SEPTEMBER 2019

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Daniel F. Runde
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CSIS | CENTER FOR STRATEGIC & INTERNATIONAL STUDIES

A Report of the
CSIS PROJECT ON PROSPERITY AND DEVELOPMENT
& THE CROSSBOUNDARY GROUP

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Contents

1 | Investment into Fragile and Frontier Markets Is Vital

It is widely acknowledged that substantial investment is necessary for meaningful economic growth to occur in developing countries. Academics have long been supporters of this notion, reflected most famously in Robert Solow's growth model and reinforced in more recent endogenous growth theories (notably by Paul Romer, Robert Lucas, and Robert Barro).[1] Investment increases productivity, which directly increases growth; it also indirectly supports growth by increasing the demand for services. This generates structural change and reduces the misallocation of funds, encouraging economic resources to be put to their best use.

As a result, increasing and sustaining private investment in developing nations is an important lever of development policy. In fact, despite the higher visibility of aid and security interventions, the private sector is already the primary vehicle by which the United States engages with economic development in developing countries.[2]

Unfortunately, the markets where private investment is most needed are also the least likely to get it. As noted in the 2013 CSIS report *Investment Facilitation in Transitional and Fragile States* by Jake Cusack and Matt Tilleard, developing markets present systemic failures that discourage investment.[3] Dani Rodrik, Ricardo Hausmann, and others have demonstrated that factors such as lack of infrastructure, institutional voids, high finance costs, and coordination failures create binding constraints on a country's growth. Private investors might expect low returns on investment because of systemic factors such as corruption, expropriation, unfair taxes, or currency risk.[4] These discrepancies result in

1. Robert M. Solow, "A Contribution to the Theory of Economic Growth," *The Quarterly Journal of Economics* 70, no. 1 (February 1956): 65–94; Paul M. Romer, "Increasing Returns and Long-Run Growth," *The Journal of Political Economy* 94, no. 5 (October 1986): 10021037; Robert E. Lucas Jr, "On the Mechanics of Economic Development," *Journal of Monetary Economics* 22, no. 1 (July 1988): 3–42; Robert J. Barro, "Government Spending in a Simple Model of Economic Growth," *Journal of Political Economy* 98, no. 5, pt 2 (October 1990): 103–125.
2. "Net ODA," Organisation for Economic Co-operation and Development, latest data from 2017, https://data.oecd.org/oda/net-oda.htm; "U.S. Direct Investment Abroad: Balance of Payments and Direct Investment Position Data," U.S. Bureau of Economic Analysis, last modified July 24, 2019, https://www.bea.gov/international/di1usdbal.
3. Jake Cusack and Matt Tilleard, *Investment Facilitation in Transitional and Fragile States* (Washington, DC: Center for Strategic and International Studies, 2013), https://www.csis.org/analysis/investment-facilitation-transitional-and-fragile-states.
4. Ricardo Hausmann, Bailey Klinger, and Rodrigo Wagner, *Doing Growth Diagnostics in Practice: A 'Mindbook'* (Cambridge: Center for International Development at Harvard University, September 2008), http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1218567884549/mindbook.pdf.

persistent under-investment and impede the successful closure of transactions that would have been mutually beneficial.

The aforementioned 2013 report proposed donor-supported investment facilitation as a new tool to reduce transaction costs and to solve coordination failures, thus driving investment and inclusive growth in fragile markets. In the subsequent six years, investment advisory groups such as CrossBoundary and others have put these ideas to the test. The investment facilitation model has been deployed under donor-supported mandates in multiple fragile and emerging markets—particularly in Western, Eastern, and Southern Africa. The U.S. Agency for International Development (USAID) and other development partnerships have funded investment advisory services, which have unlocked investment across a range of sectors in fragile and frontier markets.

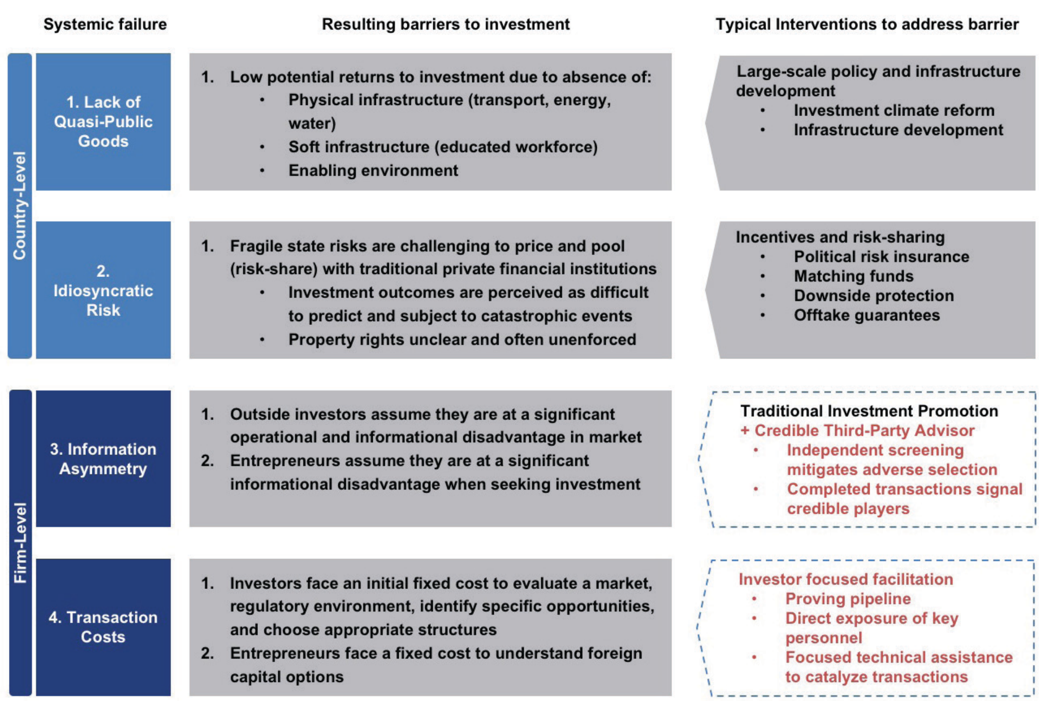
This report reflects research conducted by CSIS with CrossBoundary and others, focusing on what has been learned through practical application of the investment facilitation model in the years since the 2013 report. It updates the critical barriers to investment and illustrates how investment facilitation continues to remain relevant. It also reflects on lessons learned and makes suggestions to further optimize the impact of investment facilitation going forward.

2 | Original Thesis

Firm-level barriers to investment in fragile states have historically been neglected, but can be addressed through investment facilitation

The 2013 report noted wide-ranging barriers to investment that overlap in their symptoms, fundamental causes, and possible solutions. The framework identifies four systemic failures that hinder investment. These are shown in Figure 1 below, along with typical interventions addressing these issues; the proposed investment facilitation intervention is shown in red.

Figure 1: 2013 Investment Facilitation Framework



Source: by authors

The barriers to investment discussed in the report are categorized as country or firm-level failures. The country-level failures—lack of quasi-public goods and idiosyncratic risk—represent broad disincentives to investment. They make it harder to invest in a given market and lower risk-adjusted investment returns. Because they operate at the country level, these barriers have been generally identified, and traditional interventions have been developed to target them such as policy reform, infrastructure development funding, and provision of concessionary capital or guarantees.

However, the 2013 report also identified firm-level barriers to investment, which Cusack and Tilleard noted were often unaddressed and prevented mutually beneficial transactions from occurring. These barriers fall into two broad categories: *transaction costs* and *information asymmetries*. The fixed costs are higher for potential mutually beneficial transactions in shallower markets, which poses an obstacle to both investors and entrepreneurs. In addition, the perception (and reality) of large information asymmetries, often stemming from eroded social capital, exacerbates the distrust that can prevent parties from closing a deal.

These same barriers do exist, if to a lesser extent, in developed economies. But deeper and more robust markets enjoy sufficient deal flow for intermediaries to be established, which are incentivized to absorb and overcome transaction-related fixed costs. Developed economies are then able to distribute costs across the many successful deals that occur.

Unfortunately, in fragile and frontier markets, intermediaries are largely absent. Transactions tend to be smaller, and there are fewer deals overall, which makes the associated financial rewards inadequate for the "buy" and "sell" sides of transactions to pay intermediary fees or to undertake the necessary due diligence themselves. This forms a frustrating chicken-and-egg dilemma. Without sufficient transactions that are likely to achieve a successful close, the market is unable to sustain effective intermediaries. Without effective intermediaries, the number of transactions is unlikely to increase.

The 2013 report introduced the concept of *donor-funded investment facilitation* to address this, proposing that donors solve the dilemma by funding a neutral investment facilitator who would act as an intermediary between investors and entrepreneurs. As described in earlier research by John Boyd and Edward Prescott, intermediaries can economize the cost of information acquisition: there are fixed costs associated with acquiring transaction-relevant information investors and capital seekers need, and intermediaries can absorb these costs and then distribute them across multiple deals and deal participants.[5] Furthermore, intermediaries can credibly screen opportunities to overcome information asymmetries, as well as enhance cooperation among investors and entrepreneurs.

Cusack and Tilleard ultimately suggested that investment facilitation could have the powerful impact of reducing transaction costs and information asymmetries across developing markets, unlocking mutually beneficial transactions that would otherwise have stalled. In parallel, they argued that applying investment facilitation to these markets would prove the value of intermediary services and accelerate the market towards a self-sustaining investment ecosystem.

5. John H. Boyd and Edward C. Prescott, "Financial Intermediary Coalitions," *Journal of Economic Theory* 38, no. 2 (April 1986): 211–232.

3 | The Thesis Revisited

The failures and interventions remain the same—with added nuance

As the investment facilitation approach has now been put into practice in over 20 frontier and fragile markets, primarily in Africa, it is time to revisit the underlying thesis. Although it is not the only player in the field of investment facilitation, CrossBoundary has had the opportunity to remove barriers to investment across more than 100 transactions, so it is worth exploring their experiences here in more detail. Perhaps surprisingly, the conclusion is that the fundamental framework has not changed: even if considerable nuance needs to be added to the facilitation approach, the four previously-identified categories of barriers remain the most important obstacles to investment. If anything, subsequent work has emphasized that firm-level barriers are particularly significant, highlighting the need for highly skilled intermediaries with deep local knowledge—and emphasizing that this work should be integrated with broader country- and sector-level interventions.

The value of firm-level, transaction-centered approaches is gaining traction across the field. For instance, Jonathan Said at the Tony Blair Institute has written that most development has taken "a generic, cross-cutting fix to these [macro] problems without paying attention to specific needs of strategic sectors and private actors . . . A more transactional approach to deal making in the early stages of growth can ensure that the strategic investment . . . to unlock inclusive growth actually happens."[6]

Similarly, a 2018 report by the Organization for Economic Cooperation and Development (OECD) argued that merely making the right kinds of financial instruments available was insufficient to foster investment. The report proposed that a platform be developed to provide identification and to screen both investors and investment-worthy companies. Furthermore, establishing information and oversight hubs would provide "one-stop shops for facilitating the generation and dissemination of tailored sector- and country-specific information, networking between investors and would-be investees at country level."[7]

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6. Jonathan Said, "How Liberia Can Diversify its Economy for Inclusive Growth," (paper presented at the Liberia Development Conference, Monrovia, Liberia, February 1-2, 2017).
7. International Dialogue on Peacebuilding and Statebuilding, *How to Scale up Responsible Investment and Promote Sustainable Peace in Fragile Environments* (Paris: OECD, January 2018), https://www.pbsbdialogue.org/media/filer_public/8b/27/8b27b529-8fcc-4a2c-8d7b-87aabc55f7f3/final_privatesectorreport.pdf.

A joint report from the Omidyar Network and Dutch Good Growth Fund emphasized that "even when risks are well understood, cost relative to investment return (i.e., high transaction costs and small ticket sizes) may prevent traditional financial service providers from seeing a strong business case" for entering and investing in smaller markets.[8]

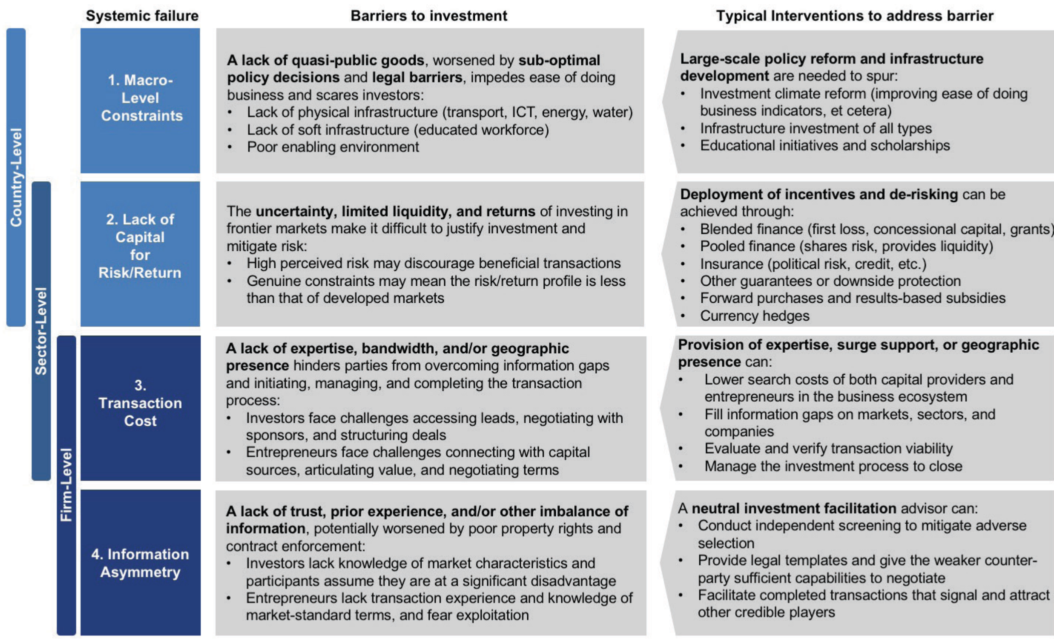
Recently, an April 2019 paper from Paul Collier and two thought leaders at the International Finance Corporation (IFC), Neil Gregory and Alexandros Ragoussis, argues that the key need in fragile states is more pioneer first-mover firms that "can grow and diversify the market in ways that no other firms do," noting that their central challenge is coordination, since "individual firms in fragile contexts face great risk and uncertainty in knowing what other firms will do."[9] They go on to state that "pioneering firms face heightened private costs which generate social benefits beyond the firm . . . The discovery process they undertake generates information on risk and reduces uncertainty, benefitting all firms and investors. This provides a rationale for subsidizing initial entry costs to correct for this externality."[10]

Finally, the U.S. Agency for International Development (USAID), which has had a long history of engagement with the private sector including reviving capital markets and starting enterprise funds in Eastern Europe after the fall of the Soviet Union, has re-embraced its engagement with private investment. Its Power Africa initiative, for instance, explicitly took a "transaction-centered approach to directly address the constraints to project development and investment in sub-Saharan Africa's energy sector."[11] In December 2018, USAID released a new Private Sector Engagement Strategy that speaks of "reorienting our investments to open markets for U.S. firms," matching "local savings with investment opportunities", and formally incorporating investment facilitation as a part of U.S. development strategy.[12] Finally, the newly announced U.S. government-wide Prosper Africa strategy also has transaction facilitation as a key line of effort, alongside approaches such as synchronizing U.S. government capabilities and fostering better business climates with robust financial markets.[13]

A more nuanced view

Although the initial views of the 2013 report have been validated through practical application over the past five years, it is necessary to refine the framework (Figure 2) in order to better reflect the specific barriers faced by investors and companies in the field as well as the best means of addressing these challenges.

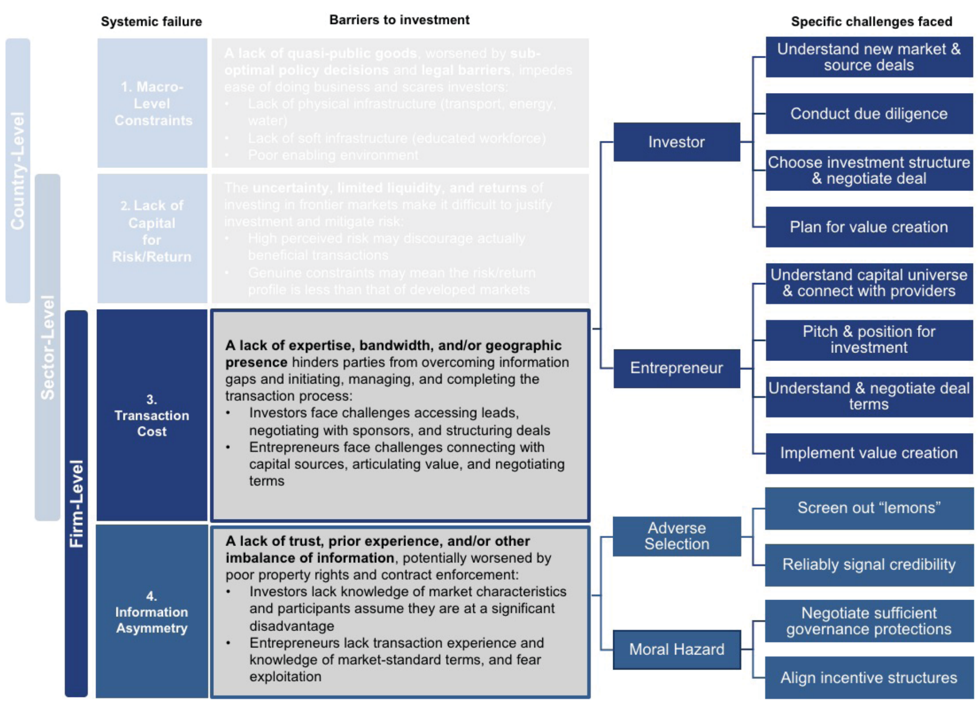
Figure 2: Updated 2019 Investment Facilitation Framework



Source: by authors

Going a level deeper, experiences over the last few years have given the authors substantial insight into the specific challenges that investors and entrepreneurs face within firm-level barriers, as depicted in Figure 3.

Figure 3: Updated Investment Facilitation Framework, Highlighting Firm-Level Barriers



Source: by authors

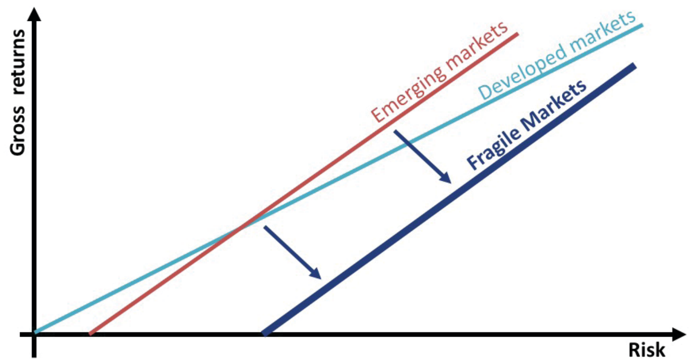
THE DEFINITION OF COUNTRY-LEVEL FAILURES HAS BROADENED, AND THE SOLUTION SET NOW INCORPORATES BLENDED FINANCE TERMINOLOGY

Although the approach here has not changed in any material way, the discussion has been reframed to talk about "macro-level constraints" rather than "lack of quasi-public goods" and "lack of capital for the risk/return profile" instead of "idiosyncratic risk." The first change, to "macro-level constraints," widens the aperture of the conversation to encompass the full range of country-level government failures and infrastructure and human capital challenges. While not the focus of this report, these are the subject of substantive literature and existing development efforts; furthermore, some of these challenges can be prioritized and addressed in parallel with investment facilitation interventions, since a transaction-centered approach helps identify the most pressing obstacles to business (rather than simply highlighting where a government or country lags behind generic best practices).[14]

The second reframing reflects that challenges in emerging markets are not restricted to unpredictability and inadequate risk-sharing. Rather, there is sometimes a fundamental mismatch between the risk/return profile and the expectations of available capital: if returns are too low, even impact-minded investors move their capital to comparatively more attractive opportunities elsewhere. These mismatches can be sector-based, such as the challenging returns of rural mini-grids, or place-based, such as the average 5 percent net internal rates of return (IRR) often seen from first time funds in fragile states (see Figure 4).[15] Such difficulties may be consistent across sectors or geographies for a given type of investment, or they could come from local gaps that may justify cross-cutting interventions, such as a lack of cost-effective vocational training for the needed workforce.

Beyond traditional development programming, blended finance has received increased attention as a way to mitigate these challenges. The core idea of blended finance is using catalytic capital from public or philanthropic sources to increase private sector investment, particularly in developing countries and for sustainable development.[16] It makes the risk/return profile of uncertain investments palatable to private investors by subordinating patient and concessional (and often first-loss) funding. In this way, blended finance can compensate for country-level or sector-level barriers—including currency volatility, a weak business environment, and challenging asset classes, such as rural agriculture. Most commonly, investment firms use the term "blended finance" to refer to structures that improve returns through concessional capital, or that protect returns through insurance or guarantees. However, in some definitions, blended finance can also include grant-funded transaction assistance and ongoing technical support. Ultimately, blended finance is an important complementary intervention to investment facilitation.

Figure 4: Stylized Framework of Gross Returns for Individual Investments in Fragile Markets



Investing in FCS presents unique risks…	• Higher political risk and security risk (elections, violence) • Severe lack of institutional capacity and/or malignant institutions • Heightened macro risks present in other markets such as currency	
… and both opportunities and challenges in generating returns	Factors **improving returns** in FCS: • Low competition (first mover advantage and perception arbitrage) • Potential access to concessional financing (lower cost of capital) • Low cost of land (can be difficult to secure) • Low cost of labor • Access to technical assistance can lower operational and governance risk	Factors **hurting returns** in FCS: • Cost of inputs (other than labor) typically higher • Limited infrastructure • Limited management talent/human capital • Expensive debt • Small/fragmented markets • Smaller transactions with risk of 'crowding-out' the entrepreneur

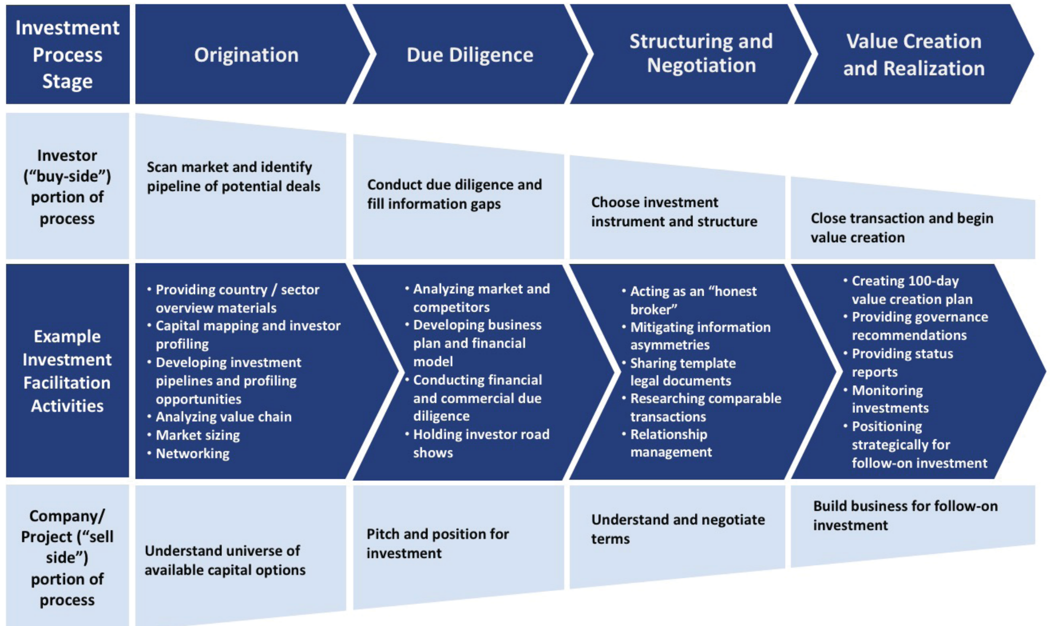
Source: CrossBoundary report for IFC SME Ventures: "Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations " 2018

Source: CrossBoundary report for International Finance Corporation (World Bank Group), Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations.

TRANSACTION COST BARRIERS EXIST BOTH FOR INVESTORS AND FOR ENTREPRENEURS, AND THEY OFTEN PUT FIRST MOVERS IN NEW SECTORS/GEOGRAPHIES AT A DISADVANTAGE

Firm-level transaction costs are a major barrier to mutually beneficial transactions. Although they affect investors and entrepreneurs in different ways, they often create a first-mover disadvantage, particularly in new markets and new sectors. Practical observations since 2013 have now made it possible to map examples of transaction costs at each step of the investment process (see Figure 5).

Figure 5: Transaction cost barriers in a typical investment process



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

Source: by authors

These transaction cost barriers pose direct obstacles to initiating, managing, and completing the transaction process. Deals are complex, especially for investors looking to enter new markets with high levels of informality and scarce information. To complete a deal, an investor must:

- understand and scan a new market for opportunities, then source/originate deals from that market;
- conduct due diligence on individual deals;
- choose the appropriate structure/investment vehicle and negotiate the deal; and
- plan for value creation and realization, including operational improvements and an eventual exit.

Similarly, for entrepreneurs and their firms, participating in a deal involves considerable complexity in a domain where they usually lack expertise. They must:

- understand the universe of capital sources available (debt and equity, at concessional or market rates, as well as grants or other "blending" tools), then identify and connect with capital providers;
- create pitch materials and position themselves for the best available investment (often this includes formalizing their business, undergoing their first audit, and putting governance in place);
- understand and negotiate deal terms, often across the table from far more experienced investors; and
- implement the post-investment value creation plan and preserve flexibility for future investors.

In fragile and frontier markets, the cost of each step in the deal process can be substantial, especially when few template transactions exist. Many investors thus opt to "stick to their knitting" and invest in markets and sectors they already know well.[17]

TEXTBOX 1: INVESTMENT FACILITATION IN PRACTICE—OVERCOMING TRANSACTION COST BARRIERS

A New York-based asset management company with limited prior experience operating in east Africa engaged an investment team when it was contemplating investing in microfinance institutions in the region.

The asset management company faced significant but necessary hurdles in their due diligence to understand the regulatory and competitive environment. Given that the transaction was small and uncertain, the opportunity cost of sending the NYC team to the region for proper diligence was hard to justify and the expenses could easily reduce the net return below an acceptable level. Although the investor had the necessary expertise, without the availability of local investment facilitation the deal-making barriers would have been too costly to surmount.

The transaction team provided extra resources (i.e., bandwidth), and brought to the table extensive market knowledge on the East Africa microfinance landscape and legal issues (thanks to its geographic presence). These resources ramped up quickly, completed the work cost-effectively and at a high standard, and rolled off after the engagement.

There are information gaps underlying many transaction costs. Gaps typically manifest in the course of investor due diligence or when a company seeks to raise capital and grow. Most commonly, information gaps are caused by a lack of bandwidth to undertake diligence and analysis, a lack of appropriate geographic presence, or a lack of expertise.

Both sides of a transaction face gaps in information, albeit in different ways and to differing extents. For investors, this typically manifests as a lack of contextual understanding of markets where they might invest, along with an inability to access reliable on-the-ground data. On the other hand, entrepreneurs spend most of their time operating a business rather than seeking investment, so they often lack a deeper knowledge of corporate finance and a perspective beyond their firm. As a result, both investors and entrepreneurs need to acquire additional bandwidth, expertise, and presence to bridge information gaps and thereby complete a transaction. All of this can be accomplished efficiently through external service providers.

17. As argued in the aforementioned Paul Collier et al. paper: "the fixed costs of creating a new market . . . are significantly higher. . . . They are partly research costs—about the market, the regulatory framework, the quality and cost of labour, the quality of infrastructure, and so on which are unobservable costs until the first firm attempts production. Then other firms can free-ride on the market information revealed by the entry of the first firm."

TEXTBOX 2: INVESTMENT FACILITATION IN PRACTICE—OVERCOMING COMPANY-SIDE INFORMATION GAPS

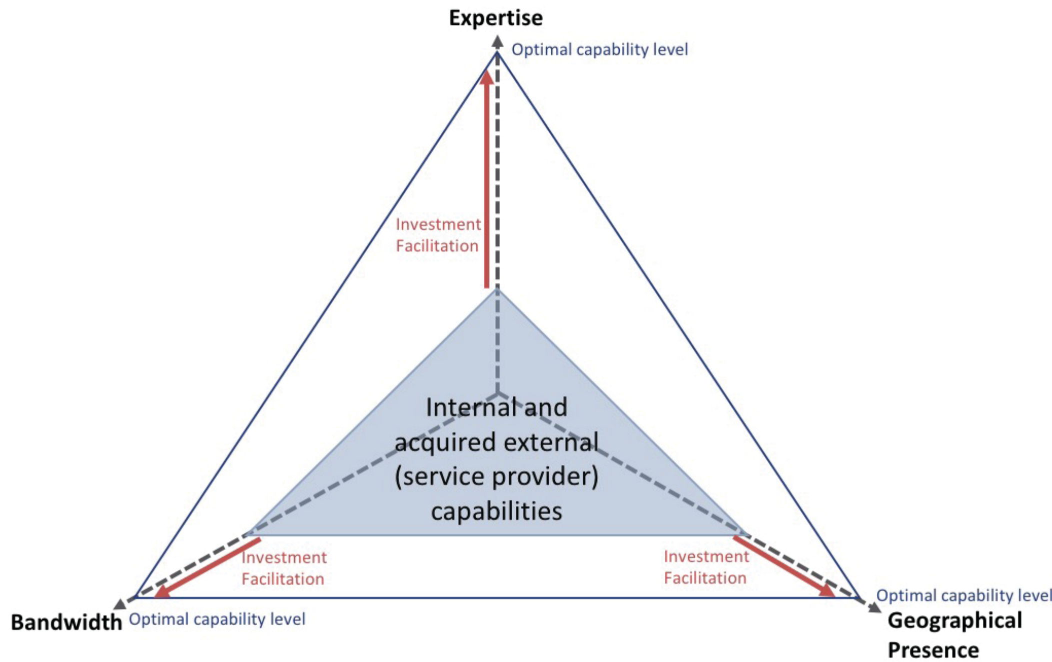
CrossBoundary worked with Sidai, a Kenyan provider of crop inputs and animal husbandry, which was seeking commercial capital for the first time and was unable to fully undertake the high fixed cost of learning how to pitch itself to investors.

Working in periodic interventions over 31 months, CrossBoundary helped the company build a financial model from scratch, spending weeks working closely with its accounting department to get the relevant financial information, with heavy involvement of the senior management team (demonstrating expertise, bandwidth, and geographic presence). In addition, CrossBoundary offered advice on which aspects of the client's business would be attractive selling points to investors, allowing Sidai to restructure its pitch to tell a compelling story.

In developed markets, investors and investee companies are likely to already have a high level of internal bandwidth, expertise, and presence. Additionally, external service providers are numerous, and they have the capabilities to supply the remaining required bandwidth, expertise, and presence to complete the transaction. Given the risk/return profile of these markets, as well as the size of an average deal, investors and firms in developed markets can afford to incur the internal and external transaction costs required to get the deal over the line.

In fragile markets, however, the internal supply of capabilities from investors or investees is frequently weaker. External capabilities may be scarce, or they may be unaffordable for the size of deal or the risk/return profile. For example, investors may lack presence in the markets they wish to invest in (e.g., virtually no equity investors have an office in Mali), and small teams may have little bandwidth available for undertaking due diligence. International service providers may not have sufficient local presence to provide adequate transaction support, and certain parts of the transaction chain may be lacking in local service provider expertise.

Figure 6: Helping Investors and Entrepreneurs with the Capabilities Needed for a Transaction to Close



Source: by authors

Investment facilitation can help market participants overcome these transaction cost barriers by:

- increasing internal bandwidth, local presence, and expertise, for example by carrying out local market monitoring or due diligence tasks;
- increasing service provider expertise as well as filling gaps in the service provider market where it is not possible to do so, for example by providing structuring advisory services; and
- reducing costs to investors and firms by utilizing a donor-oriented model.

In nascent markets, transaction costs often require testing and developing the regulatory environment for the country as a whole, forming a feedback loop with the macro environment. For example, a transaction advisory team worked with an Ethiopian poultry company to build an appropriate foreign debt investment structure. After a deep dive into the Ethiopian regulatory environment and legal precedents, the advisory team identified suitable ways to access debt funds from abroad. This process included interviewing local legal experts and representatives from the National Bank of Ethiopia to test the regulatory framework. The provided structuring options and case studies supported the successful closure of the debt fundraising; they also suggested potential policy changes that could ease future investment.[18] This facilitation process serves the public good, since assisting even one investment to overcome transaction costs benefits not only the firm in question, but sectors and countries as a whole.

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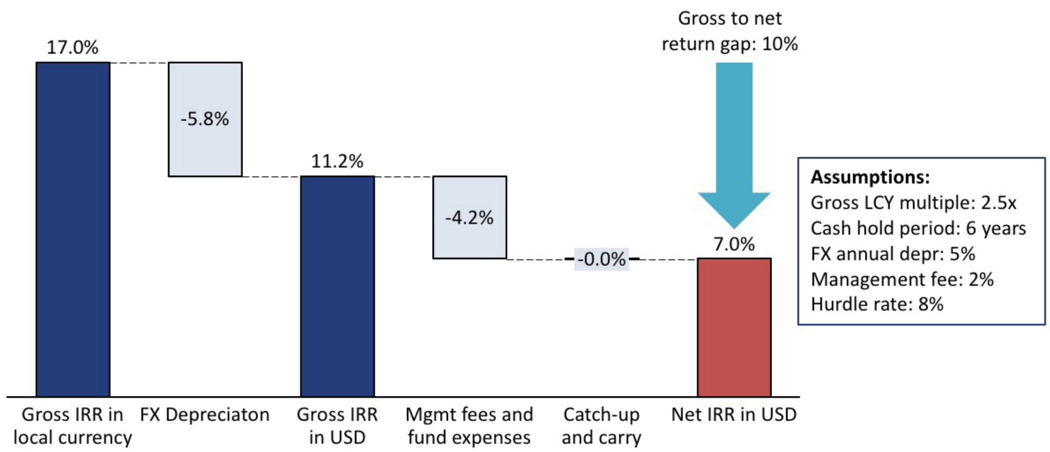
18. This transaction in Ethiopia as well as the other East African case study vignettes mentioned were completed by a team from CrossBoundary's Nairobi office, functioning from 2015–2019 as the Transaction Team for USAID's East Africa Trade and Investment Hub, implemented by DAI.

One final practical illustration of transaction costs is the high gross-net return gap that can be observed in most frontier market funds (see Figure 7[19]). In line with reporting from several development finance institutions, our research suggests that frontier market funds for small and medium-sized enterprises have an average gap between the gross return (i.e., the return on the individual investment, before management fees and costs are taken into acount) and the net return (what the fund's limited partners actually receive) of 8 to 10 percent, compared to 5 to 6 percent for wider emerging market funds and 3 to 4 percent for developed market funds. In fact, the largest private equity funds in developed markets frequently make a substantial portion of their profits from management fees (usually 2 percent of invested capital), whereas funds in frontier markets generally pay sub-market salaries relative to other investment firms and still do not fully cover their expenses.

Figure 7: Illustrative Gross-Net Return Gap for an SME-focused Fund in Fragile States



Source: CDC Group, "SME Ventures Forum" (presentation in London, UK, October 2018). CDC makes no representation as to the accuracy or completeness or the information presented.

INFORMATION ASYMMETRY IS DISTINCT FROM INFORMATION GAPS

Information asymmetry refers to an imbalance where one party has important private knowledge the other does not, creating an advantage for the former. It is worth noting, as Joseph Stiglitz said in his Nobel Prize lecture in 2001, that information asymmetry is not just a transaction cost.[20] Rather, information asymmetry leads to problems of adverse selection (where, for example, less capable firms may have a greater incentive to conceal their underperformance as they seek investment) and moral hazard (in which, for instance, investors have an incentive to deceive unsuspecting entrepreneurs by hiding onerous or unfair terms in deal documentation). The deep-seated mistrust between parties generated in this way cannot be rectified with the simple provision of information.

TEXTBOX 3: INVESTMENT FACILITATION IN PRACTICE: OVERCOMING INFORMATION ASYMMETRY

An investment facilitation team supported the wary founder of a Tanzanian medical business through a capital raise process. The entrepreneur had previously been forced to buy another investor out of the business due to unfavorable terms, causing the company to incur substantial debt. As a result, the entrepreneur was mistrustful of investors and wary of bringing new ones into the business.

Support came via a capital raise process that provided an in-depth valuation exercise, enabling the entrepreneur to evaluate whether the investors' proposal was reasonable (thanks to the team's expertise). Furthermore, the team provided a credible screen to help the company determine which of the proposed deal terms were market-standard (demonstrating their role as an honest broker). Getting the terms right prepared the company for a productive long-term partnership with the investors.

The difficult negotiations were greatly helped by the presence of a neutral intermediary that understood the needs of both parties involved. Eventually, the transaction was brought to a successful close. The investment facilitation team helped the entrepreneur overcome his initial distrust, come to the negotiating table with a strong grasp of the issues that mattered to his business and himself, and reach a deal in which he felt confident.

Absent investment facilitation, information asymmetries often fail to be resolved, as there is no intermediary present to screen out proverbial "lemons" or to assess the credibility of the players involved.[21] As observed by Roy Radner and Joseph Stiglitz in 1984, there is a fundamental non-concavity in the value of information: it rarely pays to buy just a little bit of information, because worthwhile information collection has fixed costs associated with it.[22] Put differently, it may not be economical for honest broker intermediaries—such as auditors, credit bureaus, or other trusted advisers—to exist in shallow markets. Per Hector Chade and Edward E. Schlee: "agents will not buy small quantities of information; and agents will tend to specialize in information production."[23] Consequently, the default state tends towards distrust and low quality of information. A recent working paper from Harvard Business School defines emerging markets as countries where "institutional voids (an absence of intermediaries) leaves participants struggling to find ways to bring buyers and sellers together to engage in mutually productive exchange."[24]

21. George A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," *The Quarterly Journal of Economics* 84, no. 3 (August 1970).
22. Roy Radner and Joseph E. Stiglitz, "A Nonconcavity in the Value of Information," in *Bayesian Models in Economic Theory*, ed. Marcel Boyer and Richard J. Kihlstrom (Elsevier, 1984), 33–52.
23. Hector Chade and Edward E. Schlee, "Another Look at the Radner–Stiglitz Nonconcavity in the Value of Information," *Journal of Economic Theory* 107, no. 2 (December 1, 2002), 421–452.
24. Cheng Gao, Geoffrey Jones, Tarun Khanna, and Tiona Zuzul, *Overcoming Institutional Voids: A Reputation-Based View of Long Run Survival, Harvard Business School*, 2017, https://www.hbs.edu/faculty/Publication%20Files/17-060_9db63930-4475-4eb5-ac48-a660e2d80690.pdf.

The distrust prevalent in emerging markets means that only firms that can already self-finance and vertically integrate will demonstrate growth. Research by the McKinsey Global Institute found that high-performing African businesses were twice as likely to have a vertically-integrated supply chain—and three times as likely to own their own distribution fleet—than comparatively lower-performing businesses.[25] In Tarun Khanna's book *Trust: Creating the Foundations of Entrepreneurship in Developing Countries*, he notes that "the absence of trust means that folks either must spend time and money to reassure themselves about mundane things, or must simply avoid doing them."[26]

Finally, the problems arising from information asymmetry differ depending on whether the investment instrument is debt versus equity, as well as whether local contract enforcement and property right protections are sufficient to reduce the perceived risk. When investors are confident in their ability to claw back their investments when things go awry, information asymmetry poses a less severe threat. However, this is by no means certain in frontier markets: as elucidated by Lant Pritchett and colleagues, a key feature distinguishing these markets from developed ones is the existence of a gap between official laws and "what actually happens."[27] That is, although the de jure legal regime adequately protects property rights, in practice such rules may be enforced inconsistently, increasing the severity of the information asymmetry barrier.

TEXTBOX 4: INVESTMENT FACILITATION IN PRACTICE—OVERCOMING INVESTOR-SIDE INFORMATION GAPS

CrossBoundary worked closely with Dutch impact investor Cordaid for a first-time investment in Mali. Prior to the investment facilitation team's involvement, Cordaid had never visited the country—and now, two years in, they have made three investments there.

The CrossBoundary team supported Cordaid in overcoming the significant information gap present in the fragile market of Mali. This involved producing a large volume of detailed information, analyzing data at country, sector, and specific opportunity levels (offering expertise). The investor was reassured by the team's presence on the ground and appreciated their capacity to screen local project promoters (i.e. the team's geographic presence).

Cordaid's investments in Mali include a waste management company and a mango processing facility, and Cordaid has written to the Mali Investment Authority with a commitment to future investments.

How donor-supported investment facilitation reduces firm-level barriers in practice

SUCCESSFUL INVESTMENT FACILITATION HAS SEVERAL KEY FEATURES

Firm-level barriers are real, but they are surmountable. Investment facilitation uses targeted assistance to reduce transaction costs and information asymmetries for investors and companies, in order to catalyze developmentally beneficial investments. Moreover, this is accomplished without the donor needing to invest directly into the company or project. A few key features stand out in effective investment facilitation:

1. Facilitation teams should be independent, and they should be perceived as honest brokers by investors and companies. This is important because a neutral third party has the necessary credibility to screen both sides of a transaction, which is critical for overcoming information asymmetry. Intermediaries should build trust and mission-alignment with both investors and donor partners, and to this end international reputation, shared vision, and long-standing relationships are essential.
2. The role of the intermediary should not solely be that of a "development contractor" or pure donor-facing player. Instead, the intermediary should also be providing private investment advisory work in other deeper and more established markets. Ensuring that the intermediary is thusly incentivized to grow and to protect its long-term reputation avoids the risk of it forcing unproductive investments to occur for the sake of the donor project (which would ultimately undermine the model in the long term).
3. Intermediaries should have demonstrable commitment to long-term goals (combined with trust and mission-alignment) and to rigorously avoid gaming (i.e., when intermediaries pick transactions that are already highly likely to occur without help or overstate leverage/additionality), in order to ensure the additionality of services provided and to maintain intermediary and donor reputations.
4. Having a small, dedicated, highly skilled team with a permanent geographic presence enables the intermediary to economize information acquisition, which is necessary to reduce transaction costs. This provides expertise and bandwidth to highly constrained investors and entrepreneurs, effectively increasing their capacity and capabilities for the surge periods of need during a transaction.
5. The investment facilitation model is most impactful and sustainable when this dedicated team takes a portfolio approach, taking on a basket of transactions with varying likelihoods of success, sizes, and types (debt, mezzanine, equity, blended). This enables support for riskier, highly catalytic transactions, while also ensuring that at least some transactions successfully close. This approach requires the donor to provide a predictable budget to the facilitation team in order for them to confidently apply their efforts to long-term projects that have a significant risk of not reaching closure, although success-based payments can also be incorporated.
6. Having a diverse set of capabilities is imperative, as the tasks completed by the intermediary vary across the deal lifecycle. These required skillsets range from tapping into networks to access capital providers and others in the business ecosystem, along with understanding what drives markets, sectors, and enterprises,

to producing investor-ready insights and materials, as well as managing the investment process to effectively close transactions.

Investment facilitation approaches differ from the small to medium enterprise (SME) technical assistance programs of the past, and other classic development interventions, in several key ways. First, in addition to sector- or country-wide interventions, they are oriented to the narrower focus of transactions, which makes it easier to measure and demonstrate success or failure (since successful or failed transactions are typically self-evident within a relatively short period of time). Second, compared to typical donor interventions, facilitation begins at the single firm level, focusing on specific problems from the bottom up rather than relying on a top-down vision of what general interventions might be beneficial. Third, in contrast with the technical assistance typically funded by development finance institutions (DFIs), such as donated "sidecar" technical assistance, investment facilitation generally works with seekers of capital first and foremost, and the assistance is not limited to one private equity fund but can be spread across all interested investors. So although other interventions produce valuable results, investment facilitation is a distinct tool with a clear role in the development landscape.

INVESTMENT FACILITATION BUILDS THE INVESTMENT ECOSYSTEM AND OVERALL MARKET SYSTEM, REDUCING COUNTRY-LEVEL AND SECTOR-LEVEL BARRIERS OVER TIME

Additional forces sustain the impact of investment facilitation beyond the bounds of any given transaction. Although the intermediary completes its work on a deal-by-deal basis, over time it builds a substantial body of institutional knowledge and a long-term reputation as a credible third-party advisor. The capacity of all other parties involved in the transaction is also increased with each facilitated deal. As institutional knowledge accumulates, transaction costs decrease, and the intermediary's productivity increases accordingly. Further, non-confidential knowledge and analysis can be shared, either publicly or selectively, with other investors, enterprises, and intermediaries in the ecosystem who were not involved in that particular transaction.

Investment facilitation reveals information that feeds back into policy. A considerable amount of information tends to be revealed during transactions, given that most parties have incentives to surface relevant information. In addition to using this information to facilitate the investment directly, the intermediary can directly or indirectly feed information revealed during transactions back to policymakers, which can play a role in removing country-level barriers. This facilitates strategic coordination between the private sector and government and can be a catalyst for meaningful reform.

Investment facilitation is at its best when situated within a market system approach. Techniques like binding constraints analysis or value chain mapping can be used in order to thoughtfully examine which specific transactions are most likely to have system-wide effects—either directly or indirectly, through their demonstration value. The market system approach also means delivering replicable tools and services and helping build up an ecosystem of service providers able to make use of these tools and services. As Paul Collier et al. note, "The first firm to enter bears the costs of helping regulators, customs agents, banks, trading partners, and others to climb the 'learning curve' . . . [they also] cannot prevent trained labor from being poached by later entrants, so they are left with a cost of training labor that is of benefit to all firms in the market."[28] The notion that pioneer firms can encourage needed changes in the market system of developing countries more effectively with a "pull" approach than with classic development "push" approaches is also advanced in Harvard innovation guru Clay Christensen's recent book *The Prosperity Paradox*.[29]

Countries and donors should thoughtfully select the right sectors for investment facilitation focus. In a forthcoming paper in collaboration with the Tony Blair Institute, the present authors expand on the benefits of utilizing an informed sector approach. Namely, this provides a mechanism of focus and prioritization that takes into account both the efforts of classic macro-development interventions, which seek to "set the table" and improve the enabling environment, and the firm-level transactional approach.

Sectors can be prioritized in several ways. From the perspective of the country, moving into the production of more complex products can increase innovation and growth. Further, the political economy is relevant, since certain sectors create economic incentives for elites and institutions to be more inclusive, based on whether sectors are rent-seeking or competitive, export-oriented or domestically focused, etc.[30] Lastly, some donors may wish to take into account their own country's comparative advantage in contributing to investments, to the extent that they are specifically interested in increasing home-country investment and trade with the developing world.

The analysis of which sectors are good for the country should be overlaid with an analysis of which sectors make sense from an investment perspective, broadly considering sector profitability, relevant resource base, and market size/competition. In frontier markets, investors typically find four categories of companies most attractive: first, those with revenues in hard currency, such as tourism and export-oriented agriculture; second, companies insulated from international competition, such as non-tradable goods with high transport costs like logistics, construction materials, retail, and hospitality; third, companies with restricted domestic competition (monopolies or oligopolies), such as telecoms, toll roads, energy, and other sole-license businesses; and fourth, what we call opportunistic comparative advantage companies, such as extractives or unusual high value crops specific to a country.[31]

In some cases, the optimum sectors derived from a Venn diagram of these considerations may overlay neatly with existing private investment interest. In other cases, they may not, and targeted government assistance or donor intervention can help draw private investment into the key sectors, whether through investment facilitation or through direct support to investor returns.

Finally, investment facilitation fits well as a tool within the existing ecosystem of development actors. The chart below illustrates how investment facilitation has been deployed in the context of U.S. development tools, as well as the how it could be in the

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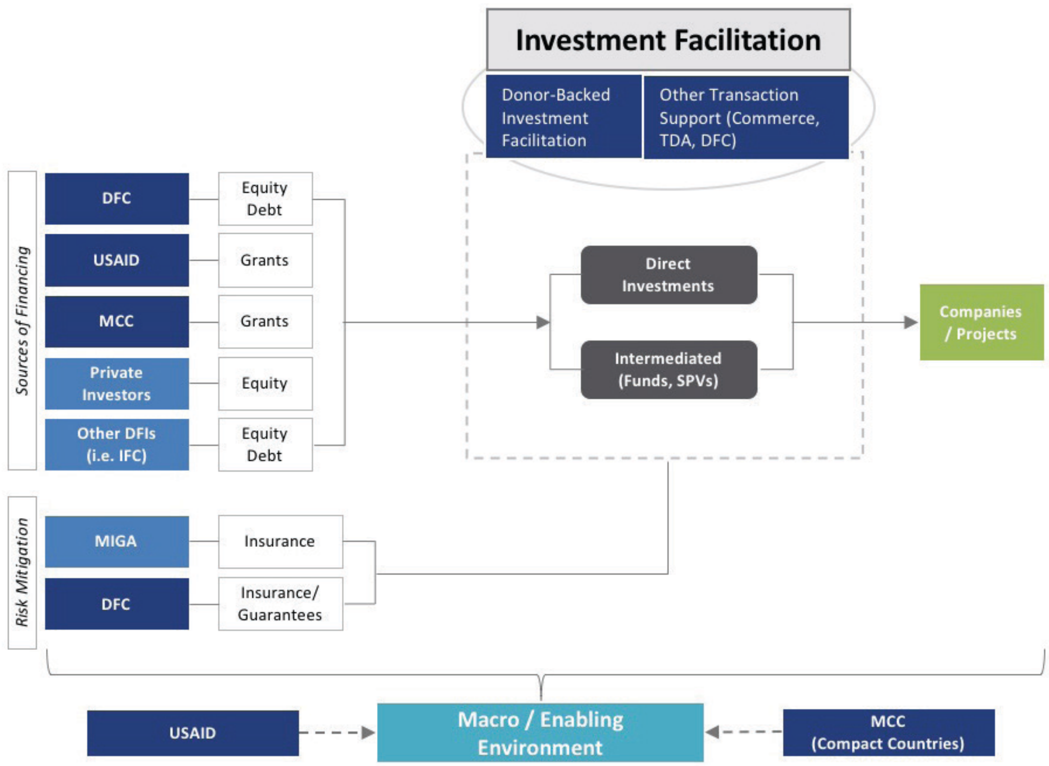
28. Paul Collier, Neil Gregory, and Alexandros Ragoussis, "Pioneering firms in fragile and conflict-affected states: Why and how development financial institutions should support them," *Blavatnik School of Government Working Paper Series* (April 2019): 14, http://documents.worldbank.org/curated/en/602071552331498209/pdf/WPS8774.pdf.
29. Clayton Christensen, Efosa Ojomo, and Karen Dillon, *The Prosperity Paradox: How Innovation Can Lift Nations Out of Poverty* (New York: HarperBusiness, 2019).
30. Lant Pritchett, Kunal Sen, and Eric Werker, *Deals and Development: The Political Dynamics of Growth Episodes* (Oxford: Oxford University Press, 2018).
31. International Finance Corporation (World Bank Group), *IFC SME Ventures: Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations*.

future with the newly empowered U.S. Development Finance Corporation (DFC, which will replace the Overseas Private Investment Corporation or OPIC on October 1, 2019). Given the recent justifiable excitement around the Better Utilization of Investment Leading to Development (BUILD) Act and the new DFC, it is important to note that robust transaction support and investment banking "sell side" solutions on the ground are still required to prep companies and projects for investment, whether that capital ultimately comes from the DFC or others.

Figure 8: Supporting the Empowered USDFC and Other Providers of Capital for Unlocking Transactions



Source: by authors

4 | Lessons and Critiques

Based on research into investment facilitation since the 2013 CSIS report, the authors have learned several important lessons that guide future work and have implications for the theory of change. As investment facilitation becomes a part of the standard donor toolkit for economic development, it is vital that programs be designed to maximize the desired development impact. As a result, we propose some modest recommendations that should be integrated into investment facilitation program design.

Firm-level barriers, and the resulting need for intermediation, differ along several axes

DIFFERENT TYPES OF BARRIERS ARE RELATIVELY MORE PROMINENT FOR INVESTORS VERSUS ENTREPRENEURS

Although selection effects prevent us from making precise quantitative claims about the relative prevalence of each kind of barrier, it is possible to make some useful generalizations on the most prominent needs of investors and companies:

- First-time investors and first-time capital raisers more commonly suffer from a lack of expertise, since there is a lack of template transactions or experience from which they can draw.
- Experienced investors (often associated with larger funds) still suffer from information gaps, since frontier markets typically have small deal sizes—which can only justify small due diligence and management efforts, leaving funds unable to conduct in-depth due diligence or create adequate value creation plans. They are less likely to need additional expertise, but often need surge bandwidth or local presence support.
- Outside investors, whether first-time or experienced, need a local presence, something that is provided by investment facilitation.
- Smaller funds ($100 million or less) and smaller companies are more likely to have their own local presence (small funds usually invest in their own geography), but they are often chronically understaffed for structural reasons and need surge bandwidth at critical moments, in addition to expertise.

TWO TYPES OF INTERMEDIARIES MAY BOTH BE MISSING FROM THE MARKET

This report has focused on the absence of advisory intermediaries, whose role is to economize on information costs and lower transaction barriers for a wide set of investors.

However, this is only one of the two distinct types of intermediaries that are often absent—and needed—in fragile markets.

As already explained at some length, *advisory intermediaries* are needed to reduce firm-level barriers and to drive economically beneficial transactions within the context of transaction costs and information asymmetry. Beyond catalyzing the deal, investment facilitation also helps close the gap between gross and net returns by absorbing some of the transaction costs that would otherwise fall on the investor.

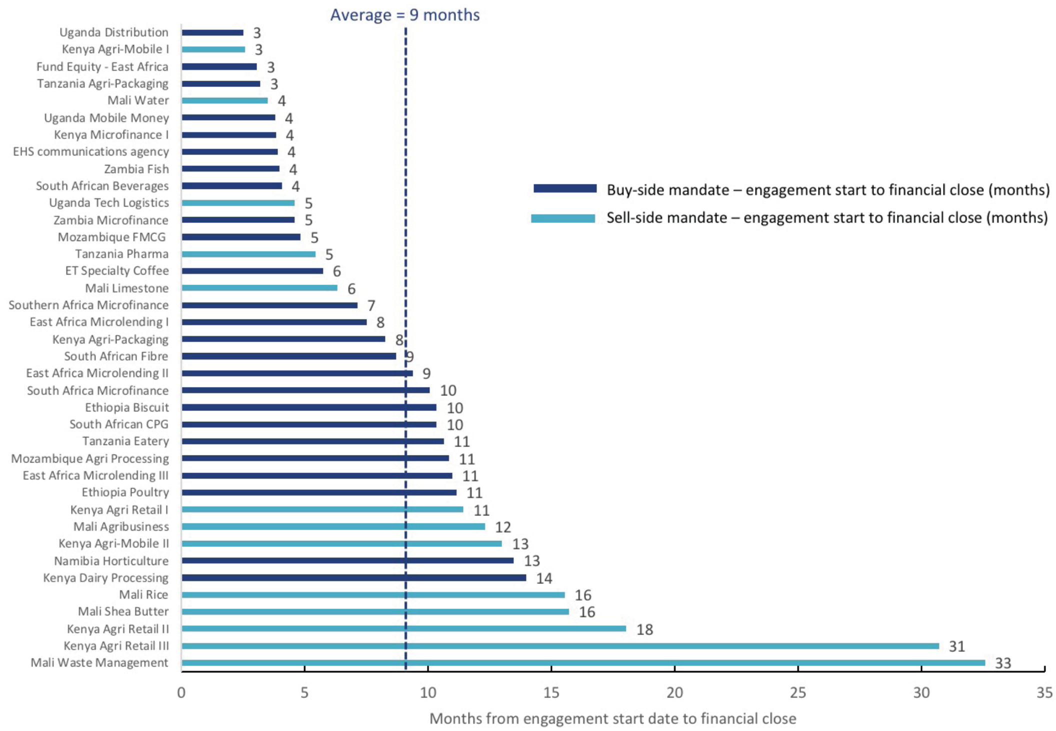
Additionally, new *investment/capital supply intermediaries* may also be required, for two reasons. First, institutions may have a hypothetical interest in investing in a given sector or country, along with pools of finance for the purpose, but may lack a trusted channel with a local team to deploy that capital. For example, although there is international capital interested in the Sahel region, there are few credible regional equity funds available for receiving investment. Second, the potential gross returns in a given sector may not reach rates considered commercially viable. For instance, stand-alone rural mini-grids in Africa usually offer a 5 percent or less IRR—a rate of return too low for the level of risk. Blended finance, structured through capital supply intermediaries, is thus an essential ingredient for crowding in private investment. Integrated investment facilitation programs should therefore consider deploying blended finance through investment/capital supply intermediaries as an effective accompanying intervention to supporting advisory intermediaries.

PATIENCE AND PERSISTENCE ARE NECESSARY FOR GETTING TRANSACTIONS DONE

Often, a neutral facilitator must contribute "hustle" beyond the initial mandate of the transaction. When the intermediary sees an economically beneficial transaction hit a slow spot—such as faltering levels of interest, or a communication breakdown between investor and entrepreneur—it is up to them to shepherd the process along. Excellent due diligence reports, financial models, and match-making may not be enough–a more ineffable show of grit is also required.

On average, successful facilitated transactions reviewed for this report took nine months to complete from the time of formal engagement of the transaction team. The chart below (Figure 9) shows the number of months from the engagement start date to financial close date for a set of completed transactions in Africa, where "financial close" indicates the execution date of the transaction's binding legal agreements.[32] Overall, the transactions took between three and thirty-three months to reach financial close; on average, sell-side mandates took five months longer to close than buy-side mandates, which is unsurprising since buy-side support begins with an already interested investor. In many instances, without the investment facilitator's continuous support financial close would have been further prolonged, or not been achieved at all.

Figure 9: Select Set of Facilitated Transactions, Time elapsed from Engagement Start Date to Financial Close Date



Source: by authors

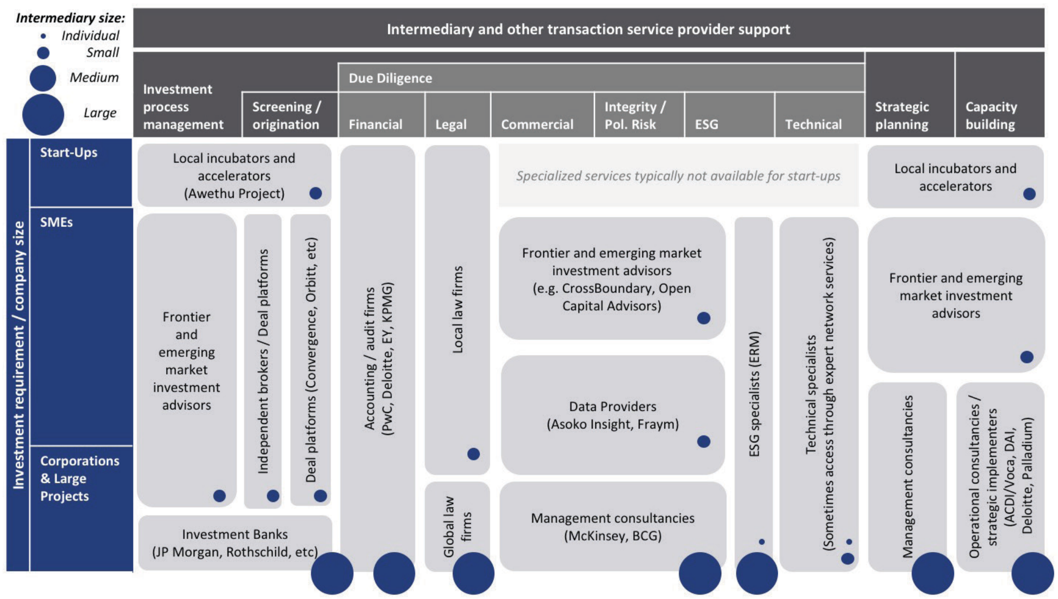
Local advisory players, beyond the lead investment facilitation firm, should be integrated into the process

As noted above, investment facilitation is most successful when the implementing advisory team establishes a permanent geographic presence. The lead implementing firm may be local or may be an international firm looking to establish a presence in the region. In either case, the engagement of a range of existing local intermediaries is also critical to help ensure the sustainability and system-wide impact of investment facilitation.

The range and sophistication of intermediary capabilities varies widely in any given market and for any specific skillset. In order to serve investors and capital-seeking companies, the lead investment facilitation firm can build local capacity in two ways: by permanently filling gaps itself in a sustainable way and by working with local intermediaries (or international service providers willing to enter the market) to fill the need. Often, though, the gaps themselves are poorly understood. Some incorrectly assert that there is a complete absence of intermediaries in frontier markets, while others presume the markets are flush with highly skilled intermediaries. The reality is always somewhere in between, which is why it pays to undertake a mapping exercise to determine intermediary capabilities at the beginning of investment facilitation interventions. Once any major gaps in available services have been established, the lead investment facilitation firm and the donor can determine whether existing firms can be upskilled to fill the gaps, or whether they should introduce the services necessary to meet local needs.

The lead firm should identify all major players in a market, taking into consideration the various categories of transaction support service providers as well as the range of investment size requirements (see Figure 10).

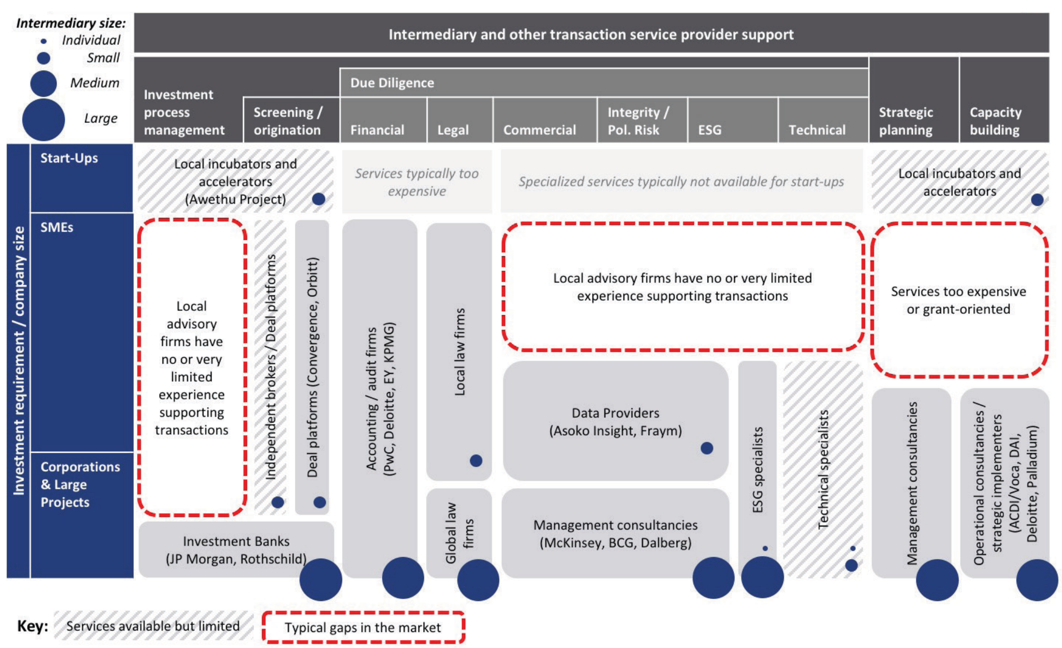
Figure 10: Representative Map of an Established Intermediary and Transaction Services Ecosystem



Source: by authors

The lead firm should then identify any major gaps in the existing market (see Figure 11).

Figure 11: Typical Frontier Markets Investment Ecosystem



Source: by authors

In most frontier markets, we found major gaps in the transaction and strategic support services available for larger and more complex transactions (those upwards of $1 million and involving multiple forms of capital, such as debt, equity, and philanthropic funding). This is the niche where frontier investment advisory firms can most meaningfully contribute to improving services.

Once gaps are identified, the lead firm can propose means of filling those gaps, either directly or by building local capacity. This can be accomplished in three ways:

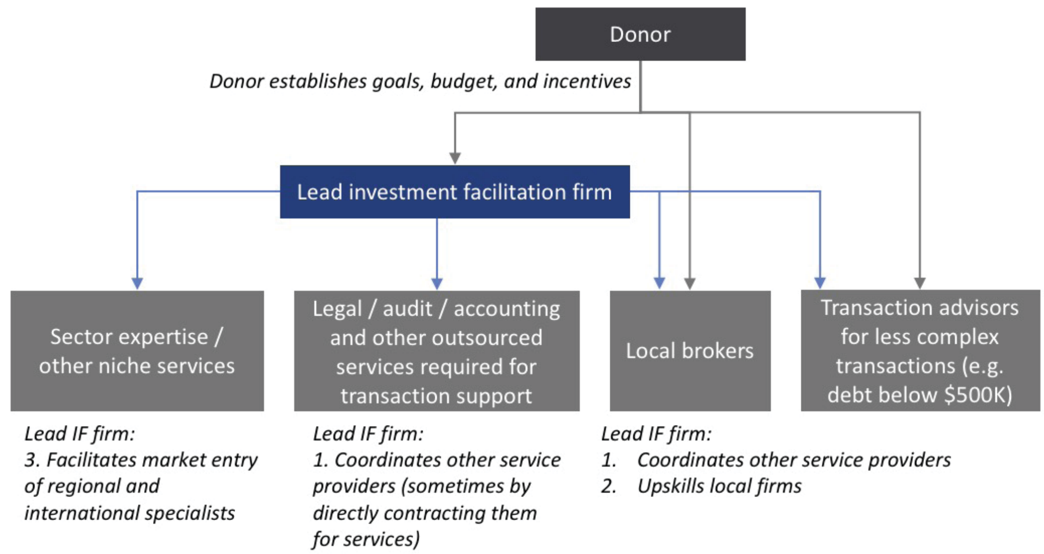
1. The lead investment facilitation firm can serve as a coordinator of local service providers, providing oversight for all transaction advisory under an investment facilitation platform. This serves to:
   - ensure cost-effectiveness by concentrating fixed cost information gathering and analysis expenditures;
   - prevent companies and investors from being bombarded by intermediaries with the same offering;
   - monitor intermediaries and ensure that kickbacks are not being given to companies and investors for providing already likely transactions; and
   - prevent the intervention from becoming an uncoordinated "hunting license" for transactions where intermediary support is neither additional nor catalytic.

   Local service providers can also be vetted and pre-qualified for the investment facilitation program, in order to ensure responsible and qualified engagement.

2. The lead investment facilitation firm can help upskill local firms, expanding on local capacity to improve skills and systems for meeting the demand of international investors and growing enterprises. Upskilling activities can include:
   - mentorship and shadowing programs, whereby local intermediaries support the lead firm on specific transactions, with the aim of gaining a better understanding of the transaction process and skills required to meet investor and company needs;
   - training sessions for independent service providers on subjects relevant to a given market's major services gaps, likely related to improving the investment readiness of local enterprises; and
   - embedding advisors from the lead firm into intermediaries, investment promotion agencies, etc., in order to build the local capacity of firms and institutions directly.

3. In areas where a local firm cannot be effectively upskilled and where the lead investment facilitation firm lacks capabilities, the lead firm can facilitate the market entry of international players. This scenario is most likely for specific large data platforms or niche service providers, such as high-end legal or technical expertise.

Figure 12: Example Structure for Investment Facilitation Coordinated by a Lead Firm



Source: by authors

Integrating local intermediaries enables investment facilitation to gradually build local capacity to support transactions, while continuing to bring transactions towards a financial close. It is only through successful engagement of local intermediaries, as well as the permanent localization of select regional and international players, that the successes of investment facilitation can be institutionalized in a given market, allowing private-sector actors to sustainably deliver relevant services.

Investment facilitation is most suited to a regional deployment model

Investors in fragile markets generally have broad regional investment mandates. Approaching a geographic region as a whole helps them overcome the shallow markets of individual countries in order to reach a scale that is both profitable and diversified. However, investors have low expertise and limited networks at the level of any individual country where they have not yet made a permanent investment.

Conversely, governments and donors operate mainly on a bilateral level, honing in on specific countries with targeted projects. This geographic mismatch can be bridged by appropriately structured investment facilitation. Optimally, donors overcome their bias toward a bilateral structure and design regional facilitation hubs that combine on-the-ground local presence with deeper centralized resources and flexibility. Local personnel are then still available to engage with the bilateral needs of donors and governments, as well as to build relationships with active investors and businesses. From a resource standpoint, a regional hub-and-spoke model enables the investment facilitator to gather expertise in the hub office, then deploy to local offices when needed, allocating staff and efforts to meet investor and business needs more efficiently than a evenly thin country-level approach would permit.

There is a need for intelligent metrics accompanied by trust and mission alignment

To date, donors have structured investment facilitation programs to substantially reward implementors on results. This is an effective approach, given that the results are tangible and measurable. However, donors should also be mindful that what gets measured gets done. If a program's design rewards implementors solely according to dollars invested, then they may be tempted to focus on the "low-hanging fruit" of large and already well-progressed transactions in order to maximize leverage and the number and size of deals closed.

In other words, the success of investment facilitation cannot be measured solely by dollars invested. It should also be measured against the development impact of the transactions, as well as the level of additionality of the facilitation provided. There is a tendency to underestimate the path-breaking benefits of small, difficult transactions in new sectors or geographies. Again, per Collier, Gregory, and Ragoussis, "the procedure for estimating the public benefit generated by each individual pioneer grossly understates the true benefit. The first entrant to the Bangladeshi garment industry employed, at most, a few hundred workers. This was not the public benefit: the public benefit was that the first entrant triggered what became a vast sector."[33]

So far, donors have mostly tried to ensure development impact and additionality by directly involving themselves in transaction selection or by putting up strict guardrails on what transactions can be chosen. Heavy direct involvement in transaction selection is problematic: it creates bureaucracy and places decision-making power further from the actor with the most knowledge of the details on the ground. Guardrails can also be a blunt instrument, overly limiting the scope of the investment facilitation program to focus only on narrow sub-sectors and sub-geographies. This can have the paradoxical result of preventing help to transactions that have a clear need and a demonstrable impact.

33. Paul Collier, Neil Gregory, and Alexandros Ragoussis, "Pioneering firms in fragile and conflict-affected states: Why and how development financial institutions should support them," *Blavatnik School of Government Working Paper Series* (April 2019): 17, http://documents.worldbank.org/curated/en/602071552331498209/pdf/WPS8774.pdf.

Figure 13: Example Multiplier Framework

	Example qualification criteria	Multiplier impact
Transaction maturity	Q.1 Are investor due diligence activities already underway?	If yes: 0.5x
	Q.2 Have investors already been actively engaged?	If yes: 0.75x (only applicable if Q.1 response is "no.")
Impact indicators	Q.3 Does the business target (or will target as a result of the transaction) any or all of the identified underserved regions?	If yes: 2x
	Q.4 Is the company woman-owned and/or do women occupy a majority of company executive positions?	If yes: 2x
Target value chains	Q.5 Does the transaction *directly* support one or more staple crops value chains?	If yes: 3x

0.5x - 7x multiplier range under illustrative program

Source: by authors

Instead, donors should consider integrating additionality and development impact multipliers into the design of their investment facilitation programs. Beyond dollar goals, donors could set a points target, where more impactful transactions increase the number of points awarded per dollar mobilized. For example, a hypothetical program intended to mobilize $100 million in investments could require 150 points. Each million dollars mobilized would be worth one point. Additional point multipliers could be applied to transactions with a female entrepreneur, in an under-served geography, and in a targeted value chain. Multipliers could also be utilized to drive a focus on additionality. Transactions supported at a late stage could be penalized with lower multipliers, while working with early-stage capital seekers could be incentivized with higher multipliers.[34] For each program, the investment facilitation team could develop specific qualification questions to determine the applicable multipliers, based on the specific objectives of the program.

Donor funding should be structured following a portfolio approach, which can be encouraged through a combination of predictable deliverable-based contracted payments and performance-based success fees. This will allow the selected intermediaries to take on a basket of transactions of different levels of difficulty, providing the long-term support that will allow them to work on riskier and highly catalytic transactions while still ensuring that some transactions successfully close. The weighting of the success fee portion should decrease when facing more fragile environments, longer time horizons, or more complicated target outcomes. Success weighting can also be reduced when there is strong confidence in the quality and long-term alignment of the transaction team. While "paying for results" may seem attractive, donors should take care that the intervention design does not encourage implementors to engage in "cherry picking," overstating additionality and prioritizing transactions that already seem likely while leaving the most difficult—but most catalytic—opportunities behind. Moreover, in some cases, the best outcome may be the investment facilitation team stopping a bad transaction from happening, as its eventual failure would have gravely damaged the reputation of a country or a sector. Ultimately, any metric will be imperfect. The integrity of the chosen implementors is the best assurance of both development impact and additionality.

Proprietary information can be more carefully separated from public-benefit work product

To be effective, donor-supported investment facilitation must rigorously protect any confidential material on both sides of the transaction. In some cases, this can extend to keeping even the existence of a transaction confidential. That said, in almost every facilitated transaction, materials and insights are generated that can be useful to the wider market. To date, implementers have taken an extremely cautious approach about sharing this material, often due to extreme confidentiality concerns on the part of investors and investees (sometimes exacerbated by past bad experiences of information leakage through donor programs).

As the investment facilitation approach matures and there is further trust between investors and capital seekers, there will be an opportunity to evolve this approach. For instance, implementers could separate proprietary work product from non-confidential work that can provide a wider benefit to the public. For example, an implementer may use both target company data and aggregated public data to provide an estimate of market size and profit potential for a selected sector of frontier market investment interest, such as dairy, poultry, mobile banking, off-grid energy, and so on. Subsequent to the transaction, the conclusions drawn from public data might be published for wider use, whereas any analysis based on target company data should be kept completely confidential. This approach would require nuance and trust between implementers, investors, and target companies, but it could help maximize the public benefit of investment facilitation expenditure.

Cost-sharing and self-reliance should be further embedded into the model

Another area where investment facilitation can evolve is by further embedding a path to sustainability into the model. The program should support the growth of the investment ecosystem and prove the value of intermediaries to clients. Given time, this could build a functioning private market, allowing intermediaries to operate without subsidization in increasingly established sectors and geographies, further permitting donor support to find new targets.

Sustainability can be accelerated and encouraged through tweaks in program design, such as the phased introduction of sharing costs with clients. Transaction cost-sharing already happens through the client paying for services that are often available locally and cost-effectively, such as basic local legal counsel and financial auditing. More high-end due diligence, structuring, or investment banking services may not be covered on the client end, since on a local level, they may be absent, too expensive, or simply not valued by clients. The percentage of costs that can be reasonably borne by investor or investee will depend on the current availability of funds, the size of the intended investment, the probability of success, and the quality and depth of transaction support needed. Most clients will prefer to pay for the success of funds raised or deployed, but this can create misaligned incentives (getting the deal done regardless of long-term outlook) and potentially lead to regulatory challenges (for example, necessitating advisers to register as broker-dealers). Investment facilitation programs should take a structured approach to intermediary fees, particularly for repeat clients: gradually reducing their subsidization until advisors are engaged on a more commercial basis and until the subsidized efforts are shifted to support more difficult and catalytic transactions.

5 | The Future of Investment Facilitation Is at a New Frontier

The research presented in this report demonstrates the power of donor-supported investment facilitation to catalyze beneficial transactions in frontier and fragile markets. As these viable markets for intermediaries are established and deepened, the need for donor-supported investment facilitation will decrease in certain sectors and geographies, and the model will be pushed into even more frontier markets. Many countries remain underserved by investment and will not reach their full potential without the presence of effective and substantive investment intermediaries.

About the Authors

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Previously, Mr. Runde held senior leadership roles at the International Finance Corporation (IFC). From 2005 to 2007, he was director of the Office of Global Development Alliances (GDA) at the U.S. Agency for International Development (USAID), and he led the GDA partnership initiative by providing training, networks, staff, funds, and advice to establish and strengthen public-private partnerships. His efforts at USAID leveraged $4.8 billion through 100 direct alliances and 300 others through training and technical assistance.

Mr. Runde is the chairman of the Advisory Committee on Voluntary Foreign Aid (ACVFA) and serves on the board of the International Foundation for Electoral Systems (IFES), the Millennium Challenge Corporation (MCC) Advisory Council, and the Ashesi University Foundation (a private university located in Accra, Ghana). Mr. Runde is a regular contributor to The Hill and hosts a podcast series, Building the Future with Dan Runde: Freedom, Prosperity, & Foreign Policy.

Jake Cusack is co-founder of the CrossBoundary Group. Prior to CrossBoundary, Jake served as a Marine Corps officer in Iraq, winning the Bronze Star for actions in Iraq, and worked for an emerging market private equity firm. He has written for the *New York Times*, *Wall Street Journal*, *Forbes*, *Harvard Business Review*, *Stanford Social Innovation Review*, *Financial Times*, *New Republic*, and *Inc*. Magazine. Jake has an MBA from Harvard Business School, a Master in Public Policy from Harvard Kennedy School, and a B.A. from the University of Notre Dame. In 2016, he was named a Presidential Leadership Scholar, and in 2019 he was named to the President's Advisory Council on Doing Business in Africa. He is based between CrossBoundary's London and D.C. offices.

Matthew Tilleard is co-founder of the CrossBoundary Group. Prior to CrossBoundary, Matthew worked at The Boston Consulting Group and helped establish the Afghan Investment Climate Facility. Matthew holds a dual bachelor's degrees from the University of Melbourne, a Master of Public Administration from the Harvard Kennedy School and an MBA from the Stanford Graduate School of Business where he attended as a Fulbright Scholar. In 2015, he was named a Young Global Leader by the World Economic Forum. Matt has written for the Financial Times, GreenTechMedia and Quartz. He is based in CrossBoundary's Nairobi office.

The CrossBoundary Group is an innovative investment firm that seeks to unlock private capital to drive sustainable growth in underserved markets. It employs over 70 investment professionals in offices in Nairobi, Johannesburg, Lagos, Bamako, Accra, Dubai, London, DC, and NYC. CrossBoundary Advisory provides investment advisory services across a range of developing countries and has also developed innovative mechanisms to attract investment in fragile states. CrossBoundary Energy finances commercial and industrial solar and is one of the largest distributed solar utilities in Sub-Saharan Africa. CrossBoundary Energy Access is a blended finance facility for distributed solar-storage mini-grids to electrify rural areas.

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