

USAID INVEST: FIVE YEAR ANNIVERSARY LEARNING SERIES



FEED THE FUTURE MBOGA NA MATUNDA

MOBILIZING INVESTMENT FOR DEVELOPMENT WITH CATALYTIC FUNDING

Learning Brief

FEBRUARY 2023

This report is made possible by the support of the American People through the United States Agency for International Development (USAID). The contents of this report are the sole responsibility of INVEST, implemented by DAI, and do not necessarily reflect the views of USAID or the United States Government.

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ABOUT USAID INVEST

USAID INVEST unlocks the power of private capital to drive inclusive growth in countries where USAID works. INVEST is a flexible buy-in mechanism designed to address the challenges that make it difficult for USAID to work alongside the private sector. Buy in scopes of work are designed to address the goals of individual USAID Missions, Bureaus, and Independent Offices (MBIOs). To date, the initiative has built a portfolio of 65 buy-ins from 36 USAID MBIO clients, with INVEST activities spanning 81 countries. INVEST has mobilized over \$500 million in new investment for development.

For more information, visit: <https://www.usaid.gov/invest>.

EXECUTIVE SUMMARY

We have less than ten years left to achieve the Sustainable Development Goals (SDGs). Unfortunately, this work remains substantially underfinanced, with the annual financing gap to achieve the SDGs by 2030 estimated at \$4.2 trillion.¹ Neither Official Development Assistance (ODA), on the part of governments and multilateral institutions, nor the private sector acting independently, can address this massive need alone.

Bringing the two together is the underlying goal of blended finance, the strategic use of development funds to mobilize private capital for financial returns and positive social and environmental outcomes.² Blended finance is most needed in sectors and regions where goods or services are undersupplied by commercial markets. These investments may focus on improving infrastructure, education, agriculture, or healthcare; financing climate action; or directing resources to underserved populations such as women-owned businesses.

The U.S. Agency for International Development's (USAID) INVEST initiative, a global buy-in mechanism, was designed to expand support for blended finance by testing new approaches to mobilizing capital for the Agency's development priorities.³ An area of significant experimentation has been supporting new and existing investment funds and financial vehicles to enable transactions with development impact that may not have been viable without USAID intervention. These intermediaries pool resources and distribute risks among investors and are a primary vehicle for blended finance. While conventional tools such as loan agreements or equity investments utilized by Development Finance Institutions (DFIs) and some philanthropies in blended finance are not available to USAID, experience has revealed significant opportunities for USAID to be an influential catalyst in this process.

A key lesson from this experience is that impact is not simply a function of dedicating more resources. It is about the strategic deployment of those resources for activities that will most likely influence the trajectory of investment capital. Under a framework of support called catalytic funding, INVEST has helped mobilize over \$140 million in new investment through support of funds and financial vehicles between May 2019 and September 2022. As of September 2022, an additional \$98.5 million in capital is being sought.

The recently released Action Plan for Climate and SDG Investment Mobilization,⁴ developed through INVEST in consultation with over 100 public, philanthropic, and private stakeholders, calls for a significant increase in the supply of catalytic funding. In the context of USAID, catalytic funding is the provision of resources to an investment fund or vehicle via a contract or grant. The funding is designed to mitigate risk and improve the fund's overall viability to attract new investment for development goals. These resources may be used to offset a wide range of operational or startup costs as well as to mitigate risks by enabling fund managers to create a first loss layer within the capital structure of the fund. Catalytic funding has helped spawn innovations in funding vehicles, enabled financing to reach

¹ Closing the SDG Financing Gap in the COVID-19 era, OECD/UNDP, 2021.

² USAID Blended Finance Starter Kit, USAID INVEST, 2020.

³ See additional USAID INVEST learning resources on the INVEST publications page.

⁴ Action Plan for Climate and SDG Investment Mobilization, Convergence, 2022.

underserved markets, and encouraged otherwise risk-averse investors to engage in new opportunities with potential for development impact.

However, not all experimentation works. Not all partners perform as expected and assumptions about markets can be inaccurate. Learning has been derived from these experiences as well. The purpose of this learning brief is to present an approach that fits within the Agency's development priorities and operational capabilities, one that is designed to complement the role of other actors, including commercial banks, impact investors, foundations, and DFIs. The priority for catalytic funding, as with any private sector engagement strategy, is to design programs to maximize additionality. INVEST's experience demonstrates this is possible.

Learning from experience is essential to increasing USAID's scale and impact in blended finance. Most importantly, the Agency needs to understand how to be a value-added partner working alongside the private sector. It needs to learn how to influence the market without undermining commercial incentives, and how financial returns can be accompanied by development impacts. This is not a straightforward task. Recognizing the relatively incipient nature of USAID's experience, this learning brief describes more than it prescribes. Approaches need to remain flexible. Nevertheless, experimentation is helping to build an evidence base and to yield useful insights worth sharing.

The learning brief responds to a set of questions, articulated below, drawn principally from the USAID INVEST experience and documented industry trends. The primary audience is USAID staff responsible for designing or supporting blended finance activities. The secondary audience includes current and prospective USAID partners, including development organizations and fund managers.

1. What is catalytic funding in the context of USAID?
2. How does USAID support relate to other sources of funding in blended finance?
3. How has catalytic funding been utilized?
4. How can USAID support result in outcomes that would not have occurred otherwise – what has been its additionality?
5. What lessons have been derived from the USAID INVEST experience with catalytic funding?

KEY TERMS AND DEFINITIONS

USAID INVEST helps mobilize investment through two distinct yet complementary approaches: direct support to fund managers and engagement of transaction advisors. Transaction advisory represents a broad category of support, including pipeline development and investor matchmaking. Transaction advisory firms can build essential linkages that help facilitate the flow of capital within a market. An example is INVEST's work with USAID Haiti, in which transaction advisors are contracted to prepare small and medium enterprises (SMEs) for investment and connect them to new sources of funding.

On the other hand, INVEST's support to fund managers is assistance designed to improve a fund's overall viability and mitigate risk to attract new investment for development. In many markets in which USAID is present, funds or financial vehicles⁵ capable of addressing USAID priorities are few in number and/or too small or inexperienced to make an impact at the needed scale. Support to these entities is a means to address this systemic weakness and is the focus of this learning brief.

It is important to understand terminology. The blended finance community, as represented by the network Convergence, refers mostly to “catalytic capital,”⁶ defined as investment capital that accepts disproportionate risk or concessionary returns to incentivize private investors to make investments they might not otherwise make. These funds are typically made available through financial instruments (loan agreements, equity investments, guarantees, or insurance contracts). Investors can deploy catalytic capital directly to an enterprise or project or indirectly through a fund or other intermediary. This type of funding is provided by DFIs, foundations, and other sources of concessional capital and is an important part of blended finance.

USAID, on the other hand, does not have the authority to lend or to invest in this manner. USAID INVEST has experimented with a form of support to investment funds called “catalytic funding” that aligns with the Agency's operational processes. Catalytic funding has been used by funds managers to create what is referred to as a “first-loss tranche” of capital, and/or to cover expenses associated with fund startup and operation.

KEY TERMS

Catalytic funding: Describes the type of support provided by USAID. It is designed to mitigate risk and to improve a fund's overall viability to attract new investment for development goals. Catalytic funding in this context may be used to enable fund managers to create a first-loss layer within the fund's capital structure and/or to cover operational costs.

Catalytic capital: Describes the type of funding provided by qualified investors like DFIs or foundations. It includes debt, equity, guarantees, and other forms of investments.

First-loss: Designates a certain portion of a fund's capital as highest risk; it is designed to absorb losses in the case when investments do not yield expected results.

⁵ The terms “funds” and “financial vehicles” will be used interchangeably in this document.

⁶ [How DFIs Deploy Catalytic Capital](#), Convergence Blended Finance, 2022.

In the case of INVEST, funds are disbursed through performance-based contracts with funding tied to the achievement of key milestones. However, in other circumstances grants may perform similar functions. USAID funds are non-recoverable. If returns are realized they are retained by the recipient organization, for example the investment fund.

Catalytic funding can help a fund achieve its financial and development-oriented objectives. A first-loss layer directly impacts the risk-return profile of a fund by absorbing losses should the investment not perform as forecasted. As underdeveloped markets have limited data for investors to make decisions, the existence of this protection can make an investment more attractive to investors that otherwise might not consider the opportunity. For the fund manager, this protection may allow them to enter new markets or test innovative products, actions that are frequently avoided to preserve investor capital.

Beyond support for first loss, the INVEST experience has demonstrated a wide variety of uses for catalytic funding. Support has been used to defray operational costs, enabling fund managers to devote time to new concepts, build relationships with potential investors, and develop pipelines of investible opportunities. Funding may also be used to contract a wide variety of external advisory or legal support. In the case of new vehicles, funding may help cover startup expenses, which can be especially valuable for pioneering first movers.

TYPES OF SUPPORT

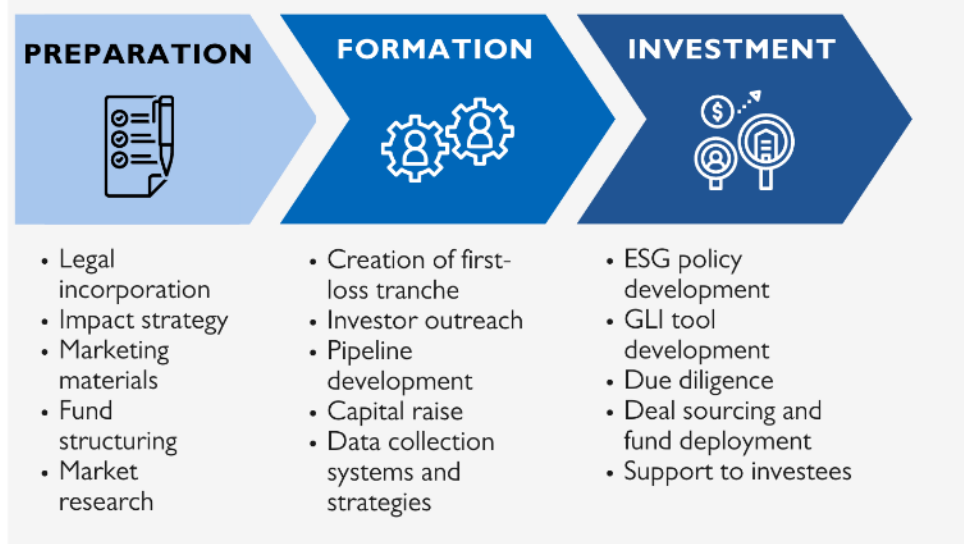
Rigid requirements influencing the use of funds have created barriers for USAID to collaborate with the private sector. In response to this challenge, INVEST has disbursed catalytic funding with a high degree of flexibility by focusing on results in lieu of tying funding to the completion of inflexible work plans. Support is designed to allow fund managers the opportunity to propose their own solutions and adapt to market conditions as needed. In practice, this has meant INVEST's Requests for Proposals (RFPs) have asked prospective partners to describe the type of support they would consider most catalytic.

Figure 1 illustrates priorities at different stages in a fund's development and illustrates the type of work that INVEST has supported. USAID may engage with a fund at any point. Support may be relatively short term and focused, or a longer accompaniment that addresses multiple needs during the fund's progression. The initial preparation stage tends to focus on feasibility and market studies, legal support, and foundational strategy. The subsequent stage prioritizes outreach to investors and building the pipeline of potential investment opportunities, while support in the later stage may be directed at strengthening the fund's investment capabilities and development impact. There is no standard timeline for this progression. Any one stage may take two or three years, with some overlap. In INVEST's experience, the support requested from fund managers has tended to fall in the first two stages.

"We don't know of many sources of support that could come in at the stage that USAID did. Helping us lay the foundation for the fund and contract the legal and other advisory support needed made a big difference and sped up what otherwise could have been a much longer process. Structuring the agreement with USAID for the period from fund design to fund launch worked out really well and gave us the flexibility we needed with our first fund."

— MCE Social Capital

FIGURE 1: STAGES OF DEVELOPMENT



Examples of catalytic funding support facilitated by INVEST (see more in [Table 1](#)):

- USAID's Office of Gender Equality and Women's Empowerment (GenDev) supported Kiva in the design and formation of the [Invest in Women Fund](#) (IWF) targeting gender focused financial institutions and social enterprises. With support, Kiva structured the fund with stakeholder feedback, identified the fund management team, prepared marketing materials, built the fund's pipeline of potential investments, and developed the fund's impact framework including a comprehensive gender lens strategy.
- USAID Haiti supported the creation the [Caribbean Resilience Fund](#), managed by Delphin Investments. The fund is a registered investment vehicle designed to mobilize capital from U.S.-based members of the Haitian diaspora to invest in SMEs in Haiti and other countries in the region. Catalytic funding from USAID was used to support the fund's registration process, development of marketing materials, risk mitigation tools and pipeline development.
- USAID's Bureau for Resilience and Food Security (RFS) provided pre- and post-launch support for the [Pomona Impact Fund II](#), which invests in small and growing businesses across Mexico, Central America, Colombia, and Ecuador. The partnership offered an opportunity to support Pomona Impact's investment in the Northern Triangle in high-impact agriculture, nutrition, and WASH-focused businesses. Catalytic funding helped Pomona refine their impact screening criteria, develop a pipeline of investible companies, and provide technical assistance to investee companies.
- USAID's Bureau for Resilience and Food Security, with participation from the Africa Bureau, supported a new blended [Water Access Acceleration Equity Fund](#) (W2AF) anchored by Danone and working in conjunction with the Incofin Foundation and Incofin Investment Management. The fund aims to invest in safe water enterprises and technologies. USAID support enabled the fund manager to create a first-loss layer to help improve the risk profile and attract investors.

CATALYTIC FUNDING: THEORY OF CHANGE

Development objectives such as improved nutrition, food security, job creation, climate action, and gender equality are fundamental reasons for USAID to engage with the private sector and mobilize new sources of capital. Done effectively, USAID programs result in additionality that leads to long-term impact in these areas. An understanding of this theory of change is critical to effective project design and to communicating USAID's primary aims.

Additionality is defined as achievement of an outcome that would not have happened without donor intervention.⁷ It provides a prime rationale for donor engagement in blended finance; without additionality, donors run the risk of wasting resources on transactions or projects that would have been equally successful without their involvement. As important as this concept is, determining whether something would not have occurred is difficult. This type of evidence generally needs to be derived from rigorous evaluations that are rarely part of private sector programming. Nevertheless, these barriers to proof should not inhibit action. USAID can still design for additionality. As the INVEST experience has demonstrated, catalytic funding has significant potential, specifically when targeting underserved sectors and/or projects at a time of their lifecycle when they are unlikely to receive traditional investment.

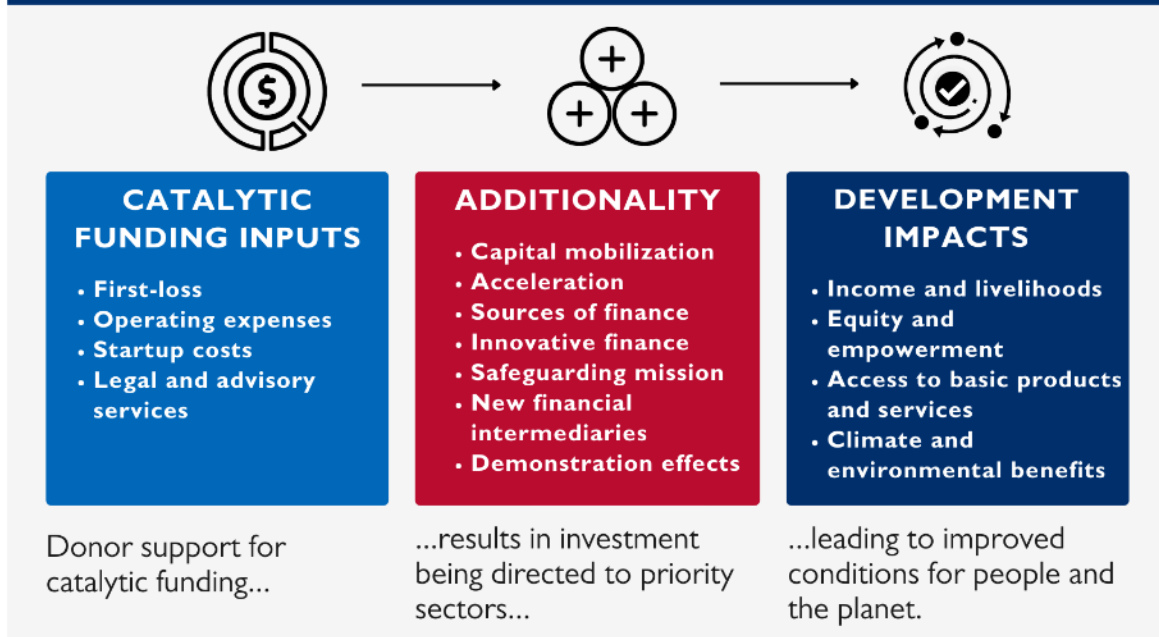
A key element for designing effective strategies is understanding additionality beyond simple measures of financial leverage. Financial leverage is the ratio of donor support to investment capital raised for a particular project or fund. Considering the massive funding gap for achieving the SDGs, this is of obvious importance. However, as Figure 2 below illustrates, financial leverage is just one among a multitude of targeted outcomes. These include benefits such as acceleration of timelines, diversification in the sources of finance, development of more appropriate forms of financing, and safeguarding a fund's development-oriented mission. At an ecosystem level, catalytic funding can increase the number of local financial intermediaries in markets where USAID is present and provide demonstration effects that serve to incentivize replication for future investments. These outcomes can improve the conditions for the fund while also helping to catalyze change in the larger market system.

Additionality is part of an impact pathway. Ultimately these interventions should translate to better conditions for people and the planet, and harnessing investment is a means to these ends. Blended finance has the potential to address multiple SDG categories, most notably income and livelihoods, equity and empowerment, access to basic products and services, and climate and environmental benefits. Driving more resources to these areas is a fundamental condition for sustainable development.

The theory of change depicted in Figure 2 presents seven distinct types of additionality, drawn from INVEST experience. The most prevalent and easily measured is capital mobilization as INVEST's support is generally linked to capital raise targets. However, other types of additionality have been intentionally part of the design influencing decisions in procurement, structure of pay for performance agreements, and overall program goals.

⁷ [Evaluating Financial and Development Additionality in Blended Finance Operations](#), OECD, 2021.

FIGURE 2: THEORY OF CHANGE



TYPES OF ADDITIONALITY

CAPITAL MOBILIZATION

Mobilizing more resources for investment is a primary focus of catalytic funding. As of September 2022, INVEST has helped mobilize more than \$140 million using catalytic funding. Capital mobilization is typically expressed as financial leverage, i.e., the ratio of capital mobilized to donor support. In the case of INVEST, most of the funds supported are still actively in a fundraising stage, making the measurement of financial leverage challenging. Nevertheless, when funds have closed, this calculation is more feasible. For INVEST leverage ratios have ranged from 5:1 to 47:1. In one exceptional case, the leverage was over 100:1. This occurred with an experienced fund manager in a relatively mature financial services market. The range is testament to the diversity of markets in which USAID operates as well as the need to look beyond a single measure of performance.

Despite challenges in measurement, capital mobilization is an important objective. INVEST is currently seeking to attract an additional \$98.5 million in investment capital through the use of catalytic funding. The investment funds being supported are focused on market failures that traditional donor funding cannot adequately address, like the transition to clean energy, climate smart agriculture, and scaling up systems for clean water. Unlocking sustainable flows of investment at scale is fundamental to meeting these challenges. USAID support is meant to be a catalyst in this process.

ACCELERATION

Catalytic funding can accelerate timelines, allowing fund managers to move more quickly through the stages of fund development. Even experienced fund managers can struggle with getting investor commitments or overcoming barriers to legal incorporation. This acceleration ultimately allows

resources to reach target investees – women-owned businesses, renewable energy firms, SMEs in agricultural value chains – sooner, the ultimate priority for USAID.

USAID's Southern Africa Regional Office (SA REGO) provided catalytic funding to Endeavor SA, a non-governmental organization (NGO) with the mission to drive inclusive growth and job creation through capitalization of high impact entrepreneurs. Building off the success and lessons learned from Endeavor's first Harvest Fund, USAID provided operational capital necessary to establish the Harvest Fund II. The Fund was designed to invest in "Endeavor Entrepreneurs," a robust pipeline of high-growth, high-impact firms with a vetted need for equity capital. USAID's support resulted in a rapid fundraise, attracting investment from a diverse set of high-net-worth individuals, South African institutions and impact investors, and a U.S. venture capital fund. The Fund was able to move quickly into the investment stage, deploying nearly \$3 million of financing to six firms in less than twelve months from the Fund's launch.

"The most difficult stage of a fund is getting the first investors on board. Once you have the first investors on board, the rest follow quite quickly. The role of your initial backer makes an enormous difference, so I want to tell USAID that it was such an incredible support as we initiated the fundraising. Who can quantify how many months that fast tracked it, as well as the quantum that came in?"

– Endeavor Harvest Fund

SOURCES OF FINANCE

The term "private sector finance" is used frequently in descriptions of blended finance. It refers to sources that are not derived from the development or philanthropic community. However, there is a spectrum of funding sources with a range of objectives and expectations as to commercial returns. A binary view of public or private origins provides little insight into the functioning of markets associated with blended finance. According to Convergence,⁸ commercial sources of funding (e.g., banks, private equity, and pension funds) make up approximately 40% of total funding in blended finance transactions globally. This means more than 60% of funding comes from sources like NGOs, DFIs, or foundations. In sectors like health or education with lower expected returns, or in higher risk countries, the percentage of commercial funding is substantially less.

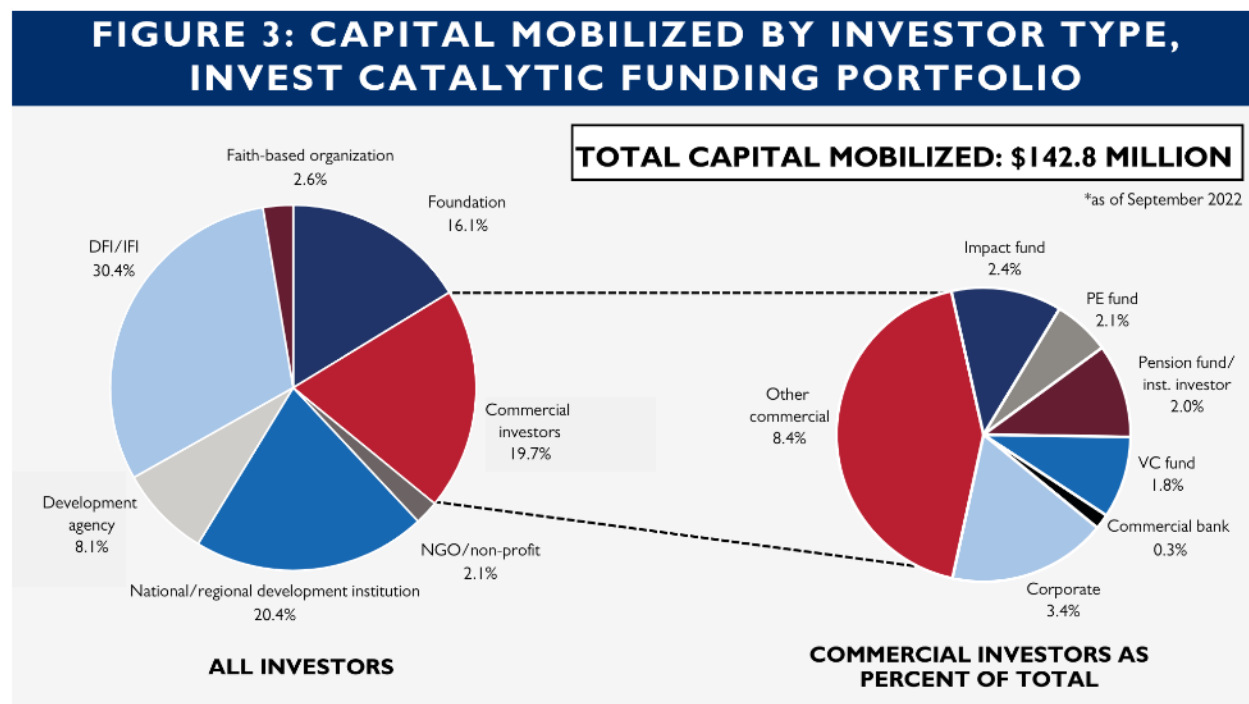
INVEST's experience facilitating investment in new and underdeveloped markets demonstrates the need to engage a large and diverse group of potential funders. INVEST tracks fourteen distinct sources of capital to derive insights into the evolution of individual funds and form comparisons across sectors and markets. DFIs presently make up the largest source of capital for funds supported by INVEST. Catalytic funding along with the concessional capital provided by these entities is helping to facilitate the entry of more commercial actors over time.

From a market development perspective, ushering in new sources of financing can be a significant catalyst. Successfully engaging a new type of investor, such as a pension fund that may have previously considered the markets as too risky, may replicate the experience outside of the donor support project.

⁸ The State of Blended Finance, Convergence, 2021.

Their actions may also signal new opportunities to their peers. Over time this can create a crowding in effect, unlocking resources that can multiply the impact of the original donor support many times over.

Figure 3 illustrates the sources of the \$142.8 million in capital mobilized as of September 2022. Most of the funds supported by INVEST are still raising capital, meaning this data represents a certain stage of development. As the funds gain experience, this composition is likely to change.



INNOVATIVE FINANCE

The lack of appropriate financial products is among the most common constraints to market development. For example, a major challenge for SMEs is the scarcity of financing that aligns with their business models. Commercial banks offering high interest rates with significant collateral requirements will do little for a water sanitation facility seeking capital to grow. Innovation in the terms, structure, and cost of financing is a precondition for sustained development in many USAID priority sectors. Catalytic funding can allow for this innovation to occur and eventually scale.

Linea Capital, an African SME-focused fund supported by USAID Southern Africa Regional Office (SA REGO), is a useful example. The fund manager is piloting an innovative revenue-based financing model: they invest upfront working or growth capital in a company, and the company repays a percentage of future revenues up to a repayment cap, with no fixed repayment date. It offers a non-debt, non-equity source of financing, which leaves ownership and the incentive to scale in the hands of company founders. As opposed to traditional venture capital equity funds, there is a predictable monthly revenue that can be re-invested, leading to a highly catalytic fund model that is evergreen in nature. And unlike debt, there is no collateral required and no interest payments.

Another example from INVEST's portfolio is the Beacon Fund, a flagship gender lens investing (GLI) vehicle. The Beacon Fund invests in women-led and women-owned businesses primarily in Indonesia, the Philippines, and Vietnam, offering fit-for-purpose financing through loans and mezzanine venture debt. Fund managers used USAID GenDev support to create a first-loss tranche to cover potential losses that could arise from its experimentation with new financial products. As an evergreen fund with an unlimited life, the fund can recycle capital that is returned into new investments, expanding its impact over time.

SAFEGUARDING MISSION

One of the most important outcomes donors like USAID can target in the use of catalytic funding is helping development-oriented funds safeguard their mission. Donors often wield significant influence that can be used to incorporate social and environmental requirements and greater accountability for impact.⁹ For example, catalytic funding can be used to develop or strengthen a fund's bylaws or investment policies to protect against future mission drift. Drafting and/or revising environmental, social, and governance (ESG) investing policies and designing impact measuring systems have been incorporated into scopes of work for many of the INVEST supported funds.

Similarly, mission alignment is a core element of the partner selection process, typically expressed as a commitment to a target market or sector (e.g. women-owned businesses, climate adaptation). For example, USAID GenDev provided seven funds with catalytic funding through INVEST. In every case, partners solicited support for developing or expanding tools to improve support to investees and deepen their impact on gender equality. As an added benefit, these kinds of measures can help attract like-minded investors looking for evidence of strong systems, thus facilitating the fundraising process.

NEW FINANCIAL INTERMEDIARIES

In many markets in which USAID is present, funds or financial vehicles capable of addressing USAID priorities are few in number and/or too small or inexperienced to make an impact at the needed scale. Building a track record is one of the most significant barriers for new fund managers. Support to financial intermediaries designed to reach USAID target markets is therefore essential. Of the sixteen funds currently supported by INVEST with catalytic funding, six involve support for first-time or emerging fund managers. While USAID did not explicitly seek partners with limited experience, solicitations have brought forth quality proposals from this group.

The USAID Southern Africa Regional Office experimented with a portfolio approach, in which they supported a mix of both first-time and experienced managers. The general dearth of local financial intermediaries was a problem USAID wanted to address. As expected, the more experienced firms raised more capital and were faster in securing investor commitments. However, new fund managers such as Thirdway Africa Rural Development Corporation have achieved gains in harder to serve sectors like agriculture focusing on climate change adaptation. The experience also presents a successful case of leveraging local expertise and knowledge, considered integral to the Mission's private sector engagement strategy.

⁹ Catalytic Capital: Unlocking More Investment and Impact, Tideline, 2019.

Predicting outcomes when supporting less experienced financial intermediaries may be relatively challenging. Consequently, a starting point for most INVEST activities is an assessment of the investment ecosystem to first determine the degree to which the private sector may already be addressing specific needs, and how USAID could help accelerate their efforts. For example, as a first step in its work with INVEST, USAID's GenDev conducted a market assessment of funds, entities, and GLI opportunities across multiple countries. The assessment allowed USAID to identify opportunities and a range of potential support options, especially those needed by new and less experienced fund managers. This information helped shape multiple future procurements.

“There is an additional kind of perceived value in having a partnership with USAID. Once USAID put out the press releases, et cetera, our inboxes started getting inundated with investment requests. So, for us it unlocked additional pipeline that we wouldn't have had within our own network.”

– Creative Growth Capital

DEMONSTRATION EFFECT

An exceedingly important but difficult to measure outcome is the demonstration effect that can result from catalytic funding. A successful case study can incentivize replication by other stakeholders that may create similar funding structures and/or direct investment into the same or similar markets or region.

Evidence of this effect may not be apparent during the implementation period of a USAID activity. However, market studies can be useful in establishing some baseline measures and can inform the design of monitoring and evaluation systems capable of capturing market level changes. USAID may also rely on data sources, such as Convergence Blended Finance, that report on a range of consolidated investment related metrics.

Demonstration effects are especially important when USAID supports a proof-of-concept activity to increase the visibility of priority markets and to use its convening power to draw attention to major challenges, such as climate adaptation or the provision of essential health products and services. While these efforts may not initially result in a large volume of investment, the experience may be sufficient to prove the potential of a market to a new and strategic set of stakeholders. USAID can foster these conditions by supporting efforts that make market and performance data widely available.

The experience of [GAIN N3F](#) is an example of a proof-of-concept activity in an early stage of development with these kinds of potential outcomes.

SPOTLIGHT: NUTRITIOUS FOODS FINANCING (N3F)

The problem: There is a chronic deficit of affordable, nutritious foods in most low-income countries, especially in Africa. The food and agriculture sector receives limited investments, and the investments that do occur go to only a handful of commodities doing little to address the availability and affordability of safe and nutritious foods for local consumption.

The solution: Local SMEs deliver most of the food consumed in low- and middle-income countries, and approximately 75% of food consumed in Africa. There is no impact investment facility or fund explicitly focused on improving nutrition in Africa, and SMEs in this space struggle to access finance. With support from USAID's Bureau for Resilience and Food Security (RFS), the Nutritious Foods Financing Facility aims to support SMEs in nutritious food value chains by providing both technical assistance and investment to help improve their financial performance, sustainability, and the nutritional content of their products. The facility will pioneer a robust set of metrics on nutrition and food to encourage other investors to move into this area.

INVEST'S CATALYTIC FUNDING PORTFOLIO

INVEST began its experimentation with catalytic funding by working with the GenDev office to support a GLI-focused fund in 2019. INVEST then expanded this work by issuing a broader solicitation to financial intermediaries with experience in GLI. The Statement of Objectives (SOO) described a range of potential support, including a first-loss tranche to catalyze commercial investment, startup support for pioneering new GLI facilities, operational support for pipeline development, and building the gender-smart capacity of local fund managers and investing partners.

The INVEST catalytic funding portfolio continued to expand in new sectors and regions with support from USAID Haiti, SA REGO, and RFS. INVEST has adjusted its approach to support the distinct set of objectives of buy-in clients and the stage of development of the financial vehicle and the target market.

Table I below presents an overview of the INVEST portfolio of funds that have received catalytic funding support between May 2019 and September 2022.

Table 1: Overview of INVEST Catalytic Funding Portfolio

Fund Name	Contracted Partner	USAID Catalytic Funding	Description	Target Fund Size
USAID Office of Gender Equality and Women's Empowerment (GenDev)				
<u>Women's World Banking Capital Partners Fund II</u>	<u>Women's World Banking</u>	First-loss	Global microfinance equity fund focused on gender lens investing and access to finance	\$100 million
<u>Beacon Fund</u>	<u>Patamar Capital</u>	First-loss	Asian evergreen fund with fit-for-purpose financing with a gender lens	\$50 million
<u>WIC Capital Fund</u>	<u>WIC Capital</u>	First-loss	West Africa-based gender lens, women-led fund with target of early-stage women-owned MSMEs	\$20 million
<u>CARE-SheTrades Impact Fund (CSIF)</u>	<u>CARE USA</u>	First-loss, operating and startup expenses	Asian SME debt fund; gender lens with a focus on gender justice	\$75 million
<u>Second Chance Success Window</u>	<u>MEDA</u>	First-loss	African SME debt fund, support targets rejected deals with a gender lens and provides technical assistance	\$2 million
<u>Ilu Women's Empowerment Fund</u>	<u>Deetken Impact</u>	Operating expenses	Latin American SME debt fund; impact bonds targeting US investors that require first-loss tranche, investments in women-led firms	\$35 million
<u>Invest in Women Fund (IWF)</u>	<u>Kiva Microfunds</u>	Operating and startup expenses	Global debt SME/microfinance fund; gender lens investing	\$100 million
USAID Haiti				
<u>Caribbean Resilience Fund</u>	<u>Delphin Investments</u>	Operating and startup expenses	Caribbean and Central America SME equity fund; Haitian diaspora targeted as investors	\$40 million

Table 1: Overview of INVEST Catalytic Funding Portfolio [continued]

USAID Bureau for Resilience and Food Security (RFS)				
<u>Danone W2AF (Water Access Acceleration Fund)</u>	<u>Incofin Foundation</u>	First-loss	Global SME equity fund; first SME equity fund focused on WASH sector	\$50 million
<u>GAIN N3F (Nutritious Foods Financing)</u>	<u>Incofin Foundation</u>	First-loss, and startup expenses	Global SME debt fund; first ag fund focused on nutrition	\$60 million
MCE Empowering Sustainable Agriculture (MESA) Fund	<u>MCE Social Capital</u>	Operating and startup expenses	Global SME/microfinance debt fund that targets investments in sustainable agriculture	\$40 million
Pomona Impact Fund II	<u>Dalberg / Pomona Impact</u>	First-loss	Latin American SME debt fund; self-liquidating investments, venture capital to agriculture, technology, basic goods, and services	\$30 million
USAID Southern Africa Regional Office (SA REGO)				
Linea Capital SPV	<u>Linea Capital Partners</u>	First-loss	African SME debt fund; evergreen fund using revenue-based financing	\$3 million
Creative Growth Capital	<u>Creative CFO</u>	First-loss and operating expenses	African SME debt, equity, and mezzanine fund targeting amongst others, agriculture, education, renewable energy, software and technology and retail and manufacturing.	\$2.84 million
<u>Harvest Fund II</u>	<u>Endeavor SA</u>	Operating expenses	African SME equity fund; co-investment model to accelerate investment process and provide funding to SMEs	\$6 million
<u>Thirdway Africa Rural Development Corporation</u>	Thirdway Partners	Operating expenses	African Permanent Capital Vehicle (PCV); evergreen fund, climate resilient agriculture	\$100 million

LESSONS LEARNED

INVEST has continued to learn and adapt with experience. In the process of implementation, several key lessons have been identified that are applicable to the design and management of USAID blended finance activities.

I. SUPPORT DEMAND-DRIVEN PRIVATE SECTOR ENGAGEMENT

A **demand-driven private sector engagement approach** is focused on assessing market needs and leveraging the expertise of the private sector to design the most appropriate form of support. INVEST uses three primary instruments: Expressions of Interest (EOI) to assess market conditions and investor perspectives; a Request for Information (RFI) to obtain essential market data; and a Statement of Objectives (SOO), along with a Request for Proposals (RFP) to solicit strategies from market actors responsive to specific development objectives. INVEST has learned that the information derived from these processes is fundamental to good program design, especially in markets where USAID has more limited experience.

Keeping solicitations from being too prescriptive, while explaining the range of potential support available from USAID, allows firms to propose the means they consider catalytic funding would be most additional. For catalytic funding, these options have included support for operating and startup costs, as well as for the creation of a first loss tranche. Proposals that include timelines and proposed performance measures have proven useful in developing appropriate monitoring frameworks. INVEST has used proposal formats familiar to the private sectors, such as 10–12 page slide decks, to lower the burden for firms, many of whom have never worked with USAID.¹⁰

Solicitations articulate desired outcomes and impacts that result from the intended theory of change. INVEST relies on prospective partners to demonstrate the connection between their strategies and desired ends. A fund's governing documents, such as bylaws and investment guidance, can further demonstrate this alignment. INVEST has found these processes are an effective means to ensure mission alignment and mitigate the risk of funding going to activities that are not supportive of USAID development objectives. Likewise, introducing the concept of additionality to prospective partners at this stage has helped private sector firms better understand USAID's priorities.

A **focus on outcomes** provides the partner with the conditions to evolve their strategies for implementation as the circumstances arise. In some cases, "go-or-no-go" decision points have been identified when the likelihood of success is questioned, allowing USAID to adjust its strategy in a timely manner. Regular meetings with fund managers to assess progress, discuss challenges, and strategy have proven invaluable to USAID as well as partners.

Circumstances have required USAID to **consider a diverse range of partnerships**. Fund managers may face tax implications or other transaction costs if they accept funding directly from a donor in the form of contracts or grants. In such cases, funds may need to be disbursed to partner NGOs or other entities that can redirect resources effectively. In some cases, separate entities have been established for

¹⁰ See, for example, [USAID Bureau for Resilience and Food Security \(RFS\) Support to Agriculture-Oriented Funds](#), in Agrilinks.

this purpose. These circumstances require USAID to be responsive to the needs of the private sector in the process of formally establishing the partnership while ensuring transparency and accountability. This is an area of continual learning and adaptation as considerations have been very context-specific.

"USAID has check-ins with the partners at regular intervals. Fund managers have said that these proved to be very helpful in keeping them focused on upcoming milestones. These are often small companies, five or six people, that are being pulled in many different directions. They appreciated the hands-on approach and support."

– USAID Southern Africa Regional Office

2. ENSURE RIGHT SIZED FLEXIBLE SUPPORT

INVEST has integrated a **high degree of adaptability** into its catalytic funding support. By and large, fund managers have been given the flexibility to use funding as needed. Market conditions can change rapidly, so flexibility allows managers to be responsive; rigid requirements for the use of funds will undermine this capability. Flexibility in timelines has also been important due to the unpredictability of certain markets. INVEST has learned to build in additional time to anticipate unforeseen circumstances.

Award sizes don't need to be large to be catalytic. Most catalytic funding awards in INVEST's portfolio have been under \$500,000. For example, when supporting first-loss, awards have been on average under 5% of the target capital raise, as specified during the period of performance of the INVEST contract. In most cases, the sum of catalytic funding, including support for operational expenses, has not exceeded 10% of targeted capital raise. The duration of engagements has varied from twelve months to four years, with success targets established in accordance with the fund's stage of development. (See [Table I](#) for more detailed descriptions of USAID support.)

Incremental pay-for-performance agreements have been a fundamental characteristic of INVEST's approach. While not new to USAID, this is an area of continual learning and adaptation as the characteristics of the market and the partner are taken into account. For less experienced fund managers or proof-of-concept activities, these structures can include early-stage milestones such as establishing investment guidelines for social and environmental impact or completing legal registration or medium-term milestones like achieving fundraising targets. If a fund is in a more advanced stage, payment may be tied to the deployment of capital into portfolio investments. In many cases, USAID support will not extend through all the stages of a fund's development (preparation, formation, and investment), making it especially important to identify appropriate milestones within the period of performance.

Submitted proposals may often indicate higher fundraising targets than what is ultimately raised within the contracted timeline due to market realities or other external circumstances. Awards can be structured to qualify lower benchmarks as a success if a minimum threshold is met to launch the fund. For example, if a fund aims to raise \$10 million but only closes \$7 million, this may be adequate to close the funding round and make an investment, and thereby qualify for the release of USAID funding. USAID funding can be prorated to match the ratio of capital raised. Once an awardee hits the minimum agreed threshold of capital, a portion of catalytic funding can be paid out and the remaining USAID funds can be disbursed proportionally as additional capital is raised.

3. DO NOT RELY SOLELY ON FINANCIAL LEVERAGE AS A METRIC OF SUCCESS

USAID offers a unique value proposition within the blended finance ecosystem. As a development agency, USAID can take risks other blended finance actors cannot. Many DFIs and other sources of concessional capital are constrained by minimum return requirements and deal sizes. This can limit their ability to support innovation in markets and sectors where the need is greatest. While USAID may use financial leverage as a point of reference to assess its work in blended finance, it should not be the exclusive measure of success.

High leverage ratios are not necessarily an indicator of greater development impact. In some cases, artificially high fund-raising targets may hinder the achievement of other kinds of additionality, such as experimentation with new products or markets. Financial leverage will vary significantly across sectors and geographies. Support for investment in renewable energy may yield a leverage ratio several times higher than a program mobilizing resources for water, sanitation, and hygiene (WASH), given the variation in market size and potential for commercial returns.

Goals need to be set based on the context and condition and include other types of additionalities in line with a clearly conceived theory of change. These can include mobilizing capital as well as other important development outcomes that address market gaps such as investment in underserved markets or the introduction of more appropriate financial products leading to the development impacts of greatest importance.

4. BUILD AN EVIDENCE BASE WHILE AVOIDING BURDENSOME REPORTING REQUIREMENTS

Reporting requirements should align as much as possible with the partner's established data collection processes and include quantitative and qualitative data to track performance related to desired outcomes. Many prospective partners will be unfamiliar with USAID. Concerns associated with reporting requirements have been cited among principal reasons private firms have chosen not to respond to USAID solicitations. While most funds will not share confidential data of investment agreements or proprietary business metrics, agreements can be made to track general outcome data associated with the capital raise as well as the core characteristics of their investment portfolio and strategy that align with the types of additionalities USAID is seeking.

USAID may also consider means to **collect longer-term impact data** beyond the period of performance through memoranda of understanding (MOUs) with fund managers, taking into consideration reporting capabilities. Many funds report internally against SDGs and manage data that is highly relevant to USAID. These may include job creation, reductions in greenhouse gas emissions, and the production of clean energy and represent information that can be shared with USAID after the close of the project to support the Agency's ability to track progress and continue to learn from their experience.

Building an evidence base is greatly needed. While reporting requirements will need to be tailored to context, using a harmonized set of measures across projects will allow for the development of a baseline set of transparent and comparable outcomes and impacts that can allow USAID to better assess approaches and further refine its strategy for catalytic funding.

CASE STUDY: SOUTHERN AFRICA REGIONAL OFFICE (SA REGO)

The USAID Southern African Regional Office (SA REGO) seeks to address the massive funding gap for SMEs in the region by supporting innovative funds and financial vehicles. This investment is designed to support job creation, women’s empowerment, food security, and development of the small business ecosystem.

SA REGO has directed catalytic funding to four pioneering investment vehicles: two first-time fund managers launching new funds (see below) and two established fund managers seeking greater scale.



PARTNER SPOTLIGHT



ThirdWay Africa
RURAL DEVELOPMENT CORPORATION
Seeding the transformation

ThirdWay Africa Rural Development Corporation (TWARDC)

GEOGRAPHY	SECTOR	ANTICIPATED FUND SIZE	CATALYTIC FUNDING	CAPITAL MOBILIZATION TO DATE
Southern Africa, with focus on Mozambique	Agriculture	\$10M by 2022, \$100M by 2025	\$195,000 for operational support	\$3.1 million

PROJECT OVERVIEW. ThirdWay Africa Rural Development Corporation (ThirdWay RDC) was established as an Indian Ocean Africa-focused impact investment vehicle in 2019. Through ThirdWay, USAID is investing in Southern Africa’s agricultural enabling environment, with a focus on opening new markets and increasing access to quality agricultural inputs. ThirdWay aims to invests in the underlying conditions necessary to scale smallholder farmers’ outputs into independent midscale commercial farms that can compete in the international market. This investment will help scale a cohort of two nucleus farms in Mozambique by end of 2022 and an additional six investments in Southern Africa by 2025, developing a strong commercial proof of concept for independent mid-scale agriculture in the region. The investment instruments are expected to be primarily equity, mezzanine, and revenue royalty instruments with maximum single investments up to 20% of portfolio.

PROGRESS TO DATE. USAID support of \$195,000 has enabled the development of ESG policies and an impact framework to ensure these investments foster a scalable model of agribusiness. The ESG policy combines community impact, environmental stewardship, and a sustainable commercial outlook while measuring improvements in livelihoods, community wellness, education, and climate change.


USAID support has also covered costs to develop investor-facing materials to directly engage investors, resulting in \$3.1 million in capital commitments sourced from two shareholder equity issuances, a World Bank agriculture grant, and a Nedbank working capital facility as of November 2022. ThirdWay is continuing investor outreach by engaging DFIs, family offices, and impact investors to progress towards their capital raise target.

PARTNER SPOTLIGHT



Creative Growth Capital

Creative Growth Fund

GEOGRAPHY	SECTOR	ANTICIPATED FUND SIZE	CATALYTIC FUNDING	CAPITAL MOBILIZATION TO DATE
South Africa 	Agriculture, education, health, infrastructure, financial services, renewable energy	\$2.84 million	First loss: \$241,500 Operational support: \$68,500	\$2.4 million

PROJECT OVERVIEW. Creative Growth Capital (“Creative”) was formed by Creative CFO, an experienced service provider to SMEs that specializes in business management services, including systems implementations, financial management and taxation advisory services, company secretarial services, and corporate finance expertise for SMEs. Creative is a first-time fund manager that launched a blended finance investment vehicle to provide sustainable financing to impact-oriented SMEs in South Africa. The fund anticipates making investments in SMEs ranging from \$30,000-\$470,000. Creative will deploy a range of diverse investment instruments to offer its portfolio companies bespoke deal structures that are best suited to each investment’s specific business model and growth trajectory. This tailored approach allows SMEs to access financing that better serves SME business models and furthers Creative’s vision of a world where more SMEs succeed. Creative also focuses on building long-term partnerships and offering technical assistance to SMEs. Through this holistic approach, Creative aims to invest in SMEs to reduce unemployment and contribute to a more inclusive economy by creating jobs and promoting inclusive business practices for women and marginalized groups within the country.

PROGRESS TO DATE. USAID support of \$241,500 enabled Creative to build a tranche of first-loss capital into its investment vehicle. An additional \$68,500 covered a portion of operating expenses. When paired with the second-loss tranche from the Creative team, this blended finance structure improves the traditional risk-return profile for investors, especially given that Creative is a first-time fund manager. In December 2021, Creative closed a \$1.25 million debt investment from one of the largest financial service providers in Africa. Follow-on support allowed them to close another \$1.25 million investment from an established private equity fund. The fund will now focus on deploying debt, quasi-debt, equity, and quasi-equity investments into approximately fifteen impact-oriented SMEs.

CASE STUDY: BUREAU FOR RESILIENCE AND FOOD SECURITY (RFS)

USAID RFS supports innovative approaches to catalyze investment in agriculture, nutrition, and water and sanitation sectors, particularly in response to economic impacts of COVID-19.




Catalytic funding was used to support four investment vehicles at various stages, including a new financial vehicle (profiled below), two pioneering proof-of-concept funds for WASH and nutrition, and one existing fund seeking to make investments in a target region.

PARTNER SPOTLIGHT



SOCIAL CAPITAL
Impact. Guaranteed.

MCE Empowering Sustainable Agriculture (MESA) Fund

GEOGRAPHY	SECTOR	ANTICIPATED FUND SIZE	CATALYTIC FUNDING	CAPITAL MOBILIZATION TO DATE
Africa, Southeast Asia, and Latin America	Agriculture 	\$40 million	\$200,000 for fund start up	\$10 million

PROJECT OVERVIEW. With USAID support, MCE Social Capital built on 16 years of experience operating a philanthropic guarantor model to establish its first debt fund. MCE has invested more than \$280 million in debt capital; the new MESA Fund allows MCE to access a larger and more diversified pool of capital. It seeks to provide transformative debt capital to gender-inclusive agribusinesses throughout their lifecycle, through direct lending to “missing middle” enterprises and financial services providers, partnering with these companies as they grow. By doing so, the fund aims to scale economic opportunities within local communities, enhance the climate resilience of smallholder farmers, and empower women in the agricultural sector. The fund plans to utilize a mix of senior and subordinated debt with initial investments ranging in size from \$300,000-\$1 million.

PROGRESS TO DATE. USAID support of \$200,000 enabled the establishment of the fund. Resources were used to contract advisory services to develop the fund strategy, investor pitch materials, and legal counsel to define legal, operational, and governance structures. Fund managers sourced a pipeline of prospective investees by utilizing their existing networks and participation in matchmaking forums. As of November 2022, MCE has leveraged an existing relationship with the Development Finance Corporation (DFC) to obtain a \$10 million investment commitment. Negotiations are underway with DFIs, family offices, and foundations for an additional \$30 million in debt financing.

CASE STUDY: OFFICE OF GENDER EQUALITY AND WOMEN'S EMPOWERMENT (GENDEV)

USAID GenDev seeks to increase the flow of capital to gender-smart businesses in support of overall women's empowerment objectives by increasing the use and quality of gender lens strategies among investors and portfolio companies, particularly targeting investments in financial services and SMEs.

Catalytic funding was part of a two-pronged approach to catalyze the field of gender lens investing while building the evidence base for gender-smart investing. Through INVEST, support was provided to seven funds at varying stages of development.



PARTNER SPOTLIGHT



WIC Capital Fund

GEOGRAPHY	SECTOR	ANTICIPATED FUND SIZE	CATALYTIC FUNDING	CAPITAL MOBILIZATION TO DATE
Francophone West Africa	Agriculture, tourism, education, manufacturing, technology, healthcare	\$20 million	First loss: \$470,000	\$5.08 million

PROJECT OVERVIEW. In March 2019, Women's Investment Club (WIC) Senegal launched WIC Capital, the first investment fund to target women-led businesses in Francophone West Africa. WIC Capital invests between \$50,000 and \$500,000 through a mix of equity and quasi-equity in companies founded by women, at least 50% women-owned, or with predominantly female leadership. While being sector agnostic, WIC's vision is to give women privileged access to modern financial instruments and promote women's leadership and entrepreneurship. Members of WIC will provide coaching and mentoring services to investees. The WIC Academy is designed to provide technical assistance and networking support.

PROGRESS TO DATE. USAID support enabled fund managers to create a first-loss tranche in the fund's capital structure. During the period of performance of the INVEST contract, WIC capital mobilized \$2.4 million from a range of investor types including high net worth individuals, an impact fund, a DFI, and a local pension fund. A portion of the additional capital was directed toward increasing the value of the fund's first-loss layer, complementing the resources provided by USAID, to further improve the risk/return profile of investors. Other donor sources have provided resources to cover operating expenses and some startup costs. WIC continued to raise capital after the INVEST contract closed, and as of November 2022, has reported an additional \$2.58 million in new investments.