



# FREQUENTLY ASKED QUESTIONS ABOUT CATALYTIC CAPITAL

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## Introduction

The Catalytic Capital Consortium (C3) is excited to partner with FSG and Courageous Capital Advisors on the development of this resource, which we hope will provide valuable information and insights to catalytic capital investors. 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 UN 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 being shared in response to questions about the role and use of catalytic capital from a range of field investors and actors, including foundations, family offices and ultra-high net worth (HNW) individuals, and development finance institutions, many of which are catalytic capital deployers. This document lays out the initiative's current thinking on these queries, drawing from our various exchanges with field leaders and our own experiences. We do not intend this document to be comprehensive, and welcome the opportunity to continue the dialogue with others in the field on these questions (and beyond). My contact information is below—please feel free to reach out to me at any time.

With our various grant-funded activity streams underway, we also see this document as the first resource offering of many more to come in 2022 and 2023. We are looking forward to engaging with the catalytic capital community in different ways through the coming months. We are currently working to launch a LinkedIn community of practice where catalytic capital investors can come together to learn from each other and discuss critical questions. To stay in the loop as these additional resources are released and to learn about future opportunities to connect with C3, [please sign up to receive updates and announcements](#) through our newsletter. We are eager to build on this work, and welcome dialogue and connections to unlock more catalytic capital and make real progress towards a more just, equitable, and resilient world.



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## This Document

Since the C3 initiative was launched in 2019, we have seen an encouraging pick-up in the volume as well as depth of discussion about catalytic capital across the field of impact investing. As the discussion has grown, important questions have arisen, and we welcome this development. In response, we have created this document, which is designed to share our perspective on these emergent questions. We hope to periodically revisit, refine, and update this document as we move forward with colleagues across the field.

## 1. What is catalytic capital?

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Catalytic capital is a subset of impact investing that addresses capital gaps left by mainstream capital, in pursuit of impact for people and planet that otherwise could not be achieved.

As defined by Tideline (2019), “catalytic capital accepts disproportionate risk and/or concessionary return to generate positive impact and enable third-party investment that otherwise would not be possible.”

Catalytic capital seeks to address *capital gaps*, i.e., investment opportunities that mainstream commercial investment markets fail to reach, partially or fully, because they do not fit the risk-return profile or other conventional investment norms and expectations that such markets require.

Capital gaps can arise in relation to aspects such as, but not limited to:

- *Population*: the ability to reach underserved populations/demographics
- *Place*: the ability to reach underserved geographies
- *Innovation*: the capacity to de-risk novel products, services, or financing models
- *Early-stage*: the building of a meaningful track record or adequate scale for a solution or a new team/org
- *Business model*: the addressing of small transaction sizes, high transaction costs, or other economic issues related to product or service (e.g., capital intensity)
- *Resilience or flexibility* in the face of shocks and crises
- *Historical biases* in capital allocation (e.g., marginalization of BIPOC<sup>1</sup> investees and communities in the United States)

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Over the last several decades, we have seen increasing amounts of capital deployed for positive impact, particularly in sectors such as financial inclusion and clean energy, and across emerging and developed markets. Catalytic capital played a critical role in developing and de-risking what are now vibrant markets for impact and commercial capital that previously did not exist, and enabling both individual enterprises and solutions—and entire impact-focused sectors—to scale.

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<sup>1</sup> Black, Indigenous, and people of color

But the unfortunate reality is that numerous opportunities to deliver much-needed impact fail to attract investment from many impact investors—this is particularly the case for those opportunities targeting poor and marginalized communities, and in sectors where capital markets are less mature. As the impact investing field grows and becomes more mainstream, it is more important than ever that catalytic capital continues to push the boundaries of impact investing into capital gaps—and impact needs—that otherwise would not be addressed.

## 2. Where and when is catalytic capital needed?

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The three “roles” of catalytic capital outlined in Tideline’s 2019 report give us a high-level guide to the kinds of gaps that exist, and what is needed to address them.

In the *Seeding* role, catalytic capital can back impact enterprises and investment managers that are advancing the frontiers of impact, but with neither a track record of their own nor ready comparables that would be required to attract mainstream capital. At the enterprise level, an example case might be investing in an early-stage venture using a novel business model to provide beneficial services (such as affordable high-quality health care or education) to underserved communities (such as communities of color in the US, or informal settlements in lower-income countries). At the fund level, examples could include investing in the first fund from a first-time fund manager that is transcending historical structural exclusion (such as a manager of color in the US, or a women-led manager in developing countries), or a fund pursuing innovative strategies (such as investing in enterprises primarily serving communities of color in the US or women-led enterprises in developing countries, or monetizing new income streams to drive a step change in forest conservation and resilience). (See under Question 3 below for more on these examples.)

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Situations like these hold the potential for achieving impact that otherwise could not be achieved, but they also involve a high level of uncertainty and therefore risk, which dissuades many investors, even where the promise is of “market-rate” returns or better. And yet, bridging this gap is the key to building the future mainstream pipeline of investable impact opportunities and resolving the pressing challenges that face people and planet. Catalytic capital can help to break this impasse, by accepting the “disproportionate risk” and entering where others fear to tread, ultimately seeding a wider and deeper range of opportunities in the future.

The *Scaling* role picks up where the Seeding role leaves off. Even after pioneering impact enterprises and investment managers demonstrate early success, they can struggle to attract mainstream capital, as their track record might be limited, their size still sub-scale, and the markets they play in relatively underdeveloped. In these cases, catalytic capital can step in to help them scale and expand their business

or strategy—or support other players in replicating these models and strategies—to reach further situations, population segments, and geographies.

In many cases, such investments are also intentionally structured and deployed in ways that de-risk and mobilize additional investment from mainstream investors, such as in a blended finance structure (see under Question 6 below). In these cases, catalytic capital providers might accept either disproportionate risks (e.g., subordinated position in a capital stack) or concessional returns (e.g., concessional-rate, fixed coupon), or some combination of both, depending on the needs and constraints of the mainstream investors that could potentially be drawn in.

One example is the [Global Energy Efficiency and Renewable Energy Fund \(GEEREF\)](#), a Fund-of-Funds aiming to scale private-sector investment into clean energy projects based on proven technologies in developing countries. Catalytic funding from European governments of €112 million has helped draw in additional funds from private-sector investors of €110 million, and this in turn is expected to mobilize over €10 billion of further investment through the funds in which GEEREF participates and the final projects in which these funds invest.

However, not all cases of Scaling involve blended finance. A different example comes from the UK official development finance institution [British International Investment's \(formerly CDC Group\) use of volume guarantees to make essential medicines more accessible in poorer countries](#): Its first deal has enabled challenger medical manufacturer Hologic to scale up volumes for viral-load diagnostic testing systems, a technology critical to the lives of people living with HIV, resulting in nearly 50% lower prices in up to 48 of the world's poorest countries, and savings of over \$50 million to those healthcare systems in the next four years alone.

The *Sustaining* role of catalytic capital is rather different in nature from the first two roles, in that it meets an ongoing (i.e., long-term or permanent) need for capital that will accept concessional returns and/or can absorb disproportionate risk, in order to maintain a focus on serving hard-to-reach beneficiaries or otherwise operate a business model that cannot achieve full commercial viability. The Seeding and Scaling roles typically come with the implication (or at least an investment thesis) that the capital gap is transient, that ultimate success is about closing the gap at the market level, such that mainstream investors would be able to pursue similar opportunities down the line *without* needing the involvement of catalytic capital.<sup>2</sup> In contrast, the Sustaining role typically assumes that the capital gap is permanent or at least unlikely to change significantly over the long term, and that it is mainly about accepting concessional returns rather than disproportionate risks at the transaction level.

For example, while in large part the global microfinance institution (MFI) sector is now a mainstream investment opportunity that attracts commercial capital (including through public equity markets), certain segments continue to require Sustaining catalytic capital. Take the case of MFIs serving particularly vulnerable, low-income communities in frontier markets, which have to walk the tightrope between affordable lending rates and high service costs. This may result in a business model that, while profitable, generates sub-commercial returns, and where profitability may be unlikely to be improved

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<sup>2</sup> The need to bridge these transient capital gaps in impact investing has been documented significantly over the past decade, including work by Monitor and 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.

without compromise to key impact objectives. Moreover, foreign investors in such MFIs could face disproportionate currency and macro risks that are likely to persist in the long term.

One investor active in the Sustaining role is the family office Ceniarth through its [Impact-First Capital Preservation portfolio](#). Writing in ImpactAlpha, Diane Isenberg, founder and director of Ceniarth, [explains](#) that “this is a portfolio of managers and direct investments that supports enterprises directly serving demonstrably poor and underserved communities. Because of the nature of serving these populations, these investments rarely (although, not never) deliver returns that would satisfy investors looking for a market-rate, risk-adjusted return. While returns from this segment may be modest, we have come to believe that they can be predictable.” Example investments in this portfolio include specific funds targeting “sustaining” catalytic capital investment opportunities managed by Global Partnerships, GroFin, WaterEquity, and Root Capital, and direct lending to maturing enterprises such as Equity for Tanzania (EFTA), Comaco, and Juhudi Kilimo.

Finally, these three roles above encapsulate our thinking to date, and we fully expect to learn much more about the roles of catalytic capital in the months and years ahead, through the work of our many colleagues, grantees, and investees. We see these roles as an initial guide to understanding why and how catalytic capital is important to the field of impact investing, and we deeply welcome dialogue and further contributions to building out this area of knowledge.

### 3. How is catalytic capital relevant to the key issues we are facing today?

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Catalytic capital is playing a critical role in addressing the key issues and challenges facing people and the planet. Take racial inequity in the United States. A long history of structural racism (as seen in discriminatory financial practices and norms such as redlining) has held back BIPOC communities in building their wealth through avenues such as housing ownership and entrepreneurship, giving rise to vast disparities in wealth between ethnic groups, and between Black and White populations in particular.

Catalytic capital has long played a role, and continues to play a role, in bridging these capital gaps. For over 30 years, catalytic capital has enabled the community development finance institutions (CDFIs) to provide affordable credit and other needed financial services to communities excluded by the mainstream banks. CDFIs’ responsible mortgage lending is enabling BIPOC borrowers to get on the housing ladder and achieve the security of owning their home.

More recently, catalytic capital has helped to develop and scale the [Entrepreneurs of Color Fund \(EOCF\)](#) model, targeting the gap in growth capital for minority-owned small businesses. Beginning in Detroit and now being replicated across the United States, the EOCF model aims to change the wealth trajectory for communities of color, through business growth that drives both entrepreneurial profits and local job creation.

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[Reinventure Capital](#) are targeting previously overlooked opportunities serving BIPOC communities and/or investing in BIPOC founders and owners, and these managers all include Black and women professionals in their leadership. Such opportunities, which lack conventional track records and deviate from mainstream strategies, often run into the headwinds of investor skepticism and hesitation, and therefore represent prime opportunities for catalytic capital to advance the frontiers of impact.

Climate change is another key area where catalytic capital is playing an invaluable role. One example is the [Forest Resilience Bond \(FRB\)](#)<sup>3</sup> model, which is accelerating forest conservation efforts in the United States. This model generates benefits for both mitigation and adaptation in the context of climate change, through the innovation of monetizing income streams from disparate beneficiaries such as forest, water, and fire agencies. Catalytic capital enabled this innovation to be tested and proven out, and to draw in commercial investment, and the initial success of the model in Yuba, Calif., has now spurred a pipeline of replication opportunities.

Another example is the [Prime Impact Fund](#)<sup>4</sup>, which invests in transformative technology companies with the potential for gigaton-scale climate carbon impact. Catalytic capital backing is allowing the Prime Impact Fund to adopt a long-term lens in supporting high-risk, high-reward ventures at the earliest stages, thereby contributing to the urgent effort to keep global warming below potentially catastrophic levels.

Yet another example is responsAbility's \$158 million [Access to Clean Power Fund \(ACPF\)](#), a private debt fund that addresses the lack of access to clean power globally with a focus on Sub-Saharan Africa and South and Southeast Asia. It is a blended finance structure with different risk tranches. Over the lifetime of the fund, portfolio companies are expected to provide clean power to more than 150 million people, add 2,000 MW of clean energy generation capacity, and reduce CO2 emissions by 6 million tons.

#### 4. Is catalytic capital just another way to refer to concessionary returns?

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Concessionary return expectations can indeed be a feature of catalytic capital deals, but they are not a necessary or universal feature. As mentioned above, catalytic capital is defined by Tideline (2019) as capital that “accepts disproportionate risk and/or a concessionary return to generate positive impact and enable third-party investment that otherwise would not be possible.”

In some cases, concessionary financial return expectations are essential as part of the flexibility required to address identified capital gaps, in pursuit of impact that otherwise could not be achieved. For example, [Root Capital](#) extends loans to early-stage agribusinesses in remote areas (in countries such as Haiti and the Democratic Republic of Congo) that provide vital market access and related services for farmers, but these enterprises

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<sup>3</sup> FRB has been supported by the Rockefeller Foundation through its [Zero Gap portfolio](#)

<sup>4</sup> Prime Impact Fund is a [C3 Field Partner](#)

have both limited track records and little collateral, and operate in challenging business environments. Root Capital’s analysis of over 1,200 loans to agribusinesses in remote areas shows that charging the full risk premium to borrowers would make the loans unaffordable. As such, Root Capital has needed to take a concessionary approach in order to preserve the quality of impact, which it intends.

However, in many other cases, the predominant characteristic of a catalytic capital deal might be disproportionate risk (i.e., elevated risk or uncertainty beyond that which the market will tolerate, and for which the investor may or may not be fully compensated) rather than concessionary returns. For instance, the critical role played by catalytic capital in standing up new BIPOC-led fund managers pursuing previously neglected BIPOC-oriented themes in the United States (as described under Question 3 above) has nothing to do with returns concessionality and everything to do with backing opportunities that are unfamiliar to mainstream capital and are therefore regarded (at least initially) with skepticism.

Note that we are discussing return expectations, which need to be distinguished from actual, realized returns: In catalytic capital investing, as in any other kind of investing, investments may under- or out-perform in financial terms relative to expectations.

While investors realizing a lower return than anticipated is a phenomenon not limited to catalytic capital, it has been observed that catalytic capital deals, because of the risk elements at play, may be sometimes compared unfavorably to other impact transactions on a financial return basis even before the risk is effectively analyzed. This plays out differently across asset classes: For example, venture capital of all types is associated with high risk and, as a result, catalytic capital VC deals are often not necessarily treated differently from other VC deals, while there is likely more discrimination in private equity, debt, and other asset classes.

Stepping back, we would also note that a narrow focus on returns alone can distract from what we think is most critical: Our starting point should always be the question of how flexible capital can enable impact in sectors, communities, and situations that mainstream capital would otherwise not reach.

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## 5. Do catalytic capital investments lead to market distortions?

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Addressing this question requires us to unpack what we mean by market distortion in this context. Typically, concerns about market distortion effects here revolve around situations where concessional (i.e., non-market-priced) capital “crowds out” other available capital in the market, e.g., mainstream investment capital, conventional bank lending.

We would argue that these effects are minimal where concessional catalytic capital is used as intended since, as described above, catalytic capital seeks to address capital gaps that mainstream investment markets fail to reach (e.g., serving specific populations/demographics who would otherwise be left behind). By definition, therefore, such capital does not crowd out mainstream finance because it targets

those opportunities that tend to fall outside the ambit of those markets, providing that catalytic capital investors are clear about the specific capital gaps they are addressing and how they are additional to what is otherwise provided in the market, and consider how they can most effectively target their deployment of capital, minimizing “leakage” outside the targeted capital gap. However, it is equally important to not allow concerns around market distortion to become a blanket concern—or reflexive excuse—that leads to paralysis.

We should also note, as explained under the previous question, that many catalytic capital deals do not involve concessional pricing, but take on disproportionate risk in pushing into areas where mainstream investment capital fears to tread—this is typical in the Seeding role of catalytic capital when backing novel investment strategies and business models that advance the frontiers of impact. In these cases, arguably no market yet exists to be distorted, and therefore the question of distortion does not arise, provided that, as above, investors are clear about which specific capital gaps they are addressing and how.

## 6. What is the relationship between catalytic capital and blended finance?

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According to Convergence<sup>5</sup>, the global network for blended finance, blended finance is “the use of catalytic capital from public or philanthropic sources to increase private-sector investment in sustainable development. Blended finance is a *structuring approach* that allows organizations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both). The main investment barriers for private investors addressed by blended finance are (i) high perceived and real risk and (ii) poor returns for the risk relative to comparable investments. Blended finance creates investable opportunities in developing countries which leads to more development impact.”

Given this definition, catalytic capital is the essential ingredient within a blended finance structure, meaning that the capital is deployed “vertically” within a capital stack and coincident with the financing that it seeks to leverage. However, catalytic capital can and is often deployed “horizontally” *without* blending, meaning that it is invested at an earlier stage than the capital it seeks to mobilize (i.e., sequentially): A typical example might be an early-stage investment in an impact venture pioneering an unproven business model, that then graduates to attracting more mainstream investment once it

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<sup>5</sup> In recognition of the connection between catalytic capital and blended finance, C3 has made a grant to Convergence as a key network partner. This award sits alongside grants to other leading impact investing networks (initially, the Global Impact Investing Network, Mission Investors Exchange, and Toniic), all of which aim to increase the knowledge, awareness, and use of catalytic capital among a diverse set of investors globally.

has begun to establish a track record of sound and profitable growth. Therefore, it is important to recognize that catalytic capital is relevant both within and outside the realm of blended finance.

## 7. How does catalytic capital relate to terms such as “impact-first investing” and “patient capital”?

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As a concept, catalytic capital is highly aligned with the term “impact-first investing” as first introduced by Monitor Institute, promoted by the family office Ceniarth, and more recently highlighted by Bridgespan, as well as with the term “patient capital” as popularized by Acumen (although we would note that “patient capital” is also used in many financial circles to denote long-term capital without any reference to impact).

As such, we believe that those who have an interest in these topics should be interested in discussions about catalytic capital, and we welcome them unreservedly. Our intention in building the field of catalytic capital is not to exclude anyone, but to invite in all who share our interest in increasing the use of more flexible, patient, risk-tolerant capital to advance the frontiers of impact.

## 8. Is it just philanthropic organizations that can provide catalytic capital?

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No, though philanthropic institutions are certainly a key group of catalytic capital provider. In the United States, for instance, foundation program-related investments (PRIs) are well suited to catalytic capital deployment, as they are required to have clear impact objectives (as the name suggests) and cannot have financial return as their primary motivation.

Beyond philanthropy, public-sector overseas aid budgets and official development finance institutions (DFIs) are active providers of catalytic capital (see the GEEREF and MedAccess examples under Question 2 above). Governments can also support catalytic capital efforts domestically. One such example is [Big Society Capital](#), which is working to build the impact investing sector in the UK and has had a significant success in areas such as the domestic charity bonds market where over £230 million has now been issued. Private HNW investors and family offices can also play a significant role in catalytic capital investing (see the examples of Ceniarth under Question 2 above, and the [Blue Haven Initiative](#)).

At the other end of the spectrum, private institutional investors are perhaps the least able of all asset owners to step into catalytic capital due to the limitations of their mandates and regulatory constraints (e.g., fiduciary duty requirements), though even here we have seen innovative moves into catalytic capital: A notable example is that of [Prudential Financial](#) creating a catalytic capital portfolio that—unlike Prudential’s main impact investing portfolio—is excluded from its standard asset-liability matching process, and can therefore tolerate higher risk and volatility.

It is in recognition of this wide range of current and potential providers of catalytic capital that C3 has partnered initially with four leading impact investing networks engaging with diverse impact investor segments—[Convergence](#) (working with DFIs), the [Global Impact Investing Network](#) (working with multiple investor types including institutional investors), [Mission Investors Exchange](#) (working with philanthropies

mainly in the US), and [Toniic](#) (working with private HNW investors and family offices)—to increase the knowledge, awareness, and use of catalytic capital among a diverse set of investors globally.

## 9. Is grant funding catalytic capital?

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We see catalytic capital as investment capital, a definition that historically excludes grant funding. However, we recognize that some grant funding now blurs the line between grant and investment as conventionally understood. In recent months, we have engaged in discussions with colleagues across the field about this topic, and have been reconsidering the exclusion from the catalytic capital definition of grant funding that is positioned and structured to have investment-like attributes.

In particular, grants deployed as capital into transactions (e.g., as equity-like financing in pioneering early-stage ventures, or a first-loss layer of credit enhancement in the capital stack of a blended transaction) are increasingly viewed as a type of investment capital by participants in the market. In some cases, these grants are also recoverable, i.e., they contain provisions for repayment if certain condition is met. As such, we recognize that categories including capital grants and recoverable grants should be added to our conception of what catalytic capital is, and we support efforts to learn from and advance the practice of providing such capital in pursuit of greater impact.

We continue to recognize and appreciate the value of more conventional grant funding that is not being deployed as a part of impact transactions, but instead facilitates and supports them (such as through technical assistance, design or structuring work, research, impact measurement), and that help to build the wider ecosystem. While these types of grant funding do *not* fall within the definition of catalytic capital, we do see them as enormously valuable tools that can work in powerfully complementary ways with catalytic capital deployment to achieve impact that otherwise would not be possible.

## 10. Does the concept of catalytic capital reflect all the ways in which investors can play a catalytic role?

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Our use of the word “catalytic” is not intended to monopolize discussions about what it means to be catalytic in the field of impact investing, or otherwise seek to claim exclusive rights to use of the word. Instead, we see ourselves as part of a broader community that shares an interest in how impact investors can play the most effective role they can in driving toward impact for people and the planet.

We recognize that the word “catalytic” in impact investing will show up both within and beyond the discussions about catalytic capital. Our discussions with colleagues across the field have pointed to a wide range of actions that seek to catalyze additional transactions and impact, and other developments in the impact investing sector. Examples include:

- At the transaction level: funding up-front transaction costs; leading a fundraising round; lending one’s name where helpful in attracting other investors; helping to design the structure of the deal; helping to assemble or strengthen an investee team; supporting an investee with expertise and networks; and sharing market intelligence or due diligence findings with other investors

- At an ecosystem level: generating and disseminating market information; developing new financing constructs; establishing deal sourcing platforms; and providing investment readiness supports for enterprises

The actions above can (and often are) taken in connection with the deployment of catalytic capital, but they can also be taken in unrelated contexts. We absolutely welcome the use of actions like these above to enhance the effectiveness of catalytic capital in achieving its intended goals.