



Advancing Practice in Catalytic Capital *Guidance Note 3 - The Sustaining Role*

December 2022

Guidance Note Series



SEEDING



SCALING



SUSTAINING

About Courageous Capital Advisors

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

Learn more at www.courageouscapitaladvisors.com.

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



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FOREWORD

The Catalytic Capital Consortium (C3) is excited to continue its partnership with the Courageous Capital Advisors team on this guidance note - the last in our series of three in-depth commentaries offering insights on the Seeding, Scaling and Sustaining roles of catalytic capital. The series draws on the expertise of seasoned investors, who have generously shared lessons learned from their own strategies and experience in order to help others develop high-impact catalytic capital approaches, which are critical to tackling the world's most pressing challenges.

C3 is an investment, learning, and market development initiative to promote greater and more effective use of catalytic capital, in recognition of its essential role in realizing the full potential of the impact investing field and achieving the Sustainable Development Goals. Together, the C3 Strategic Partners - [The Rockefeller Foundation](#), [Omidyar Network](#), and the [MacArthur Foundation](#) - are supporting field-building work through the [C3 Grantmaking Program](#), housed at and managed by the New Venture Fund.

C3 Grantmaking works to advance learning and market development related to catalytic capital and helps to answer critical questions about the scope of the need for catalytic capital, when

and how catalytic capital can be most effective, and what tools and practices are needed. It does this through activities aimed at strengthening the evidence base, advancing the practice in the field, communicating and facilitating engagement among investors, and fostering solutions and infrastructure. [Learn more about the various C3 Grantmaking workstreams here.](#)

This document is focused on the Sustaining role of catalytic capital and follows our earlier guidance notes on Seeding (September 2022) and Scaling (November 2022). In many respects, the Sustaining role can be the most challenging of the three because it addresses structural and continuing capital gaps rather than transitory ones. They cannot be easily ameliorated even as proof points and track records are elevated to demonstrate their value.

In the Sustaining role, catalytic capital is deployed to address the world's hardest-to-serve populations, geographies and sectors. These investments are generally not commercially viable because, over the long-term, they require investors to accept concessional returns or disproportionate risk to address deep, systemic challenges. Without catalytic capital to fill the gap, opportunities for progress on some of the most intractable aspects of poverty, health, justice and peace could be lost.

We encourage you to read through these findings to learn how seasoned catalytic capital investors have successfully incorporated Sustaining catalytic capital into their investment strategies and consider whether these practices might also help inform your own activities.

This final guidance note connects to C3 Grantmaking's broader work as well. Our Building the Evidence Base partners, which have been conducting research on how, when and where catalytic capital is most effective, are beginning to share their conclusions and will be offering substantive takeaways for the field. Our funding for Fostering Solutions and Infrastructure projects is being finalized as well, with partners moving forward on a range of efforts to make the catalytic capital market more efficient and effective.

We will also be pursuing additional opportunities for engagement in 2023, working to build a

strong community of practice around catalytic capital and helping investors and practitioners collaborate in new and, we hope, impactful ways.

Keep an eye out for our new C3 website, which we expect to launch in the first part of next year to host data, analysis and commentary relevant to the field. In the meantime, please follow us on LinkedIn to stay abreast of ongoing developments or [sign up](#) to receive more information directly.

We hope we can continue to connect, share and learn from each other in pursuit of a more just, equitable, and resilient world.

Urmi Sengupta

Urmi Sengupta

Chair, Project Advisory Board, C3 Grantmaking





INTRODUCTION

Impact investing is now part of the investing mainstream. Major financial services institutions have entered the field, and size estimates of the sector range from \$1.2 trillion¹ to \$2.3 trillion². Yet while much has been achieved, numerous opportunities to deliver impact still fail to attract investment.

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

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

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

About This Document

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

¹ Global Impact Investing Network (2022) [Press release](#)

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

³ Tidaline (2019) [Catalytic Capital: Unlocking Investment and Impact](#)

It is the **third in a series of three** such notes, each of which focuses on one of three roles of catalytic capital - Seeding, Scaling, and Sustaining - as set out by Tideline⁴ and explained further in this document. This third guidance note specifically addresses the **Sustaining** role. While this series focuses on **indirect investment** (i.e., investors deploying capital into funds and other indirect investment vehicles or platforms), we expect that much of the discussion below is also relevant to direct investment.

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

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

- **Alex Goodenough**, Innovative Finance Lead, Capital Solutions, British International Investment (formerly CDC)
- **Allison Clark**, Associate Director, Impact Investing, John D. and Catherine T. MacArthur Foundation
- **Catherine Godschalk**, Vice President Investments, Calvert Impact Capital

- **Chris Jurgens**, Director, Reimagining Capitalism Team, Omidyar Network
- **Daan Besamusca**, Associate Principal, Open Society Foundations
- **Harry Davies**, Principal, Program Investments, Ceniarth
- **Josephine Ragni**, Social Investment Manager, Fundación Netri
- **Karina Wong**, Head of Investments, Small Foundation
- **Pooja Yadav**, Managing Director, Office of Equity and Investment Funds, DFC
- **Radana Crhova**, Impact Investing Team Leader, FCDO
- **Shiru Mwangi**, Regional Director, East Africa, Acumen

We also thank the following investment managers and organizations for providing vital input and perspective to ensure that the challenges discussed reflect their experiences:

- Aceli Africa
- Acumen Capital Partners
- AgDevCo
- Community Investment Corporation
- GAWA Capital
- Global Partnerships
- Housing Partnership Network
- Incofin
- Injaro Investments
- International Housing Solutions
- Root Capital
- SDS Capital Group

We would note that the C3 Sustaining Learning Lab Series adopted the “agriculture” and “financial inclusion” themes to provide a focal point for discussions, and readers will see this reflected in certain parts of this guidance note, in particular with respect to deal examples used. At the same time, we believe that the transaction challenges and responses illustrated can be extrapolated beyond our Learning Lab themes to any investments, vehicles and managers that seek to address the needs of the “hard-to-reach” through the effective use of catalytic capital.

⁴ Ibid

THE SUSTAINING ROLE OF CATALYTIC CAPITAL

Setting the Scene: the Roles of Catalytic Capital

This guidance note addresses **Sustaining**, the third of the three roles of catalytic capital as outlined in Tideline's 2019 report⁵. It is important to note that the three roles of Seeding, Scaling and Sustaining were used as a tool in framing our Learning Lab discussions and to organize this guidance note series. As this note focuses on what is *different* in Sustaining compared to the other two, we encourage the reader also to review the first two guidance notes in this series to gain the full picture of deploying catalytic capital effectively and efficiently (see Advancing Practice in Catalytic Capital: [Guidance Note 1 - The Seeding Role](#); and Advancing Practice in Catalytic Capital: [Guidance Note 2 - The Scaling Role](#)).

The **Sustaining** role of catalytic capital is perhaps the most difficult because it addresses the most challenging capital gaps that are structural in nature. This role seeks to extend capital - and deliver impact - to people and places that are the hardest to reach. Sustaining capital focuses on sectors (or sub-sectors), business models, population segments or geographies that are typically sidelined when it comes to investing, as they entail persistent high risks and/or low returns. Sustaining vehicles and strategies cannot achieve full commercial viability in the foreseeable future

without catalytic capital to absorb ongoing (i.e., long-term) disproportionate risk and/or accept concessional returns.

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

Meanwhile, the **Scaling** role, featured in the second guidance note, comes into play after pioneering fund strategies and investment managers demonstrate early success. Scaling funds or investment vehicles aim to achieve significant multiplier effects. These multiplier effects can apply with respect to progression and growth of the underlying investees or the manager itself; they can also be associated with the maturation of the investment strategy and the mobilization of capital within a blended capital structure. As the track record of Scaling funds may

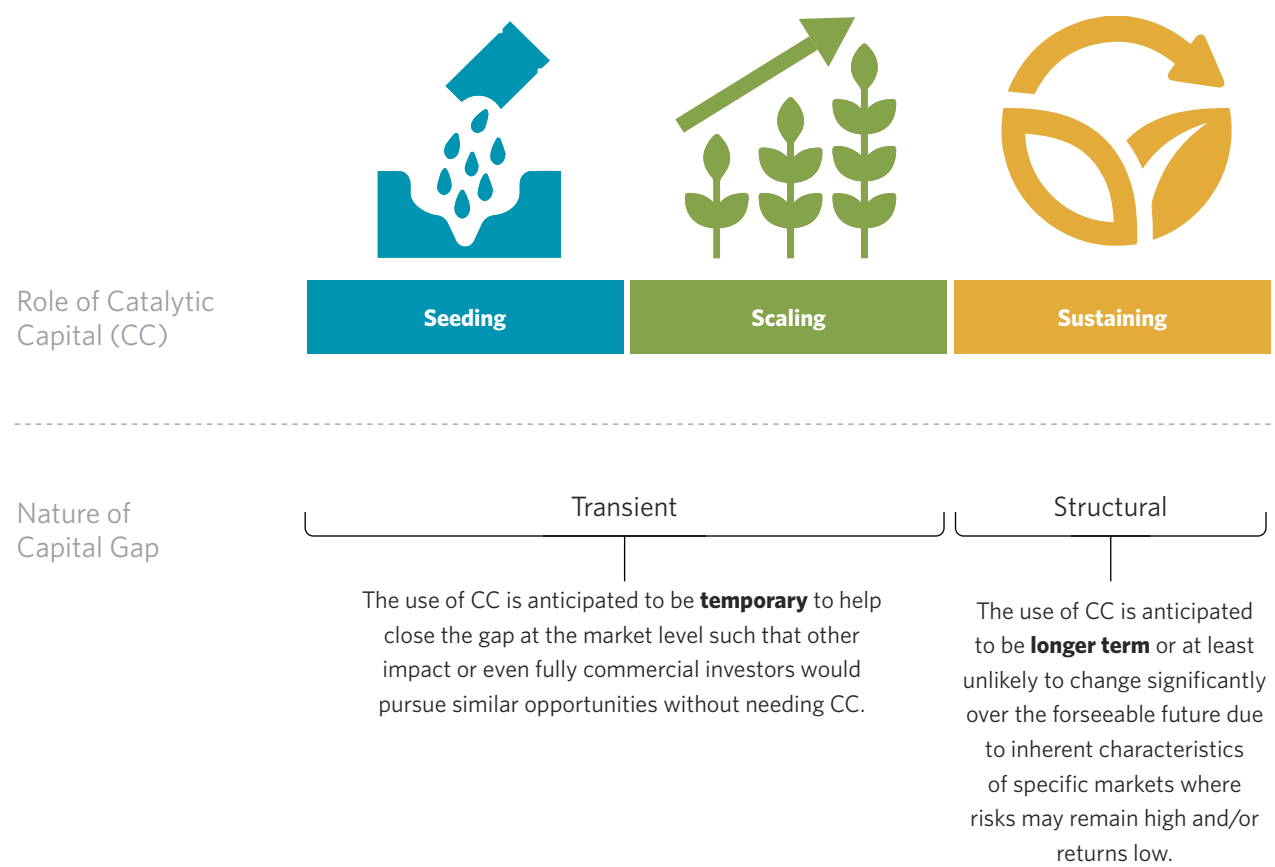
⁵ Ibid

be limited, their size subscale, and the markets in which they play relatively underdeveloped, they often struggle to attract impact as well as commercial capital investors. Catalytic capital is needed to help strategies and managers expand, with the aim of achieving the necessary size and track record so that further catalytic capital support is no longer required.

The Seeding and Scaling roles typically come with the implication (or at least an investment thesis)

that the capital gap and need for catalytic capital is **transient** - that ultimate success is about closing the gap at the market level such that mainstream impact or even fully commercial investors would be able to pursue similar opportunities down the line *without* needing the involvement of catalytic capital⁶. In contrast, the Sustaining role typically assumes that the capital gap is **structural**, meaning that it is anticipated to persist for an uncertain period generally understood to be over a longer term, as explained in Figure 1 below.

FIGURE 1: CATALYTIC CAPITAL ROLES AND CAPITAL GAPS



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

While we have organized our series along the three roles of catalytic capital, the reality of transaction design and execution often blurs the lines between roles. **Many investment vehicles integrate elements of more than one role** in the same structure. Two examples within the affordable housing theme are:

- ✓ **Sustaining and Seeding:** the Housing Partnership Equity Trust (HPET), established by the Housing Partnership Network, is a social-purpose real estate investment trust (REIT). The REIT acquires and operates existing multifamily rental apartment properties across the United States (US) to preserve affordable rental homes for residents with low and moderate incomes. Investing to maintain affordable housing, the fund pursues a long-term strategy with structurally modest returns, requiring equity investors that support and understand the strategy and its risk-return profile in order to be competitive and achieve the mission. At the same time, HPET was the first ever non-profit social-purpose controlled REIT, applying a familiar structure in an innovative way to further its affordable housing strategy (see also box on p. 15).
- ✓ **Sustaining and Scaling:** IHS II SA, managed by International Housing Solutions (IHS), focuses on the development of green affordable residential real estate in South Africa, targeting lower- and middle-income households in peri-urban areas, hence addressing the affordable housing shortage in the country. As affordable housing is a high-impact but relatively low-margin business with structural risks (planning, bulk services, market, etc.), the fund struggles to attract both commercial and impact equity investors at scale. At the same time, the fund is the follow-on fund to the manager's first IHS I fund, seeking to scale the strategy (see also box on p. 15).

Catalytic capital can also play different and additive roles in building markets and sectors and in addressing distinct **segments within markets or sectors**. For example:

In financial inclusion there is a wide range of institution types serving diverse markets. Many mature microfinance institutions (MFIs) and Community Development Financial Institutions (CDFIs) have benefited from Seeding and Scaling catalytic capital for decades and can now attract commercial capital. However, catalytic capital investors are still needed to support those MFIs and CDFIs pushing to serve poorer and harder-to-reach borrowers and savers not served by mature operators - the Sustaining role.

- ✓ **MFIs in emerging markets:** in emerging markets, many mature, regulated MFIs have developed to the point where they are able to attract and rely on commercial capital from investors and funds. Other MFIs are still in the process of scaling and require Scaling catalytic capital. Yet others, within the same financial inclusion sector, are MFIs (often unregulated) that intentionally target the most difficult geographies (such as fragile states or low-income states⁷), the hardest-to-reach clients (such as the poorest or most rural population segments), and/or the most challenging (sub-)sectors or business models (such as small agricultural enterprises) - these are the MFIs that typically require Sustaining catalytic capital.
- ✓ **CDFIs in the US:** the same dynamic described in emerging markets can be seen in the development of the CDFI market in the US. Mature deposit-taking institutions increasingly scale and are able to attract commercial investors, while those CDFIs seeking to serve very low-income communities, often in particularly challenging geographies, look to Sustaining

⁷ "Fragile states" are typically known as "weak states"; different definitions exist as to what exactly is considered a fragile state.

catalytic capital investors that are able to stretch their capital flexibility to serve them.

Lastly, **many catalytic capital investors invest across the roles**. Some may not explicitly separate between them. To illustrate this point, four of the investor institutions in our Sustaining Learning Lab have also participated in our Seeding or Scaling Learning Labs.

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



Catalytic capital investors should allow enterprises and funds in Sustaining markets to take risk to explore and create solutions to structural gaps. The perspective on what 'success' means should shift from economics to the impact achieved - even if that could mean economic 'failure'."

Allison Clark, MacArthur Foundation

Introducing an Example Sub-Sector for Sustaining Vehicles: Financial Inclusion of Agricultural SMEs

Assessing the sub-sector of **agricultural small and medium enterprises** (agri-SMEs) in emerging markets and the financing gap

they face, Dalberg Advisors has identified an estimated funding gap of \$65 billion in East Africa alone⁸. This gap translates to about three out of four agri-SMEs - which, in Africa, are estimated to account for about 60% of all food production and trade⁹ - lacking financing, which hampers their growth. Why does such a large capital gap exist for agri-SMEs? The introductory paragraph in an article by Brian Milder, CEO and Founder of Aceli Africa, writing about a 2017 meeting of international lenders who are members of the Council on Smallholder Agricultural Finance (CSAF), illustrates lenders' experience serving this market:¹⁰

"We sat around the conference room table, as we'd been doing every six months for the previous five years, stealing furtive glances. Poker faces. Finally, someone broke the silence: 'We're not making any money - is anyone else?' Collective exhale. One after another we went around the room, competitors finally acknowledging the shared challenges that confronted us all in trying to lend in nascent markets. From one seasoned impact investor: 'We thought agriculture would be just like microfinance - three or four years to learn the sector and then solid returns and impact.' From another: 'Forget decent returns - our board is pushing hard for us to reach break-even. The only way to do that is by going upmarket. We wish we could lend farther on the market frontier and achieve more impact, but the economics just don't work.'"

Similarly, local commercial banks consider lending to the agri-SME sector to be risky and unprofitable, with banks in many countries allocating 5% or less of their portfolios to agriculture despite its significant contribution to GDP and employment.

⁸ Dalberg in partnership with CSAF (2018) [The Economics of Agri-SME Lending in East Africa](#)

⁹ CSAF (2020) [State of Sector 2020](#)

¹⁰ For the full article see [link](#)



Root Capital, a permanent investment vehicle founded in 1999, **invests in the growth of agri-SMEs** that support the sustainable livelihoods of smallholder farmers in Latin America, South-East Asia and Sub-Saharan Africa. Due to the nature of its investments, the **fund is concessionary**, using both grant funding and private capital in order to offer affordable loans to the small agribusinesses it targets. Most of its loans fall into one of two categories: either they yield a negative financial return to Root Capital and thus require a subsidy, or they yield a positive but below-market return. In 2017 the company published the results of an internal portfolio analysis, helping to create a tool kit that would support its decision-making going forward¹¹. It assessed and integrated data on both the financial and social/environmental performance of its loans to analyze how different financial and social/environmental goals relate to each other and to identify trade-offs, developing the concept of an “efficient impact frontier”. This frontier shows the “line” where investments offer the greatest possible impact relative to their cumulative risk-adjusted returns.

This approach has since allowed the company to take better-informed decisions on its investments and is still used to provide much needed capital to agri-SMEs.

The approach also allows the vehicle to engage more effectively with its investors and donors, explaining its portfolio approach and discussing the need for subsidies in order to achieve “more” impact.

The risk-return profile and economics of serving agri-SMEs are not attractive to commercial lenders: these businesses are typically small, lacking economies of scale, have limited access to competitive markets, are located in remote areas and often in challenging countries, have limited assets to serve as loan collateral, and frequently lack management skills to navigate the risks they face. These factors, among others, mean that (affordable) returns that can be achieved from loans to agri-SMEs typically do not compensate for the risks and costs of serving them. The described reluctance or inability of most investors, including impact investors, to tackle the agri-SME space

highlights the importance of funds in Sustaining sectors that address structural capital gaps - and catalytic capital investors that support such funds.

One example of a fund seeking to increase access to relevant finance for smallholder farmers in rural emerging markets is the Huruma Fund. Concessional first-loss equity provided by the EU and concessional debt from the Agencia Española de Cooperación Internacional para el Desarrollo (AECID) allow the fund to pursue a strategy that seeks to improve access to financing in rural areas in emerging markets *as described in the box on the following page*.

¹¹ Stanford Social Innovation Review: Michael McCreless (2017) [Towards the Efficient Impact Frontier](#)



The **Huruma Fund**, launched in 2019 and managed by **GAWA Capital**, is a €120 million fund seeking to **improve access to relevant finance in rural areas** in Latin America, the Caribbean, Sub-Saharan Africa and Asia, providing debt and equity investments predominantly to financial service providers that offer financing to smallholder farmers, but also (up to 30%) to agricultural organizations and SMEs directly across the agricultural value chain.

Ultimately, the fund seeks to improve the productivity and income of smallholder farmers that have fewer opportunities through customised financial products and the provision of market linkages.

The fund has a **blended finance structure**: it benefits from a first-loss junior equity tranche provided by the EU and concessional debt extended by the Agencia Española de Cooperación Internacional para el Desarrollo (AECID), both of which enable a €90 million participation of private investors in the senior equity tranche.

Complementing its capital, the fund is enhanced by a €8.5 million technical assistance facility to support its investees and the development of suitable products for smallholder farmers.

Another example is Aceli Africa. While the approach taken by this vehicle is quite distinct from typical agricultural fund structures, the ultimate aim to increase financial inclusion for agri-SMEs is similar.

Aceli Africa offers financial service providers incentives to increase their lending activity to agri-SMEs, seeking to build, over time, a competitive finance market for the agricultural sector in Africa.





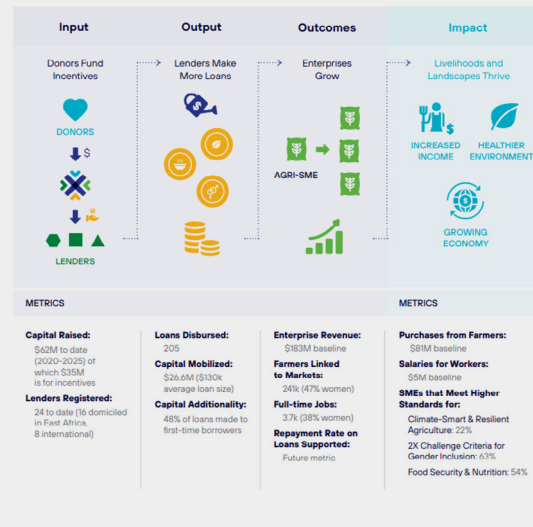
Aceli Africa (Aceli) emerged from discussions amongst CSAF members on the prevailing financing gap in the agri-SME market. The grant-funded vehicle was launched in 2020 as a specialist market facility, **offering concessional funds in the form of financial incentives to participating lenders that then deploy their own capital to agri-SMEs on commercial terms.** In a nutshell, the facility provides a subsidy to lenders for the impact they generate. In the long term, the approach aims to create a more competitive, inclusive and sustainable lending market for the agricultural sector in Africa.

As part of its incentives offering, Aceli provides first-loss coverage at a portfolio level and origination incentives to lenders (including impact bonuses when loans meet criteria related to gender inclusion, climate & environment, food security & nutrition, and/or opportunities for youth) plus technical assistance both to SMEs and financial service providers. The incentives seek to improve the risk-return profile of lending into the market and motivate lenders to serve the highest-impact SMEs. To date, Aceli’s incentives have generated a leverage ratio of 12x (i.e., \$1 in donor-funded incentives mobilizes \$12 in private sector financing to the target sector, compared to e.g., ~4x leverage that Convergence Finance found across blended finance vehicles overall). The rationale for and the sizing of incentives is based on data collected over several years on loan-level and portfolio-level economics indicating that risk in agricultural lending is 2x other sectors' and that transaction costs - which are not addressed by loan guarantees - are also 2x as high in agriculture compared to other sectors. In addition, Aceli provides technical assistance in partnership with local service providers to expanding addressable demand.

Aceli rigorously tracks data and seeks to generate learnings through transparency, assessing the effects of its incentives, the impact of access to credit and the flow-through benefits to farmers and workers’ livelihoods. The vehicle published its year 1 Learning Report¹² in 2021.

To date Aceli has signed up 27 lenders for the financial incentives program, located in four East African countries and internationally, comprising a mix of commercial banks, national development banks, non-bank financial institutions (NBFIs) and international impact investors (including CSAF members and others).

Benefit Breakdown of Incentives



There is no easy or fast way to change structural risk-return challenges in order to close prevailing financing gaps. Bringing affordable and suitable capital to agri-SMEs in Africa is hard work and

requires investors’ focus and flexible capital if demand is to be met or the situation even to be improved - at least in the long-term. Herein lies the role for Sustaining catalytic capital.

¹² Aceli Africa (2021) [Learning Report: Year 1 - Unlocking Private Capital for African Agriculture](#)

The Sustaining Role and Structural Capital Gaps

It is important to reiterate that for Sustaining vehicles - and catalytic capital investing in them - there are no “quick wins” or “fast track solutions” to eradicate a market failure and achieve commercial viability. It is the tenacious grinding of the stone that will eventually shape it. Sustaining investments address **structural capital gaps** that persist on a risk or return level:

- 1. Risk:** there are many risks that, when significant, can lead to a long-term structural capital gap. While transient risks typically include those that can be reduced over time - such as perceived risks that are addressed through increased data and track record, and also some real risks that can be addressed through market maturation (e.g., business models becoming increasingly tested and refined; sectors gaining maturity through gradual maturation and sophistication of operating enterprises) - structural risks are (even) more difficult to address and reduce. They are typically anticipated to remain over the longer term and carry a high degree of uncertainty as to when or whether they will be fully resolved. Structural risks can include one or more of the following:
 - ✓ high and persistent risks related to a targeted *geography*;
 - ✓ high and persistent risks that are inherent to *investees in a targeted sector* (or sub-sector) or pursuing a certain *business model*; and/or

- ✓ high and persistent risks that stem from the nature of the *end-users* or *clients* of the investees or their targeted *population segment*.

- 2. Return:** similarly, there can be structural return challenges, where no short- or medium-term growth trajectory will allow for the underlying enterprises, strategy or vehicle to scale out of initially sub-commercial returns. Structural return challenges can apply in sectors or strategies that are “*tried-and-tested*”, i.e., with a track record, but also in combination with untested, sidelined markets that bear uncertainty and high risks. Return challenges, leading to a vehicle needing to offer sub-market returns to investors, usually occur with respect to:

- ✓ sub-market investor-level returns reflecting *moderate investee-level returns*: e.g., due to structurally sub-commercial unit economics or pricing constraints linked to the target market; and/or

- ✓ sub-market investor-level returns reflecting *high fund-level costs*: e.g., due to small fund size leading to relatively high operating costs; high transaction costs due to small investment amounts; or high management fees due to small investment amounts and/or high-touch investee support.

The risk and return factors shown above are not mutually exclusive. Risk and return are two sides of the same coin and, usually, more than one of the factors apply to a Sustaining vehicle.



Often people think that situations with high risk, where repayment is uncertain, are best addressed with grant funding. I believe, however, that we as catalytic capital investors should provide investment capital where possible to allow investees to build track records and signal belief in a proposition or market.”

Allison Clark, MacArthur Foundation

RISK			RETURN	
GEOGRAPHY	INVESTEES (SECTOR/BUSINESS MODEL)	END-USER	INVESTEE RETURNS	FUND COSTS

HOW SUSTAINING CC HELPS

Allowing the manager to push into geographies where others fear to tread	Allowing the manager to invest in investees that operate in sectors (or sub-sectors) and/or apply business models that are considered too risky by others	Allowing the manager to pursue population segments that are unserved, as they are considered too risky by others	Allowing the manager to offer investees affordable investment products	Allowing the manager to invest small amounts and/or add hands-on support to investees
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EXAMPLES OF RISK OR RETURN FACTORS	Persistent macro risks, such as challenging and unstable political situations; volatile currencies; or underdeveloped laws and regulations	Persistent risks inherent in certain sectors (or sub-sectors) and their business models, such as small agribusinesses	Persistent risks inherent in certain population or end-user/client segments, such as families with lack of/unstable income	Persistently low-margin businesses allowing for only sub-market interest payments or leading to sub-market IRRs	Relatively high fund-level costs, such as management fees, operating expenses or transaction costs
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EXAMPLE AREAS

Vehicles investing in fragile states ¹³	Vehicles investing in small agribusinesses and cooperatives in the agricultural sector; or Investments in the mini-grid business model within the access-to-energy sector	Vehicles investing along the agricultural value chain in enterprises focusing on products and services for smallholder farmers; or Financial inclusion investments with a focus on the persistently underserved and hardest-to-reach population segments	Vehicles providing debt financing to agricultural processors that yield low returns	Vehicles providing debt financing to small agribusinesses, such as producer or processor organizations serving smallholder farmers
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DEAL EXAMPLE	Injaro’s Injaro Capital Holdings Ltd fund is focused on challenging geographies in West Africa: Burkina Faso, Côte d’Ivoire, Ghana, Mali, Niger and Sierra Leone; in addition, the fund targets early-stage agribusinesses leading to sub-market investor returns	Root Capital’s substantial grant support and debt allows the vehicle to offer affordable loan products to agribusinesses and cooperatives. Augmenting this are significant portfolio loan guarantees providing loss protection to Root Capital if clients are unable to repay their loans	Global Partnerships’ Impact-First Development Fund provides debt funding to social enterprises serving people that live below the international poverty lines, in particular women and the rural poor	AgDevCo’s investors receive modest returns, allowing the vehicle to invest in and provide affordable funding to agribusinesses along the agri and food value chains, recognizing the (i) lower returns in the sector and (ii) high transaction costs See also e.g., Root Capital	Incofin’s Fairtrade Access Fund provides access to finance to smallholder farmers through cooperatives in order to foster market access and encourage sustainable farming practices; the fund targets 3% p.a. returns to investors, allowing the fund (i) to in turn offer affordable funding to its investees and (ii) to engage in small loan sizes of \$300k to \$3 million and in loans in remote markets (both of which entail high effort and transaction costs) See also e.g., AgDevCo
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¹³ “Fragile states” are typically known as “weak states”; different definitions exist as to what exactly is considered a fragile state.

In Sustaining investments, the difficulty often lies in understanding the nature of the capital gap, resulting in a realistic assessment of what results can be reasonably and credibly targeted. This underscores the importance of cooperation and data sharing as *highlighted on p. 25*).

Unlike the Seeding and Scaling roles of catalytic capital, Sustaining vehicles are typically **not**

regarded as “shiny and exciting”. Indeed, they are often considered boring as they may lack the excitement of new players, innovative models and novel strategies, and newsworthy levels of commercial capital mobilization. That said, they are critically important. They tackle the hard-to-reach households and communities in the places forgotten or in the shadows.

Housing Partnership Equity Trust and IHS Fund II SA - TACKLING THE AFFORDABLE HOUSING SHORTAGE



Housing is a basic need. That said, **affordable and safe housing for the less affluent is often scarce and is an overlooked investment segment** by investors, including impact investors. But it is necessary. As Catherine Godschalk from Calvert Impact Capital, a leader in that segment in the US, noted: “the outcomes of this work go far beyond a roof over people’s heads; affordable housing contributes to improvement in health, education, and economic opportunities”¹⁵. Two exemplary funds that have taken on the fight to maintain or extend affordable housing in different geographies are the following:

- Founded in 2012 by the **Housing Partnership Network** (HPN), the **Housing Partnership Equity Trust** (HPET) is a social-purpose real estate investment trust (REIT) that acquires and operates existing multifamily rental apartment properties to preserve affordable homes for residents with low and modest incomes. HPET partners with 14 HPN non-profit members, offering them low-cost, long-term equity capital to acquire units across the US. HPET was created as a solution for members competing against commercial developers with easy access to cash, thereby ensuring that currently affordable buildings are not converted into higher-priced apartments. The trust, seeking to preserve naturally occurring affordable housing, pursues a long-term strategy with relatively modest returns and low risk, requiring equity investors that support and understand the strategy and its risk-return profile in order to be competitive and achieve aspired impact.
- **IHS Fund II SA** is **International Housing Solutions’** (IHS) second fund focusing on the acquisition and development of affordable residential real estate in South Africa. The fund targets lower- and middle-income households in peri-urban areas, addressing the affordable housing shortage in the country. In addition to the impact generated by the provision of affordable dwellings, IHS Fund II SA integrates energy efficiency into the housing units (based on the IFC’s Excellence in Design for Greater Efficiency (EDGE) standard). IHS is committed to improving the availability of affordable housing in South Africa - a high-effort, low-margin business - and has expanded its operations into other Southern and also East African countries, as well as seeking to address social housing and the needs of even poorer population segments, e.g., those without formal employment.

¹⁴ The fund applies the World Bank poverty lines of \$3.20 per day and \$5.50 per day, reflecting the median poverty levels typically found in lower middle-income countries (LMICs) and upper middle-income countries (UMICs) respectively; these poverty lines were introduced in 2018 to complement the extreme poverty line of \$2.15 per person per day (\$1.90 prior to the 2022 update); see also under [link](#) and [link](#)

¹⁵ For the full blog see [link](#)

All this can lead to the perception that these deals are stagnant and devoid of innovation. However, that is not the case. While they do require tenacity, and progress can be slow and difficult to observe in the near term, there can be - and often is - innovation and advancement in how capital is being deployed and the impact being generated.

One example showing the dynamism that can be found in Sustaining catalytic capital is the OneAcre Fund: the team started in 2006 with an idea and pilot that has since grown, through hard work and persistence, to a sizable vehicle with deep impact (see box below for more information).



Sustaining transactions are oftentimes perceived as static due to their long-term horizons. However, they are - or should be seen as - dynamic. It is important to ensure incentive mechanisms are created to ensure all stakeholders (including fund managers and investors) are continually refining and optimizing to maximize the impact achieved and no one is 'sitting on their laurels'."

Alex Goodenough, BII

OneAcre Fund - CHANGING THE WAY SMALLHOLDER FARMERS ARE FINANCED



OneAcre Fund started in 2006 with a pilot in Kenya looking for new ways to increase the profits of smallholder farmer families by providing them with the **combined offer of suitable products** (such as seeds and fertilizer) and **services** (such as crop insurance), **training** (such as planting and crop health advice) and **affordable financing options**. In 2020, the fund surpassed the 1 million farmer milestone. What started as an innovative small pilot proved a scalable idea, adding more and more families to life-improving farm services each year. The fund has a blended-revenue model: about 70% of field expenses are financed through farmer purchases, with donor dollars covering the rest.

	2017 Actual	2018 Actual	2019 Actual	2020 Actual	2021 Actual
Scale					
Farm families served	614,800	809,800	1,005,000	1,340,900	1,441,300
Scale					
Full-time staff (95% rural jobs created)	6,600	7,300	8,400	8,700	8,700
Impact					
\$ gain in farmer income (annual + asset impact)	\$140	\$91	\$111	\$83	\$104
Impact					
% gain in farmer income (annual + asset impact)	53%	42%	53%	34%	45%
Sustainability					
% loan repayment	98%	97%	96%	94%	92%
Sustainability					
% field sustainability	69%	71%	73%	77%	73%



A particular potential use of catalytic capital in the Sustaining role is for investments in **disruptive exploration**, whereby an investment seeks to go beyond the “tried-and-tested” and allows for the imaginative pursuit of new ways to tackle structural problems, seeking to break out of the familiar mold. Such investments aim to change - or add to - the usual approaches and toolkits and experiment with alternative models.

To be clear, this does not mean that through such new approaches or models the structural gap disappears or transforms into a transient one. Rather, such investments allow for alternative, additional or even disruptive ways to address the structural risk-return gaps and underlying challenges, hopefully finding a further piece of the complex puzzle that will ultimately change a market or even a system.

An example was provided by Allison Clark from **MacArthur Foundation** (MacArthur) during the Learning Labs: in the past, there was no funding available for energy efficiency upgrades in affordable housing in the US. Seeking to disrupt that gap, the foundation partnered with **Community Investment Corporation** (CIC) in 2008, providing the corporation with limited-recourse capital to be on-lent to building owners and developers of affordable housing for energy efficiency upgrades of their buildings. The foundation’s funding took the entire risk of the proposition (whereby any losses would be applied towards the repayment amount under the MacArthur loan), thereby allowing CIC to meet a financing gap in the market. The approach has taken hold over several years such that CIC now includes loan capital for energy efficiency upgrades as part of their standard underwriting for all projects.

Another example was given by Harry Davies from **Ceniarth** and Daan Besamusca from **OSF**. In 2008 **ROC USA** was formed to improve land ownership by manufactured home communities (MHCs or “mobile home parks”), seeking to ensure that the communities’ land was not acquired by commercial players that had the sole intention of extracting maximum rental income or repurposing the use of the land. Replicating a pilot in New Hampshire by the New Hampshire Community Loan Fund, ROC USA helped homeowners overcome the three barriers to resident ownership: the lack of opportunity, expertise, and financing. ROC USA, a social venture, provided loans to cooperatives, so that homeowners could jointly buy their MHCs’ land, preserving affordable housing in their communities. In addition, it offered technical assistance programs, including leadership development, online peer networking and education, aggregation, and marketing.

While, as discussed, structural risk-return gaps are persistent - i.e., with no anticipation of a short- or medium-term transition and consequent reduction of the need for catalytic capital - investors in these strategies nevertheless often have a long-term view on change beyond the deal-level impact. Throughout our Learning Lab discussions, investors reflected that they engaged in Sustaining vehicles with the following aims:

1. **Deal-level** change: focus on the direct investee enterprises and the strategic impact of the vehicle in the targeted markets (including sector, geography, and underlying client segment), addressing a specific problem and market failure;
2. **Market-level** change: focus on whether and how the impact generated can advance the way in which a persistent gap and market failure can be tackled by way of replication, by generating additional investment activity and/or by tapping additional tools to address the gap in the targeted market or beyond; and/or
3. **Systems-level** change: adopting a holistic approach to analyze a structural gap, focusing on interventions that address the root causes rather than symptoms with a recognition that investment capital will need to be augmented by other interventions to achieve lasting change in addressing the structural gap.

These three levels are not mutually exclusive, and Sustaining investors often target more than one. Aiming for market- or systems-level change is particularly relevant in Sustaining transactions, where long-term routes towards reducing tenacious structural capital gaps are often the explicit motivation for deploying catalytic capital. There is an increasing number of investors and organizations that apply a market- or systems-level approach, including, for e.g., Omidyar Network (see *box*), Small Foundation (see p. 38) or the Inter-American Development Bank (IDB), which seeks to select projects based on a systematic approach to its strategic sector investments, targeting an “impact greater than that of an individual project”¹⁶.



When looking at systems change, we need to build the track for a race, not to bet on the best horse. In order to change markets, or even systems, the starting question must always be about market need: what is required to (step-by-step) effect change? For that, one cannot invest in just a single business but pursue multiple interventions, that play together.”

Karina Wong, Small Foundation

Omidyar Network - PURSUING MARKET-LEVEL IMPACT



Omidyar Network (Omidyar) pursues a dual long-term market-level impact thesis with its Sustaining catalytic capital¹⁷, seeking to support:

- *Markets that benefit from data and reasonable certainty:* use catalytic capital to buy relatively predictable additional impact in certain markets, bridging unit cost gaps by providing concessional catalytic capital or, at times, grant funding; the aim is to improve the breadth and depth of such markets, making them more efficient over time; and
- *Markets that are underdeveloped and lack data:* use catalytic capital to support the development of nascent markets, helping to build market infrastructure, pioneer models and accumulate data by offering high-risk, patient capital.

Both contexts are relevant in Sustaining in order to build and change markets; both require catalytic capital support.

¹⁶ For more information on the Inter-American Development Bank’s approach see [link](#)

¹⁷ See also Omidyar Network’s publications, for example [link](#)

Without the support of Sustaining catalytic capital, many of the most dire and urgent needs of people and planet remain unaddressed. For impact investing to fulfill its ambition of contributing to solutions, Sustaining catalytic capital - combined with significant effort and willpower - is needed to pursue investment opportunities inclusive of the people and places that are hardest to reach, so that no one is left behind.

Sustaining Impact

Impact is central to Sustaining transactions. The catalytic capital investor's determined effort will only be made if the promise of additional impact is possible. There is no (and there does not need to be a) uniform view on or expression of what additional impact means, what "amount" is expected or how it is measured. Our Learning Lab participants generally recognised that in order to deliver the additional impact, concerted effort (pushing further and harder) and stamina combined with a long-term perspective (there are no quick fixes) are needed. While some catalytic capital Sustaining investors may focus on direct impact, others go beyond and seek to assess long-term indirect effects and the role an investment plays within a particular ecosystem (see also previous discussion on market- and systems-level change).



When talking about the structural capital gap, there is, on the flipside, an impact opportunity. My concessional capital can buy incremental impact and finance solutions that improve lives. This positive frame is perhaps a more compelling motivation for action."

Chris Jurgens, Omidyar Network

Getting Catalytic Capital Flowing

As shown above, catalytic capital investors in the Sustaining role tackle impact investing areas that are underserved. We are talking about the hard-to-reach people and places that are often neglected and forgotten. These are areas that cannot remain left out of the impact investing equation as they are meaningful and significant: a vast number of people currently do not benefit from products and services that meet basic needs; a vast number of enterprises have no access to suitable funding or markets; and a vast number of places remain unpenetrated by impact investing. If we want a world with lasting change, Sustaining catalytic capital is critical. **We believe that catalytic capital investors willing to tackle Sustaining challenges are crucial to ensure impact does not stop at the "easy" but reaches everyone and everywhere.**

While Sustaining catalytic capital and the impact it generates are truly needed, there are many challenges in the way of its realization. To begin with, attracting catalytic capital willing to commit to Sustaining vehicles is difficult, in particular if needed at larger scale. As most Sustaining vehicles utilize a blended structure, the challenge is amplified by the need to find and attract the right investors for each of the capital tranches. It is by and large left to the asset manager to do the heavy lifting in forming an investor group that works, from the initial outreach down to plugging the last gaps in their respective structures.

Even once investors have been gathered, weaving them together through structuring, due diligence and legal negotiations can end up being a long and convoluted process. Again, this challenge is particularly pronounced in vehicles that have a blended structure, and for Sustaining vehicles in particular, where diverse investor types participate across different layers of a capital stack and where at least some investors need to allow for long-term subsidized risk and returns.

As a result, managers face delays and often do not achieve the fund size aspired, ultimately failing to deploy their capital with the speed and urgency required, frequently falling short of their original Sustaining objectives. Delays in Sustaining funds - getting them off the ground or to the size intended - mean that problems in the real world remain unaddressed. **The catalytic capital community can play a vital part in addressing these challenges and working to get capital flowing as it should: effectively and efficiently. This recognition - and the motivation to break through challenges holding back that flow - is the common spark that fostered collaboration among the investor participants in the Sustaining Learning Lab.**

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

The general challenges are largely the same as for Seeding and Scaling. We encourage the reader to read the two earlier guidance notes where challenges and approaches are discussed in

detail, to benefit from the full content, including challenge descriptions, approaches, examples and ideas. **In this guidance note we focus on different implications of the specific challenges that may apply to the Sustaining role**, typically the most difficult to execute (as discussed in this note), catalytic capital role.

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

- A. STRATEGY:** determining strategic objectives and parameters for the use of Sustaining catalytic capital and building a community of practice
- B. UNDERWRITING:** approaching underwriting of Sustaining transactions effectively and efficiently for all
- C. CAPITAL-RAISING:** supporting the Sustaining capital-raising process toward a successful and timely conclusion
- D. STRUCTURE & TERMS:** designing an efficient Sustaining structure and enhancing terms negotiations



A STRATEGY

CHALLENGE SUMMARY

As laid out in more detail in the Scaling and Seeding guidance notes, catalytic capital investors are often confronted with a lack of internal and/or external clarity on their catalytic capital's objectives and investment parameters, including risk-return parameters.

Clarity is particularly important in Sustaining transactions as they require the willingness to go the extra mile, both with respect to effort and flexibility of the capital. If there is no clear intentionality *internally*, including an articulation of objectives and additional flexibility on the parameters, such transactions are likely to stay unaddressed.

Externally, a lack of clarity increases the degree of difficulty for managers to put together and execute already challenging deals. While in Scaling vehicles the blended structure puzzle is tough to solve, it is often even trickier for Sustaining vehicles. In Sustaining deals some pieces of the puzzle need enhanced willingness, capacity and ability to put in effort to get a deal over the finish line and to accept disproportionate risk-return propositions.

Also, particularly in Sustaining investments, close collaboration - including the sharing of data and analyses, the discussion of multiple viewpoints and brainstorming of ideas, and effective cooperation on initiatives and deals - is needed to chip away at the structural issues and, over time, achieve change.

To reiterate, if there is no clear strategic intentionality to the effective deployment of catalytic capital, the Sustaining capital gaps and their underlying market failures and challenges are likely to remain unaddressed.

Specific Challenges and Approaches Set Out in the Scaling Guidance Note that are **Applicable** to Sustaining

A number of specific challenges and related approaches or solutions discussed in the Scaling and Seeding guidance notes are in principle **the same** (or very similar) in Sustaining deals (see *in particular the Scaling guidance note*, where the below points are discussed in detail):

1. Clarity in strategic objectives and parameters: provide a clear articulation of objectives (what) and investment parameters (how) internally and externally; importance of specificity;

2. Strategic flexibility and market responsiveness: ensure the strategy is flexible, holistic and actionable to meet market - and not predominantly investor - needs; and

3. Community of practice: collaborate and form partnerships; example areas can include the sharing of pipeline, data and learnings, co-investing or standardizing approaches and templates.

While there are many overlaps, there are some important distinctive implications that are typical for Sustaining vehicles and transactions. These implications are summarized on the next page:

Additional aspects: clarity (1) and flexibility (2)

In order to attract real and continuing internal attention and focus - despite the effort needed and challenging economic proposition - a strategy, including objectives and underlying parameters, that focuses on Sustaining transactions needs clear articulation. Sustaining deals typically require particular focus, effort and flexibility and will remain neglected if not purposefully lifted to the foreground through an intentional and clear expression of a long-term strategy.

Some of the questions that engaged catalytic capital investors should ask themselves when articulating their Sustaining strategies include:

- ✓ **Objectives:** *what* are our long-term objectives?
 - What structural gap and market failure do we seek to address with our catalytic capital on a deal-level?
 - Is there a longer-term ambition to pursue market-level and/or systems-level change? If so, are there “accompanying” investments that should be pursued to support market development - and is there sufficient “density” of possible investments to achieve market-level change over time? And what and who may be needed in addition to our capital?



We need to ask ourselves: Are we solving a specific problem or a wider market failure?”

Karina Wong, Small Foundation



We have to be honest with ourselves that sometimes the sectors we invest in will never be sustainable, and how do we deal with that over the long term?”

Josephine Ragni, Fundación Netri

- ✓ **Investment parameters:** *how* can deal-, market- and systems-level change be achieved? What are suitable investment parameters that address the prevailing structural gap and also potentially enable long-term change for the better? In more detail:
 - What should be the geographic/ sectoral/ thematic focus? How wide or narrow should it be to be inclusive and effective? Should there be built-in flexibility to react to the market?
 - What are the most suitable instruments? Should there be grant funding complementing investment capital?¹⁸
 - What risk-return appetite is needed to provide relevant and additional financing (potentially different to our other, even catalytic, impact capital)? What role(s) can we play in blended structures? How concessional can we be? And who can we subsidize?
 - How do we look at fund commercial viability, and what is our flexibility on funds vis-à-vis the manager, e.g., fund and manager sustainability? Do we offer grant support to ensure commercial viability of a vehicle down the road?

¹⁸ For further information on the role of grants in catalytic capital investing we refer the reader to C3's [FAQs](#)



British International Investment (BII, formerly CDC Group) has invested considerable time and effort to ensure a **clear and concise communication** of its catalytic capital strategies, “Catalyst” and “Kinetic”, including the delineation against the more commercial “Growth” strategy. The DFI:

- Produces manuals and analyses to be shared internally amongst colleagues to frame and explain the Catalyst and Kinetic strategies;
- Stimulates the development of analytical tools for catalytic capital deployment such as defining the “Enhanced Development Impact” bar a catalytic capital transaction must meet;
- Organizes internal workshops to share innovation and experience across BII’s catalytic capital portfolio and help teams to originate pipeline; and
- Provides training to its IC members on its catalytic capital strategies to ensure ICs have the appropriate focus and risk tolerance when considering a Catalyst or Kinetic transaction.

These efforts allow BII to build a common understanding across the organization and ensure clarity on the nature, objectives, and applications of its Catalyst and Kinetic strategies. They also open the doors for internal collaboration, opportunity identification and pipeline referrals between the different teams.

With internal clarity on its way, BII is also looking to collaborate with other catalytic impact investors and is sharing its approach externally with peers both on a bilateral basis and through a series of blog posts, including:¹⁹

- An investor’s journey: How CDC Group is innovating with catalytic capital;
- Assessing impact and risk when deploying catalytic capital; and
- Managing the impact of our Portfolio: Our Impact Score.

✓ **Terms of the capital:**

- What is the additional flexibility that is required on our catalytic capital terms in general? Is there flexibility to stretch beyond the “usual” restrictions set by the wider parameters?
- In particular, what is the flexibility to subsidize risks and returns?
- What are the limitations of our catalytic capital?
- Are our catalytic capital terms allowing other investors to remain in their comfort zones, rather than challenging them to look and work harder?

✓ **Beyond capital:**

- Is grant support needed as part of the capital structure or in addition to investment capital, and if so, can we combine and provide both?
- Are there partnerships, potentially investors with complementary instruments or flexibility, that can enhance the overall funding provided?
- What or who else is needed to achieve long-term change, and are there initiatives, projects and partnerships we should pursue in parallel with our Sustaining investments?

¹⁸ See the full blogs [here](#), [here](#) and [here](#).

✓ **Impact:**

- What is/are we clear on our impact thesis?
- Is there additional or deeper specific impact that the institution is seeking to achieve (in return for higher risk-return appetite and flexibility; it is important to note that there is no uniform or “right” answer to this question)?
- Are we seeking to create indirect market- or systems-level impact in addition to the direct impact of a particular investee vehicle?

Clarity and a concise articulation are particularly important, as was stressed by several of the Learning Lab participants, especially when an institution is coming historically from a more commercial investment approach and newly moving into a Sustaining strategy. In this case, explicit clarity can help investment teams and investment committees to move from their comfort zones - the business-as-usual approach with respect to their “legacy portfolios” - to implement the “stretch” needed to execute Sustaining investments.

A particular strategy challenge stressed during the Learning Lab for Sustaining was how an institution can set the guardrails today to ensure continuing engagement and support in the long term. If the strategic intention is to achieve market- or systems-level change, the institution’s **horizon** or outlook on Sustaining strategies must outlive the typical short vehicle tenors, budget cycles, or the tenure of teams and individuals at the institution. One way to address this timing issue is by providing grant funding into a capital structure, allowing the perpetual use of capital²⁰. Further, organizations may consider the establishment of long-term strategic focus areas as explicit mandates that are intended to outlive short-term cycles, providing the required focus and resources in the longer run.

²⁰ For further information on the role of grants in catalytic capital investing we refer the reader to C3’s [FAQs](#)

Calvert Impact Capital
and Small Foundation



**- THE CHALLENGE OF THE TIME
HORIZON**

While **Calvert Impact Capital** provides debt financing that is time-limited in its nature, the organization does enter into certain strategies with an **expectation to renew its commitment** over time, being an implicit “evergreen investor”. This expectation is set to address the duration mismatch of its debt capital vis-à-vis the market failure that is being addressed (see *also example on p. 35*).

Small Foundation benefits from flexible capital and the ability to commit to long-term investment strategies as part of its **multi-generational institutional approach**. Applying a **systems-change lens** for its investments, the foundation tries to assess (and, importantly, reassess on a regular basis) where its investees play in a certain system (the foundation’s “systems transformation plan”), what pathways it expects the investee to take, and how the system may develop over the long-term (i.e., within the next 10 years and beyond). The role Small Foundation contributes to an investee may change along the way as the role of the enterprise or fund may change within a system.



To achieve market- or systems-level change, the horizon or outlook on Sustaining strategies must outlive typical short vehicle tenors, budget cycles or team tenures.”

Aceli Africa - THE LONG GAME



Aceli Africa (introduced on p. 12, see for more detail) is a vehicle that has been established with the **aim of achieving long-term, market-level change**. Its strategy of providing targeted and data-driven incentives to engaged lenders tied to specific objectives (e.g., food security or economic opportunities for women) allows the vehicle and its lender partners to increase the funding provided to agri-SMEs today. The long-term objective is, however, to change the market by increasingly crowding in commercial investors, hence generating competition that will reduce the amount required to incentivize new loans in the (distant) future.

Additional aspects: community of practice (3)

Investors active in Sustaining deals and sectors seek to tackle persistent structural capital gaps. As these are hard nuts to crack and as catalytic capital here is even more scarce than in Seeding and Scaling, cooperation is even more crucial. In particular, if there is a wish - and ambition - to change markets or systems, engaged investors

may want to **connect** and **cooperate** with aligned investors and also with other stakeholders, including donors and governments, to understand and change the relevant market or system and its inherent structural gaps.

In a similar realm, comments from Learning Lab participants stressed the importance of **data sharing** - as many Sustaining markets have the benefit of existing data - and more **targeted research**. For Sustaining transactions, it is crucial to understand and demonstrate the prevalent structural capital gap and delineate it as clearly as possible from transient gaps in order to:

- ✓ Justify the need for subsidized capital and the extra effort required, particularly to internal stakeholders and decision-makers; and
- ✓ Avoid the ongoing use of subsidized capital for challenges that are not structural in nature, to preclude negative market distortion effects.

Catalytic capital investors active in Sustaining markets often struggle and have to work hard to pinpoint the structural issues in a deal. The strategic pooling of data and analyses and targeted sector-level research can help to advance investors' understanding and ultimately increase their appetite for and efficiency when participating in Sustaining vehicles.





In 2017 the **Council on Smallholder Agricultural Finance** (CSAF), a global network of lending practitioners committed to promoting an inclusive finance market for agricultural SMEs, convened donors and other stakeholders to discuss the challenges of addressing the financing gap, estimated at \$65 billion annually, for agricultural SMEs in Africa.

Following the convening, CSAF initiated and its members participated in a number of significant **data collection and analysis efforts**. They engaged East African banks and non-bank lenders to quantify the lending economics of serving agricultural SMEs, to find out where the core needs for solutions lie and to establish how subsidies could be used without distorting the markets. Two important initiatives and reports include the following:

- **Aceli Africa:** Aceli Africa partnered with **Dalberg Advisors** to analyze both loan-level data and lender financial performance, complemented by interviews with lenders, to develop a better picture of the challenges limiting their agri-SME lending. This analysis of data, comprising 31 lenders on 13,000 loans totaling \$4.5 billion across 61 countries (with a focus on East Africa), indicated as one of its findings that the risk of bank lending to agri-SMEs is twice as high as lending to other sectors in East Africa, while returns are significantly lower, in part due to higher operating costs for agricultural lending. The research further found that for regionally active social lenders, lending risks were twice as high and operating costs more than 20% higher in Africa than in their more mature agricultural portfolios in Latin America.²¹
- **Small Foundation:** Small Foundation, the core funder for CSAF from 2017-2021, commissioned **Genesis Analytics** to conduct research into the operational processes and financial performance of seven agri-SME lenders, most of which are members of CSAF. The aim was to identify best practices and better ways to effectively serve agri-SMEs, improving risk, costs and turnaround times, ultimately driving greater efficiency and profitability.²²

The research informed, amongst others, Aceli's design of financial incentives that compensate lenders for the risks and costs incurred in financing agricultural SMEs, and it helped the vehicle in its fundraising, as it provided objective hard data on the market risk-return gaps and challenges. Further, AgDevCo considered the independent data provided by the research initiatives on realistic agri-SME returns as instrumental in helping with its own fundraising.

More such research is needed to analyze structural capital gaps. This necessitates more funders of such initiatives, but also more investors and managers that are willing to disclose detailed information (including not only the headline numbers but specific data on underlying risk-return factors and drivers), providing specificity that will make the research tangible, applicable and valuable.

²¹ Aceli Africa, in partnership with Dalberg Advisors (2020) [Bridging the Financing Gap: Unlocking the Impact Potential of Agricultural SMEs in Africa](#)

²² Small Foundation, in partnership with Genesis Analytics (2020) [Profit and Impact - Lessons on operational efficiency in agri-SME lending](#)

DISSEMINATING AVAILABLE INFORMATION



In order to ensure the (limited) available data and learnings are shared most effectively, and to avoid duplication of effort, one idea that came out of the Learning Labs was to establish “**information dissemination platforms**” covering select market segments (geographies, sectors or sub-sectors).

The idea is that such platforms would seek to provide **comprehensive information on the current state of a market** ((sub-)sector or geography), listing all relevant reports on the respective market, advertising current initiatives, sharing posts on new developments and learnings and showcasing relevant funds and enterprises - in a nutshell ensuring that interested and engaged investors, managers and wider stakeholders are abreast of the latest and greatest information and activities in the targeted market.

Action step: would a funder be willing to set up and maintain one or more platforms with a comprehensive collection of market-relevant materials for a specific Sustaining (sub-)sector or geography?

Beyond the sharing of existing information, **forward-looking partnerships** and joint initiatives

are crucial to enable long-term change. No single investor can move the dial alone.





Beyond a compilation of “what is there”, the next step of a more forward-looking initiative could be the formation of a “**collaborative**” of catalytic capital investors that are willing to roll up their sleeves to work jointly on the advancement of a market segment (geography or (sub-)sector). In particular in Sustaining investments, a holistic view and complementary activities are important ingredients in changing the prevailing market failures and structural gaps. The **starting questions** could include:

- 💡 Why is there a structural gap? What are its elements?
- 💡 What specific information and data are needed to assess the structural gap? And who has that data (if anyone)?
- 💡 What are the key drivers and reasons that prevent investors from investing?
- 💡 How can these drivers be (at least partially) addressed? Or, how can investment be made “easier”?

Possible resulting **initiatives** could include:

- 💡 **Pipeline and sourcing:** setting up a deal dashboard showing relevant pipeline, deals and gaps in the capital structure that need filling (see also the deal dashboard idea in the Scaling guidance note);
- 💡 **Deal execution:** forming “clubs” (on a deal or strategic level), closely cooperating throughout a deal, possibly starting at design and co-creation; close cooperation should seek to optimize the use of catalytic capital and enhance the transaction timeline, ultimately enhancing each institution’s throughput of Sustaining deals;
- 💡 **Data sharing:** sharing of data and analyses, enhancing the mutual understanding of structural capital gaps (on a deal or strategic level), improving the internal understanding and acceptance of Sustaining deals and encouraging others to join the engagement in the targeted Sustaining market segment;
- 💡 **Research initiatives:** joint engagement in relevant and targeted research initiatives, from funding to data provision, collection and analysis (see also CSAF example above); or
- 💡 **Brainstorming:** engaging in joint brainstorming and discussion that may result in innovation, cooperation and, ultimately, change. Convenings and focused and open discussions by experts and practitioners, such as the one organized by CSAF that spurred various research initiatives and the formation of Aceli Africa, are important tools to find the current best and potentially future better or additional ways to address a structural gap.

Action step: could a group of catalytic capital investors join forces around a specific market failure and endeavor to cooperate on targeted initiatives with the objective of getting more deals done and done faster?

If engaging in Sustaining strategies, in order to chip away at structural barriers, catalytic capital investors should widen their perspectives to the long-term time horizon that is needed for demonstrable change.

Also, as indicated above in the additions to points 1 and 2, for Sustaining markets it can be helpful to expand the partnership perspective beyond investors and managers and consider carefully who

else is needed to instigate meaningful change (e.g., donors, governments, accelerators, enterprises and end-users or clients, etc.) and what role each stakeholder could or should play to further the objectives (e.g., advocacy, funding, research and market understanding, capacity building, etc.). The big question is how the different stakeholders can be activated to form a joint and executable action plan that goes beyond the discussion stage and translates talk into action steps towards change.

B UNDERWRITING

CHALLENGE SUMMARY

The Scaling and Seeding guidance notes discuss typical challenges faced as part of the underwriting of catalytic capital transactions across roles, including delays and unnecessary loops due to unclear asks and obscure processes and the inefficiencies that stem from a lack of sharing of materials, analyses and knowledge.

For Sustaining vehicles the same overall challenges apply. In addition, though, there are further specific challenges that arise because of the often-opaque nature of the structural capital gaps and the need for bespoke and tailored responses, as well as the struggle to internally justify the use of subsidies.

Underwriting Sustaining deals often requires additional effort, leading to particularly long and convoluted processes and delays, preventing the capital from reaching its destination in a timely manner - or at all.

*Specific Challenges and Approaches Set Out in the Scaling Guidance Note that are **Applicable** to Sustaining*

As in the Strategy section above, there are specific challenges and approaches that are in principle **the same** in Sustaining deals, when compared to Scaling or Seeding (*for detail see, in particular, the Scaling guidance note*):

- 1. Sharing of data:** share and disseminate available data and analysis;
- 2. Clarity on underwriting information needs:** be clear on your needs, internally and externally; delineate must-haves and nice-to-haves; and
- 3. Clarity on process, timely communication and transparent feedback:** drive your process towards a decision; be clear with the managers and judicious with their time.

Again, there are some important additional implications applicable to Sustaining vehicles:

Additional aspects: data sharing (1)

There is one particular point to note on the sharing of data with respect to the crowding in of new investors: while in Scaling deals the sharing of track record is important to convince new investors of the commercial soundness of a vehicle, in Sustaining deals the importance can at times stem from the need to explain to new investors that the modest returns offered are not a result of underperformance but based on a **realistic assessment** of the targeted market. Learning Lab participants pointed out that independent data (i.e., data that does not come from the manager, but from other experienced investors or independent market research (see *also above on p. 25*)) is particularly helpful for their assessment of structural gaps and internal justification of the proposed deal structure and concessional terms.

For Sustaining vehicles, however, there are some important new distinctive challenges when it comes to underwriting vehicles, as set out on the following page.

Specific Challenges and Approaches that are New for Sustaining

For the underwriting of Sustaining vehicles, there is a particular challenge in **understanding and evidencing the structural capital gap** - and delineating it from transient capital gaps - and as a consequence in determining and justifying the use of subsidized or concessional capital.



There is not a single answer to the question of 'what is the structural capital gap' - but, regardless, we need to chip away at it."

Karina Wong, Small Foundation

As there is often limited data available, it can be difficult to dissect the headline gap into the underlying drivers:

- ✓ What are the specific underlying risks? Which ones are really structural?
- ✓ What are the drivers for sub-commercial vehicle returns (i.e., return or cost elements)? Are they on the investee and/or vehicle level? And what are the underlying reasons?
- ✓ What are realistic returns, and where does underperformance start?

Catalytic capital investors should ask themselves in their underwriting of a Sustaining deal if such an investment is really needed to address a structural gap and generate development impact - or if it is effectively long-term "lazy investing", i.e., do investors distinguish transient from structural capital gaps that need to be addressed with effective catalytic capital in the long term? And do they identify operating challenges that cannot be overcome by scale, maturation or improvements in efficiency?

Related to this, when dissecting the capital gap, catalytic capital investors should carefully consider the **level of their subsidies** and concessional nature of returns, including who benefits

from subsidies - whether investors, investees and/or underlying end-users.

Further, the potential risk of **market distortion** needs to be analyzed: assessing potential tensions that arise from and negative consequences of subsidies was voiced as important by Learning Lab participants. Long-term reliance on subsidies can crowd out commercial investors, in particular important local players. The provision of subsidies to select funds may also provide them with an unintentional but unfair competitive advantage vis-à-vis other, similar funds. Learning Lab participants agreed that market distortion is an important yet addressable consideration in the assessment of Sustaining vehicles, and pointed to three categories of assessment results for potential market distortion:

- ✓ There is no market, so no market to "distort", but the opportunity to create a market;
- ✓ There is a dysfunctional market that would actually benefit from a "positive" distortion, making the market more efficient, equitable and sustainable; or
- ✓ There is potential for "negative" market distortion that needs to be considered.

In particular in the case of Sustaining deals, market distortion should not only be interrogated upfront but continuously over the lifecycle of a Sustaining market transformation.

Another aspect that needs particular attention when underwriting a Sustaining vehicle is **impact**: as per above, Sustaining vehicles sometimes require a particularly high level of effort to understand the underlying structural capital gaps. In addition, extra work is often needed with respect to the assessment of impact, extending beyond the direct deal-level impact. Some catalytic capital investors seek to adopt a long-term view on market- or systems-level change and the related indirect impact that is sought to be achieved. As there is mostly only limited data or even expectations on impact available on such a long-run perspective, investors need to go the extra mile to consider long-term outcomes scenarios and possible routes to change.



Open Society Foundations (OSF) typically develops a **theory of change** for a certain theme or sector it strategically pursues, including investments but also grant support or advocacy work. For transactions, it then seeks to assess not only the direct impact of a vehicle but also the wider and longer-term indirect impact an investment has within its market and the foundation’s targeted theory of change.

A recent example of an investment fitting within OSF’s work on workers’ rights was Simplifica, which supports the formalization of work relationships for domestic workers. One challenge was to measure and track the company’s long-term indirect impact on the wider evolution of strengthened workers’ rights, workers’ organizing and formalization of the industry. To follow such long-term outcomes, certain KPIs are provided by the company, and others are gathered by 60 Decibels, an end-to-end impact measurement company, and the OSF team itself over time. To provide a few examples, the company collects data on items like churn and average days worked by part-time workers; OSF on the percentage of workers paid for overwork and/or sick leave/vacations and the number of workers reaching out for information about their rights; and 60 Decibels on the percentage of workers that has increased knowledge of labor rights, that access job benefits for the first time or that report an improvement in their quality of life - and the percentage of employers that improve their formalization knowledge or actually formalize for the first time.

Lastly, the vehicle’s **commercial viability** must be carefully assessed, as Sustaining funds typically show high risks and/or low returns. That said, in our Learning Lab discussions, a number of investors voiced their comfort with a vehicle’s operations being supported by grant funding as long as the manager can demonstrate that those funds can be sustainably raised over time (*see deal example on the next page*).



If there is a real structural capital gap, continuous subsidy is not lazy or wasteful; it may be the long-term sustainable operating model.”

Harry Davies, Ceniarth





Three example vehicles that made the choice to pursue **deep impact**, targeting the hardest-to-reach borrowers, are Root Capital, AgDevCo and Global Partnerships' Impact-First Development Fund. To achieve their strategic aims, all three vehicles leverage **philanthropic support**:

- **Root Capital:** Root Capital complements its concessionary investment capital with grant funding and loan guarantees, allowing the vehicle to make affordable loans to its lending clients: small agribusinesses that support the sustainable livelihoods of smallholder farmers in Latin America, South-East Asia and Sub-Saharan Africa. When looking at cumulative risk-adjusted returns (including fees and coupons from the loans and costs of lending, adjusted for risk), the vehicle's loans typically either make a loss or yield a positive, but below-market return. As a result, the company uses grant support to cover the required subsidy, allowing it to extend funding to - and generate impact from - the smaller and harder-to-reach agri-enterprises (*for more on Root Capital's return and impact analysis see p. 10*).
- **AgDevCo:** AgDevCo has historically been funded by a combination of concessionary investment capital and grant funding in order to provide senior and mezzanine loans (and some equity) to its investees: agribusinesses across the agricultural and food value chain, from primary production through processing to retail, across Sub-Saharan Africa. Initially the vehicle focussed on seed-stage ventures, where the risk profile of investments combined with the small average ticket sizes (below \$2 million) and associated high transaction costs made the vehicle economically unsustainable and led it to rely on grant-funded operational support. Nowadays, the company focuses on larger early-stage (but post-seed) enterprises in order to achieve economic viability and greater impact. The strategic shift to venture- and growth-stage businesses has helped achieve financial sustainability, scale and impact, and enabled the company to offer modest returns to investors, thereby also allowing the vehicle to attract DFIs' investment capital.
- **Global Partnerships' Impact-First Development Fund (IFDF):** the IFDF provides loans to social enterprises that intentionally target and create value for people living below international poverty lines²³, especially women and the rural poor. Three factors that enable the fund to focus on impact for these hard-to-reach segments: (i) the fund's non-profit ownership (Global Partnerships is the sole owner), (ii) the provision of low cost, patient capital by the fund's investors and catalytic capital providers, and (iii) philanthropic capital that helps cover the manager's operating expenses, including impact research, underwriting, monitoring, and evaluation.

Fundamentally, to allow for effective underwriting (and, as a result, effective structuring) it is vital that engaged catalytic capital investors are willing to put in **effort** to go the extra mile to assess a deal and ultimately to justify the use of scarce concessional catalytic capital.

A sound and thoughtful analysis of the structural gap and envisaged impact (direct and indirect) is needed to inform the resulting vehicle structure and terms. They need to be **pulled through** the entire transaction process, contextualizing the deal structure and terms for the internal investment committee.

²³ The fund applies the World Bank poverty lines of \$3.20 per day and \$5.50 per day, reflecting the median poverty levels typically found in lower middle income countries (LMICs) and upper middle income countries (UMICs) respectively; these poverty lines were introduced in 2018 to complement the extreme poverty line of \$2.15 per person per day (\$1.90 prior to the 2022 update); see also under [link](#) and [link](#)

CAPITAL-RAISING

CHALLENGE SUMMARY

Capital-raising, from start (finding investors) to finish (transaction signing and closing) takes a long time. The reasons for this are myriad and are discussed in detail in the Scaling and Seeding guidance notes. They include challenges around topics such as bespoke blended structures (leading to an intricate “investor puzzle” that needs solving), siloed investor processes and lack of cooperation, from underwriting to legal documentation and negotiation.

For Sustaining vehicles, these significant challenges become even more pronounced. In addition to the underwriting challenges discussed before and the structuring challenges to be discussed in the next section, fundraising is particularly challenging as not many – even catalytic capital – investors focus on Sustaining transactions, and the ones that do at times do not have large amounts of capital they can invest in Sustaining deals. Catalytic capital investors active in Sustaining propositions need to be willing to roll up their sleeves, stick with it and continue to be flexible along the path, if they want to truly achieve change over time.

Opportunity Investment Fund - **WHEN FUNDRAISING TAKES TOO LONG**



Community Investment Corporation (CIC) started the design of its **Opportunity Investment Fund** (OIF) in 2016, targeting the preservation of affordable rental units in strong rental market communities. It provides flexible, low-cost mezzanine debt to developers who purchase existing, functioning rental buildings in higher-cost and emerging neighborhoods, with the proviso that 20% of units will be kept affordable for 15 years. The thesis was that the OIF funding would effectively allow such developers to be competitive.

OIF's capital-raising process took a long time: **more than two years** to first closing. During the time from design to launch, the market changed and more alternative cheap capital became available, making the fund's mezzanine loans less competitive and less attractive to developers. This resulted in a challenge for the fund to achieve the targeted deal volumes and made an early restructuring necessary in order to increase the flexibility on returns. That restructuring then led to a decrease in fund size, as one of the investors was unable to lower its return targets.

These Sustaining puzzles often mean very long transaction processes for investors and managers, requiring time, patience, effort and, in the managers' case, money. The results are often suboptimal, where the originally envisaged structure or strategy cannot be achieved and the vehicle ends up in a different place, at times responding more to investor than market needs.



We seek to showcase the impact in a more mission-driven way, demonstrating the long-term market dynamics that could be achieved as a result of a specific Sustaining initiative by assessing how the impact narrative could attract sustainable support over time by subsequent investors.”

Daan Besamusca, Open Society Foundations

*Specific Challenges and Approaches Set Out in the Scaling Guidance Note that are **Applicable** to Sustaining*

Again, underneath the general headline challenges, there are specific challenges and approaches that are **the same**, or at least similar, in Scaling or Seeding vehicles (*for detail see, in particular, the Scaling guidance note*):

- 1. Clarity on catalytic capital powers:** be clear, internally and externally, on catalytic powers you have as an investor: terms, timing and quantum; be clear on the power(s) you don't have;
- 2. Continuing investor support:** seek to demonstrate stamina through continued engagement to allow funds and managers to succeed over time;
- 3. Investor role:** based on your position and appetite in a deal, consider taking a leader

or follower role to enhance underwriting, structuring and/or legal negotiation processes;

- 4. Effective cooperation with fellow investors:** engage and jointly drive a deal towards closing; and
- 5. Support beyond capital:** consider the support you can provide in addition to your capital to allow a vehicle, manager and strategy to thrive and grow.

Sustaining vehicles have, however, their own particular challenges that are somewhat distinctive in nature, including the following:

Additional aspects: clarity (1) and continued support (2)

While the **catalytic capital powers** identified in the Scaling and Seeding guidance notes apply also for Sustaining investments, the Sustaining Learning Lab participants identified two additional powers that are particular to this role:

- ✓ **Tenacity:** tenacity is effectively an extension or elevation of the importance of “stamina” discussed in the Scaling guidance note. Given the persistence of structural capital gaps, continuing tenacity is a needed characteristic and power of catalytic capital in Sustaining vehicles. This holds true whether or not an investor is pursuing the long game needed to achieve market- or systems-level change: a one-off investment will not be enough to move the dial. This also extends beyond single investments to the continuing support of certain markets - sectors, business models or geographies. The Sustaining time horizon of need - and potential change - lies beyond the time horizon of a single transaction (*see also p. 24 for more on time horizon*).
- ✓ **Spotlight:** Sustaining challenges are often not “shiny and exciting” (*see also p. 15*); an

investment by a catalytic capital investor can provide an important signal to the wider market and help move propositions from the shadows to the limelight. It further can signal the credit- or investment-worthiness of a proposition, sector or geography.

CATALYTIC “SUPERPOWERS”



Different catalytic capital investors have different powers. Small Foundation, for example, with its systems-change approach, sees “tenacity” and the ability to embark on a long-term journey to build a “system” as one of its core powers. DFC on the other hand considers “quantum” its main power, but also recognizes “spotlight” as an important power. This power is particularly important in Sustaining investments, signaling interest to others with a view to attracting further investors to a deal, strategy, sector or geography, and, at times, convening broader market stakeholders with a view to working on market- or systems-level change.

Calvert Impact Capital - LONG-TERM TENACITY DESPITE A SHORT-TERM TOOL



Calvert Impact Capital (Calvert) consistently uses the “tool” of providing typically three- to five-year senior debt to its investees - including for Sustaining vehicles. In Sustaining sectors, it often invests in “tried and tested” markets with available data and understood risks, seeking to extend reach and create long-term indirect impact (in addition to direct) by making the market more efficient and ultimately more widely investable. To achieve such impact despite its short-term debt tool, Calvert typically initiates an **investment with the intention of being a long-term reliable partner**, i.e., with the implicit expectation of being a repeat investor over time (to be clear, there is no a priori commitment or automatically rolling facility), whereby at times the organization’s role can change (but not its tool) depending on the evolution of the market and financing environment.

For example, Calvert provided senior debt funding to the Low Income Investment Fund for nearly 15 years. Once the CDFI was able to attract lower-cost capital from other sources (including bond markets), Calvert changed its role from a direct investor to an indirect partner. The organization created a structured “participation facility” that invests alongside the CDFI, enabling it to take on larger deals with a nimble and predictable source of partner capital and increase its affordable housing preservation impact in the US.

International Housing Solutions - NEEDING THE CONTINUING INVESTOR FOCUS



International Housing Solutions (IHS), a South African real estate fund manager focusing on affordable housing in Sub-Saharan Africa, managed to raise approximately \$240 million equivalent for its first South Africa-focused fund, the South Africa Workforce Housing Fund (SAWHF). Its follow-on fund, IHS Fund II SA - which intended to scale the strategy - however, struggled. Many of the commercial investors engaged in affordable housing at the time of SAWHF had since lost focus on the sector. And some impact investors shied away, being wary of the affordable housing market's structural low margins and underlying risks, as well as the fund's single-country focus on South Africa and related currency exposure. IHS SA II eventually closed at \$133 million equivalent, far below the originally envisaged target - and the market need.

Affordable housing is one of these not particularly "shiny and exciting" but critically needed sectors. It often requires **tenacious** catalytic capital with more flexible risk-return tolerance that is willing to go the extra mile for an extended time to come, and that provides a **spotlight** for the sector, so it is remembered by others.

Additional aspects: cooperation (4)

As discussed previously, Sustaining transactions are often particularly challenging to bring together. This starts with the need to find catalytic capital investors that are willing to put concessional capital and effort into Sustaining deals, and extends to the

negotiation of often-complex blended structures. As a result, close cooperation throughout a transaction process - importantly, knowledge sharing and market education - is vital. Often a more strategic collaboration is helpful (see p. 25), at times starting cooperation as early as co-creation of a deal or acting as sponsor or early anchor.

Acumen Resilient Agriculture Fund - GCF KICKS OFF THE DEAL



The **Acumen Resilient Agriculture Fund** (ARAF), is an impact VC fund investing in early and early-growth stage agribusinesses in East and West Africa. It enables smallholder farmers to adapt to climate change, thereby supporting climate resilience and agriculture productivity. In order to achieve commercial viability of the fund, the vehicle blends investments into platform businesses that offer farmers access to inputs, financing, agronomy support and markets.

Sponsored by **Acumen** and anchored by the **Green Climate Fund** (GCF), ARAF benefited from a \$25 million **first-loss layer** (junior equity) provided by GCF and Acumen that allowed ARAF to raise \$33 million in senior equity from investors, including DFIs, impact funds and family offices in the US and Europe. Beyond the important first-loss capital, GCF also contributed valuable input to the design of the fund, strengthening the overall proposition with their experience.

D STRUCTURE & TERMS

CHALLENGE SUMMARY

Many catalytic capital transactions have complex and blended structures, entailing long and convoluted negotiation processes and legal documentation as discussed, in particular, in the Scaling guidance note. The same is true for Sustaining deals, perhaps even more so. Sustaining transactions typically require more catalytic capital flexibility on terms and risk-return appetite, given the nature of the structural capital gaps.

The risk and return challenges prevalent in many Sustaining transactions, and the often-limited underlying data and bespoke nature of the challenges at hand, can make these vehicles challenging to structure.

*Specific Challenges and Approaches Set Out in the Scaling Guidance Note that are **Applicable** to Sustaining*

As before, specific challenges and approaches that were discussed in the previous two guidance notes are largely the **same** in Sustaining vehicles (*except for point 3, see further below for explanation*); *for detail on the specific challenges and approaches see, in particular, the Scaling guidance note:*

- 1. Clarity on risk-return appetite:** be clear, internally and externally, whether you are a risk mitigant “giver” or “taker” (on deal level or strategy level);
- 2. Efficient capital structure and ratios:** seek to optimize use of scarce catalytic capital by performing an in-depth analysis, delineating drivers; sharing analysis and engaging with others;
- 3. Reducing use of catalytic capital over time:** engage on reduction pathways early;

- 4. Landing a deal that works for all:** be clear on “must-have” terms and be flexible beyond; and

- 5. Agreeing on terms that allow for delivery of impact and investee-level sustainability and scaling:** use your “catalytic capital lens” when considering terms.

There are, however, distinctive implications that apply to Sustaining vehicles, including the following:

Additional aspects: efficient capital structure (2)

In the case of Sustaining transactions, it was pointed out repeatedly in the Learning Labs that a dissection of risk-return elements and drivers and the delineation of what is transient and what is structural are particularly important. This helps to ensure that scarce catalytic capital is not wasted and subsidization is not lazily applied given the long and winding road towards change. That discussion includes a careful consideration of appropriate instruments to be applied in a

blended structure, including potentially the use of grant funding that allows for a long-term time horizon.

The Learning Lab participants also stressed the importance of taking a close look at the investor table and who is potentially being supported in blended finance vehicles by catalytic capital. Again, Sustaining catalytic capital should be applied wisely, and over-subsidization of other investors should be avoided.

As Sustaining vehicles tend to be particularly bespoke and challenging to pull off, the importance of precedents and precedent-setting was discussed. To avoid re-inventing the wheel for every vehicle, investors and managers alike could aim more for the creation of replicable structures.

Small Foundation - PAVING THE WAY



As introduced previously, **Small Foundation** invests in Sustaining vehicles and engages in select markets, seeking to - over time - **achieve systemic change**. Small Foundation has just started on its journey to intentionally view investments with a “systems change lens” and recognizes the complexity this brings. Initially, the foundation assesses where an investee sits within a “system” and what pathways it expects it - and the system - to take over time. The system and the investee’s role in it are reassessed periodically, at least every year or two.

Given its approach, when investing, it is important to the foundation that it sees its investees playing a relevant role in a system (individually or in combination) and that investments lead, if possible, to a faster route to change by influencing others to replicate and/or improving how stakeholders can engage with each other.

Additional aspects: catalytic capital reduction (3)

Given the structural capital gap, in the case of Sustaining vehicles there are typically no medium-term reduction trajectory expectations, unlike in the case of transient capital gaps in Seeding and Scaling transactions.



Using subsidy in capital stacks in Sustaining vehicles - even at times grant funding - does not dilute the investment proposition but enhances it. Some of the lowest risk investments are alongside grant funders who support operating expenses but also additional services to end beneficiaries that ultimately de-risk the entire business model.”

Harry Davies, Ceniarth

Additional aspects: deal for all (4) and terms allowing impact (5)

As discussed, Sustaining vehicles’ blended structures are often particularly complex and bespoke. Consequently, it is vital to be flexible as a catalytic capital investor and stretch, where possible, with a catalytic capital lens, to ensure that the capital really serves the hardest-to-reach people efficiently and effectively, and arrives at the hardest-to-reach places. For that to happen, terms may need to be atypical from market standards.

In addition to flexibility, catalytic capital investors may want to seek out workable structures that are cognizant of the long-term horizon.

Open Society Foundations - ALIGNING THE TIME HORIZON



Open Society Foundations (OSF) is regularly looking at **perpetual fund structures** as they are often more aligned with underlying investees' funding needs and the pace of growth trajectories to establish new markets.

One structure the foundation looked at is an evergreen fund that was designed with predetermined decision points after five and 10 years, providing investors with an opportunity to exit or continue their commitments, based on the performance and their assessment of the fund at these points in time. The decision points were designed to provide otherwise-hesitant investors with comfort to commit to an open-ended fund at the outset, providing them with distinct points in time to liquidate their investments, if desired.

Another structure the foundation has considered, which sought to push the boundaries on tenor, was a fund with multiple extension points, upfront providing the flexibility and documentation for a longer-than-usual structure, while again providing investors with a way out earlier, if needed.

One particular term sheet item discussed in the Learning Labs is the importance of allowing managers to earn fees that enable them to deliver the impact targeted. This may be achieved through management fees that are higher than levels seen in mainstream investing, or through impact-based incentive fees that may complement - incentives based on financial performance. Impact-based incentive fees are increasingly pursued in Sustaining vehicles given the economic challenges frequently faced by such

vehicles and the centrality of impact targets. That said, it was recognized that such fee structures are not always easy to establish and need to be balanced against potential complexity and the difficulty of measuring meaningful KPIs.



In Sustaining transactions it is key to structure an appropriate fee and incentive structure, moving from the classic private equity '2/20' model to a structure that is appropriate for the work required and impact sought."

Alex Goodenough, BII

Acumen Resilient Agriculture Fund - INCLUDING IMPACT AND FINANCIAL INCENTIVE FEES



Acumen Resilient Agriculture Fund (ARAF) includes a **combination of financial and impact incentives** for its manager Acumen Capital Partners. In addition to the usually seen financial return hurdle rate, ARAF's management team faces an additional impact hurdle rate, represented by a minimum number of farmers to be impacted during the lifetime of the fund, once the financial hurdle rate has been met. Consequently, the level of the incentive fees (carry) depends not only on the economic performance but also on meeting pre-agreed impact targets.

Also, it was stressed that the inclusion of adjustment mechanisms over time, as "reality kicks in", can be a useful tool to ensure a fair mechanism for managers.

WORKSHOPPING STRUCTURES



Structuring is particularly challenging in Sustaining transactions. One idea voiced in the Learning Labs is the potential usefulness of **targeted workshops** that focus on real vehicles, their **structures** and the underlying analysis and drivers:

- 💡 What is the structure (layers, instruments, return expectations, etc.)?
- 💡 Why was this structure chosen?
 - How does the structure relate to the underlying strategy and the realization of intended impact?
 - What are the underlying driving capital-related factors and considerations (e.g., risk-return analysis, investor needs, scarcity of catalytic capital, other)?
 - In an ideal world, could there have been a better structure?
- 💡 Was the final structure as originally envisaged?
 - If not, why was it changed (e.g., lack of certain capital, investor requests, other)?
- 💡 Is there a precedent that could be set with replicability potential in this sector/geography/market segment? Are there limitations to the structure (e.g., lack of certain capital, market demand, other)?

Action step: could an investor organize a workshop within a particular sector/geography/market segment, presenting and discussing the structural elements of select transactions, including the respective managers, participating investors and outside investors interested in the market?

As discussed in the Scaling guidance note, catalytic capital investors should consider each term with impact in mind. For Sustaining transactions, a long-term view beyond the direct impact of a vehicle, adding indirect outcomes, is important when applying a market- or systems-level ambition on change. Applying a rigorous “catalytic capital lens” in term sheet negotiations

allows catalytic capital investors in Sustaining deals not to lose focus - or even better: to really focus - on the targeted impact and end goal. This catalytic capital lens should be applied throughout the term sheet review. The obvious terms are structure and returns, but it is important to extend this idea to other provisions, e.g., management fees and incentive structures and many more.





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

1. **Objectives** (*in particular, why is this a catalytic capital deal?*)
2. **Term** (*does the vehicle term allow for the strategy to be executed?*)
3. **Capital structure and target returns** (*including rationale for the structure, in particular for blended structures; risk-return considerations and concessionality*)
4. **Investment strategy** (*strategy alignment with thematic, geographic, catalytic capital or other priorities*)
5. **Impact objectives and reporting** (*specific catalytic capital impact objectives and KPIs*)
6. **Hedging/FX** (*ability to provide local currency funding*)
7. **Investment restrictions** (*ability to stretch beyond the usual*)
8. **Covenants and events of default** (*ability to stretch beyond the usual*)
9. **Management fees and management incentives** (*accounting for level of effort and impact focus*)

In the Appendix: Select Considerations for Catalytic Capital Deal Term Sheets, we take a closer look at the selected terms, providing a starting point for relevant questions.

In addition to the different implications of points raised in the Scaling guidance note, there is one noteworthy new point as per below.

Specific Challenges and Approaches that are **New for Sustaining**

While there is no medium-term catalytic capital

reduction trajectory, many catalytic capital investors that engage in Sustaining vehicles invest with a view on long-term market and systems change, seeking to chip away slowly at failures in a long game. This often includes partnerships and interventions beyond the deal level with other investors or broader stakeholders to tackle specific market or systemic failures.



CONCLUSION

Investing in Sustaining markets is, for all the reasons provided in this document, often particularly challenging. While acknowledging not everyone has the mandate or capacity to pursue such deals, **it is also particularly compelling** if impact investing has the ambition to invest in solutions such that “no one is left behind”.

In our Sustaining Learning Lab discussions, participants were highly engaged, being realistic about key roadblocks to more and faster Sustaining catalytic capital deployment - but also being hopeful that more can and will be done. We sought to capture important considerations and implications that are particular to Sustaining investments in this document, and we hope that the discussion triggers further engagement among investors and others - as individual institutions and in cooperation with others - to make progress against these persistent structural capital gaps.

Some of the key messages from this paper for Sustaining catalytic capital investors include:

- 1. Play the long game.** Sustaining strategies require tenacity. To reflect the importance of that feature in catalytic capital in the case of Sustaining investments, we added tenacity to the capital “superpowers”. By itself, one investment will not fill the structural capital gap and even less chip away at it. Therefore, catalytic capital investors that take up the challenge to tackle structural gaps should have a realistic long-term perspective when they
- 2. Build the racetrack.** Picking up on a quote provided by one of our participants (see p. 18), in Sustaining deals one needs both investors with a deal-level perspective, engaging to fill a structural gap in the market, and investors with a longer-term market- or even systems-change perspective, that choose their investments with a view to, step-by-step, shift a dysfunctional (or at times build a non-existent) market and thereby create long-term indirect impact beyond the immediate direct impact of the investment itself.
- 3. Purposeful outreach.** Even more than Seeding and Scaling catalytic capital, Sustaining requires close cooperation, on both a strategic and deal level, between investors and beyond. As discussed in this note, Sustaining deals are difficult to pull off, all the way from underwriting to structuring and negotiation. Further, as per above, Sustaining investors often seek to look beyond the deal level to the market or system level. In all scenarios, building relationships, sharing data, embarking on joint initiatives and co-investing are important to unlock deals and create new - maybe even more relevant - vehicles.
- 4. You are not alone.** The pursuit of Sustaining strategies is often an uphill battle - both outside an institution, where one may be the only investor (or just one of few) tackling a structural gap, but

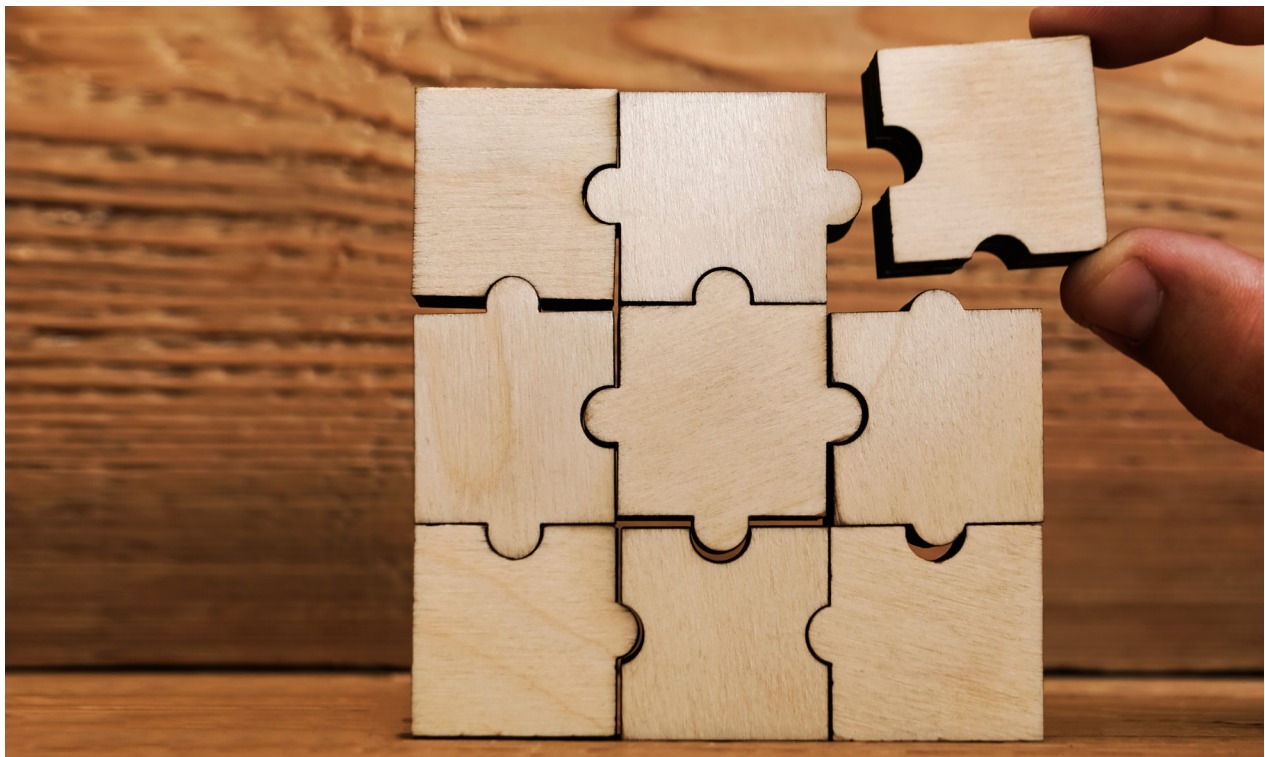
also inside an institution, where Sustaining propositions, or pushing the envelope on them, are often pursued by single champions or new teams that still need to do substantial internal convincing to get the broader institution on board. That said, as our Learning Labs proved, there are peers out there that share both willingness to engage and a similar vision - who are happy to exchange experiences, approaches and work together.

In this note, we hope that we have done justice in conveying some of the key challenges particular to Sustaining transactions and providing the readers with useful reflections that may enable and inspire them to do more and better Sustaining deals. We further hope that the discussion does not stop here, but that this note sparks further conversation, reflection and ultimately action.

As pointed out throughout the note, structural capital gaps are persistent. This note does not change that. With this guidance note we hope to make the effort to get Sustaining vehicles across the finish line a little easier, the timelines of such

deals a little shorter and shifts to structural gaps and markets a little more likely.

Reflecting on the three guidance notes and the investor input that contributed to them, it is our vision that catalytic capital investors will continue to roll up their sleeves individually and collaboratively across investor types and across the catalytic capital roles of Seeding, Scaling and Sustaining to advance the practice of catalytic capital in pursuit of positive impact. We believe these investors can form a catalytic capital community of practice that takes on critical challenges in ways that can be transformative - in fact, that is already happening. C3 and Courageous Capital Advisors want to help build that community, in part drawing on our series of Learning Labs. We are eager for your input to do so. It is vital that investors with aligned objectives connect, cooperate and drive efforts that directly address the United Nations Sustainable Development Goals. Accelerating the flow of efficient, effective catalytic capital is an essential pathway to a more just, equitable and resilient world.



APPENDIX

Select Considerations for Catalytic Capital Deal Term Sheets

HEADLINE	DESCRIPTION	CC INVESTOR QUESTIONS TO ASK/COMMENTS
OBJECTIVES	Vehicle-specific description of overarching objectives	<ul style="list-style-type: none"> • Why is this a catalytic capital (CC) deal? • Do the deal objectives fit my institutional objectives and strategy? • Can I stretch, if needed, to address a need? • Why is this a Sustaining CC deal? What is the capital gap addressed? What gap elements and underlying drivers are structural?
CAPITAL STRUCTURE AND TARGET RETURNS	Detailing the target capital structure, including any capital classes/ layers and target %s (i.e., provided first loss and further subordination, as applicable) and target returns or coupons, e.g., <ul style="list-style-type: none"> • Senior [equity/ debt]: \$[x]m at [x]% p.a. • Junior [equity/ debt]: \$[x]m at [x]% p.a. • First-loss [equity/ debt]: \$[x]m at [x]% p.a. 	<ul style="list-style-type: none"> • Am I clear about my catalytic power in the transaction - terms/ quantum/ timing/ tenacity/ spotlight - and communicate such? • Which offered tranche(s) can I consider for participation? Do I need downside protection? <ul style="list-style-type: none"> - What instruments can I invest in? - Can I contribute grant capital; if so for what? • How much am I willing to invest in a certain tranche and what are my constraints? Am I willing to invest in more than one tranche? • What analysis can I perform to dissect and understand the capital structure and ratio (and each of the tranches), the capital gap addressed and its different drivers: <ul style="list-style-type: none"> - What elements are structural and what are transient? - What are the key risks and return elements that are being addressed? - Are there other factors that determine the capital ratio (investor regulatory requirements, returns etc.)? - Who should be supported by CC junior layers? • What analysis can I perform to dissect and understand the proposed returns, including concessionality/ subsidy <ul style="list-style-type: none"> - Do I have the information to understand realistic returns, including realistic investee returns and vehicle-level expenses (including management fees) that allow for strategy execution and (long-term) impact delivery? - What are my required returns for a Sustaining investment? Can I provide concessional returns? - Is concessionality/ subsidy required? If so, in what part of the structure (investee/ fund level)? What is the rationale and time horizon? Is there a risk of market distortion? If so, how could this be addressed/balanced? • What evidence/ analysis do I have access to? Do I need more? <ul style="list-style-type: none"> - Can I find data (from the manager and outside) to help my analysis? - What evidence/ analysis do I need to justify a Sustaining investment (including subsidy and time horizon) internally? - Am I willing to share my information with others? • Am I willing to engage with any prospective investors early in the process to understand the rationales around the table and optimize the structure?

HEADLINE	DESCRIPTION	CC INVESTOR QUESTIONS TO ASK/COMMENTS
INVESTMENT STRATEGY	Vehicle-specific description of investment strategy	<ul style="list-style-type: none"> • Does the investment strategy fit my institutional objectives and strategy? Is the structural gap being addressed aligned with my investment strategy and priorities? • Can I stretch, if needed, to address the unaddressed, to tackle a structural capital gap and pursue a need of hard-to-reach segments or geographies?
IMPACT OBJECTIVES AND REPORTING	Spelling out key impact objectives and KPIs	<ul style="list-style-type: none"> • Do the Sustaining impact objectives fit my institutional objectives and strategy? <ul style="list-style-type: none"> - Do I understand not only the vehicle's direct impact but also the long-term market- or systems-level theory of change? - Are these objectives distinct from objectives of other CC or general impact deals? - Can I stretch, if needed, to address a particular Sustaining market need? • How do I compare/ evaluate the impact of this deal versus others? • What are my impact reporting requirements? Are they enhanced as this is a Sustaining deal? <ul style="list-style-type: none"> - If so, do I consider (and how do I account for) the potential strain of delivering on the additional reporting on the manager and the underlying investees? • Do I have flexibility to harmonize impact needs, including KPIs, with other investors and also with a view to simplicity for the manager? • How do my requested KPIs and impact reporting add to the burden on the manager and underlying investees?
HEDGING/FX	In case of debt strategy, setting out local currency/ hard currency lending strategy and hedging strategy, if applicable	<ul style="list-style-type: none"> • Does the proposed FX and hedging strategy fit my institutional objectives and strategy? • Can I accommodate local currency risk, if needed, to address a market need in hard-to-reach segments or geographies?
INVESTMENT RESTRICTIONS	<p>Investment restrictions typically address concentration and other risks; they typically include some of the following examples:</p> <ul style="list-style-type: none"> ▪ Single name limit ▪ Single country limit/regional limits ▪ Single (sub-) sector limit ▪ Unhedged currency exposure limits <p>Some investment restrictions may apply only at the end of the investment period (in particular, those targeting diversification)</p>	<ul style="list-style-type: none"> • Are the proposed restrictions providing me with sufficient comfort, while still providing the manager with flexibility to execute on the strategy? • Do I have greater flexibility with a view to this being a Sustaining deal - to address a hard-to-reach market need? • Have I specified my must-haves versus nice-to-haves?

HEADLINE	DESCRIPTION	CC INVESTOR QUESTIONS TO ASK/COMMENTS
COVENANTS AND EVENTS OF DEFAULT (EODS)	In case of a debt strategy, setting out key covenants and EoDs	<ul style="list-style-type: none"> • Are the proposed restrictions offering me sufficient comfort, while still providing the manager with flexibility to execute on the strategy? • Do I have greater flexibility with a view to this being a Sustaining deal - to address a hard-to-reach market need? <ul style="list-style-type: none"> - Can I allow for adjustments over time, to account for initial uncertainty, if relevant? • Do I have flexibility to provide other investors with comfort, in particular, in the case of different capital layers?
MANAGEMENT FEE AND MANAGEMENT INCENTIVES	Annual management fee (often initially % of commitments, subsequently % of invested capital) Incentive fee mechanism (financial and/ or impact- based incentive)	<ul style="list-style-type: none"> • Is the management fee adequate to deliver the CC objectives and execute the investment strategy? • Am I willing to consider higher-than-usual management fees in case the strategy/ fund size requires them (often due to substantial heavy-lifting, e.g., because investees are still relatively early-stage and hence invested amounts are relatively small, or hands-on capacity support is provided by the manager)? <ul style="list-style-type: none"> - In order to catalyze commercial investors, am I willing to support management fees, e.g., through grant funding or by contributing more than my pro rata share to management fees? • Is the incentive fee adequate to deliver the CC objectives? <ul style="list-style-type: none"> - Am I willing to consider alternative incentive structures, in particular those linked to the delivery of impact to align the manager with delivery of pursued impact? - If so, what is the adequate balance between impact- and financial performance-linked incentive fees?

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