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# Investment facilitation: A new tool for economic development

*Jake Cusack, Matt Tilleard, and Tom Flahive, Partners at The CrossBoundary Group*

In 2013 we collaborated with the Center for Strategic and International Studies (CSIS) to suggest a new approach to attracting private investment into overlooked and underserved economies. Our report proposed donor-supported "Investment Facilitation" as a means to increase investment in developing economies by reducing information asymmetries, decreasing high transaction costs, and solving coordination failures.

Over the past seven years, alongside our continuing private investment advisory work in more developed sectors, we executed this approach through USAID support or with other donor partners. These facilitation efforts closed over $500 million in transactions across over 45 different deals, with sizes spanning from $500K to the tens of millions, and in wide-ranging locations such as Mali, Nigeria, Rwanda, Ethiopia, Malawi, Mozambique, Iraq, Afghanistan, and beyond. Given this traction, last year we published with CSIS a review of the Investment Facilitation approach and the lessons we've learned from implementing it.

## What is Investment Facilitation?

In frontier markets, *transaction costs* are higher than in developed markets both in absolute terms – due to the peculiarities and opacity of tough places – and in relative percentage terms, due to the smaller average deal size. In addition, real and perceived information asymmetries – often stemming from eroded social capital – drive costs higher as investors and capital seekers work to overcome initial distrust of each other.

These same barriers exist even in developed economies. But in these countries, intermediaries (investment banks, rating agencies, financial and commercial due diligence firms) overcome these transaction costs by providing trusted information and analysis. These firms depend on the volume of successful transactions or "deal flow" to remain profitable. Unfortunately, most frontier markets don't have the requisite deal flow to support these intermediaries, creating a 'chicken and egg' problem: *too few deals leads to very few intermediaries and too few intermediaries leads to very few deals.*

*Donor-supported investment facilitation breaks this deadlock* by introducing a trusted, neutral intermediary to reduce transaction costs and serve as an honest broker in reducing information asymmetries. The donor supports the costs of the intermediary's activities with the intention that for every donor dollar funded to the intermediary, many more private dollars will be mobilized both in the near-term by the completed investment and in the long-term through development effects.

Successful investment facilitation has several key features, including credibility, trust, and mission alignment of the intermediary with both investors and donor partners; a team based in the market with the requisite skills and expertise to alleviate the bandwidth constraints of investors and entrepreneurs; and the full range of capabilities to support investors and entrepreneurs across the deal lifecycle.

As an example, we worked as the investment facilitation team to support the founder of an East African medical business through their 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.

We supported the capital raise process by providing an in-depth valuation perspective, enabling the entrepreneur to evaluate whether the investors' proposal was reasonable. Our team served as an honest broker, offering trusted advice to help the company determine which of the proposed deal terms were market-standard, and which could or should be negotiated to ensure a productive long-term partnership with their investors. The difficult negotiations were 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. Our role and work 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.

## What have we learned about the approach?

The success of investment facilitation has meant that it is increasingly becoming a part of the standard toolkit for economic development. As the approach scales, our report outlines lessons learned and highlights new opportunities to enhance its impact.

**Patience and persistence are necessary to close the deal.** Without the investment facilitator's ongoing support, financial close is delayed or never realized. Across a sample of 38 successful transactions, we worked an average nine months to reach financial close - but in many cases it took 2-3 years, some even as long as five years. Investment facilitation mandates should be structured with time for the process to work and achieve results.

**Beyond the lead investment facilitation firm, local advisory players should be integrated into the process.** It is only through the successful engagement of local intermediaries, as well as the permanent localization of regional and international players, that the successes of investment facilitation can be institutionalized.

**Investment facilitation is most suited to a regional deployment model.** Given the regional lens of most investors and companies, and the fact that some countries will have periodic macro slow-downs (for instance a contested election), investment facilitation is often most efficiently applied with a regional mandate, with a hub and spoke team approach.

**Transaction work should be in a feedback loop with necessary policy and regulatory reforms.** Transactions are the point of greatest scrutiny for a country's ability to work with the private sector. Having empirical data from which to suggest policy reforms is critical in markets with poor transparency. By providing tangible examples of where certain policies can prevent economic growth, transactions motivate governments to take action. Feeding this information into policy efforts allows for a virtuous cycle between accelerated policy reform and increased investment in the local economy.

**Investment facilitation can serve the public good.** As noted above, the effects of facilitating go beyond a specific investor and company helped and can benefit sectors and countries as a whole through the path-breaking nature of pioneer transactions and the demonstration effect of others seeing successful investments.

An example from our work under the USAID-backed Mali Investment Facilitation Platform (MIFP) demonstrates this thesis. MIFP was instrumental to the decision of a Europe-based impact investor to start investing in Mali, despite many initially perceived difficulties. Working as transaction advisors under the Platform, we approached the investor to explore interest in extending their coverage to Mali, given their interest in other fragile African countries. We supported the investor in overcoming their information gaps on Mali and completing an analysis of opportunities in SMEs and the microfinance sector. Reassured by the Platform's on-the-ground presence and hands-on approach to supporting projects and sharing information, the impact investor ultimately made credit investments in three MIFP-supported local SMEs.

After the end of our mandate under MIFP, Mali has remained a priority country for this European investor, with three additional investments completed to date, and several other opportunities under consideration. Building on its track record and experience in the region, the impact investor will be launching in 2021 a regional SME-focused fund extending its coverage to Burkina Faso and Guinea. This demonstrated the inherent sustainability of the investment facilitation approach, as after the initial fixed costs of understanding the market and making pioneer commitments have been absorbed, it becomes logical for the investor to extend and deepen their investment presence.

**Example Investment Facilitation Activities**

| Investment Process Stage | Origination | Due Diligence | Structuring and Negotiation | Value Creation and Realization |
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| Investor ("buy-side") portion of process | Scan market and identify pipeline of potential deals | Conduct due diligence and fill information gaps | Choose investment instrument and structure | Close transaction and begin value creation |
| Example Investment Facilitation Activities | • Providing country / sector overview materials<br>• Capital mapping and investor profiling<br>• Developing investment pipelines and profiling opportunities<br>• Analyzing value chain<br>• Market sizing<br>• Networking | • Analyzing market and competitors<br>• Developing business plan and financial model<br>• Conducting financial and commercial due diligence<br>• Holding investor road shows | • Acting as an "honest broker"<br>• Mitigating information asymmetries<br>• Sharing example template legal documents<br>• Researching comparable transactions<br>• Relationship management | • Creating 100-day value creation plan<br>• Providing governance recommendations<br>• Providing status reports<br>• Monitoring investments<br>• Positioning strategically for follow-on investment |
| Company/ Project ("sell side") portion of process | Understand universe of available capital options | Pitch and position for investment | Understand and negotiate terms | Build business for follow-on investment |

**There is a need for intelligent metrics accompanied by trust and mission alignment.** The success of investment facilitation should be measured by the amount of investment unlocked and the development impact of the transactions, as well as the level of additionality of the facilitation provided. Donors sometimes address this by applying overly strict criteria for selecting transactions, which can be very restrictive and actually slow down development impact.

Instead, donors can provide a more flexible approach to achieve their priorities and to adapt opportunistically to the interests of the private sector. M*ultipliers* of private capital per donor facilitation dollar is a reasonable metric for performance targets (we typically suggest minimum leverage targets of 5-20x). But progress towards these multiplier targets could also incorporate development impact metrics that incentivize support to smaller, high impact, and pioneer transactions. For example, a higher multiplier could be applied to transactions into women led companies or in neglected value chains so that these transactions are more attractive to the facilitator. These nuanced metrics combined with a portfolio approach would allow flexibility to avoid mandating that *every* transaction must meet *every* criterion.

**Payments should be predictable but also have a result-based component.** Transactions in nascent markets are tough for advisors to support commercially because they are too small (so available fees are insufficient), too risky (so advisors cannot be confident of eventual payment), and take a long time (creating a liquidity issue as it may be years between work and the “success” payment of transaction close). Thus, payment for investment facilitation is not as straightforward as simply introducing larger donor-backed success fees but needs to be a combination of predictable deliverable-based payments and performance-based incentives. This will allow intermediaries to take on a portfolio 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 providing strong incentives to ensure that some transactions successfully close.

An example of this is an engagement we are working on through the Haiti USAID INVEST program. Our mandate is not sector or geographically specific, which allows us to take a portfolio approach to transaction support. We are working on transactions across energy, agriculture, manufacturing, financial sector and consumer goods. Predictable payments (not entirely success fee based) allow us to work on deals that could not be supported by purely commercially motivated advisors. Some transactions are highly pioneering and early stage, while others are more mature businesses in sectors that have not traditionally attracted much international investment, like agribusiness.

One such client is an agribusiness in Haiti that works closely with both buyers and smallholder farmers to boost production quality and volumes, efficiently aggregate products, and provide logistical solutions to ensure timely deliveries. The business serves farmers primarily within the peanut value chain, but expanded to new crops, including mango, lime, and moringa in 2016.

We recently facilitated a successful capital raise for the agribusiness — the new funds will be used to 1) expand business operations, 2) increase production and export of a spicy peanut butter consumer product, and 3) construct a moringa processing facility. For the raise, we helped the client to develop and refine its business assumptions, investment marketing materials, and financial model. The level of advisory assistance provided over a long period of time to a small transaction in a difficult market would not have been possible without USAID support.

**Proprietary information can be separated to allow a public-benefit work product.** Donor supported investment facilitation must protect confidential material, while seeking to share generalizable lessons and insights to benefit the market. For example, the investment facilitation firm may use both company data and aggregated public data to provide an estimate of market size and profit potential for a selected sub-sector. Subsequent to the transaction, the market sizing conclusions drawn from public data might be published, whereas company-specific analysis should remain confidential.

**Cost-sharing and self-reliance should be embedded into the model.** Sustainability can be encouraged by the phased introduction of sharing costs with clients. This could include a structured approach to intermediary fees, gradually reducing their subsidization as the donor-supported efforts are shifted to support more difficult and catalytic transactions. Given time, this could build a functioning private market, support the growth of the investment ecosystem and prove the value of intermediaries to clients.

**Other tools such as blended finance can complement investment facilitation.** In addition to investment facilitation that reduces transaction costs and information asymmetries, support to the creation of new investment/capital supply players may also be required. In some cases, institutions interested in investing in a given sector or country, may fail to do so because they lack a trusted channel with a local team to deploy that capital. For example, there might be international capital interested in a geography but few credible regional private equity funds available that could receive, manage, and deploy institutional investment. Development finance institutions and donors should continue to support the creation of these vehicles. Second, the potential returns in some sectors, such as rural mini-grids, may not yet reach a risk-return rate considered commercially viable on standalone basis. For such projects, we have seen blended finance help to crowd in private investment.

## Investment facilitation is as relevant now as it ever has been

Our experience over the past year indicates that investment facilitation during the COVID-19 crisis created a lifeline between new funding vehicles and businesses who most need that capital. While impact investors and development finance institutions have created pools of capital to provide liquidity to businesses in frontier markets, the barriers to deploying it are higher than ever.

Through our existing investment facilitation mandates, we think we have been able to provide much needed bandwidth and advisory support to businesses and investors so they can renegotiate their existing obligations, while raising additional capital to get them through the storm. At a time when these businesses and investors are the most bandwidth constrained; trusted advisors are critical. We believe we can continue to refine this model to drive even greater efficiency, development impact and sustainability, both in times of crisis and in times of relative stability.

### Additional Resources

Investment Facilitation Revisited (2019)
Short Video: What is Investment Facilitation? (2019)
Short Video: Examples of CrossBoundary's transaction work (2019)
Investment Facilitation in Fragile States (original 2013 report)