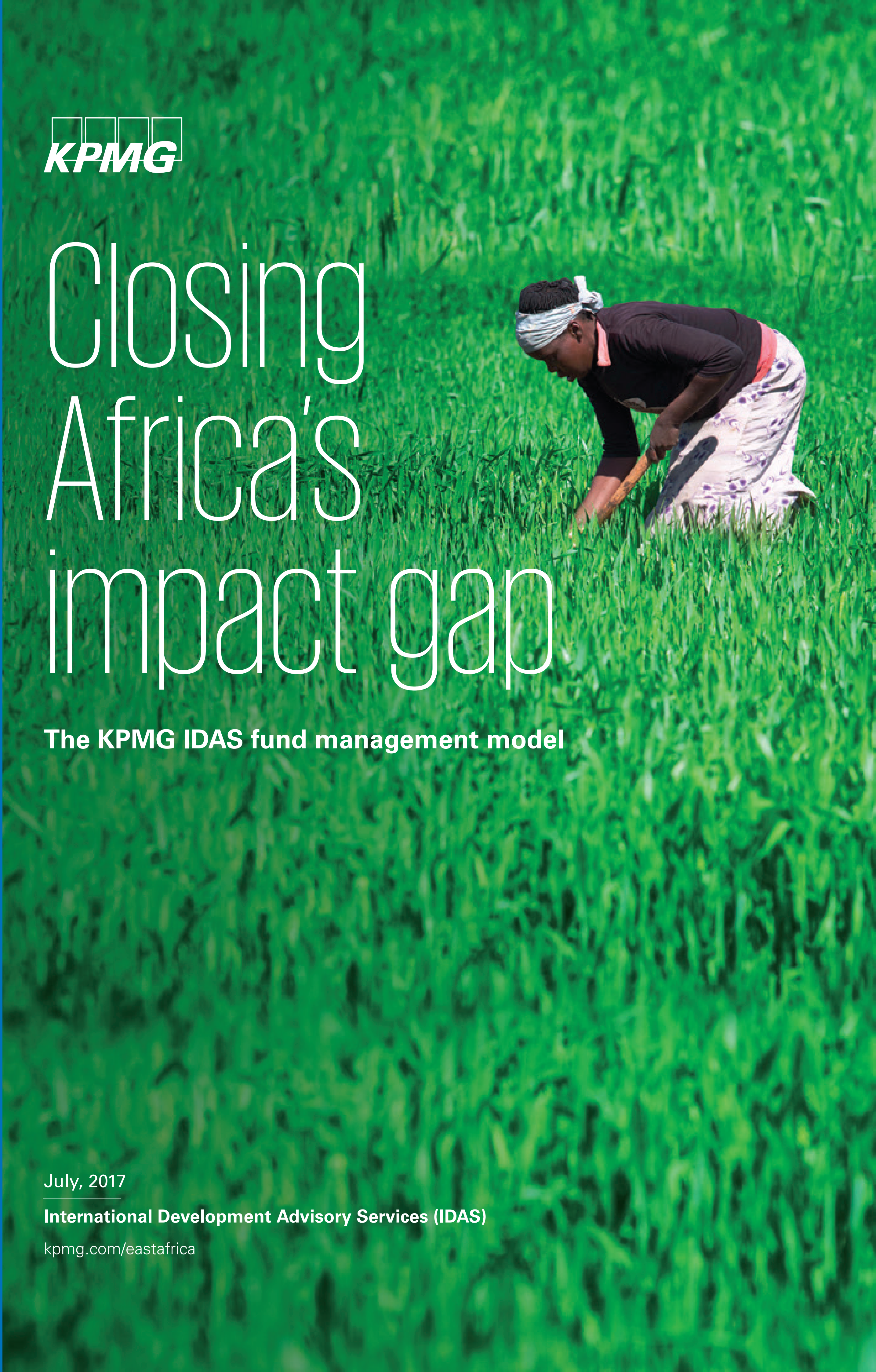


Closing Africa's impact gap

The KPMG IDAS fund management model

July, 2017

International Development Advisory Services (IDAS)

kpmg.com/eastafrica

Closing Africa's impact gap

KPMG's International Development Advisory Services (IDAS) Africa manages philanthropic funding for private sector-led development across Africa. Headquartered in Nairobi, Kenya, IDAS has managed hundreds of private sector grants in 30 African countries over the last decade.

Since the founding of our business in 2007, we have seen African development change fundamentally, driven by phenomenal private sector growth. Income poverty is falling. Aid and charity are being replaced by social investments, and by individuals and companies who believe that Doing Good is Good for Business.

On the flip side, Africa remains a difficult place to operate. Much private sector capital is being channelled toward achieving the Sustainable Development Goals. However, hundreds of millions of people remain persistently excluded from markets where investors can operate.

They have very low incomes and live in high risk environments, small markets or remote areas with low population densities and weak infrastructure where it is hard to create jobs or make money. Across the continent, entrenched social problems require a superhuman amount of creativity, tenacity and persistence to overcome.

Thus, in Africa a large impact gap remains: between areas of robust private sector-driven progress, and persistently marginalised communities. Can the private sector close this gap?

We think the answer is yes, if the right mix of companies can be found and given the right incentives. While every company and market is different, we have seen three important private sector pathways to achieve broad based and lasting impact: **Innovation, Reach,** and **Scale.**

What stands out is that no one pathway is enough to meet Africa's challenges. Innovation is important but also expensive and can be limited in its reach. Scale is essential, but not all entrepreneurs are capable of it. We need all three, and we need them in every country. This paper is about how we have designed a grant-based, private sector fund management model to support companies along and across each of these pathways to achieve a diverse range of impact goals.

- ***The model is capable of operating in almost any environment.***
- ***It fills the gaps where commercial and impact investors hit their limits.***
- ***It seeks to better match the needs of capital owners to the demand from local business.***
- ***And above all, it puts people first.***

This is how we make it happen.

Closing the impact gap

Our Experience

Over the last decade IDAS has managed roughly US$1bn disbursed to over 400 grantees on behalf of donors and philanthropists. We have worked with hundreds of companies piloting solutions to problems across Africa and Asia. These grantees have benefitted nearly 70 million people. Programs and funds that we have managed have transformed the lives of smallholder farmers, supported the development of revolutionary technologies, improved access to essential health services, pushed modern financial services into remote rural areas, given citizens a voice through better governance, brought government and civil society together to adapt to climate change, and made families more resilient to climate shocks.

Our work has focused on using catalytic grant capital to leverage broad resources and achieve systemic change. In renewable energy, for example, US$ 7m in grant funding to innovative start-ups through one of the programs we managed leveraged US$ 66m in private sector investment and helped create a new industry that will have a sustainable impact for decades to come.

US$ 1bn

FUNDS MANAGED BY KPMG IDAS OVER THE LAST DECADE.

OVER **400 GRANTEES** RECEIVED THE DISBURSED FUNDS BY IDAS ON BEHALF OF THE DONORS AND PHILANTHROPISTS.

NEARLY **70 MILLION** PEOPLE BENEFITTED FROM THE GRANTEES.

IMPACTS OF THE PROGRAMMES & FUNDS

Agriculture
Transformed the lives of smallholder farmers.

Technologies
Supported the development of revolutionary technologies.

Health
Improved access to essential health services.

Financial Services
Pushed modern financial services into remote rural areas.

Governance
Given citizens a voice through better governance.

Resilience
Brought government and civil society together to adapt to climate change, and made families more resilient to climate shocks.

1.0 Innovators, Reachers and Scalers

For the private sector to contribute to closing Africa's impact gap we need to find and work with companies capable of innovation, reach and scale

1.1 Innovators

There is no shortage of enthusiasm today for innovation in Africa. From pay-as-you-go solar energy to mobile health care solutions, innovation is a powerful force to improve lives. What is not always mentioned is that innovation is also expensive. Failure rates are high and gross margins often slim. Start-ups require support far beyond finance. Uptake of technology by risk-averse low-income consumers is slow. And many problems extend beyond the reach of the tech sector. There are several ways to overcome these challenges, as shown in the table. Looking beyond start-ups to work with established businesses via pilot grants is one good way to reduce innovation costs by leveraging existing networks, capital and human resources.

What can they achieve?	Market gaps: what do they need?
■ Develop solutions to persistent problems ■ Change the way business is done to be more inclusive or to provide better products and services to the poor ■ Design new business models and practices, products, processes, and technologies ■ Leverage technology to bring costs down and open up low income markets	■ Grants to cover high up-front development costs and market building ■ Capital with a high tolerance for failure and the appetite to look beyond transactions and measure value at a market systems level ■ Capital that can endure long timelines to profit ■ Business development services and fundraising support

Credit: The MasterCard Foundation Fund for Rural Prosperity

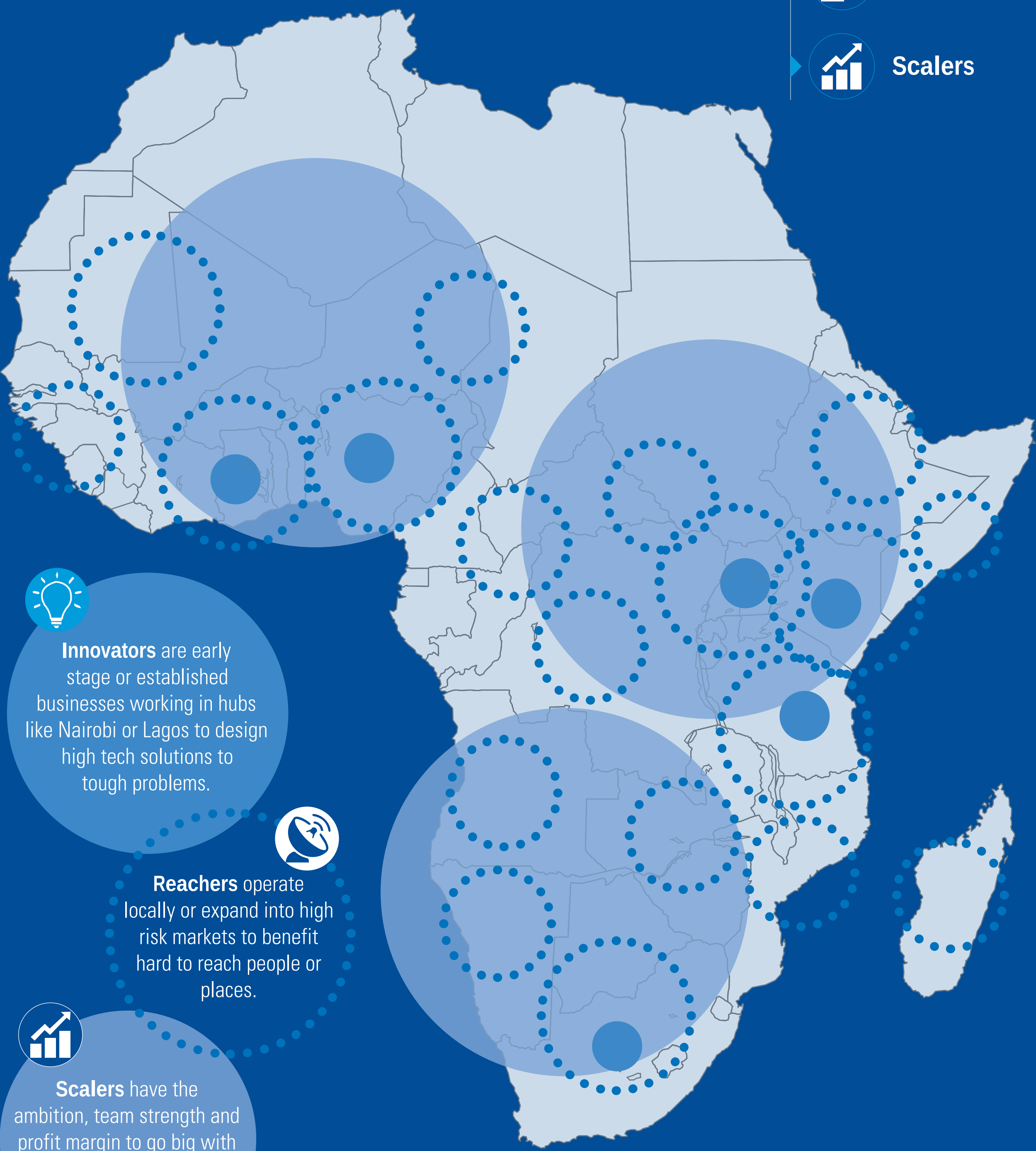
Going **100%** digital dramatically reduces costs

CASE STUDY: Digital finance for smallholder farmers

One company that we manage has developed an entirely cashless, paperless micro-finance platform. Going 100% digital dramatically reduces costs, enabling the company to extend loans to remote smallholder farmers. Technology development has been costly and time consuming, alongside high staff costs related to marketing and education for uptake of digital services by smallholders. Covering these costs with initial grant capital has helped to make the business model viable.

For the private sector to contribute to closing Africa's impact gap we need to find and work with companies capable of innovation, reach and scale.

- **Innovators**
- **Reachers**
- **Scalers**



Innovators are early stage or established businesses working in hubs like Nairobi or Lagos to design high tech solutions to tough problems.

Reachers operate locally or expand into high risk markets to benefit hard to reach people or places.

Scalers have the ambition, team strength and profit margin to go big with solutions that can operate across an entire region.

Graphic A : Innovators, Reachers, Scalers / Source: KPMG Closing Africa's Impact Gap

1.2 Reachers

Recent studies found that roughly 90% of impact investment capital deployed across sub-Saharan Africa has gone to just eight countries: Kenya, Tanzania, Uganda, Nigeria, Ghana, South Africa, Angola and Zambia [1]. Investments have also been concentrated in urban and peri-urban segments within those states.

The space leftover – dozens of countries and remote communities – constitutes much of the impact gap highlighted in this paper. Reach can be achieved in several ways: innovation can reduce the cost of services in remote communities. But low profit margins and high risk prevent innovative reachers from closing this gap alone.

We also need to work with local companies in high risk markets who have existing networks, understand how to operate, and may just need help formalizing, strengthening or expanding their businesses.

What can they achieve?	Market gaps: what do they need?
■ Innovative reachers can use mobile tech to reduce costs and serve remote communities	■ Innovative reachers need grants to pay for high up-front design costs and market building in remote areas
■ Local companies can operate in high risk areas, creating jobs and improving services	■ Local companies with no access to finance need risk tolerant early stage and growth capital, along with strong business development services
■ Regional companies can expand into underserved markets	■ Companies expanding into challenging, underserved regions need grants to cover market entry costs, along with local insight and network support
■ Non-profit networks can help businesses enter remote areas	■ Programs to encourage diaspora investment at home

Local distillation increased the profit margin by a factor of

50

CASE STUDY: reaching remote farmers in Somaliland

One grantee company under one of the funds we managed works in Somaliland, exporting high quality grades of raw gums and resins extracted by collectors in rural communities from trees in very remote areas. Once distilled, the oil is used around the world as a base scent for many perfumes, cosmetics and shampoos. With grant support, the company set up a factory for local distillation. Rather than exporting raw materials to be processed abroad, local distillation has increased the product's local profit margin by 50 times.

The capacity of the distilling has also meant that the company can start buying other types of gums and resins providing additional income opportunities in rural communities. The price of some of the gums has more than tripled since the project started. The project developed a profitable value chain from an unstructured traditional market that has employed remote communities of farmers for generations.

[1] Defined as impact investment not coming from development finance institutions. Reference: "The Landscape for Impact Investing in Southern Africa," The Global Impact Investing Network, with Open Capital Advisors. (February 2016); "The Landscape for Impact Investing in West Africa," GIIN, with OCA (December 2015); "The Landscape for Impact Investing in East Africa," GIIN, with Dalberg (July 2015).

KPMG

Credit: Kate Holt/KPMG IDAS

Innovation can be replicated by many small businesses to achieve industry scale, or be rolled out within the existing structure of a large corporate.

1.3 Scalers

Scale is required to meet the scale of the challenge and achieve lasting systemic change. But not many companies have the ambition, management team strength and profit margin to achieve it. It is therefore important to separate scaling of the model, product or industry from the individual business. Innovation can be replicated by many small businesses to achieve industry scale, or be rolled out within the existing structure of a large corporate.

The search for scale can also overlook the depth of impact. From an impact perspective, sectors that lend to scale, such as financial services or off-grid energy, tend to provide less benefit per person compared to less scalable projects in areas like agribusiness.

What can they achieve?	Market gaps: what do they need?
■ Systemic change ■ Broad impact ■ Strong leverage of private sector resources	■ Grant capital to leverage in debt or equity by reducing risk and improving deal viability ■ Support to formalize, establish strong corporate governance standards, and improve business models and growth strategies to attract investors

CASE STUDY: Off-grid energy

Not since the mobile phone has an impact solution gained as much attention across Africa as off-grid energy. Leading the way are the pay-as-you-go solar companies that have brought energy access to millions of people and raised hundreds of millions of dollars to fund their expansion.

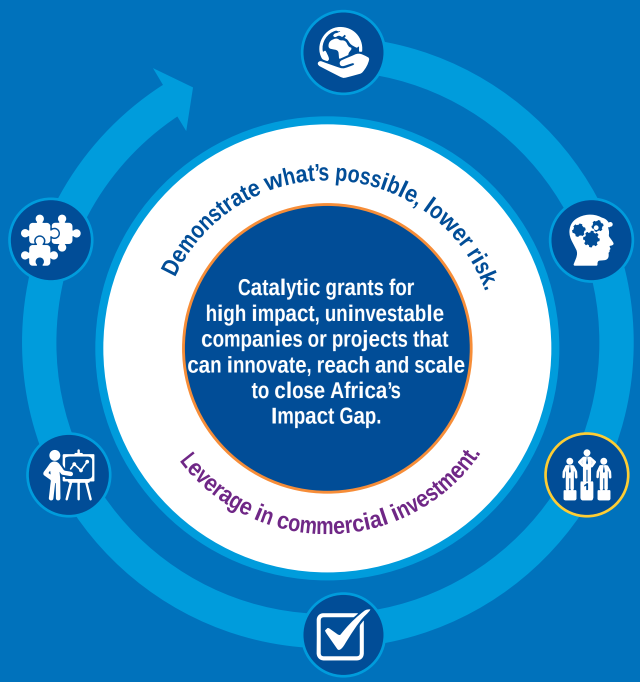
Through managing dozens of pilot grants in this space, we have observed some key lessons: rapid growth has enabled regional expansion of leading companies, but local knowledge and networks held by small players is also essential to reach underserved markets.

Much more cost reduction also needs to happen before truly remote, very low income people will benefit. Scale is happening at the industry level, supported by a critical mass of funding, technical assistance, research, standard setting, consumer education and policy advocacy. Despite their success, many companies continue to operate pre-profit for many years due to high costs, relying on grants and soft capital.

And finally, depth of household impact depends largely on a long-term sequence of moving up the energy ladder, and the productive use of energy at the community and enterprise levels.

2.0 Making it happen

The IDAS fund management model



Impact
Know what you want to achieve, and understand what you have achieved.

Think
Design the ideas portfolio and financing structure according to your goals and lessons learned.

Compete
Find the right companies, reach far and wide.

Check
Manage risk, be rigorous.

Manage
Disburse funds and track progress with a rigorous yet iterative and tailored approach.

Connect
Help companies raise follow-on finance for scale.

There are many different ways to leverage the power of the private sector for social impact – from impact investment and blended finance to making markets work for the poor.

The KPMG IDAS fund management model is distinct in several ways; it:

- uses catalytic high risk grants to fill gaps in the market, working with "uninvestable" high impact companies or projects to push market boundaries and ensure additionality
- takes a coherent approach to development, focused on communities and systems rather than single transactions
- prizes innovation as a way to overcome stubborn social problems
- is localized and able to work with a variety of businesses and in any market or industry
- puts the needs of people ahead of the needs of individual companies or investors by prioritizing long-term impact goals at the market systems level
- thinks ahead looking at potential growth paths and appropriate finance beyond grants
- helps companies connect to other finance sources
- adopts a rigorous mentoring approach to grant investment regardless of company size or geography, which is critical to facilitate consolidation and growth

We do all this by following the cycle shown above: always beginning with what we have learnt across programmes and funds regarding impact, and then on the basis of the specific issues to tackle designing funds and supporting companies with what it takes to get there. This section of the paper describes our process, including lessons from implementing across the continent.

2.1 The end game: THINK and IMPACT

We design funds beginning with a clear understanding of impact goals, and working backwards from there, relying on what we have learned from past engagements and the market.

For example:

What kind of finance do those companies need?	Which companies can achieve the impact you want?	Who do you want to impact and how?
■ Companies in markets with few active investors may need larger and/or longer term grants ■ Growth companies with strong models in good markets can use early stage grants to quickly leverage commercial investment ■ Established companies can expand their reach with payment by results incentives	■ Financial services reach millions with marginal benefits. ■ Outgrower schemes change lives but are hard to scale in the near term. ■ Start-ups are nimble and innovative but can fizzle out ■ Established companies are risk averse but can leverage big resources.	■ **Breadth:** benefit a handful of people, or millions ■ **Depth:** marginal improvement or life changing ■ **Duration:** immediate change, or a long play, short lived or long lasting ■ **Difficulty:** benefit the poor, or very poor, in urban or remote places

Alongside designing for impact, we structure grant funds to leverage maximum private sector investment in several ways:

- Co-investment: grant funds can surface deals, decrease risk, improve balance sheets, strengthen corporate governance, and signal confidence to the market, helping companies to simultaneously bring on debt or equity
- Follow-on investment: grant funds can prepare companies for investment to come afterward
- Blended finance: grants can be structured alongside debt or equity at the fund level to reduce risk, improve returns to investors, or coordinate diverse types of capital to meet company needs

Our **IMPACT** Unit measures project and portfolio impact, documenting project results and lessons learnt. IMPACT ensures our clients understand their investment. Critically, knowledge built here informs how we design new funds for maximum impact [2].

Our **THINK** team works with our clients to design innovative delivery concepts ensuring that the selected approach is best suited to meet intended development objectives.

THINK builds on the lessons learnt through IMPACT and from the market.

[2] In addition to our own impact measurement, our portfolio has been regularly subject to external evaluations which are in many cases public documents.

2.2 Finding the right companies: COMPETE

Market competitions to solve problems → Thousands compete: start-ups, SMEs, corporates → Winners emerge → Businesses replicate their success → Industries grow, markets strengthen → Investors pick the best and invest


Credit: The Mastercard Foundation Fund for Rural Prosperity

Our **COMPETE** unit manages competitions, undertakes marketing and communication for the funds, manages calls for proposal and the project selection process.

Rather than source deals through crowded known networks, we market grant competitions to solicit responses from a broad range of companies capable of solving specific social problems. Over the last decade, our team has reviewed over 10,000 applications looking for those with potential for impact.

We look for projects not served by existing or traditional finance (often including impact investment) to ensure the grant capital is additional. Our selection process focuses on coherent impact goals, broad industry and economic development, community benefit, and long-term systemic change. To achieve this, our competitions start races rather than picking winners. Starting races crowds in many companies to promote competition and industry development [3].

Systemic change

One of the most important things we look for is a company's potential to change the status quo. Systemic change can be promoted in a number of ways:

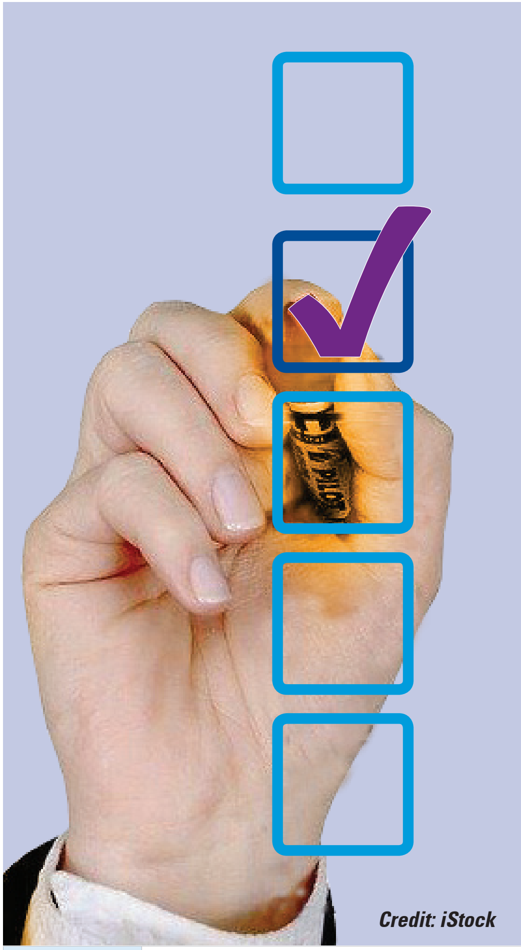
- Policy change can be facilitated by a business or group of businesses lobbying to overcome legal or regulatory constraints to their models
- Innovative companies with strong commercial potential can change the system at scale
- Funding service providers can have a multiplier effect through broad B2B networks
- Supporting clusters of industry competitors and open platforms encourages replication and crowding in.

[3] IDAS has written extensively about Challenge Funds, please visit http://www.kpmg.com/das

2.3 Money out the door: CHECK and MANAGE

Our grant management model is designed to support companies in even the riskiest environments, while assuring our clients their money is safe and well spent. We do this in several ways:

- Rigorous risk management that identifies and addresses capacity gaps and prevents fraud to create a safe space for companies to innovate and learn from failure.
- Working with networks of service providers across Africa to help companies improve operations
- Tailoring risk management requirements to market realities through a phased and relationship driven approach that prioritises understanding over box ticking
- Deriving value for clients by learning from failure, and identifying failure early on through a phased funding and reallocation approach
- Mentoring companies to support strategy, corporate governance and follow-on finance



Credit: iStock

Through KPMG established and refined assessment tools, our **CHECK** team evaluates recipient organizations' systemic capabilities, challenges and fiduciary risks to ensure appropriate organizational and risk mitigation.

As Fund Managers, our **MANAGE** team contracts grantees, and manages grantee projects for timely and quality delivery, good financial management, monitoring, evaluation and reporting.

Managing grants in high risk markets

In high risk markets such as post-conflict states, grants can help to "formalize the formal sector", but must also be managed with appropriate flexibility. More flexibility is often required at the start of the grant.

We might link formal requirements to a second rather than first disbursement, or scrap requirements that don't make sense to avoid box ticking. While the standard question may be, "does this grantee have a best practice procurement policy in place?", the more appropriate question in a high risk market may be, "who is even willing to sell to this grantee, and what can we do about that?"

Leveraging Technology for Grant Management

KPMG IDAS grant management operations are run on various tailored technology platforms that drive efficiency, facilitate collaboration, and improve monitoring across all stages of the application and grant management cycle.

The platforms streamline the application and reporting process for our grantees, giving them more time to focus on implementation. The platforms allows us to track progress, facilitate timely disbursement schedules, and analyse trends based on reliable data across the portfolio to inform real time strategic decision making by our portfolio and programme managers.

2.4 Get together to scale up: CONNECT

Our CONNECT unit helps companies ready for fundraising to identify the right investors, know how to pitch them and negotiate a good deal. Connect works closely with KPMG's Deal Advisory Unit, profiting from the world class expertise of the firm. Learning how to raise funds is one thing. Getting a business to the point that it can attract investors is another. We intentionally give grants for projects that would be otherwise uninvestable. The hope is that the grant will cover high costs and demonstrate success to the point that other investors are willing to come in.

A few lessons along the way:

- Timelines to profit vary by industry but are almost always longer than expected – anywhere from five to 10 years based on our portfolio experience. We need better performance data to embrace this reality and engage patient capital [4] .
- Companies that don't attract investors can still have a sustainable impact, and are often the only way to achieve private sector driven progress in hard to reach markets.

Where investors still won't go

Even with time and grant support, many high impact companies do not appeal to investors for a number of reasons, listed below. Often, these are the grantees capable of reaching into markets where investors won't go.

Some may ultimately close down without access to commercial finance. But many others continue to operate long after grant support ends, making enough money to sustain their operations and continue to have an impact on local communities.

- **new markets**
- **small company or market size**
- **low margins**
- **long working capital cycles**
- **very long project development cycles and payback periods**
- **insufficient returns on capital**
- **operations in high risk and post-conflict states**

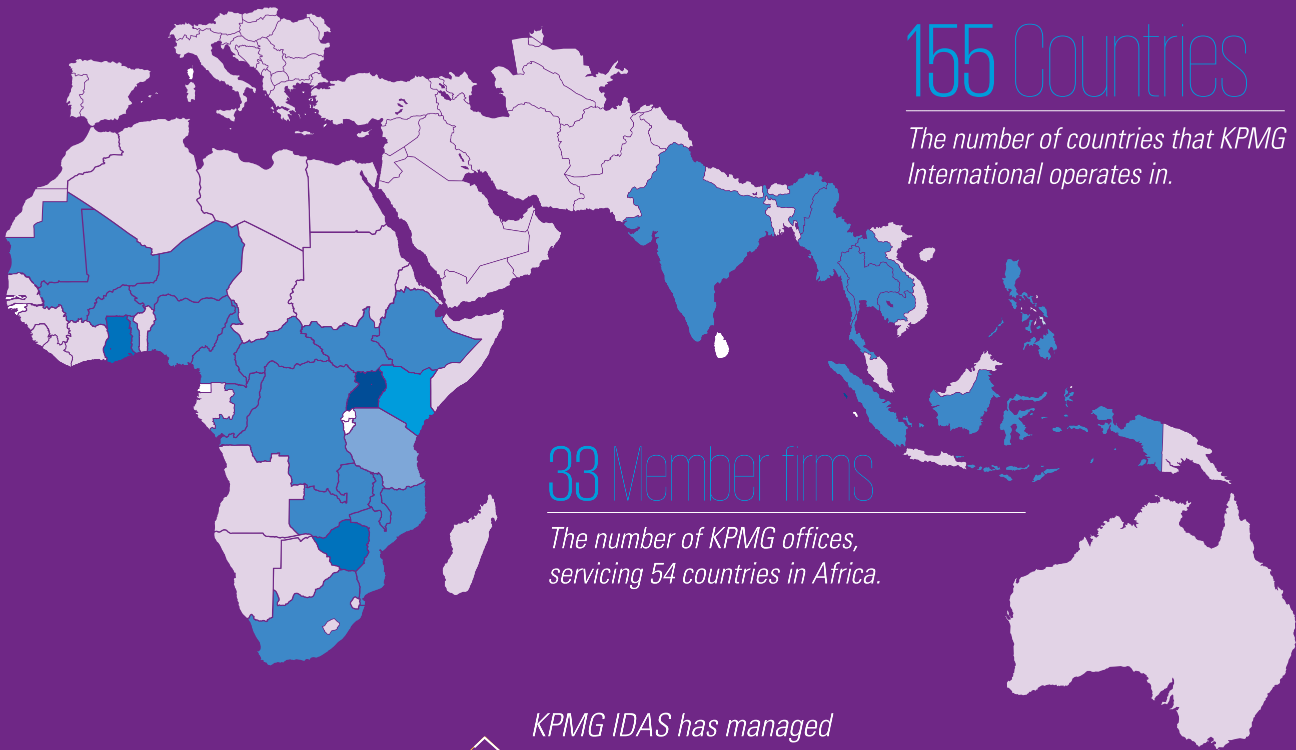
Our **CONNECT** unit helps our grantees to raise capital from investors and lenders enabling them extend impact by leveraging funding from private investors.

Credit: iStock

[4] For a broad ranging analysis of portfolio performance please refer to "Impact Investing in Africa: Performance Insights from the KPMG IDAS Portfolio". https://home.kpmg.com/content/dam/kpmg/ke/pdf/idas/thought-leaderships/kpmg-impact-investing-april.pdf

2.5 Work anywhere

KPMG's IDAS works cohesively across geographies in Africa and beyond, through the network of KPMG offices and local teams on the ground



155 Countries

The number of countries that KPMG International operates in.

33 Member firms

The number of KPMG offices, servicing 54 countries in Africa.

Grantees & Offices Distribution

- Grantees IDAS has managed
- IDAS Africa Headquarters
- IDAS Africa (Southern Africa Hub Office)
- IDAS Africa (West Africa Hub Office)
- IDAS Africa (Uganda Office)
- IDAS Africa (Tanzania Office)

KPMG IDAS has managed

Over 425 *Grantees* *in* 45 *Countries in Africa & Asia*

KPMG

Join us!

If closing Africa's impact gap is important to you, work with us. No one entity alone has the magic solution; rather it is by working together that we will find the right paths. To maximise impact we need technology and innovation, to leap frog development stages as quickly as possible, since Africa is catching up with other regions.

We need philanthropists willing to push into frontiers where investors still can't go. We need more organisations partnering and blending finance with different characteristics together, we need more Special Purpose Vehicles, we need new business models. We need to be bolder.

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