecessary loops and duplication of work. It further leads to *improved outcomes*, meaning (i) more efficient deal structures, where scarce catalytic capital is used wisely, and (ii) more catalytic and commercial capital crowded in. Both allow for the envisaged scale to be achieved. Our Learning Lab participants have planted ideas and provided tangible examples of ways to enhance collaboration in order to accelerate deal closings and capital flows.

    b. **Strategic level:** only through col-laboration - between investors and managers alike - can knowledge and learnings be shared and adopted, and relationships of trust be built. If the catalytic capital community seeks to enhance its efficiency and reach, it needs to build communities of practice that work together on sectoral, thematic and geographic focus areas , tapping both informal and structured ways of interacting. Throughout this Learning Lab series, investors have identified actionable ways to form such pockets of active engagement, which will enable the field to grow. There is appetite to build a dynamic community of practitioners that challenge and encourage one another to up their respective catalytic capital investing activities. The intention is to be an inclusive hub that grows its "members" and shares learnings with the wider impact investing universe.

2. **Sharpen the tools.** At the core of all catalytic capital deals is a capital gap. As a community of practice, we need to refine our analysis and understanding of these gaps - from underwriting to structuring - in order to leverage catalytic capital for Scaling transactions effectively. Such analysis cannot be limited to a quick comparison of past capital structures but must go deeper: it needs to identify the drivers behind the need for catalytic capital participation and generate data-driven analyses, including forward-looking market expectations and models, to assess the required capital ratio in any given vehicle.

3. **Hang in there.** To move an initial Seeding fund through the Scaling trajectory to scale - where no further catalytic capital is ultimately needed - stamina is crucial. Ongoing, patient and flexible catalytic capital support is immensely powerful, both through the capital provided and also by the signaling effect to the market, indicating confidence and trust. Together, these contributions accelerate capital-raising and increase the likelihood of attracting new investors. Scale is not achieved overnight through the use of a catapult; rather, it is often a long and strenuous process where investor confidence and familiarity and resulting participation are built over time.

4. **Make room to grow.** As important as stamina is the willingness to support tested and repeat deals. While the "new" is shiny and exciting, it will not change the world without growing to meaningful size and reach. Moreover, it is essential for investors to put their capital to work in response to market need. Underpinning an informed catalytic capital Scaling strategy is a holistic market view and the flexibility to adjust to dynamic and evolving markets.

We hope that our Learning Lab participants find their experiences and our rich sessions reflected in this note, allowing them to further digest the findings and bring some of the discussed approaches and ideas to life. Equally, we hope that other catalytic capital investors, both those already active and those aspiring to commence activity, will benefit from some of the outlined approaches and behaviors. **The insights and ideas presented in this guidance note are intended to accelerate the deployment of catalytic capital in Scaling deals, allowing innovative concepts to blossom into maturity, achieving the scale of impact that they seek - and that is needed to contribute to achieving the SDGs**.

We can offer no silver bullet, but we hope for this note to trigger opportunities to reflect, encouraging catalytic capital investors to take stock of how they individually and as institutions execute transactions. We seek to provide food for thought, outlining tangible ways on how processes can be improved and communication enhanced. And we aspire for this note to lead to deeper, more transparent and problem-solving dialogue between and among catalytic capital practitioners, including investors and also managers that seek such capital, to ensure that the full potential of limited pools of catalytic capital is realized.

APPENDICES

Appendix 1:
Explaining the Scaling Trajectory and its Influencing Factors

Funds and their underlying strategies follow **individual trajectories** that differ in starting point and slope. **Influencing factors** are diverse and can change over time. Example factors can include the following:

- ✓ *Starting point* (e.g., what was the Seeding fund size; who were the initial investors; what is the level of risk and newness etc.?);
- ✓ *Investment strategy* (e.g., how early stage/mature are the target enterprises; how early stage/mature is the sector; how risky are the target geographies? But also, over time how does the strategy evolve? Are there new or adjacent elements added that alter the risk profile? So, ultimately, what is the underlying risk-return profile of each consecutive fund?);
- ✓ *Relevant data* (e.g., what is the quality and quantity of available performance data for the fund strategy and the manager; how well is the wider market understood?);
- ✓ *Continuing investor support and stamina* (e.g., is there sufficient catalytic capital support; is there an ongoing sponsor or lead investor; are the investors providing continuing support to follow-on funds (important also for the signaling effect); and how meaningful is the continuing investor support (amount and terms)?);
- ✓ *Maturity of the fund manager* (e.g., what track record does the manager have; how well connected is the manager across investor types, including catalytic and commercial?); and
- ✓ *Market trends and appetite* for the investment strategy (e.g., is the theme/sector/geography attracting wide investor attention; and are investors allocating capital to it?).

Whatever the influencing factors, much of this also comes down to hard work - and at times a fair bit of luck.

Appendix 2:
Creating Communities of Trust

While some investors at times seek more formalized partnerships to drive common areas of interest and mission, they also pursue and benefit from informal partnerships and relationships, building on repeated market interactions and participating together in past deals, thereby creating communities of practice that are "communities of trust". The communities were consistently cited by the Learning Lab participants as vibrant and dynamic ways of improving catalytic capital activity. Both forms (and everything in between) are needed to help in accelerating deals or particular elements thereof. There are many different examples of collaboration partnerships, including the following three:

- ✓ *FMO and Shell Foundation*: in 2017 the two institutions signed and announced a memorandum of understanding (MOU), formally agreeing to join forces on increasing the flow of funds for impact finance in the energy sector; the actual cooperation of the two institutions is largely kept informal, with regular calls to discuss market, pipeline and potential areas of collaboration; one important outcome of the cooperation is the joint initiation of and investment in the Energy Entrepreneurs Growth Fund;

- ✓ *DEG, FMO and Proparco*: the three DFIs formed a partnership in 2012, whereby they agreed to foster closer cooperation. They set up a more formalized process to execute on their intention, with regular calls, including on a regional basis, and an annual in-person meeting; and

- ✓ *The Climate Justice Investor Collective*: the Collective is a forum established to identify and collaborate on investment opportunities with the dual purpose of addressing the climate crisis and increasing racial, gender, and/or economic equity. It is managed by Candide Group and its members include a number of foundations and family offices (*see Seeding guidance note for further information on the Collective*).

One investor pointed out the importance of going beyond relationships within familiar investor types (e.g., between DFIs) and develop ties, relationships and a community across investor groups, as was done in the Learning Labs. This cross-investor type of collaboration was seen as particularly important to enhance the effectiveness and efficiency of working together in blended deals.

Appendix 3:
Select Considerations for Catalytic Capital Deal Term Sheets

HEADLINE	DESCRIPTION	CC INVESTOR QUESTIONS TO ASK/COMMENTS
OBJECTIVES	Vehicle-specific description of overarching objectives	• Why is this a catalytic capital (CC) deal? • Do the deal objectives fit my institutional objectives and strategy? • Can I stretch, if needed, to address a need? • What multiplier effects (one or more) are being addressed by my investment?
CAPITAL STRUCTURE	Detailing the target capital structure, including any capital classes/ layers and target %s (i.e., provided first-loss and further subordination, as applicable)	• Am I clear about my catalytic power in the transaction: t*erms/ timing/ quantum* and communicate such? • Which offered tranche(s) can I consider for participation? Do I need downside protection? • How much am I willing to invest in a certain tranche and what are my constraints? Am I willing to invest in more than one tranche? • Have I done my sizing homework? What are the drivers for sizing? What evidence/analysis do I have? Do I need more? Am I willing to share my information with others? • What do I need to justify a CC investment internally? • Who should be supported by my CC? • Am I willing to engage with prospective co-investors early in the process?
TARGET RETURNS	• Senior [equity/ debt]: [x]% p.a. • Junior [equity/ debt]: [x]% p.a. • First loss [equity/ debt]: [x]% p.a.	• Do the offered target returns allow for impact delivery? • Is concessionality required? If so, what is the rationale? And is there potentially market distortion that should be considered? • How am I comparing returns on this deal to others? • What are my required returns for a CC investment? Am I receptive to a low(er) ongoing yield, potentially in return for upside sharing?
INVESTMENT STRATEGY	Vehicle-specific description of investment strategy	• Does the investment strategy fit my institutional objectives and strategy? • Can I stretch, if needed, to address a need? • What multiplier effect factors are being addressed?
IMPACT OBJECTIVES	Spelling out key impact objectives and KPIs	• Do the impact objectives fit my institutional objectives and strategy? • Can I stretch, if needed, to address a need? • Are the impact objectives distinct from objectives of non-CC deals? • How do I compare/evaluate this deal relative to others I have done; do I compare to other CC deals or non-CC deals or both? • Do I have flexibility to harmonize impact needs, including KPIs, with other investors (also with a view to simplicity for the manager)? • How do my requested KPIs and impact reporting add to the burden on the manager and underlying investees?
MANAGEMENT FEE	Annual management fee (often initially % of commitments, subsequently % of invested capital)	• Is the management fee adequate to deliver the CC objectives and execute the investment strategy? • Am I willing to consider higher-than-usual management fees in case the strategy/fund size requires them (often due to substantial heavy-lifting, e.g., because investees are still relatively early-stage and hence invested amounts are relatively small, or hands-on capacity support is provided by the manager)? • In order to catalyze commercial investors, am I potentially willing to contribute more than my pro rata share to management fees?

Contact

info@courageouscapitaladvisors.com

Authors

Laurie Spengler, Leonie Arnoldi, Rizlane Baladi, Harvey Koh

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Catalytic Capital Consortium

COURAGEOUS CAPITAL ADVISORS