



Special Purpose Vehicles as a Development Mechanism

What it takes to get it right

Development In Practice

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International Development Advisory Services (IDAS)

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Special Purpose Vehicles as a development mechanism



What it takes to get it right

Abstract

This paper takes a critical look at Special Purpose Vehicles (SPVs), from the perspective of the development community using such vehicles as one modality through which aid programmes can be delivered. Over the past few years, Development Partners(DP)¹ have made increasing use of SPVs and it is time to review that experience in terms of what has worked well and what has been problematic and challenging. KPMG International Development Advisory Service (IDAS) has been at the frontline in the design and implementation of a number of the most significant SPVs, particularly in Africa, from which millions of poorer households have benefited. This paper focuses on what must be done right if an SPV is to achieve its stated aims and objectives.

This paper looks at why there has been increasing interest in SPVs, their alternative legal forms and domiciles, the various roles “owners” (usually DPs) can and should play, and the possible governance and management arrangements they can adopt.

In recognition of the fact that SPVs will be increasingly important as current efforts to blend soft (DP) and commercial finance become more frequent, we highlight what needs to be done right for them to work effectively, and share the lessons we've learned to inform those wishing to set up similar development mechanisms.

Introduction

Over the past few years, DPs have been making increasing use of SPVs, to achieve particular development outcomes and impact. We define SPVs in this context as “not-for-profit” legal entities, into which DPs can place often large amounts of money to implement programmes and projects.

While such mechanisms were a rarity in the nineties, they have become increasingly popular, and we now see many types of SPV with various legal, ownership, governance and management structures – some of which would appear to have worked better than others.



This is one of a series of short pieces from KPMG IDAS Advisors, based on our extensive experience. The series is edited by Julio Garrido-Mirapeix, Head of IDAS Africa and Twebese Mugisha, Communications Director. This paper was written by Hugh Scott - Director, IDAS.

¹ The term development partners here refers broadly to any entity that is financing development activities such as international multilateral and bilateral donors, private and corporate foundations, social and impact investors, philanthropists and many others.

Why the increasing interest in and use of SPVs as a modality for implementation of development programmes and projects?

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Credit: iStock

Before looking at the pros and cons of various ownership, governance and management structures for SPVs, it is worth reminding ourselves why SPVs have become so popular with DPs and philanthropists in recent years.

Before the mid-nineties the only SPVs on the scene were the Development Finance Institutions such as CDC, DEG, IFC and the like, and subsidiaries set up by these institutions such as Development Finance Company of Uganda (DFCU), Housing Finance Company of Kenya (HFCK) and many others. After 1995, we started to see some DPs – particularly DFID – supporting the creation of the ⁱⁱⁱ[Private Infrastructure Development Group \(PIDG\)](#) group of institutions legally domiciled in Mauritius; setting up institutions such as the ^{iv}[Financial Sector Deepening Trust in Kenya](#) in 2005; establishing the ^v[FinMark](#) Trust in South Africa in 2003 (a programme of the Banking Council of South Africa – now the Bankers Association of SA); creating the Investment Climate Facility for Africa (ICF) registered in Tanzania in 2006 (with corporate as well as DP finance) and, TradeMark East Africa (TMEA), designed and set up in 2010/11 and based in Nairobi.

The key aspects of such SPVs, that has led to their popularity, are the ease with which joint/multiparty funding can be handled, longevity, embeddedness and legitimacy, absorptive capacity, value for money, flexibility and other valuable characteristics. The joint/multiparty funding advantage was perhaps the driver of SPVs as, historically, DPs found it difficult to co-fund projects and to fund projects with different partners. SPVs make this task easier, with all parties able to fund the same registered not-for-profit entity – and to do this without a tender process – with associated timing and cost advantages. The second key advantage, is that a well-structured, governed, staffed and positioned SPV can play a medium to longer term more influential role than time limited development projects are able to do.

Empirical and anecdotal evidence suggests that SPVs have served the development community and beneficiaries well. With further adjustments in design to make them even more fit for purpose, the future for SPVs in the development business looks fairly secure, with new SPVs such as ^{vi}[AgDevCo](#) and ^{vii}[AECF](#) being set up more recently.

ⁱ <http://www.agdevco.com/> ⁱⁱ <https://www.aecfafrica.org/> ⁱⁱⁱ <http://www.pidg.org/> ^{iv} <http://fsdkenya.org/> ^v <http://www.finmark.org.za>



Alternative legal entities and domiciles

The simplest issue is one of alternative legal entities. Many thousands of dollars have been spent by the DP community on consultancies seeking legal advice on whether the SPV should be a Trust or a Company Limited by Guarantee (CLG).

Our experience suggests that one may be marginally better than the other in one country rather than another, perhaps more so with regard to the legal and regulatory environment for Trusts, which tends to vary more than for CLGs. But in reality, the choice of legal structure is not a major issue or problem. Lawyers can advise without a significant investment of time (and fees) which legal vehicle to use in their country.

The choice of domicile can be a bit more involving. These days the choice of domicile is more likely to be affected by reputational risk than anything else, more so since the Panama Papers and the negative view by the general public, of offshore financial centres as

"unacceptable tax havens for the rich". In terms of SPVs established for development purposes, this view has made it difficult to propose countries such as Mauritius as the domicile, despite the legal and regulatory regime there being particularly well developed in this regard. It is likely that more of the SPVs of tomorrow will be registered in the country of one of its funders e.g. Sweden or the United Kingdom, or the country where the entity will be based in terms of its operational headquarters. An example is the Investment Climate Facility for Africa (ICF), an Africa-wide facility registered as a not-for-profit Trust in Tanzania where its head office was located.

Lawyers can advise without a significant investment of time (and fees) which legal vehicle to use in their country.

Who are the owners and how can and should they play their ownership role?

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Private Sector Structures

VS

SPV Structures

Owners (Shareholders)

Governance

Management

Owners (Settlors, Founders)

Governance

Management

Donors

The challenges with regard to legal entity and domicile are relatively minor compared to issues of how the “owners” of an SPV should or should not influence its operations, and if they should, then how should this “influence” be structured and channelled. These are complex questions which frequently present challenges to successful implementation, but are seldom carefully considered in programme design.

The mantra for designing SPVs should be that their structure should, as far as possible, mirror the “for-profit” private sector. As such, owners should appoint the governance and governance should appoint management and management should appoint staff, which creates an uncomplicated and direct accountability structure. Traditional DP efforts to mirror this structure, even where they have tried hard to do so, have not been very successful. The fundamental problem lies with the “owners” (the DPs), who as civil servants, only represent the ultimate owners – the taxpayers – and frequently are not able to behave in the way that true owners would.

The reality is that in several SPVs, DP owners wish to influence and increasingly control what the SPV does, but cannot or do not wish to play a direct role on the Board of the SPV. In the private sector, the shareholders depending on how much of the shares they own or control, will decide who should be on the Board and ensure the Board is fully accountable to them. DPs may not be able to sit on a Board legally, and even if they are, frequently do not wish to. Be that as it may, there is a tendency to micro-manage without being part of the legal structure.

This has the potential to undermine the governance structure they have so carefully developed. DPs find it difficult, if not impossible, to act like true owners who typically meet with executive and non-executive directors just once per year at the company AGM. We would suggest that it is probably better to recognise that DPs will always wish to direct the SPV and thus the structure should be designed to accommodate this. Some suggestions are made below.

Alternative governance structures

Advantages and disadvantages

Assuming that the SPV is being created as a Trust or a CLG then the legal governance of the organisation will either be the Board of Trustees or the Board of Directors (of the CLG).

Normally, as stated above, we would expect Board members to be appointed by, and act on behalf of, the “owners” of the entity. Unless great care is taken this creates two centres of authority – the Board and the DPs – both of which believe they are responsible for deciding what the entity should be doing and how it should be doing it. This is a challenge, particularly when the DPs, following much work and complicated selection procedures, have chosen the great and the good to sit on the Board only for the Board members to find that they have little real ability to influence the organisation despite being given the legal mandate to do so. Not surprisingly, and in many cases, the DP believes it knows better than the Board --because it designed the facility – with the latter frequently believing the opposite – as they often have the local knowledge and networks. Our experience to date would suggest that except in special cases, the best option is probably not to select a Board made up of the great and good but to contract a well-respected law or accountancy firm to act as “legal trustees”. The advantage of this is that the legal Trustees will not engage in the management of the entity, but will ensure that all legal, regulatory, fiduciary and operational procedures will be followed to the letter, while leaving others to ensure that the SPV does its business. In reality, this is somewhat akin to having two boards – a legal board for legal and fiduciary purposes, and an operational board in the form of an advisory committee of DPs, whose roles is to approve the activities proposed by management. There are financial and practical issues to think about also. Boards made up of the great and good, particularly for multi-country SPVs, can be difficult and expensive to convene and manage.

The only time that a Board of the great and good is really essential, is where the SPV has a policy and advocacy mandate, and where the SPV is expected to be a legitimate player in the field and embedded in the institutional landscape of the country or region. The ICF was such an entity, with a strong and explicit advocacy role and a Board made up of high level, influential and political Africans and representatives from the local and international private sector. The ICF's co-chairs were a past African President and the Chairman of a large multinational. Similarly, TMEA has an important advocacy and influencing role to play across East Africa, and as such, it requires a Chairman and Board Members with high level networks to be successful. In addition, there may be cases where the great and the good have a major fund raising role, but this is rare.



Alternative management strategies

Pros and cons



There are many different approaches to the management of SPVs. The options are really on a continuum between carrying out all the management tasks in-house with their own staff, and contracting out the management of the SPV in its entirety.

The pros and cons of the various options are really ones of efficiency and effectiveness. Two particularly successful SPV's, as shown by the numerous impact reviews of their activities – TMEA and FSDT (K) – both fall into the former model, with all staff directly hired but with various activities outsourced where necessary.

The option where an SPV is managed by a third party is the most typical private sector approach to fund management. This might suggest that if the main purpose of an SPV is to be a "fund," then the most appropriate approach would be to have a Fund Company (the SPV) with a Board of Directors. The Board would employ a Fund Management Company to manage all the affairs of the Fund, who would report to the Board directly. The Fund Management Company can be hired by competitive tender, with regular external performance assessments to ensure satisfactory and timely delivery.

Perhaps more important than whether an SPV is managed in-house or management is out-sourced, is getting the right CEO and senior staff. The success of an SPV, much more so than most DP projects, seems to depend on getting the right team to run the show. The basic message is that people matter, and the quality of the CEO matters most.

The reality is that good leaders of development entities are passionate about what they do, but still expect to be paid well. SPVs need to pay competitive salaries if they are to attract the best and achieve the most⁵.

Alternative management strategies

01 Hiring

Staff can be directly hired but various activities outsourced as in the case of TMEA and FSDT (K).

02 People matter

Get the right CEO and staff.

03 Quality of CEO

People matter and quality of the CEO matters most.

04 Remuneration

Leaders of development are passionate about what they do but still expect to be paid well. SPVs need to pay competitive salaries if they are to attract the best and achieve the most.

⁵ However, the remuneration of both Board Members and SPVs' management has proven to be a thorny issue in practice.

Summary and conclusions

The three things that will need to be right for an SPV to work well



This note just touches the surface of an increasingly complex and interesting topic.

SPVs are particularly relevant at the moment, because we have many new actors in development finance that are looking for solutions that enable them to partner with others, to design and implement social and impact investment initiatives. The future is here and it is a blend of traditional donors, Foundations, social investors, angel investors, corporates and the like. The sum is more than its parts.

As more philanthropic money is made available for, in particular, private sector development, so will the need to have more SPVs that can effectively deliver the development outputs, outcomes, impact and value for money that DPs and recipients seek.

Our initial view is that the three things you need to get right for an SPV to work well are the governance structure, management strategy and leadership.

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