



USAID
FROM THE AMERICAN PEOPLE

UNLOCKING CAPITAL *for* DEVELOPMENT

An Introduction to
Engaging with Finance
Providers to Address
Development Challenges

For more information visit: <https://www.usaid.gov/pcm>
and
<https://www.usaid.gov/documents/1865/finance-vignette-handbook>

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INTRODUCTION

The rapid growth of private capital in emerging economies has created an unprecedented opportunity for USAID to use its resources to enable private capital providers, or investors¹, to become a primary driver of inclusive growth, reform, and poverty alleviation. USAID Administrator Mark Green leads with a vision: *“At USAID, we’re reaching beyond contracting and grant making to collaborating, co-financing, codesigning programs, tools, initiatives. We’re embracing the notion that the private sector, not donors and government, will be the ultimate drivers and sustainers of development and we know that we need to re-envision our role accordingly.”*

In fact, in terms of volume, foreign and local private investment has far outpaced traditional development assistance.

Data suggests, moreover, that local private investment in developing economies has grown to be three times the size of foreign direct investment in recent years.² At the same time, available private capital often remains underinvested in key sectors due to obstacles such as perception of higher risk and lack of market knowledge. These two trends present an opportunity for USAID to help shape the way private resources are invested to maximize development impact.

Engaging the private investment community can create more impact using fewer USAID resources. Investors bring financial resources as well as relationships, technical expertise, and innovations that can improve the viability, sustainability, and scalability of development efforts. USAID can use various tools and capabilities to remove the roadblocks for these investors and amplify the impact of every dollar the Agency spends. USAID is increasingly looking to partner with the private sector to promote long-term, sustainable development outcomes and embrace enterprise-led development.

This document provides an introduction on how USAID staff can meet development objectives through engaging investors that can deploy essential capital.

¹ “Investors” here refers to the range of private sector capital providers, including: **Local banks**, which primarily provide access to credit (e.g., short-term loans for SMEs) and **Local and foreign investors**, which primarily provide debt or equity investment. USAID has worked with several types of these investors on different programs: (a) **Angel investors**, which provide funding to very early-stage enterprises, (b) **Venture capital investors**, which invest in early-stage, high-growth enterprises, (c) **Impact investors**, which invest for both social and financial returns to improve sustainability, (d) **Private equity funds**, which typically make equity investments in private companies for 5–7 years, (e) **Institutional investors**, like pension funds or insurance companies which tend to invest in larger, more mature companies, infrastructure projects, or government debt (f) **Strategic or corporate investors** that make capital investments to support their business.

² European Report on Development (2015) cited in USAID (2017), “Investing for Impact”

GUIDING QUESTIONS

This series of questions can help USAID staff determine how to work with investors to achieve development objectives:

1. What is the role of private investment in the development challenge I'm trying to address?

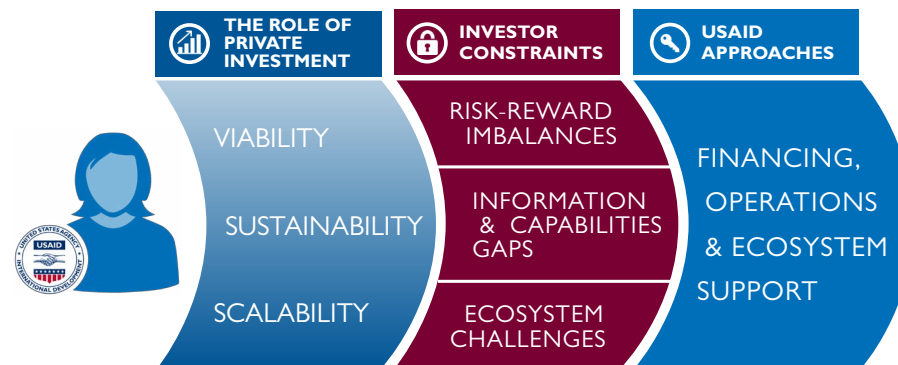
Addressing development challenges often requires private investment to ensure viability, sustainability, and scale of high-impact initiatives or businesses. For example, small agricultural enterprises that face volatile revenues need financing to continue providing services, maintain employees, and invest in growth. Significant investment is also needed to build infrastructure such as roads, off-grid energy, and water facilities that can dramatically improve the lives of people in emerging economies. The key for USAID staff is to assess what role private investment can play in addressing development challenges.

2. What is holding investors back from meeting these financing needs?

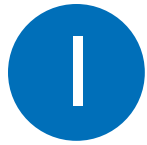
Investors face various constraints in developing economies, ranging from unfamiliarity with a new market to the actual and/or perceived riskiness of a specific investment. Through discussions with investors, staff can determine the main obstacles that are holding them back.

3. How can I work with investors to unlock needed investment?

USAID has a wide range of tools at its disposal to address investors' and lenders' constraints, but determining what approach is most applicable in a specific setting can be challenging. USAID has a range of approaches available to staff to address specific constraints to development.



The following sections walk through the guiding questions in greater detail to assist USAID staff in determining whether and how to engage the private sector.

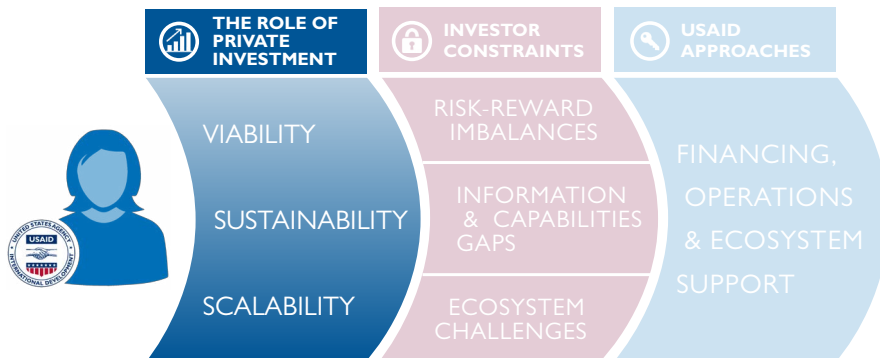


What is the role of private investment in the development challenge I'm trying to address?

Insufficient investment is often a key contributing factor to development challenges. The connection isn't always obvious, though. For example, attracting investment to help women access finance often leads to improved levels of health, education, and nutrition for families since women tend to put the vast majority of their income back into their family and prioritize these areas for spending.³ Thus, staff focused on issues ranging from undernourishment, disease, and/or poor educational outcomes could consider partnering with investors (e.g., local banks) to expand women's access to finance as part of their approach.

The path through which investment generates development impact is by supporting the viability, sustainability, and scalability of businesses and projects, which in turn help address a development challenge.


- **Viability.** Working with a private sector partner from the outset to co-design and co-finance a project can give it an opportunity to become viable and attract appropriate private investment.
- **Sustainability.** Private investment can lead to longer-term impact of USAID's funding as interventions are likely to continue as long as a business case exists. Access to investment can also make projects more resilient against shocks to funding or revenue, helping them endure and create lasting impact.
- **Scalability.** Access to private investment can significantly boost the impact of enterprises and programs by helping them grow quickly to enter new markets and reach new customers and/or beneficiaries.



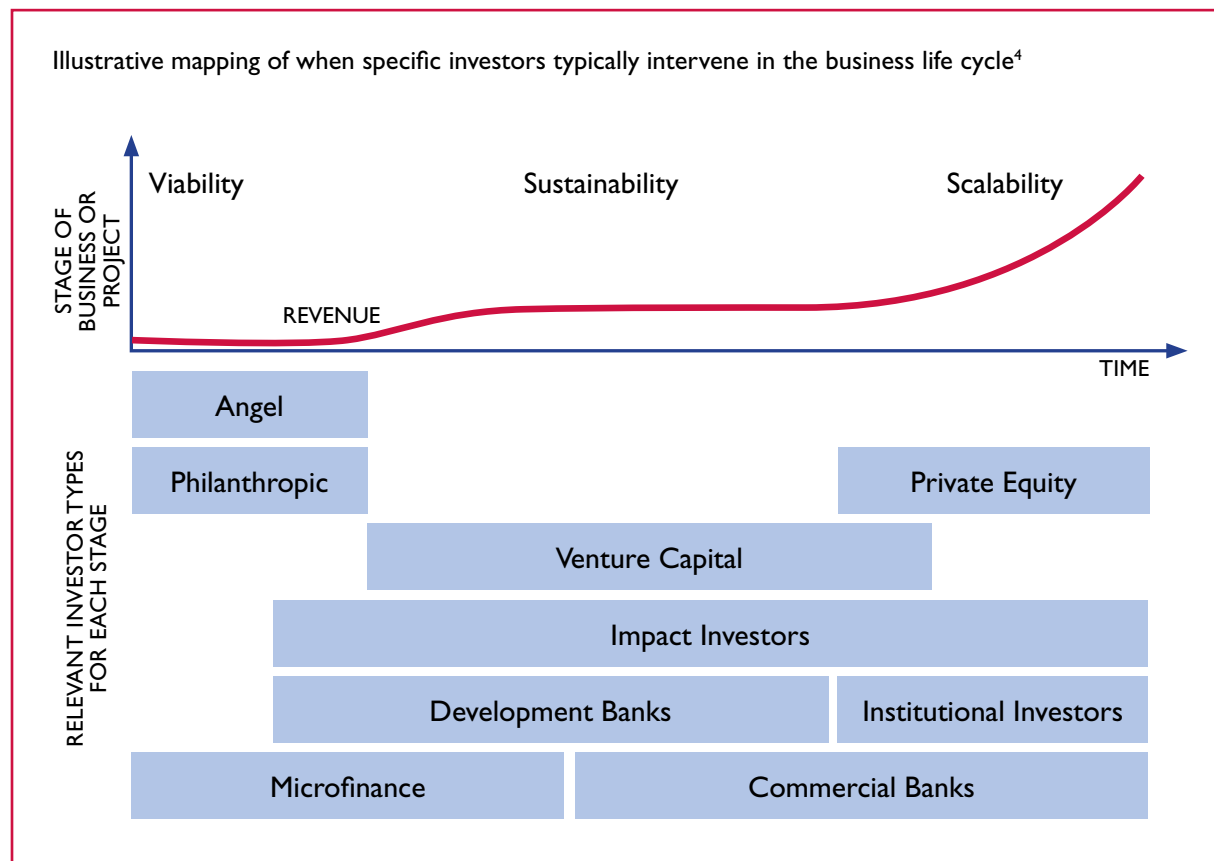
³ Women's World Banking (2013)

The **Medical Credit Fund Case Study** below, which continues on the next few pages, will help navigate staff through the three guiding questions on how to work with investors.



Medical Credit Fund Case Study	
 <p>What's the role of private investment in the development challenge I'm trying to address?</p>	<p>Healthcare service providers require credit to scale. Across sub-Saharan Africa, private sector SMEs provide 50 percent of healthcare. However, they are chronically underfunded. Access to finance—particularly loans—can help these SMEs expand and acquire the training and equipment necessary to provide higher quality care to more people.</p>

USAID can work with a range of investors depending on the stage of the business and the risk appetite of the investor. See the chart below to understand where different investors typically engage.



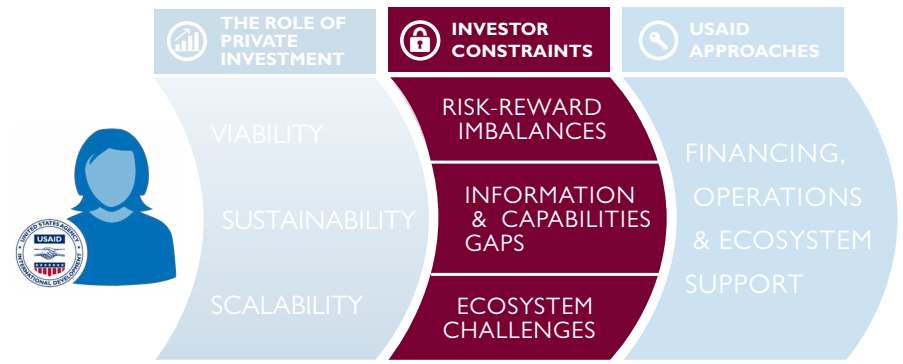
⁴ In this illustrative mapping, the "Viability" stage is the period when businesses are launching; "Sustainability" stage shows businesses that are stable, but have not yet scaled; and "Scalability" stage depicts businesses that are growing rapidly or are poised to do so.

2

What is holding investors back from helping to address this challenge?

Investors typically face three kinds of constraints when considering opportunities in a development context:

- Risk-reward imbalance.** Private investors look for opportunities where the expected financial reward will outweigh the actual or perceived risks. In developing economies, investments are often viewed as risky due to high transaction costs, limited information, and/or unfavorable regulatory environments.
- Information and capabilities gaps.** In many developing economies, **domestic investors** may lack important capabilities (e.g., due diligence, fundraising, market research, strategic planning, personnel training) that limit the extent to which they invest. **Foreign investors** may face similar constraints, but they also may not have enough information about the local market (e.g., regulatory requirements, key stakeholders) to source deals and conduct due diligence. Investors also struggle to find investable opportunities because SMEs often lack core capabilities (e.g., management skills, IT systems, personnel, and internal governance structure) to make good use of growth-oriented financing.
- Ecosystem challenges.** Investors are less likely to engage when they are concerned about macro-level challenges that could potentially threaten their investments (e.g., uncertain regulatory environments, lack of credit reporting agencies and other enabling institutions, or bankruptcy protections).



Medical Credit Fund Case Study



What is holding investors back from helping to address this challenge?

Risk-reward imbalance. Medical SMEs tend to have few assets that can be used as collateral for loans. They also have volatile revenue streams because payments come from a small pool of patients, who either pay out of pocket or are accompanied by delayed reimbursements from health insurance. These factors increase risk for investors, as they make it difficult to assess the ability of SMEs to make loan payments.

Information and capabilities gaps. Many SME owners are medical professionals with little to no experience in business management. They lack credit history and have weak bookkeeping and accounting practices, which makes it difficult for investors to accurately assess the financial performance of SMEs. Additionally, without independent and transparent healthcare benchmarks or a quality-assurance system, investors have difficulty assessing the effectiveness of medical professionals, which is important for both development impact and financial performance.

3

How can I work with investors to unlock needed investment?

USAID staff can use three main approaches to address investor constraints: financing support, operations support, and ecosystem support. Each approach comprises more specific tools and capabilities that staff can draw on. Below are overviews of the three broad categories of support with some illustrative examples of specific tools. Additional examples are available online.

FINANCING SUPPORT

Catalytic Capital: USAID leverages its financial resources to attract additional investment.

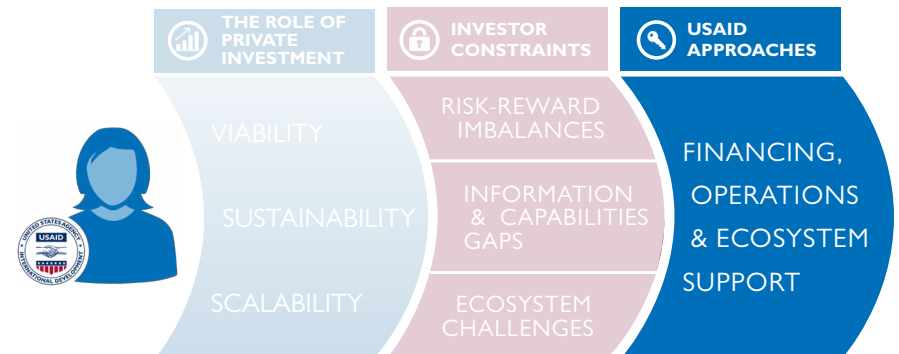
- **Seed funding:** Grant funding into early-stage, high-risk and potentially high-reward projects to prove their viability, so that they can be further commercialized or scaled by private investors. USAID has used basic seed and repayable grants to reduce investors' risk.
- **Co-funding:** USAID directly invests in projects alongside a private sector partner, combining assets and expertise from both parties. The Global Development Alliance (GDA) framework is a common way that USAID staff deploys co-funding.
- **First-loss Capital:** Grants that take the first loss on an investment if it loses money—protecting other investors—to catalyze the participation of private investors in development projects. USAID has used this tool in its partnership with [CrossBoundary Energy](#) to support the development of solar energy systems in Africa.

Risk Mitigation: USAID reassures investors by protecting them against potential losses on a project.

- **Guarantees:** USAID agrees to pay back a portion of loans to developmentally important but underserved sectors like health, rural energy, or agriculture if the borrower defaults. Within USAID, this is typically provided by the [Development Credit Authority](#).
- **Insurance:** USAID partners with insurance companies to develop and/or scale new insurance products to mitigate risks for investors or covers some or all of the cost of premiums to a private insurer to protect investors in projects against some level of loss in the event the project is unsuccessful or the borrower is unable to repay the investment.

Pay-for-results: USAID makes payments toward a project when [milestones or outcomes](#) are achieved.

- **Results-based Contracts:** Incentive payments to investors as they disburse financing to target sectors or beneficiaries. The FinGAP project in Ghana uses this mechanism to increase financing to agriculture SMEs (see page 10 for more detail).
- **Development impact bonds (DIB):** A pay-for-results model that ties investor repayment to program impact. [DIBs](#) enable private investors to provide upfront financing for development programs, which is repaid with a return by USAID if an impact evaluator shows that programs have achieved a pre-agreed outcome.



OPERATIONS SUPPORT


USAID can work directly with investors or investees to improve operational performance or enable them to expand into new markets.




- **Investor support:** Providing funding for training or providing direct assistance to investors to help them expand into new markets or increase their activity in existing markets through support with fundraising, market research, strategic planning, and staff development.
- **Investee support:** Providing funding or direct assistance to investees for advisory services such as business plan development, management training, or structuring financing requests to improve their performance. This can be done through a technical assistance or “sidecar” facility that is coupled with investment.
- **Investor-investee matchmaking:** Directly matching and/or encouraging participation in networks that match investors with investees.
- **Market research:** Conducting specialized research on regulations, market factors, and investment opportunities to support investors’ decision-making in a specific marketplace.

ECOSYSTEM SUPPORT

USAID can work with the private sector and governments to make the investment ecosystem itself more attractive

- **Customized instruments:** Developing customized financial tools to address challenges produced by a specific investment ecosystem (e.g., foreign exchange risk).
- **Market enabler support:** Working with governments and the private sector to develop critical enablers of investment (e.g., credit bureaus).
- **Research and regulatory support for policymakers:** Working with governments to liberalize investment policies or create regulations for the financial sector.

Medical Credit Fund Case Study	
	<p>How can I work with investors to unlock needed investment?</p> <p>Catalytic capital and investor/investee support. PharmAccess Foundation is an organization that focuses on improving healthcare delivery in sub-Saharan Africa. They created the Medical Credit Fund (MCF), which combines loans with business and medical training to healthcare SMEs. After proving its viability on a small scale, MCF won a G-20 SME Financing Challenge and received \$1 million in grant funding from USAID. USAID grant funding enabled MCF to access over \$17 million in loans from other investors (OPIC, Calvert Impact Capital, and two private investors). After proving their model in four countries they were able to access an additional \$28 million in investment to expand to eight more countries.</p> <p>As of early 2016, the MCF had enabled over 1,450 clinics, which see a combined 640,000 patients each month to make critical investments in infection control, basic infrastructure and equipment, and improved staffing and skills. MCF has demonstrated the viability of its business model and no longer requires donor support to provide its services.</p>

FinGAP Case Study	
 <p>What is the role of private investment in the development challenge I'm trying to address?</p>	<p>Scaling the capacity of the agricultural value chain. As production in Ghana increased following the successful implementation of Feed the Future initiatives, the rest of the agricultural value chain needed to expand to absorb the increased production. Ghana needed financing to develop more input stores, grain warehouses, and agri-processing facilities</p>
 <p>What is holding investors back from helping to address this challenge?</p>	<p>Risk-reward imbalance. The agriculture sector was fragmented and lacked transparency, meaning that Ghanaian banks and investment funds would incur significant costs scouting and conducting due diligence on investees because of their smaller sizes and highly variable cash flows.</p>
 <p>How can I work with investors to unlock needed investment?</p>	<p>Connecting investors to investees and investee support. To help investors more easily and cheaply find investment opportunities, USAID's Financing Ghanaian Agriculture Project (FinGAP) assembled a group of local business advisory service providers to scout promising businesses and help them develop investment requests. This reduced risk for investors and improved the attractiveness of investees. Advisors were paid for finding the businesses, but only when the businesses received financing.</p> <p>Results-based contracts. To encourage investors to enter this space, FinGAP targeted banks, microfinance institutions, and investment funds with grants that were paid when investments were made. For investors, this shifted the risk-reward calculation of participating in agricultural finance. Investors competed to receive grant money, ensuring that USAID's funds were spent efficiently. USAID's grants—totaling \$3 million—have spurred over \$155 million in new financing in the agricultural value chain.</p>

NASP Case Study



What is the role of private investment in the development challenge I'm trying to address?

Making infrastructure projects viable. In Africa, \$93 billion in new investment is needed to provide services to the continent's booming urban populations. Institutional investors, like pension funds and insurance companies, often look for investments like infrastructure projects with steady returns over long time horizons. These investors would be potent partners to help close Africa's infrastructure gap and ensure sustainable urban growth.



What is holding investors back from helping to address this challenge?

Information and capabilities gaps. In the United States, many institutional investors – particularly those not otherwise engaged in emerging markets – lack the information and capabilities needed to assess infrastructure investment opportunities in Africa. Institutional investors in the United States are disconnected from local government contacts or planning discussions around infrastructure development projects, so are often unaware of potential investment opportunities. At the same time, they are unfamiliar with the local market and investment environment, limiting their ability to effectively assess these opportunities.



How can I work with investors to unlock needed investment?

Targeted research; connecting investors with investees and investee support. To introduce U.S.-based institutional investors to the African infrastructure markets, USAID partnered with the National Association of Securities Professionals, an industry organization, to convene an institutional investor conference in sub-Saharan Africa to inform investors about high-growth, high-impact investment opportunities and facilitate investment partnerships with governments across Africa. U.S.-based financial professionals also traveled to Africa to help governments structure and market their infrastructure investment opportunities, better positioning them to access private investment. Through these efforts, USAID and NASP have secured over \$100 million in investment commitments from U.S. pensions and domestic African savings institutions investing in Africa infrastructure to date.



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