



WHITE PAPER #3

DFID AND DFAT PROCUREMENT AND ASSISTANCE APPLICATIONS FOR USAID

GSA Innovative Finance Task Order

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ACRONYMS

ADP	Asian Development Bank
AMCs	Advance market commitments
CDC	Commonwealth Development Corporation
DCA	Development Credit Authority
DCED	Donor Committee for Enterprise Development
DFC	Development Finance Corporation
DFAT	Department of Foreign Affairs and Trade (Australia)
DFID	Department for International Development (U.K.)
DIBs	Development impact bonds
EMIFF	Emerging Markets Impact Investment Fund
E&Y	Ernst & Young
GEB	Gender Equality Branch
GLI	Gender lens investing
IFC	International Finance Corporation
IIP	Impact investment partners
IW	Investing in Women program
iXc	innovationXchange
PSE	Private Sector Engagement
SEAF	Small Enterprise Assistance Fund
SFI	Scaling Frontier Innovators
SME	Small and medium enterprises
SWOF	SEAF Women's Opportunity Fund

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INTRODUCTION

USAID and other donors recognize the unprecedented role the private sector is playing in providing opportunities to improve the lives of people and communities around the world. As the engine for job creation and growth, the private sector is a critical partner in providing a pathway for countries on the journey to self-reliance. It can take new innovations to scale, commit investments to build or expand new markets, and provide countries with the tools to finance their own development. Given the complexities of global challenges, donors are recognizing the need for more flexibility and maximizing available tools to mobilize financing, catalyze investment, and pay-for-results in innovative ways to fund development outcomes.

BACKGROUND

Donor support for innovative finance recognizes the need to mobilize private capital to support development impact. With the adoption of the Private Sector Engagement (PSE) policy, USAID codified collaboration with the private sector at all stages of development. In particular, it highlighted innovative finance structures developed as a means to achieving development results at scale and more effectively and sustainability. It also brings in the private sector as a key stakeholder in providing solutions to the development challenge. Innovative finance solutions often involve using traditional financial instruments to a new sector, country, or region, and/or applied to solve a development challenge. Thus, the driving force behind these new financial mechanisms is two-fold: to mobilize additional resources and to make those resources more effective and efficient in addressing global social and environmental challenges.

How is innovative finance defined? According to the USAID PSE policy, innovative finance “deploys proven approaches to new markets (new customers and segments), introduces novel approaches to established problems (new asset types), or attracts new participants to the market (such as commercially-oriented investors). This broad definition includes a variety of financial tools, including securities and derivatives (e.g., grants, guarantees, loans, bonds, and notes); results, output- or performance-based mechanisms (e.g., advance market commitments, challenge funds, and development impact bonds); voluntary contributions (e.g., donations made as part of consumer purchases); and compulsory charges (e.g. taxes).” For consistency, we will refer to “debt financing instruments” in lieu of derivatives and “prizes” instead of challenge funds.

According to the 2014 “Innovative Financing for Development” report by Dalberg, innovative finance is not necessarily financial innovation. Despite the attention on new structures, established instruments, such as guarantees and bonds, constitute nearly 65 percent of the innovative financing market at that time. Generally, most resources mobilized through innovative financing use existing products in new markets or involve new investors. The “innovation” aspect refers to the introduction of new products using traditional structures, or applying existing products to new markets or sectors, and the presence of new investors. Innovative financing mechanisms typically address specific market failures, build political momentum to increase and coordinate the resources of multiple donors, and provide certainty to investors. Often, innovative financing instruments reallocate risks from investors to institutions better positioned to bear the risk such as donors and, in the process, enable participation from mainstream investors. Instruments that have mobilized significant resources benefit from relatively simple financial structures and a proven track record that clearly describes the financial and social returns for investors. Simply put, innovative financing mechanisms channel funds *from* people and institutions that want to make investments *to* projects that require more resources than traditional donors and philanthropies can provide.

What constitutes innovative financing? According to the Dalberg report, debt financing instruments constitute more than 80 percent of the amount of capital mobilized between 2000 and 2013. The largest

category within these debt instruments is guarantees (\$36 billion, or 39 percent of the total). Although these statistics are dated, it is likely that the percentages may not have changed significantly given the tools available to donors spearheading innovative finance transactions. A more recent 2019 DCED working paper on innovative finance cites that blended finance — an approach for raising funds that blends concessionary capital with private resources — mobilized more than \$126 billion in capital to date; and impact investing, investing that generates both positive, measurable, social and environmental impact alongside financial returns, has an estimated market size of \$228 billion in 2018. These statistics further emphasize the need to mobilize capital toward development solutions.

Pay-for-results financing is another category included in the discussion on innovative finance. Although it is significantly smaller in size, it is getting increasing attention. It refers to mechanisms where funders pay upon *accomplishment* of results, rather than *efforts* to accomplish those results. The incentive-based payments are designed to increase the performance of investments and to transfer risk from the investor that funds the delivery of goods and services to the company or NGO that provides the goods and services. The mechanism is an explicit contract between the outcome funder and the delegated implementer who receives a payment. Pay-for-results financing mechanisms include performance-based contracts/grants, development impact bonds (DIBs), advance market commitments (AMCs), and prizes.

Although DIBs, AMCs, and prizes have had successes, they may work best in specific situations. For example, prizes are designed to incentivize innovative approaches to development challenges while engaging a large pool of stakeholders focused on solutions. They are best structured as an element within a broader program with a clear sustainability plan after the prize. In contrast, a DIB leverages private sector investors to provide upfront financing, shifting the risk in implementation to achieve social development outcomes. It brings together private sector investors, governments, and the implementation community under one concept, set of outcomes, and unified contractual structure. DIBs can improve efficiency and effectiveness of service delivery but are complex, challenging, and expensive to structure. AMCs have been utilized primarily in circumstances where the cost of developing a new product is too high to be worthwhile for the private sector without a guarantee of a certain quantity of purchases in advance – to date, it has been predominantly used for vaccine development.

Simple and practical donor tools to facilitate innovative financing. Given this broad definition, this paper will focus on tools that are more commonly deployed by DFID and DFAT that have the most applicability for USAID. For the majority of programs, USAID and other donors have simple and very practical tools that can be brought to bear that alone may not be “innovative finance” models but support larger innovative finance structures. These tools can also work to ensure buy-in from the private sector while not locking out the ability to engage smaller/new firms or investments in new, high-risk sectors or geographies. First and foremost, donor governments and particularly USAID have amazing convening power with its strong relationships with national and local governments, prominent businesses, key organizations, and civil society. This is one of the most important contributions that USAID can bring to discussions with the private sector. This convening power and trust provides the private sector with access to leaders and information so they can make informed decisions on market entry and investment.

USAID provides technical assistance and other services through grants, cooperative agreements, and contracts; and up until the establishment of the Development Finance Corporation (DFC), USAID provided credit enhancement programs through the Development Credit Authority (DCA). All these tools can be used in innovative ways to crowd-in the private sector and spur financing for development. For example, grants can be used to support seed funding for start-ups or innovative social enterprises. In fact, grant capital may be more appropriate for reducing risk and crowding in private investment, particularly for early stage companies in frontier markets rather than complicated financing structures. They can also allow USAID to co-fund and co-invest in new products, tools, or businesses that have high

potential for development impact but are deemed too risky for traditional investors. Moreover, they can be used as first loss capital, recoverable grants, and prizes to support innovation. In addition, grants can be used to offset fee structures in blended finance funds, launch crowdfunding platforms for investment, or facilitate collaboration models that would in turn support the broader investment and entrepreneurship ecosystem. This paper discusses a few simple but effective tools below that have been recently funded by donors such as DFAT and DFID.

THE ROLE OF DONOR GOVERNMENTS

AUSTRALIAN DEPARTMENT OF FOREIGN AFFAIRS AND TRADE (DFAT)

PROCUREMENT APPROACH

The Australian government's 2017 Foreign Policy White Paper states that "Australia's national interest is served by strong and enduring prosperity in the Indo-Pacific region," and affirms the government's commitment to serving as a leading development partner for Southeast Asia. Similar to USAID, this entails making a shift from traditional donor-beneficiary dynamics to a more mature economic relationship and people-to-people links. The white paper also emphasizes that a fundamental barrier to this prosperity is gender inequality, underpinned by a growing body of research that demonstrates the direct link between levels and quality of women's participation in the workforce and the economy. This led to DFAT's groundbreaking [Investing in Women](#) (IW) program, discussed below.

Australia's aid policy stimulates the need to crowd-in private financing to contribute toward development efforts in the region. This recognizes that while grant funding is invaluable in helping to catalyze growth and investment, it is not the only tool available for achieving DFAT's strategic objectives of inclusive economic growth and poverty reduction. DFAT has traditionally focused on promoting private sector development through grants by working with local governments to improve the local business enabling environments, strengthening key markets or sectors such as agriculture or infrastructure, or by building business capacity and improving enterprise investment-readiness.

In recent years, DFAT has increasingly explored how to deploy its grant funding more creatively through "investment-based approaches." DFAT has mainly pursued these efforts indirectly by funding multilateral development bank partners such as the International Finance Corporation (IFC) and the Asian Development Bank (ADB), and jointly supporting initiatives in collaboration with DFID and USAID. They have even brought in staff from USAID DCA to help them facilitate transactions. While this has allowed DFAT to build on the longstanding investment expertise of their partners, it has not allowed DFAT to utilize this expertise for their highest-priority regions, sectors, and transactions. Given this, DFAT has experimented with a new division called the InnovationXchange (iXc) that operates similar to USAID's Global Development Lab and most recently launched the Emerging Markets Impact Investment Fund (EMIFF) that is structured to serve as a DFI-like vehicle to make priority investments.

BEST PRACTICES & CASE STUDIES

Unlike the U.S. and U.K., DFAT does not have a development finance institution nor does it have development credit authority. This may be seen as a challenge, but it also forces DFAT to be creative with the tools available to them. Combined with the fact that DFAT priorities are very focused (primarily in Southeast Asia and the Pacific) and its operations are lean (primarily through its embassies), DFAT must maintain a good deal of flexibility in its operations. With this smaller budget and footprint, it has prioritized co-investment platforms which facilitates bigger ticket investment programs. For context, the blended finance network Convergence has found that commitments from donor governments for

blended finance transactions are between \$100 - 250 million in size. Australia has committed funding to the largest transactions on average, with an average deal size of \$478 million and the United States has committed funding to the smallest transactions on average, with an average deal size of \$142 million.

From its successful Investing in Women (IW) program and other initiatives, DFAT has demonstrated that flexibility and adaptability is key particularly when catalyzing investments in new sectors. It has also learned that establishing the right balance between risk mitigation and innovation facilitation requires sound processes of due diligence and partnering with highly credible global players. More details on one of their more successful programs are below.

CASE STUDY I: INVESTING IN WOMEN

DFAT's Investing in Women (IW) program is a \$107 million, seven-year, multicountry initiative for Southeast Asia that seeks to improve women's economic participation as employees and entrepreneurs and influence the enabling environment to promote women's economic empowerment. It began in April 2016 with operations in the Philippines, Indonesia, Vietnam, and Myanmar and is managed by the Gender Equality Branch (GEB) in Canberra with contributions from three of the Australian embassies in the region. In other words, the program receives funding from four sources within the Australian government, which makes management and reporting challenging, but IW has been able to successfully navigate these complexities. Given that this practice has become increasingly common at USAID, particularly for centrally or regionally managed programs, IW has multiple applications for USAID.

IW operates in 2 phases. Phase 1 ended in June 2019, and Phase 2 will end in June 2023. The program uses innovative approaches to improve women's economic participation through three strategic areas: workplace gender equality, impact investing to support women-owned and operated SMEs and influencing gender norms (see text box right).

This paper will focus on the impact investing program component given its relevance to the objectives of this paper. Specifically, IW is partnering with impact investors to strengthen access to finance for women-owned and -operated SMEs in Indonesia, the Philippines, and Vietnam, and to build a business case for a more inclusive investing environment globally. Through direct investments, gender advice, and operational support, IW is working with impact investors on:

- *Investment financing.* Unlocking finance through funds that incentivize higher levels of investment in women-owned and -operated SMEs.
- *Operational Support.* Strengthening the regional footprint of global impact investors so they can better tap into women-owned and -operated SME investment opportunities in the region.
- *Knowledge Building.* Producing evidence to build the business case that investing in women-owned and -operated SMEs can deliver good financial and social returns.
- *Gender Lens Ecosystem.* Helping impact investors customize their products to the needs of women-owned and -operated SMEs, so that supply and demand for capital are better aligned.

INVESTING IN WOMEN PROGRAM COMPONENTS

- **Workplace Gender Equality:** Support to business coalitions who work with influential businesses on shifting workplace cultures, practices and policy barriers to achieve workplace gender equality (WGE)
- **Impact Investment for Women's SMEs:** Partner with Impact Investors and ecosystem builders to expand market opportunities for women, with a view to incentivizing and catalyzing access to capital for small and medium enterprises (SMEs) – led by and responsive to the needs of women
- **Influencing Gender Norms:** Work with partners to positively shift attitudes and practices to support women in the world of work.

Source: *Investing in Women*

IW uses performance-based grant agreements to provide capital and operational support to four impact investment partners (IIPs) operating in the region: [Capital for Development \(C4D\)](#), [Patamar Capital](#), [Root Capital](#), and the [Small Enterprise Assistance Fund \(SEAF\)](#). As a result of these partnerships, IW has made significant progress toward developing the Southeast Asia blended finance market, deploying capital to women owned and operated small and medium enterprises (SMEs), moving capital with a gender lens, and leveraging private sector capital toward women-owned and -operated SME investments.

IW is comprehensive in its approach and addresses the multiple dimensions of economic empowerment for women. In fact, IW is the first program to holistically address women's economic empowerment in Southeast Asia. Given limitations in IW's abilities to engage impact investors, it mainly uses traditional tools like grants and technical assistance, but in very creative and comprehensive ways. For example, it utilizes performance-based grant agreements to leverage private capital by requiring that the grantees (impact investment firms) have private sector leverage targets, which trigger the next tranche of payments. If a target is not met, the grantee will not receive their next payment and those funds (which need to be obligated within a two-year timeframe) can be moved to another grantee that is meeting or exceeding its targets. The agreement is also structured so that their co-financing is directly tied to the fund's carried interest. In fact, an accelerated carry interest kicker is in place that allows the carried interest to go up as high as 40 percent depending upon how much the firm is able to leverage.

Other innovative aspects of these agreements include a 10-year agreement to mirror the typical lifespan of a private equity fund, which exceeds the life of the project, the front-loaded management fees for staff (which in a typical fund is usually at 2 percent), a requirement to focus on women-owned and -operated SMEs, technical assistance, and a gender lens investing (GLI) action plan. Moreover, the investment decisions made by the grant recipients (impact investment funds) is made in collaboration with IW with a strong impact management approach and metrics. The specificity in which IW requires GLI action plans speaks to the impact that they are seeking. For example, a focus on women entrepreneurs is not a strategy. However, a focus on women entrepreneurs in rural Vietnam aimed at the cocoa supply chain would be considered a component of a strategy. This focus would be combined with ensuring that the firms hire more female investment officers and incorporate gender considerations into their sourcing and due diligence process. IW also brought in leading players from women's organizations such as the Criterion Institute and Value for Women to support the grantees in developing the GLI action plan.

One important note is that IW prioritized making the business case for gender lens investing. They felt that the best way to do that was to seek partnerships with the best-in-class impact investors in Southeast Asia. Given the small pool of impact investors in the region relative to Africa and Latin America and the strong impact investment team at IW, they had a clear perspective on the type of partners they wanted to work with. They issued a limited tender to work with firms that had a track record of successful investments and an openness to the GLI framework. They used this as a starting point to make the business case and to demonstrate to the broader investment community that GLI is both profitable and impactful.

Finally, the large auditing firm Ernst & Young (E&Y) is part of the IW consortium, serving as an advisor to the program by undertaking market studies, advising on the tender processes, evaluating impact investing partners, and providing strategic and legal advice. Prior to this program, E&Y did not have a background in impact investing nor in Southeast Asia but conducted the evaluation for all four grant agreements to the impact investment firms. Their commercial approach helped identify quick wins for the project and, most importantly, their stamp of approval on impact investing and GLI helped provide the business case for DFAT and other donors. Two grant agreements from IW are highlighted below.

Patamar Capital - Investing in Women Fund

IW grantee Patamar established an AUD\$4.1 million IW special purpose investment vehicle to focus on growth-stage investments. The purpose of this vehicle is to undertake a range of proof of concept investments that may be leveraged to demonstrate the merits of gender lens investing. Patamar aspires to build an investment market around female entrepreneurs by using their success stories to demonstrate to investors the value of applying a gender lens to their investment strategy.

TERMS	INVESTING IN WOMEN FUND
Grant	AUD4.1m
Leverage target	Targeting private investment of 2.0x to 5.0x (AUD4.0m)
Instrument	Focus on equity investments
Investee companies	Growth stage, women's SMEs in Indonesia, Philippines and Vietnam
Fund term	Five to eight years, including two-year investment period
Ticket size	AUD250k to AUD350k
Target return (p.a.)	Target return will be an IRR of 10-20% p.a.
Social impact focus	Gender equality and businesses that build distribution platforms to better serve low-income communities, businesses that develop life-enhancing products and services for low-income communities and businesses that reconfigure supply chains to better serve low-income producers.
Post-investment services	Various, including financial and cash flow management and strategic planning

Source: E&Y, *Investing in Women Case Study Series: Patamar Capital, October 2019.*

IW's partnership with Patamar also featured a partnership with Jakarta-based Kinara, to manage the women's SME Accelerator Program in Indonesia. The program was executed over a two-year period (2017 and 2018), with a key focus on the following two areas with Kinara: agriculture and food security and innovative and ethical fashion. For agriculture, this included supporting businesses working in upstream agricultural sectors, food/raw material production, and retail food and beverage. For ethical fashion, this meant supporting businesses which have or aspire to source, process, produce, distribute or sell fashion products using inventive and ethical approaches, which benefit the community and environment at scale. The Accelerator Program adopted the Village Capital curriculum, which concentrates heavily on peer learning. Participants learn and obtain feedback from other participants and, at the end of the program, a peer-selection process determines the recipient of investment capital.

Through this process the top four businesses from each cohort were selected to receive start-up capital (at \$25,000 each). The start-up capital was provided in the form of mezzanine financing, a loan made by investors to a company with the option to convert the debt to a future equity stake in the company, at a specified time and a specified value (percent of the company). In addition, Patamar may seek to provide follow-on investments for promising entrepreneurs and make introductions to other investors in its Indonesian network for additional investment capital.

According to the E&Y report and the IW impact investing director, Patamar has made outstanding progress in developing a pipeline of eligible women SMEs and moving toward closing these deals, which provides evidence that there is an investable pipeline of women SMEs for investors that are wishing to adopt a gender lens in their investing approach. Women entrepreneurs in early-stage businesses have found the access to technical assistance a key differentiating factor from other sources of capital, which may include advice on capital structure, operations, and improving gender equality within the business. Moreover, there has been great demand for the Village Capital accelerator program given its usefulness to the entrepreneurs and a lack of comparable competitors that have the same women’s SME focus.

Small Enterprise Assistance Funds (SEAF) - Women’s Opportunity Fund

IW provided a \$6.1 million grant to SEAF to develop the SEAF Women’s Opportunity Fund (SWOF), designed to deliver a range of finance options to support the growth of women’s SMEs in Indonesia, Philippines, and Vietnam. The SWOF was designed as a pilot with the ability to scale later in the program. With a seed grant from IW, SWOF made five investments in women SMEs as proof of concept.

Through this phase, gender lens investing activities were developed, tested and evaluated to understand their ability to increase capital to women’s SMEs and to prove that the investment thesis can be implemented in a manner that results in attractive financial results and positive social impact. The grant was structured so that it required SEAF to seek leveraging at a 1:1 ratio whenever possible. The ambition of SEAF is to use this pilot fund, along with the proven a gender lens investing approach integrated across the SEAF platform, to raise a follow-on fund called the SEAF Women’s Economic Empowerment Fund of \$100 million.

TERMS	SEAF WOMEN’S OPPORTUNITY FUND (“SWOF”)
Size	AUD9.0m
Grant	AUD6.4m
Leverage target	Seeks to arrange co-financing at a minimum ratio of 1:1 where possible
Instrument	Equity and quasi-equity
Investee companies	Early growth-stage, women’s SMEs in Indonesia, Philippines and Vietnam
Fund term	Ten years, including two-year investment period
Ticket size	AUD650k– AUD1.4m
Target return (p.a.)	Equity or Quasi-equity: greater than 20% (targeting ownership of 25%-49%) Mezzanine: 11%-14% (6%-7% (fixed) plus percentage of revenues)
Social impact focus	Gender equality, quality job creation, health care, education, and environmental and agricultural sustainability
Post-investment services	Various, including financial and cash flow management, strategic planning, leadership development, gender equality improvements

Source: E&Y, *Investing in Women Case Study Series: SEAF Women’s Opportunity Fund, October 2019.*

SWOF provided a range of financing options for women SMEs. These include a mix of equity and debt to accommodate the variety of needs and preferences of the entrepreneurs. The experience of SEAF to date is that in general, women SMEs prefer equity structures over debt-oriented structures. This is mainly due to a lack of available debt investors that share their business goals and aspirations, a factor which is important to women SMEs when choosing an investor. SEAF has also found that, more than capital, women entrepreneurs seek a partner that can provide the business support necessary to build their businesses. As such, the women entrepreneurs seek a partner who will be an owner alongside them and thereby be aligned in building the company for the long-term. Investor market reaction to the follow-on fund indicates significant interest and appetite to invest following the SWOF. IW's performance-based grant served as catalytic capital to mobilize and accelerate investment toward women owned and led businesses. In partnership with IW, SEAF also developed a proprietary Gender Equality Scorecard to assess women's economic empowerment and gender equality within an individual investment.

Lessons Learned

At the end of Phase I (2016 -19), the four impact investors engaged with IW built robust pipelines of prospective businesses, made initial investments, and marketed nearly \$300-million worth of combined new investment vehicles targeting women-owned and -operated SMEs and GLI. These impact investment partners (IIPs) have also demonstrated the importance of non-financial services, particularly accelerators and business advisory support, in building their pipelines and executing deals. In addition, through gender lens action plans required by the program, the IIPs strengthened their own internal capacities in GLI as well as creating significant new investment vehicles to channel capital to WSMEs.

One important achievement has been the creation and refinement of a unique model for using grants to incentivize investments in WSMEs, particularly for commercially oriented investment funds. The main elements of this model include the selection process and criteria (led by E&Y); the mix of accountable activities—through the deployment of investment capital and operational support. IW's performance-based grant and leverage requirements has proven to be an effective catalyst for both investment and demonstration effects, showing promising ongoing leverage on multiple fronts. For every dollar contributed by the program toward initial investments, two of the IIPs, combined, have leveraged commitments for another \$2.14 dollars in private-sector financing mainly from Singapore and Indonesia.

IW considers local presence to be a key success factor in helping investors develop networks, business relationships, and transaction pipelines. In recognition of this fact and to increase IW's focus on localized investment support, IW intends to partner with local investor networks in Phase 2 of the program in order to strengthen the financial ecosystem and help bridge the funding gap. In conclusion, IW and its partners have strengthened DFAT's credibility and effectiveness as an international player in both impact investing and gender lens investing.

CASE STUDY 2: EMERGING MARKETS IMPACT INVESTMENT FUND PILOT

DFAT recently launched the Emerging Markets Impact Investment Fund (EMIIF), its first non-grant financing facility. EMIIF aims to build DFAT's bilateral investment capability, engaging more directly with private investors, while also providing greater control over the ultimate deployment and impact of investments made in line with DFAT's development priorities and bilateral relationships in the Indo-Pacific region. Awarded fall 2019, Sarona will partner with MEDA, Volta Capital and the Whitelum Group to meet EMIIF's twin objectives of addressing the financing gap for SMEs that improve the lives of the poor and building the impact investing market in South and Southeast Asia. The fund has an initial capital investment of AUD \$40 million with the potential to expand in later years.

Recognizing that SMEs are major drivers of inclusive economic growth and poverty alleviation but often lack access to the capital they need to grow, EMIIF will invest in funds that target early and growth stage SMEs. It is intended that EMIIF will use a range of non-grant financial instruments such as loans, equity and guarantees to encourage additional investment into investee funds from private investors. It will also provide technical assistance to SME funds and SMEs to improve their commercial success and development impact. Given EMIIF's deliberate focus on deploying capital to SME funds that represent a significant gap in the market, it will reinforce its market-building role by offering an anchor investor role in its investee funds and risk mitigation solutions that will de-risk co-investments by private investors.

EMIIF will operate primarily in Southeast Asia and the Pacific and selectively in South Asia. It will invest across a variety of sectors including agriculture, healthcare, education, financial inclusion and clean energy. Development impact, including progress on gender equality, will be fundamental to EMIIF's operations. In particular, its investment strategy incorporates lessons learned from the IW program and will use a gender lens to identify and make investments in SMEs that are women-led, provide products and services for women and girls, and/or promote gender equality in their workplaces. EMIIF also builds upon the lessons from the Dutch Good Growth Fund and DFID's Impact Programme.

Established as a trust with DFAT as the sole beneficiary, EMIIF's proposed governance structure is set up to allow DFAT to direct EMIIF's alignment with the department's policy and strategic direction while at the same time providing EMIIF with sufficient independence for the management of daily operations. DFAT will oversee implementation by appointing a delegate to EMIIF, establishing an Impact Investing Advisor Group and secretariat. Although DFAT does not currently have the internal capabilities to make investment decisions, DFAT structured the contract to allow for opportunities for knowledge transfer and capacity building including DFAT staff potentially embedded within EMIIF to maximize the learning opportunity. The initial pilot phase will be operational in July 2020 and will test the efficiency and effectiveness of this proposed approach.

CASE STUDY 3: SCALING FRONTIER INNOVATION (SFI) PROGRAM - FRONTIER BROKERS

Designed by the iXc division in DFAT, the Scaling Frontier Innovation (SFI) Program is an experimental 5-year, AUD 15 million program that supports social enterprises to scale their development impact in the Asia-Pacific region, in support of the Sustainable Development Goals (SDGs). SFI has three components that focus on different but interdependent parts of the ecosystem that supports entrepreneurs: 1) Frontier Innovators – which provides select innovators with peer learning opportunities, technical assistance, and grants; 2) Frontier Incubators – which connects and builds the capacity of incubators and accelerators in the region; and 3) Frontier Brokers – which channels capital to social enterprises for scaling through a network of impact investors, known as the “Brokers”. The overarching goal of SFI is to achieve development impact in the Asia-Pacific region by driving catalytic growth in enterprises through acceleration support, greater ecosystem

FRONTIER BROKERS

Value: AUD 4.5 million

Period of Performance: March 2019 – December 2021; Extended to June 2022

Pilot Projects and Brokers:

- BIDUK: Athena Global Alliance
- Asia Pacific Impact Notes: Brightlight Group, SecondMuse, University of Melbourne
- Impact Connect: Good Return, Palladium
- Equity at Scale: IIX

Location: Southeast Asia (Regional), Indonesia, Cambodia, Singapore

Results in 2020:

- AUD 7.2 million facilitated in debt and equity by FB for seven social enterprises.
- Increased capacity of stakeholders in gender lens investing – 2,693 stakeholders trained in total
- 54 promotional items disseminated including blogs, videos, graphic recording, and LinkedIn Posts.

Source: [Frontier Brokers at Medium.com](#)

connectedness, and strategic injections of capital. This paper will focus on SFI's Frontier Brokers component which utilizes pay-for-results contracting mechanisms with the program's Brokers.

SFI's Frontier Brokers component supports new innovations in investment vehicles to attract new capital, applying a gender lens approach to measurably address gender inequality in capital markets, investment processes and local contexts. Of SFI's AUD 15 million budget, AUD 4.5 million is allocated for Frontier Brokers and an innovative network facilitation subcomponent designed to support and encourage networking among the Brokers and other financial intermediaries in the ecosystem. The Brokers implementing the pilot projects were selected through a competitive procurement process that included a co-creation workshop to encourage collaboration among other players and to help ensure a focus on gender lens investing and financial inclusivity.

The selected Brokers represent a network of seven impact investment firms - Athena Global Alliance (BIDUK platform); Brightlight Group with Investing for Good, SecondMuse and University of Melbourne (Asia Pacific Impact Notes); Good Return with Palladium/Enclude (Impact Connect); and IIX (Equity at Scale program). The pilot projects are described below:

- **BIDUK** (Investing in Business for Progress): Lending platform aimed at meeting needs of Indonesia-based small and growing businesses with an emphasis on those owned by women. Offers flexible debt products and services that meet the needs of underserved women-owned businesses in Indonesia and throughout Southeast Asia, targeting loan sizes from AUD \$25,000 to \$100,000.
- **Asia Pacific Notes Series:** World's first fixed income securities to aggregate bespoke, fit for purpose loans to social enterprises from across the Asia Pacific region. Designed to meet institutional investor requirements of scale, standardization, diversification and liquidity.
- **Impact Connect:** Leverages risk capital from impact-first investors both local and international, stimulate financing for missing middle social enterprises. Works primarily in Indonesia and Cambodia; uses an innovative loan structuring method, basing principal repayments on business cash flow (rather than fixed repayment schedule) to meet early-stage enterprise needs, reducing risk to both banks and investee enterprises.
- **Equity @ Scale:** Focuses on improving human capital (investment readiness training), social capital (mentoring and corporate networks), and financial capital (private sector equity and debt instruments)

Pay-for-Results Design

Given the complexity of the Frontier Brokers concept and lack of consensus about a clear solution, the iXc and DFAT's procurement team chose to pilot an innovative two-stage co-creation process to design the RFP, rather than using DFAT's typical prescriptive procurement approach. They conducted an initial co-design workshop with potential financial organizations which were selected based on an open and competitive Expression of Interest process. The workshop participants played a critical role in the design of the final RFPs which were based on the outputs of the co-creation workshop and informed by practitioners in the finance ecosystem. For instance, the success criteria discussed during the workshop informed the final evaluation criteria used by DFAT's review panel.

Workshop participants were given a few weeks to form new partnerships with each other and submit final proposals following the initial workshop. This innovative approach to program design encouraged proposals that had higher than usual risk and reward and which were based on the market experience and expertise of the participants. In total, the process resulted in the submission of 13 proposals and the funding of four pilot projects focused on bespoke brokering. The RFP and resulting contracts were

designed to be fully pay-for-results – containing only milestone payments – without any cost-reimbursement elements. It was incumbent on the winning bidders to negotiate the actual terms of award, milestones, and payment structure with DFAT.

Pay-for-Results Pricing and Payment

At the onset of the procurement process, DFAT determined the total amount of funds available for Frontier Brokers (AUD \$4.5 million). When proposals for the pilot projects were submitted, the evaluation committee also considered the costs associated. DFAT then entered into negotiation with each winning proposal to ensure the total cost was within the allocated amount (AUD \$4.5 million). Rather than using standardized formulas or specialized techniques such as cost-benefit analysis, DFAT and the Brokers negotiated and agreed on the milestones for the life of project, pricing for the milestones, and the timing of milestone payments to maximize the intended impact for target beneficiaries. The key consideration in these negotiations was the principle of DFAT's investment supporting the development and design of new, innovative models for brokering finance that no other actors had heretofore funded. While the four pilot projects are all distinct, the milestones and payments attributed were negotiated to enable them to create those new models. An additional general consideration. DFAT avoided making large payments towards the end of a project, as it would not allow enough time for capital to drive impact.

All Brokers' milestone payments are frontloaded to cover the launch and initial operational expenses pertaining to the pilot projects. These first payments represented 30% of the overall contract and would be unlocked by successfully completing activities such as signing a loan agreement with certain characteristics, developing a certain number of products with a gender lens, among others. Of note, the Frontier Brokers' program was designed without set targets (e.g. catalyzing X amount of dollars for SMEs), but tracked performance through a framework of approximately 50 standard indicators. This was a deliberate design choice to avoid a disproportionate focus on achieving numerical targets and to redirect efforts towards innovative technical approaches and generating lessons learned, given the pilot projects' experimental nature.

Two types of milestones exist under SFI Frontier Brokers: required standard milestones and stretch goals. Subsequent payments beyond the initial front-loaded payments are unlocked through meeting standard milestones, such as new financial products (e.g. loan and underwriting methodology) designed and brought to the market, an agreement signed with a financial institution (e.g. financial services provider), or identification of a pipeline or SMEs successfully raising an investment. Stretch goals vary considerably in their types, but generally involve achieving results beyond that of a standard milestone: for instance, expanding loan products to new geographical locations beyond those included in the contract's original scope. Other stretch goals diverge from standard milestones, such as developing discrete knowledge products on lessons learned and knowledge gained from implementation. The stretch goals are laid out as a "menu" of funds awaiting to be unlocked should an implementer achieve predetermined results. Much of these stretch goals have already been met to date, and DFAT expects to disburse 100% of these funds by project end.

Required standard milestones have a set timeline for payment. By comparison, stretch milestone payments are not made at scheduled intervals – rather, as soon as a stretch milestone is fully achieved and the results are verified, an implementer can invoice DFAT. This approach makes budgeting more challenging for DFAT, as often the timing of these payments is hard to predict, especially during the COVID-19 pandemic. For stretch goals, partially completed milestones can also result in split payment, with the delta being paid when the remaining results are met – in practice, this was a relatively rare instance. For every milestone that was not achieved, DFAT documented the reason and justification for why that was the case (e.g. COVID-19 related challenges).

DFAT is committed and able to withhold payments should an implementer fail to meet its milestone detailed in the contract. Each contract also had built-in flexibility allowing activities to shift under certain situations, which could be initiated through contract amendments in dialogue with DFAT (e.g. no cost extension). No-cost extensions can be granted should more time be needed for a project to achieve results, given their innovative nature. Due to COVID-19, one of the projects will not achieve its milestones by Dec 2021. Accordingly, the contract for the project has been extended for 6 months (June 2022), to give the implementers sufficient time to achieve their milestones.

Pay-for-Results Monitoring and Evaluation

DFAT plays an active role in monitoring the Brokers' activities. The agency closely monitors, communicates, regularly discusses progress, and shares information with the pilot projects, addressing issues as they arise. SFI Frontier Brokers has one Monitoring, Evaluation and Learning (MEL) partner – a consortium of Moonshot Global and Living Collaborations. They are responsible for monitoring and evaluating Brokers' progress but are not directly involved in the verification of the results outlined in the contracts. DFAT uses the MEL partners' detailed reports and supporting evidence to verify results internally, prior to paying out for achieved milestones. For instance, examples of evidence can include documentation of a signed agreement, a finance product that is designed and successfully goes to market, and loan records. External, third party validators are not used.

Lessons Learned

Even with the COVID-19 pandemic, the Brokers did not shift their projects' milestones. A no-cost 6-month extension was granted to one project, with another being currently processed, to pivot activities and achieve expected milestones. For instance, much of the investor outreach and strategic communications work transitioned to virtual platforms during the pandemic. Outside of the Brokers component, SFI provided entrepreneur-specific support designed to build resilience and support business strategies for SMEs.

DFAT noted that co-creation provided a genuine value add to the Frontier Broker project's overall design, injecting it with innovative, disruptive, and experimental thinking closely aligned with the overarching philosophy of SFI. Frontier Brokers did not face any challenges in avoiding numerical target-setting, given its experimental, testing, and learning purpose. However, not setting targets may be more challenging for other programs, contexts or other donors/funders, where there is a stronger demand or requirement to be able to define and specify numerical targets. Still, a more generous time cushion was needed in the initial set-up of the Frontier Brokers' pilot projects.

DFAT placed an increased emphasis on building relationships with the implementers, managing financial risk, and sharing learnings from the experiments both internally and externally. For instance, in addition to the four pilot projects, DFAT also provides modest funding to a dedicated Frontier Brokers Network, which includes all Brokers. The purpose of the Network is to support learning and exchange among the pilot projects and to better communicate their experiences, especially with gender lens investing. DFAT spends significantly more time than usual with the Brokers, communicating, managing changes between payments, and adjusting indicators as needed. This is due to the innovative, experimental nature of the pilot projects, whereby DFAT accepts a higher risk. Being close to the projects and investing more time is critical in enabling adaptive management and in identifying any issues or new risks, and addressing them in real time, rather than acknowledging them at mid- or endpoint of the projects. DFAT also places greater emphasis and value on learning. Spending more time with the Brokers enables DFAT to learn about innovative finance for SMEs, gender lens investing, among other topics, while deepening partnerships.

Given the adaptive management and learning emphasis of the Frontier Brokers, greater alignment between the Brokers' activities, own reporting, MEL monitoring, data collection and analysis would be desirable. Although SFI's MEL partner is working closely with the pilot projects to collect data and lessons learned, the opportunity to effectively use such data and learnings by the Brokers are not being fully leveraged. Greater streamlining and alignment could enable more effective adaptive management in the implementation of the pilot projects, and timely monitoring and documentation of progress.

U.K. DEPARTMENT FOR FOREIGN AFFAIRS AND INTERNATIONAL DEVELOPMENT (DFID)

PROCUREMENT APPROACH

Over the years, DFID has streamlined its procurement process and currently operates mainly on “framework agreements,” which offers multi-year contracts to select suppliers of services within a consortium. Frameworks provide access to a pre-qualified range of partners, making it easier and quicker for DFID to draw down support and respond flexibly to opportunities as they arise. By aggregating the procurement process, these agreements provide DFID with better “value for money,” and they also reduce the administrative burden on supply partners, shorten procurement timescales, open up the market to new supply partners and increase opportunities for SMEs. These framework agreements operate similar to the U.S. federal government’s indefinite delivery/indefinite quantity contracts (IDIQs). A “call-down” is the process by which DFID issues a procurement under a framework agreement (similar to a request for task order proposal or RFTOP) and a “lot” is the actual award (similar to a task order). DFID currently has 6 framework agreements across multiple sectors.

In 2019, DFID issued a procurement for a new International Multi-Disciplinary Framework for smaller programs across multiple sectors up to £3 million, which has expanded the pool of suppliers to 81 partners including many small businesses. Although the framework agreements are frequently used, DFID may still issue stand-alone procurements that may not fall under the framework agreements. Finally, other divisions within the UK government also utilizes framework agreements that are separate from DFID’s including those focused on crisis response and economic support.

BEST PRACTICES & CASE STUDIES

Similar to USAID’s PSE policy, DFID’s approach to private sector engagement is to act as a catalyst and facilitator, rather than intervening in markets; working in partnerships with a range of other actors, including the private sector; strengthening the business environment for firms; and making markets work better particularly for low-income communities in the countries in which it operates. For example, DFID’s Impact Programme takes a similar approach to impact investing using a mix of grants and guarantees through DFID’s development finance institution, the Commonwealth Development Corporation (CDC) Group. Most recently, at the U.K. African Summit that took place in January 2020, DFID announced £1.5 billion in new initiatives intended to mobilize £2.4 billion in private investments for African countries. Although the specifics have not yet been announced, it is clear that DFID is utilizing all its tools to mobilize capital for its development priorities.

CASE STUDY 4: IMPACT PROGRAMME

When the Impact Programme was launched by DFID in 2012, it marked a recognition by the U.K. government that aid can be used alongside private investment or to leverage private investments to increase development impact and sustainability. The Impact Programme has three main components: a market-building grant facility aimed at addressing the barriers to impact investments in Africa and South Asia; two investment vehicles, the Impact Fund and Impact Accelerator; and a technical assistance facility to support investee companies. The investment vehicles are managed by CDC while the market-building and technical assistance facilities are managed by PwC for Phase I (2012-2018) and Palladium for Phase II (2019-2023).

The Impact Programme Phase I

By the end of 2017, the Impact Programme has provided £130 million in investments to catalyze the market for impact investment in Sub-Saharan Africa and South Asia. Within the first five years, the program provided up to £5 million in grants to design and test innovative investment products, tools, and services that aim to increase the flow and distribution of capital in these regions. The Programme made the strategic decision to not provide direct assistance to assistance to individual businesses but focus on reducing market-level barriers in the impact investing ecosystem with a priority for partners who demonstrate a commitment to sustainability and wider ecosystem engagement with counterpart or matching funds. Palladium in partnership with Enclude Capital Advisory and The Good Economy implements the market-building activities across five strategic themes (see box at right).

Although DFID does not have financing authority, it is the sole shareholder for the CDC. Given this unique relationship, DFID and CDC collaborates closely on its initiatives and they're able to jointly manage the program. The Impact Fund component supports investment funds pursuing high-impact strategies such as investing in businesses that provide access to improved goods and services, and income generating opportunities to underserved communities or investing in more challenging or fragile regions with limited investment activity. Through the Impact Accelerator, CDC supports pilots for new, high-impact business models, investment in difficult countries and strategies that target provision of goods or services to the underserved.

Given that the Impact Fund invests in young, fragile or high-growth businesses, these companies generally require significant support, which goes beyond the limits that standard fund management fees cover. This is where the technical assistance component comes in, to provide the support that is needed for the start-ups post-investment. A technical assistance committee, comprising representatives from CDC and independent members, provides oversight of the facility, including ensuring that the funds are being deployed in a transparent and accountable manner.

Impact Programme Phase II

The Impact Programme is comprehensive in its approach - addressing all aspects of the impact investing ecosystem. The challenges, however, is that the program is spread relatively thin with five objectives

THE IMPACT PROGRAMME PHASE I: MARKET-BUILDING STRATEGIC THEMES

Open up new sources of finance. The Impact Programme will work with partners to develop new models for intermediation between a wider range of investors and enterprises and support the innovation of new structures that facilitate greater capital flows. Partners: Eighteen East Capital, Enclude.

Improve impact measurement. The Impact Programme will work with partners on establishing industry-level, standardized frameworks and norms for impact measurement and management to help build a more efficient and transparent impact investment industry globally. It will support the development of practical, innovative and low-cost measurement tools and services that provide business insights for managing impact. It will also build connections between impact measurement and management stakeholders. Partners: Impact Management Project, GIIN, Acumen, Profit Probability Index, ANDE.

Build fund manager capacity. The Impact Programme will work with partners to build fund management capacity. It will do this by supporting the development of sustainable and scalable models that identify early-stage Fund Managers and provide capacity building for them at scale. It will also support the development of new models that reduce costs for Fund Managers. Partners: Capria Ventures.

Bridge information gaps. In order to bridge information gaps and increase market linkages the Impact Programme will work with partners that offer structures with credible information, including analyses of fund economics in DFID target markets, to investors, Fund Managers and enterprises. It will also support the development of mechanisms which identify (quickly and easily) investors, enterprises and appropriate quality service providers. Partners: GIIN, UK National Advisory Board on Impact Investing, Council on Smallholder Agriculture Finance, the Global Steering Group, International Center for Research on Women (ICRW).

Support deal flow. This theme supports the up-skilling of entrepreneurs in developing countries. Partners: Capria, Village Capital, Endeava and ANDE.

Source: DFID's Impact Program

across Africa and South Asia. Moreover, the component focused on grants has been relatively small compared to the Fund and Accelerator. Further, the timeline for the grants has been lengthy in Phase I, much longer than the average timeline for USAID grants. For example, the first grant issued took several years while in contrast, DFAT negotiated and issued the grant agreements to their IIPs in six months. Further, the broad nature of the Impact Program - geographically but also by sector has made metrics a challenge; whereas DFAT's IW program is more focused despite being sector agnostic.

These lessons learned have allowed DFID to focus its efforts in the second phase of the program. For Phase II of the Impact Programme, DFID narrowed its focus to: (i) creating innovative products, tools and services for investors and investees in sub-Saharan Africa and South Asia; (ii) strengthening impact monitoring and measurement – building upon its work with the Impact Management Program; and (iii) building knowledge and awareness on impact investing. For the first objective, Palladium established a challenge fund, or funding window to support new ideas, which closed in October 2019. They will implement additional funding windows for the other objectives. Phase II will build upon the previous work under Phase I but really dive into the supply side of impact investing and specifically the innovations in market building for impact investing.

The most noticeable aspect of Phase II is that the Impact Fund and Accelerator has been completely transferred to CDC given their comparative advantage, as well as to minimize the management burden on DFID staff allowing them to focus their efforts. With the learnings from the Impact Fund and Accelerator, the CDC has embarked on a new initiative launched in fall 2019 called the Catalyst Strategies, which focuses on supporting nascent markets and investments in early stage enterprises.

MOVING FORWARD

Given its experience with the Impact Programme and other similar initiatives, DFID has more frequently used “development capital,” or grants to a private entity that would make investments on their behalf. This approach has a double bottom line – modest financial returns alongside significant development impact. The financial returns will be redeployed into their development programs. Given the frequency with which DFAT is deploying development capital, DFID has prepared an internal guidance document on best practices for deploying development capital.

In addition to development capital grants, DFID will also pursue more opportunities to test development impact bonds. After their initial DIB pilot in 2017 with Village Capital (a collaboration with USAID), DFID plans to pursue it more aggressively through a new fund focused on piloting DIBs. At the UK-Africa Summit in January 2020, DFID announced the planned launch of a new Development Impact Bond Fund to help underwrite new bonds (£79 million in funding). This work will look at building the evidence for the suitability of DIBs in improving the efficiency and effectiveness of development outcomes. Evidence generated through the pilot will provide data on when DIBs may be an appropriate tool, how they can be designed to support providers to innovate and deliver better outcomes, and the costs and benefits of using DIBs.

RECOMMENDATIONS

The experiences from DFAT and DFID demonstrate that donor governments are uniquely positioned to mobilize private capital to support development impact in emerging markets. The most appropriate role for donor governments include:

- supporting the business enabling environment and broader entrepreneurship ecosystem,
- supporting new actors with localized knowledge and expertise,
- providing catalytic capital to encourage the private sector to enter riskier markets,

- providing technical assistance, and
- supporting organizations and social enterprises that may not be profitable but still provide a valuable public good.

By using simple tools in creative ways, donors can spur broader innovative finance structures. For example, USAID can also deploy technical assistance in collaboration with the private sector to encourage their buy-in, cost-share, or leverage. A private equity fund interested in social impact may not be able to loan to early stage enterprises but would be willing to do so if USAID supported a ‘sidecar’ technical assistance TA facility. This facility is critical to ensuring that enterprises have access to low-cost TA to help grow their businesses. By deploying technical assistance strategically, USAID could encourage mainstream investors to enter new sectors that were previously deemed too risky for private capital while supporting new firms and creating a demonstration effect. This TA facility could be combined with a loan guarantee to maximize impact.

Another issue that we have heard frequently from the private sector is the need for donors to facilitate procurement timelines and streamline requirements. GIIN’s Blended Finance Working Group sites that the single largest barrier for the private sector and particularly investors is the timeline for procurement. For example, a fund manager may be waiting over a year for a donor agency to provide a grant while their anchor private investor is on a much shorter timeframe for closing the transaction, which puts capital from the anchor investor at risk. We recommend a focus on reducing the project development timeline to more closely align with the private sector, streamlining the funding process so requirements are straightforward and incorporating co-creation throughout program design in order to better attract private capital.

Finally, a common concern from a wide range of stakeholders is that more risk capital is needed in order to crowd-in private capital. Donor funding is best used in catalytic ways and can help de-risk a transaction to bring in significant private dollars. Even DFI funding has high requirements/thresholds, which actually crowds out private investors. Donors can take on higher risks while still driving results and value.

CONCLUSIONS

Innovative finance mechanisms complement traditional international resource flows to mobilize additional resources for development and address specific market failures and institutional barriers. It has become an essential tool as the development community strives to maximize social and environmental impact. Although the private sector is an important partner, donor governments have a critical role to play to help address market failures and mobilize private resources to meet these global challenges. Both DFAT and DFID experiences have shown that very simple tools used in creative ways as part of a larger holistic program can be very effective in spurring broader innovative finance structures to mobilize capital for development.

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UPDATE: FOREIGN, COMMONWEALTH & DEVELOPMENT OFFICE (FCDO) UTILIZATION OF PAYMENT-BY-RESULTS APPROACHES

INTRODUCTION

Over the past decade, the British Government has made increased use of pay-for-results (hereafter referred to as “payment-by-results” in accordance with DFID nomenclature) approaches to deliver public services through contractors. The principle is that a payment will be made in exchange for a specified output delivered to the satisfaction of the client. As far back as 2011, the British Cabinet Office explained the relevance of payment by results to relevant cabinet departments: “Open commissioning and payment by results are critical to open public services... Payment by results will build yet more accountability into the system, creating a direct financial incentive to focus on what works, but also encouraging providers to find better ways of delivering services.”¹ Further, The UK Independent Commission on Aid Impact (ICAI), which reports directly to Parliament, noted in 2018 that “For more complex interventions, however, it is not enough to focus on efficient delivery; DFID also needs to focus on whether it is doing the right things, and whether it is on track to achieve the intended results in the most cost-effective way.”²

DFID’s greater use of payment by results approaches were driven by several key goals and associated theories of change³, as shown in the table below. In doing so, DFID has taken an incrementally ambitious and sophisticated approach in applying a payment-by-results lens in determining outputs and establishing prices. Accordingly, this update to the “DFID and DFAT Procurement and Assistance Applications for USAID” white paper provides a summary overview of DFID’s procurement cycle when payment-by-results-approaches are applied.

Goal	Theory of Change
Accountability	Increasing visibility of results → <u>Increased assurance</u> to donors and beneficiaries
Incentives	Payment for results → <u>Aligning incentives</u> to increase effort of implementers to achieve results
Flexibility/Efficiency	Focusing on results → Allow space for adaptive use of inputs and processes to <u>efficiently</u> achieve results
Innovation	Targeting difficult-to-achieve results → Allow space for contractors to pilot, monitor and evaluate different <u>innovative approaches</u> , scale up successes and scale down failures

PROGRAM GOVERNANCE

DFID is a highly decentralized organization, with significant program management delegation to departments located in the UK and partner countries. This includes responsibility for the design of a “Business Case”, which uses strategic, technical, financial, and commercial analysis to explain to the

¹ National Audit Office: “Output-based Payment Schemes: Government’s Use of Payment by Results”: June 2015

² Independent Commission on Aid Impact: “DFID’s Approach to Value for Money in Programmes and Portfolio Management Vol2 : 2018

³ Department for International Development: “DFID’s Evaluation Framework for Payment by Results”: 2014

relevant government minister why supporting a program would be a sound use of British taxpayer funds. Day-to-day management may be issued to external implementers under contracts or grants.

Overall control rests with the senior responsible officer (SRO) from the program team, assisted by Procurement and Commercial Department (PCD) on matters of supply chain management. The SRO’s program team is responsible for delivery of outputs and outcomes, even if management is outsourced to external implementers. PCD ensures contracts comply with relevant laws and policies.

PCD staff lead tendering exercises, “owning” the tendering package, including instructions to bidders, terms and conditions of contract, and financial spreadsheets. The program team drafts the terms of reference (TORs) and leads identification of the payment-by-results formula, usually derived from the outcomes and “impact” of the project business case, which is DFID’s highest level program aim. PCD often proposes additional indicators related to program administration.

ESTABLISHING AND MANAGING PAYMENT-BY-RESULTS DELIVERABLES

In adopting payment-by-results, DFID moved away from its traditional contracting model whereby contractors submit monthly invoices in arrear for reimbursement, detailing inputs and fees earned by each individual named in the contract or agreement, and related costs. The invoice would be paid in exchange for a monthly progress report. Payment-by-results enables DFID to be more ambitious in its choice of deliverables and related fee structures. Effective payment-by-results regimes require a number of elements. First, deliverable objectives should be challenging but achievable. Second, outputs must be measurable. Third, markets must be willing to accept the contractual risks of payment-by-results. The table below sets out different types of payment-by-results outcome and output indicators that may feature in individual contracts, and how these should be evaluated.

Indicator source	Description and context	Evaluation method
Technical deliverables directly taken from objectives contained in the project Business Case log frame	Appropriate when delivery of the entire project is to be outsourced, and the outputs and outcomes are fully within the service provider’s control. Normally, a range of service providers will contribute to achievement of log frame objectives.	Evidence regularly submitted of progress towards delivery. DFID managers monitor on-the-ground, and through engagement with recipients. Premature claims of delivery may be rejected.
Technical deliverables derived from business case log frame objectives.	May include both log frame outputs and outcomes, but should be identified through consideration of: <ul style="list-style-type: none"> • what is reasonable to ask of a provider; • whether outcomes require actions by recipients, such that placing delivery risk with a contractor may limit market interest because such risks may in turn yield higher fees and/or longer delivery time. 	Evidence regularly submitted of progress towards delivery. Deliverables may be narrower and more specific, and evaluation may be straightforward for the DFID programme managers.

Indicator source	Description and context	Evaluation method
A range of key performance indicators related to quality of project management and customer relationships.	Increasingly common in DFID, due to greater value placed by smart management and communications as much as technical know-how. Examples: <ul style="list-style-type: none"> • Strong value for money performance in economy, efficiency, and effectiveness; • Active engagement with partners; • Team leadership; • Ability to respond to changing contexts 	PCD helps programme managers monitor and evaluate performance, notably on value for money and financial control issues. Deliverables may be subjective compared to project progress indicators, so DFID clarifies the documents and evidence required to support claims. Contractor’s reports may be insufficient.
Bidders are asked to propose deliverables	Less common; carries risk that the contractor offers “low hanging fruit”	Evidence regularly submitted of progress towards delivery. DFID managers monitor on-the-ground, and through engagement with recipients. Premature claims of delivery may be rejected.

EARLY MARKET ENGAGEMENT

DFID’s Early Market Engagement (EME) reform (a process or event by which DFID informs potential suppliers about opportunities and give them the opportunity to ask questions) is one mechanism to determine whether a TOR and overall contract purpose are suitable for payment-by-results, and also consider the readiness and appetite of the market. This involves meeting potential contractors to describe the project in detail and take questions. Sometimes this occurs before design is finished, to seek the market’s views on the advisability of the proposed method. A further EME is held once the Invitation to Tender (ITT) has been issued, enabling DFID to explain the role envisaged for contractors and the proposed payment-by-results approach, and get a sense of market interest.

Appraisal of how the market may respond is not simply a question of the number of potential tender responses. EME provides a sense of whether the size and complexity of the project is likely to stimulate single-contractor responses, or alternatives such as a consortia, including a main contractor and sub-contractors. This may have implications for the timing of deliverables and accompanying invoices. The trend is towards quarterly rather than monthly deliverables, partly for administrative convenience to DFID, but also because progress is easier to see over a longer period. But if delivery appears likely to feature a lengthy supply chain of developing country contractors, even if a main contractor is confident they can deliver, they may push back against quarterly invoicing if their sub-contractors may face cash flow problems.

WEIGHTING OF INDICATORS

There are large variations within DFID in the weight placed on the indicators, and complex scoring mechanisms may be applied to judge performance. The Independent Commission on Aid Impact sampled 44 DFID contracts for its “Value for Money Through Procurement” review. Thirty featured payment-by-

results in some form. The following two case studies illustrate how DFID contracts increasingly segment types of deliverables, assigning individual indicators and fee weighting to them:

The Rwanda Improving Early Childhood Development program requires the contractor to identify deliverables for the **inception phase**, a preparatory stage during which project administration is set up and relationships are formed with stakeholders around the outputs that must be achieved during the life of the project. Usually, 100 percent of inception fees are tied to delivery, achievement of which may include a feasible milestone for such outputs as hiring of support staff, opening of project office and bank accounts, purchase of equipment, and negotiation of partner agreements. The **implementation phase** is more complex – 25 percent of the fees are tied to delivery of log frame outputs (the log frame includes detail on the inputs and outputs necessary to achieve the intended results or project's purpose as well as project assumptions⁴), and 75 percent to quality milestones based on work plan activities. Meanwhile all expenses are automatically reimbursable at quarterly intervals. Although this ties all fees to delivery, the implementation phase represents most risk for the contractor, because it relates to actions and changes with the widest range of stakeholders in addition to the contractor. The contractor has more control over the inception phase through effective project management.

The Partnership for Learning for All in Nigeria program requires outputs that demonstrate efficiency, flexibility and adaptability, and accountability, requiring quality in project management performance from project inception to closure. Typical **inception phase** deliverables, assessed twice over six months, include the development of the delivery chain map, stakeholder engagement, and communications plans. 40 percent of fees are at risk. The **implementation phase** splits deliverables between contract management, outputs, and outcomes. As seen in the table below, every month, 10 percent of fee is linked to outputs or outcomes. The contractor is responsible for self-assessing performance for DIFD's consideration, with TORs providing examples of appropriate and inappropriate evidence. For example, payment would be triggered by "recruitment policy agreed by Nigerian Government and legislators and in use in at least two partner states", but "report of stakeholders' workshop on recruitment policy" would be insufficient evidence. The contractor should also be assured that changes may be made at quarterly intervals when changes in the operating or external environment justify adaptation and flexibility.

<i>Typical Indicators</i>		
Indicator type	Fee element tied to performance and payment point	Performance evaluation point
Contract management	5% quarterly	Quarterly
Progress towards outputs or outcomes	10% from months 1-6, payable in month 7	Twice a year at six monthly intervals
Outcomes	10% from months 7-12, payable in month 13	Annually

⁴ <https://www.usaid.gov/project-starter/program-cycle/project-design/logical-framework>

EVALUATION

Evaluation of performance is vested with the program team. Invoices claiming fees are submitted to PCD, but may be paid only with the program team’s formal confirmation that a satisfactory product has been verified. Third party evaluators may also be used, but their role is usually broader. They are often engaged for the life of the project, to conduct evaluation simultaneously with project progress. Their focus would include evidence of the contractor’s delivery and outputs throughout the entire project. Sometimes, they evaluate a suite of projects that stemmed from one business case.

Performance evaluation involve meetings that vary in formality at which the contractor has an opportunity to justify with evidence its claim that payment is due, but also independent assessment notably through contact with recipients and other third parties, and ideally some physical inspection. An example would be a redesigned health unit or a new school curriculum in action. Independent views should ideally be obtained in advance, so that DFID may challenge with knowledge if they wish to dispute claims that delivery has been affected. The program team may inform the contractor of acceptance, but normally only advises PCD that payment may be made.

The table below illustrates the range of questions that DFID evaluators may ask to determine acceptable delivery. DFID’s Evaluation Framework for Payment by Results⁵ notes that DFID does not expect any one evaluation to answer all evaluation questions. Each payment-by-results initiative will need to first identify the purpose of the evaluation, the theory of change for the selected Payment by Results instruments, and then identify the evaluation questions which can and should be answered.

Expectations	Evaluation Question(s)
<i>Interventions uphold DFID policy and produce intended outcomes</i>	To what extent and for whom did the intervention achieve intended outcomes? Are the outcomes indicators still relevant? Were there any unintended negative outcomes to beneficiaries – for example to marginalised or harder-to-reach groups? Did it uphold policy (for instance gender, environment)?
<i>Payment-by-results mechanism alter incentives of suppliers and/or recipients</i>	Did payment-by-results incentives impact (positively or negatively) on behaviour of the supplier? Did incentives have the anticipated effect on processes, outputs or outcomes? If not, was this due to insufficient incentive, inappropriate design, or factors out-with the control of DFID, the supplier or recipient? Were there unanticipated (positive or negative) effects or consequences of the instruments on the implementer, and/or on the beneficiary? Was there evidence of distortion and/or gaming?
<i>Improved economy, efficiency or effectiveness of delivery</i>	Did the payment-by-results mechanism allow the supplier to achieve economies (lower cost procurement of inputs) beyond what were expected? Did the payment-by-results mechanism lead to improvements in efficiency – in converting inputs to outputs? Was there scope to capture the benefits of any efficiency improvements in the pricing mechanism? How do the unit costs per output for the supplier compare to alternative procurement mechanisms delivering similar outputs?

⁵ Department for International Development: “DFID’s Evaluation Framework for Payment by Results”: 2014

Expectations	Evaluation Question(s)
	<p>Did the payment-by-results mechanism lead to improvements in effectiveness – in converting outputs to outcomes?</p> <p>Did the payment-by-results mechanism lead to greater costs to the donor, supplier or partner government, or beneficiary?</p> <p>Could these additional costs be reduced, without eroding benefits, in future interventions?</p> <p>Were additional costs justified by additional benefits, relative to alternative modalities?</p>
<i>Increased flexibility in delivery</i>	<p>Did the payment-by-results mechanism allow the supplier or recipient government more (or less) flexibility to undertake adaptive programme management?</p> <p>Did flexibility in the use of inputs and processes lead to more effective delivery of outputs or outcomes?</p> <p>Was there scope to capture the benefits of innovation in the pricing mechanism, e.g. through gain-share arrangements?</p>
<i>Increased innovation in delivery</i>	<p>Did the payment-by-results mechanism increase (or decrease) the ability of suppliers or partner governments to pilot, monitor and evaluate different innovative approaches, scale up successes and scale down failures?</p> <p>Were innovations successful? Are innovations replicable in future programming?</p>
<i>Increased transparency and accountability</i>	<p>Was there a shift in focus to results and away from inputs?</p> <p>Has the payment-by-results mechanism improved beneficiary feedback, ownership and advocacy?</p> <p>Has the payment-by-results mechanism strengthened the accountability of suppliers and recipient governments to donors?</p>
<i>DFID and partners have sufficient capacity and time</i>	<p>Did DFID focus on results instead of inputs, and if so on which type of results (processes, output, outcomes)?</p> <p>How did the effort required to design and implement the intervention compare with other aid instruments?</p> <p>What was the additional burden or benefit for DFID and for the supplier in contract design, and are there varying effects of payment-by-results contracting on different types of implementing organisations?</p> <p>Where there is competitive bidding for payment-by-results contracts, has there been a diverse range of bidders competing?</p>
<i>Stakeholders have the capacity and resources to cooperate in ways which maximises their comparative advantage</i>	<p>How did stakeholders respond to paying for results? To what extent did the decision to use payment-by-results affect the market of suppliers? What roles do stakeholders play in the intervention?</p> <p>To what extent did these roles make maximum use of their comparative advantages?</p>
<i>Sustainability</i>	<p>How sustainable are the outputs, outcomes and impacts delivered by the programme?</p> <p>How did the sustainability of processes, outputs and outcomes produced compare with other aid instruments?</p>