

Catalytic Capital Training Module 2: “Inform”

Content sponsored by the Catalytic
Capital Consortium



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Who we are

We are a global community of high net-worth individuals, family offices and foundations from more than 25 countries who are active impact investors.

We curate a global community, enable peer-sharing, provide educational resources, and offer investment opportunities for our members, who use Toniic to amplify their impact.

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Catalytic Capital Series

01

Inspire

What is catalytic capital and why you should consider it in your portfolio

02

Inform

How to deploy catalytic capital, roles, uses, and case studies

03

Implement

How to set your portfolio up for catalytic capital, structure, analytical questions, and implementation

Overview

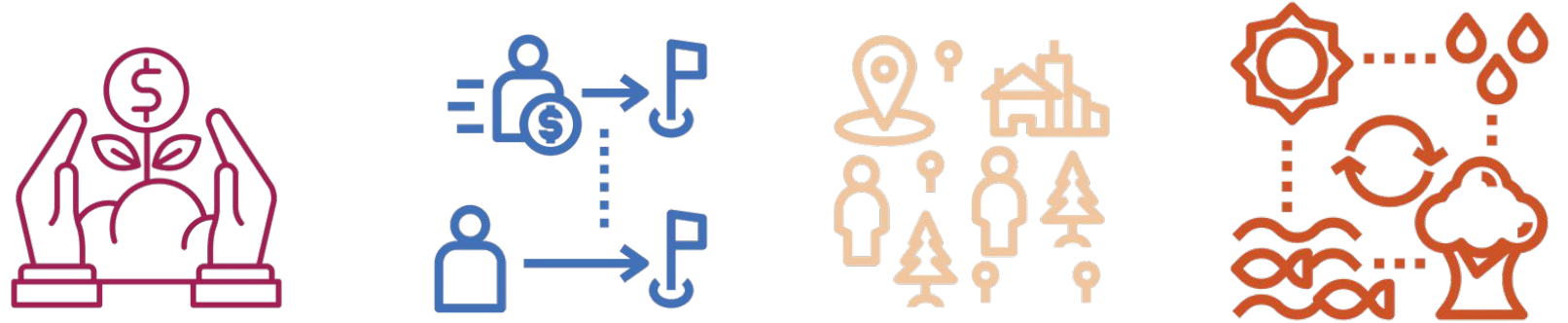
- 1 Defining Catalytic Capital
- 2 Forms of Catalytic Capital
- 3 Roles and Stages of Catalytic Capital
- 4 Challenges of the Seeding Stage of Catalytic Capital
- 5 Conclusion

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Lesson 1: Defining Catalytic Capital

Catalytic Capital

Catalytic capital is a subset of impact investing that enables impact that market rate capital cannot achieve, due to capital gaps



<https://www.macfound.org/press/article/catalytic-capital-work>

Defined as debt, equity, guarantees, and other investments that **accept disproportionate risk** *and/or* **concessionary returns relative to a conventional investment** in order to generate **positive impact** and enable third-party investment that **otherwise would not be possible**

Risks and Returns



Disproportionate risk

- Difficult markets or solutions
- Extending your timeline and duration
- Flexible deal structures and terms
- Lack of track-record and benchmarks

AND / OR



Concessionary returns

- Below market return expectations on equity
- Sub-commercial rates of return on debt investments

Investor Contribution

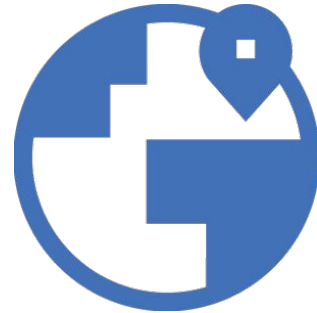


Generate positive impact and enable third-party investment that otherwise would not be possible

Catalytic Capital Gaps



Population



Place



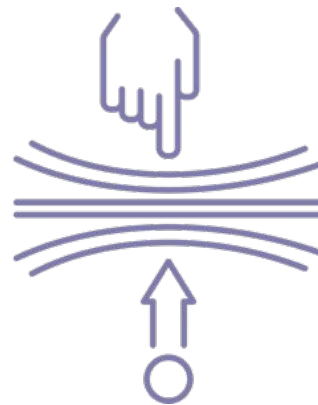
Innovation



Early-stage



Business Model



Resilience and Flexibility



Biases in capital allocation

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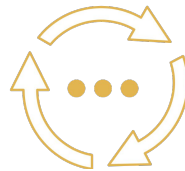
Lesson 2: Forms of Catalytic Capital

Forms of Catalytic Capital - The Five Ps



Price

Accepting an expected rate of return that is below-market relative to expected risk



Patience

Accepting a longer or especially uncertain time period before exit



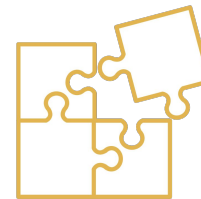
Position

Taking a subordinated position or undercompensated risk



Pledge

Using guarantees to unlock more capital



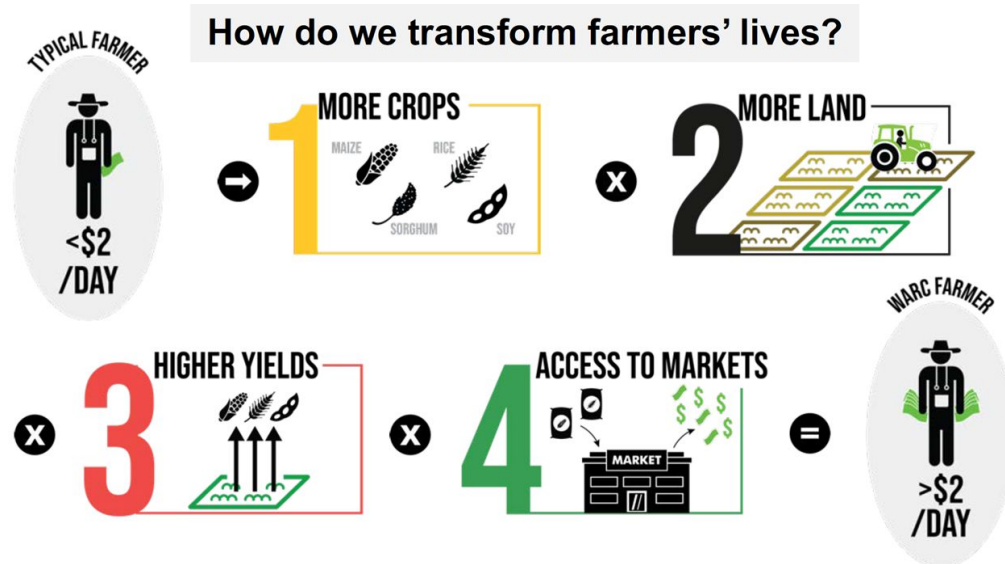
Purpose

Accepting non-traditional terms to meet the needs of an investee

Case Study - Price



WARC Africa empowers African farmers by designing and selling regenerative farming inputs as a service, to access the best available machinery, agricultural practices, and technical advice, and training them to perform high-value tasks



How is it concessionary?

Bond pays 5% over 5 years

How does it differ from commercial expectations?

Lower interest rate, no collateral

Why is it needed?

Lack of investments in smallholder African farmers

What impact does it catalyze?

It seeds and validates a new model

Case Study - Price



SocialAlpha Investment Fund (SAIF) invests senior and subordinated debt since 2010 in leading impact ventures in Latin America & Sub-Saharan Africa

MISSION

- Reduce poverty
- Preserve the environment
- Invest with a Gender Lens

THEORY OF CHANGE

- Identify commercial solutions for the SDGs
- Grow SMEs to national market leadership
- Expand them across borders

INVESTMENT STRATEGY

- Latin America & Sub-Saharan Africa
- Food, Finance, Energy, Housing
- Progressive exposure to SMEs
- Partial collateral
- Co-investment upside

How is it concessionary?

Fund targets net 3-5% IRR

How does it differ from commercial expectations?

Lower interest rate, limited diversification

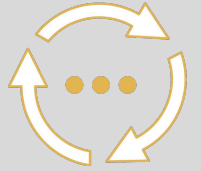
Why is it needed?

Access to capital is one of the main limiting factors of SMEs growth in Africa

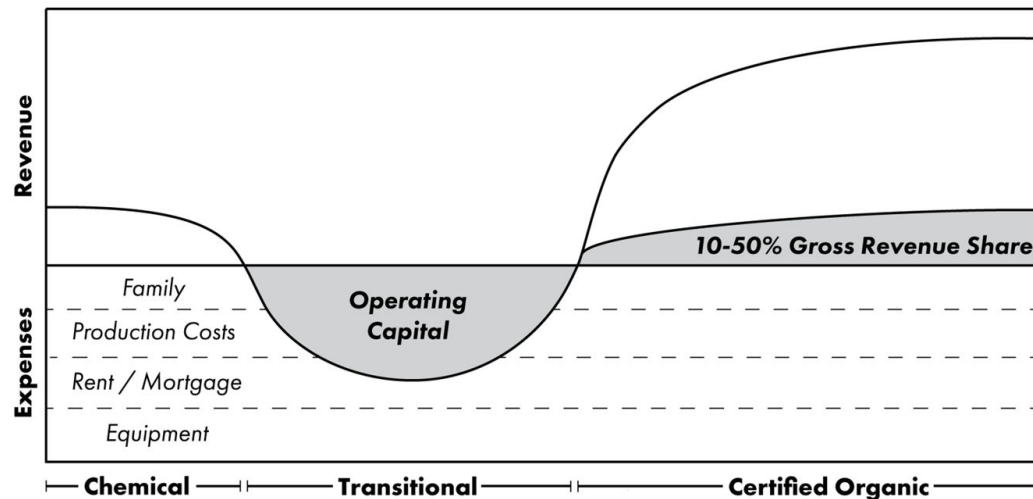
What impact does it catalyze?

Direct impact to reduce poverty and first institutional investors to scale and support SMEs growth

Case Study - Patience



Mad Agriculture Perennial Fund provides organic transition operating loans to help organic farmers expand their acreage. Farmers access low-cost capital, individualized farm plans, and market offtakers



How is it concessionary?

Investment will be repaid only when farmers generate greater revenues

How does it differ from commercial expectations?

Commercial lenders would require high rates and or collateral such as mortgage loans with amortization

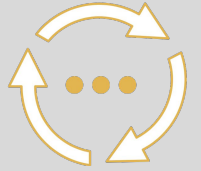
Why is it needed?

Lack of operating capital funding does not enable the transition to organic

What impact does it catalyze?

It seeds and validates a new model

Case Study - Patience



CNote Wisdom Fund is a fixed income vehicle that increases capital access and lending for women of color owned businesses. Money is deployed by CDFI (Community Development Finance Institutions) partners as affordably-priced loan capital and training



How is it concessionary?

There is a 5 years lockup, and the fund pays 1% per annum (as of Sept 2022)

How does it differ from commercial expectations?

Another impact product, the Flagship Fund, pays 2% p.a. with 30 months term and quarterly liquidity

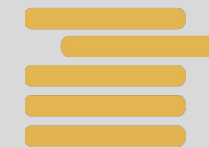
Why is it needed?

Lack of investments in women of color and business training

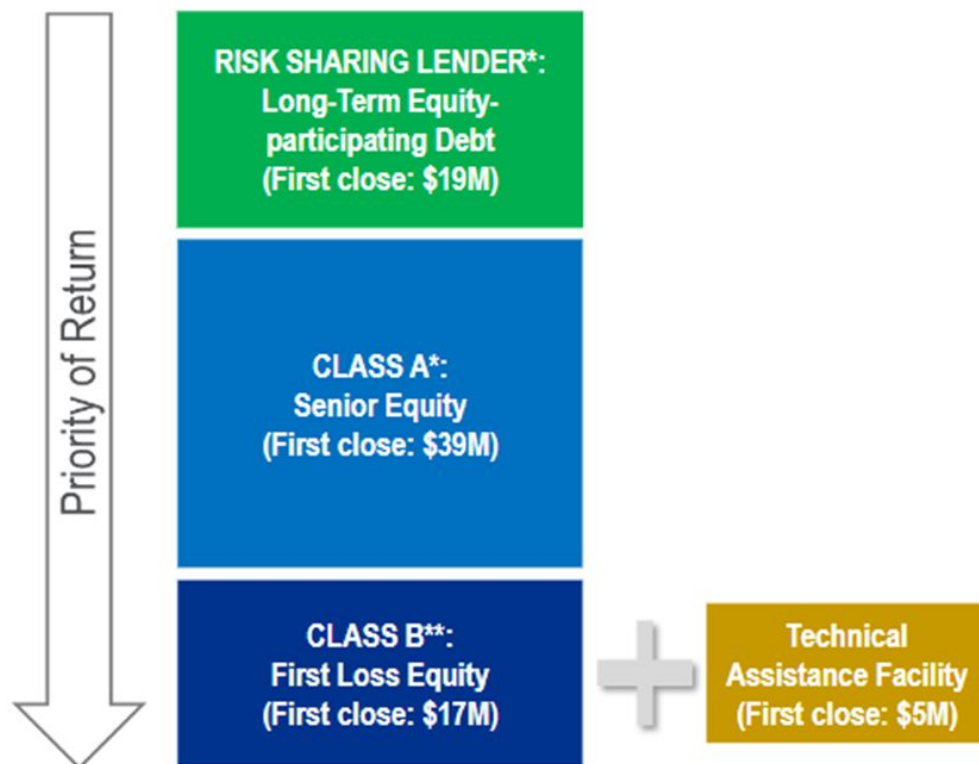
What impact does it catalyze?

It reaches an underserved population and addresses biases in capital allocation

Case Study - Position



Women's World Banking Capital Partners II is a blended finance, gender-lens PE fund with a dedicated technical assistance facility for women's financial inclusion & empowerment



How is it concessionary?

Class B investors have a junior position and their return is capped at 2.5% IRR

How does it differ from commercial expectations?

Uncompensated risk because Class B takes first loss and no upside

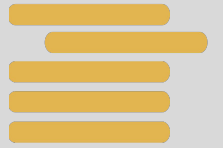
Why is it needed?

Mobilizes additional capital from more risk averse investors in Class A

What impact does it catalyze?

It scales up funding for an underserved demographic group in developing countries

Case Study - Position



SunFunder SET Fund invests in solar assets in Sub-Saharan Africa where either the electric grid is often not reliable to power companies or where opportunities exist to displace diesel and other fossil fuel generators



How is it concessionary?

Junior investors receive 0-3% over a 9-year note, subordinate to the senior tranche

How does it differ from commercial expectations?

Arguably also senior investors have are providing catalytic capital, but they receive 6% over 5 years

Why is it needed?

Junior investors mobilize capital from more risk-averse investors

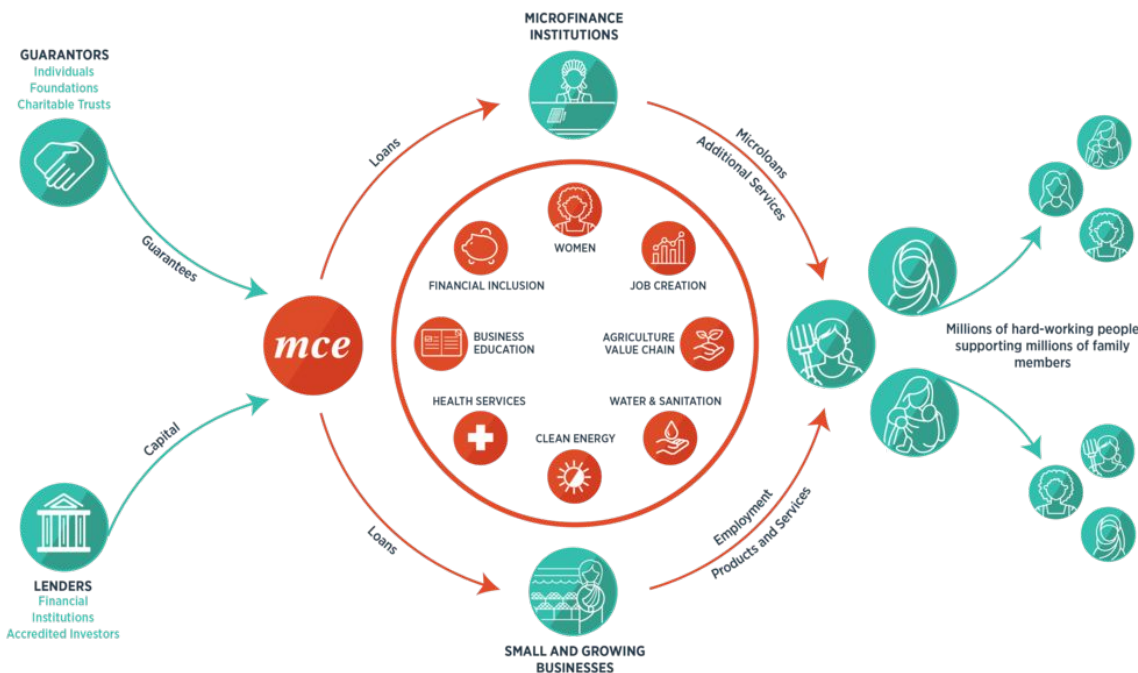
What impact does it catalyze?

It scales up funding for underserved geographies and grows the offgrid solar sector

Case Study - Pledge



MCE Social Capital provides flexible capital to enterprises committed to generating sustainable livelihoods in emerging markets—with a focus on women and the environment—to allow these enterprises to scale and better serve their customers, their employees and their communities



How is it concessionary?

Guarantors may take a loss

How does it differ from commercial expectations?

Guarantors are not remunerated for this risk

Why is it needed?

MCE can raise loans at lower rates, mobilizing more capital

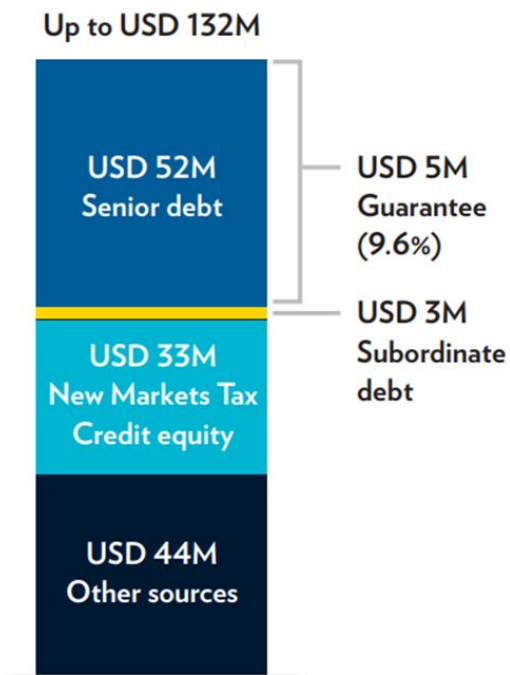
What impact does it catalyze?

By giving access to low cost capital to MCE, then MCE can have lower interest rates for the end borrowers

Case Study - Pledge



The Collaborative for Healthy Communities finances community health centers, providers primary and preventative care to some 25 million people in low-income communities around the United States. When it started, the The Kresge Foundation provided a \$5M guarantee to support co-lending among the CDFIs



Note: 'Other sources' could include state and local contributions, HRSA grants, and other philanthropic capital.

How is it concessionary?

The Kresge Foundation will not receive a return on its guarantee

How does it differ from commercial expectations?

Guarantors are not remunerated for this risk

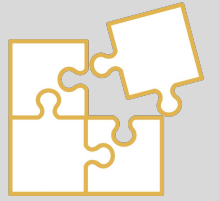
Why is it needed?

CDFIs had no experience in lending in the newly developing federally qualified health center market

What impact does it catalyze?

Validated a lending practices and eventually able to raise capital from the private sector

Case Study - Purpose



Navajo Power is a Public Benefit Corporation that develops utility-scale clean energy projects on tribal lands. This promotes a Just Transition from coal to renewables for Navajo through solar and storage projects as the imminent closure of local coal plants accelerates



How is it concessionary?

Turquoise share dilutes other equity investors

How does it differ from commercial expectations?

Navajo Power is sharing with the community equity and voting rights

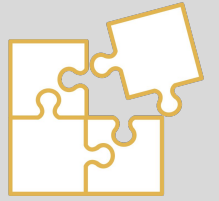
Why is it needed?

It aligns the company interests with the community that it serves

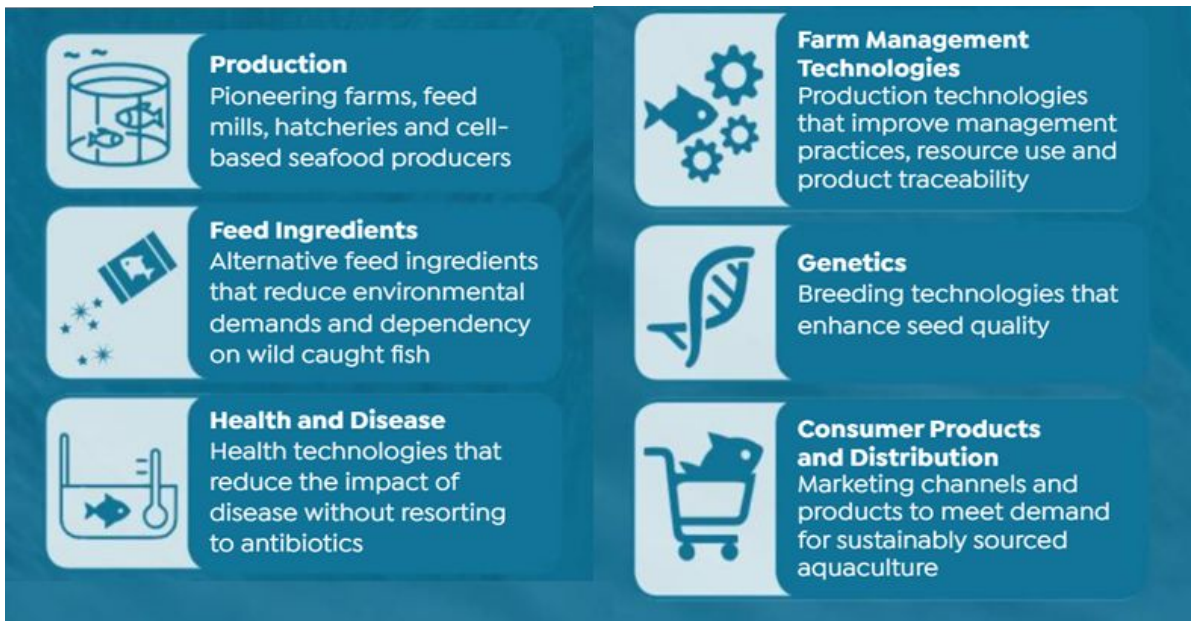
What impact does it catalyze?

Indigenous people are often disenfranchised and this is a replicable model

Case Study - Purpose



AquaSpark is a global fund, developing an optimal and sustainable aquaculture food system by investing all along the value chain working to solve industry challenges, with a shared vision of a sustainable future



How is it concessionary?

Investment has no limited life and investors have to rely on a sale or buyback of their investment

How does it differ from commercial expectations?

Evergreen equity structures are very rare in impact investing, most funds have a limited life

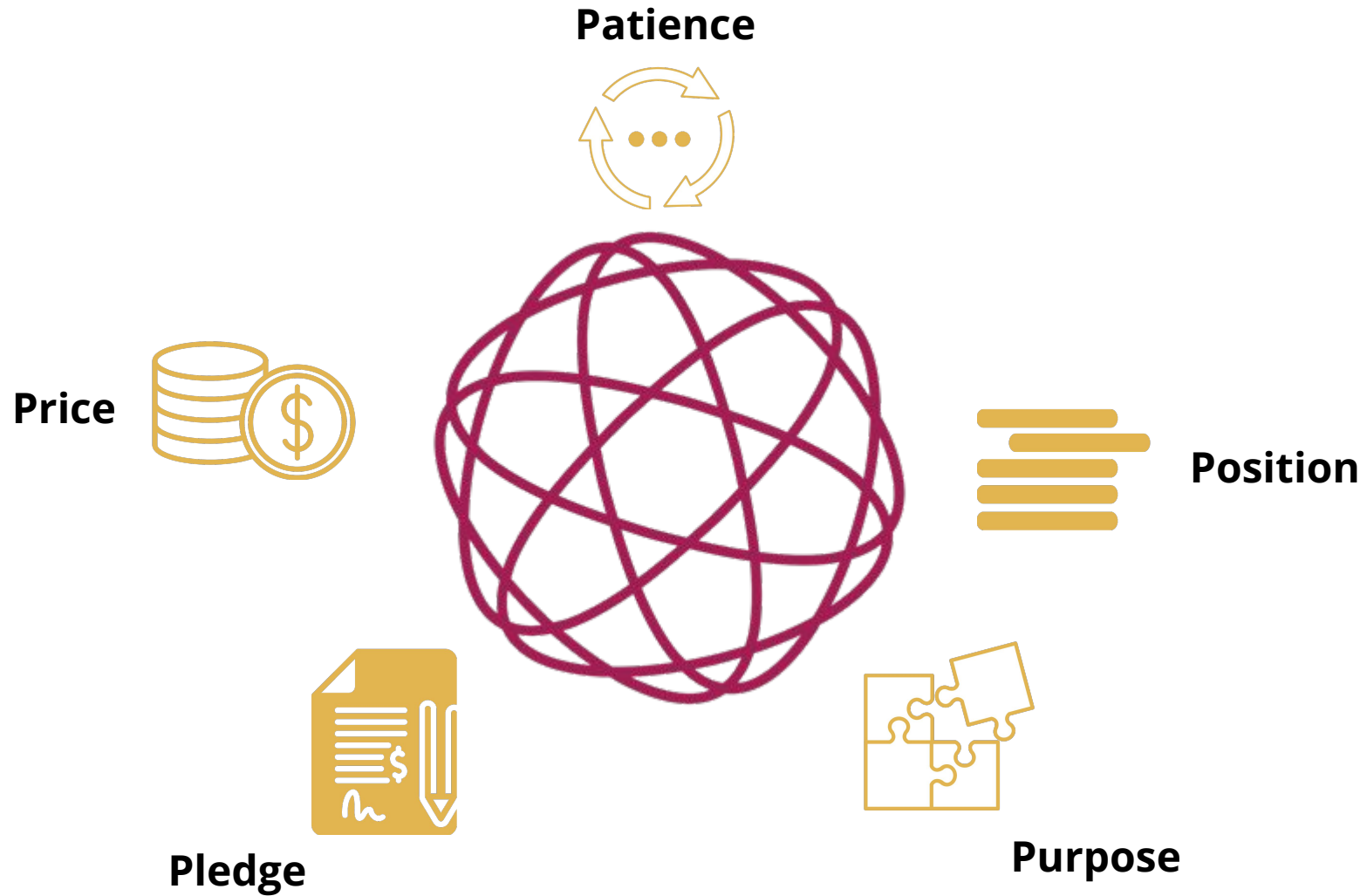
Why is it needed?

Long term approach to change the industry and create portfolio synergies

What impact does it catalyze?

It seeds and validates new technologies and best practices to feed the planet sustainably

Conclusion



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Lesson 3: Roles and Stages of Catalytic Capital

Three Roles that Catalytic Capital Plays by Investment Stage

Seeding

Seeding early-stage innovation



Scaling

Scaling to reach new geographies and populations

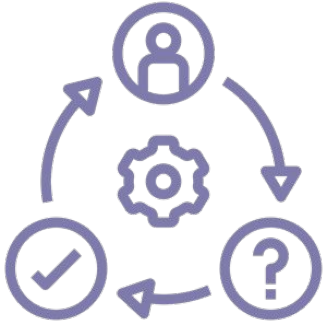


Sustaining

Supporting an investee that requires subsidy on an ongoing basis



Seeding



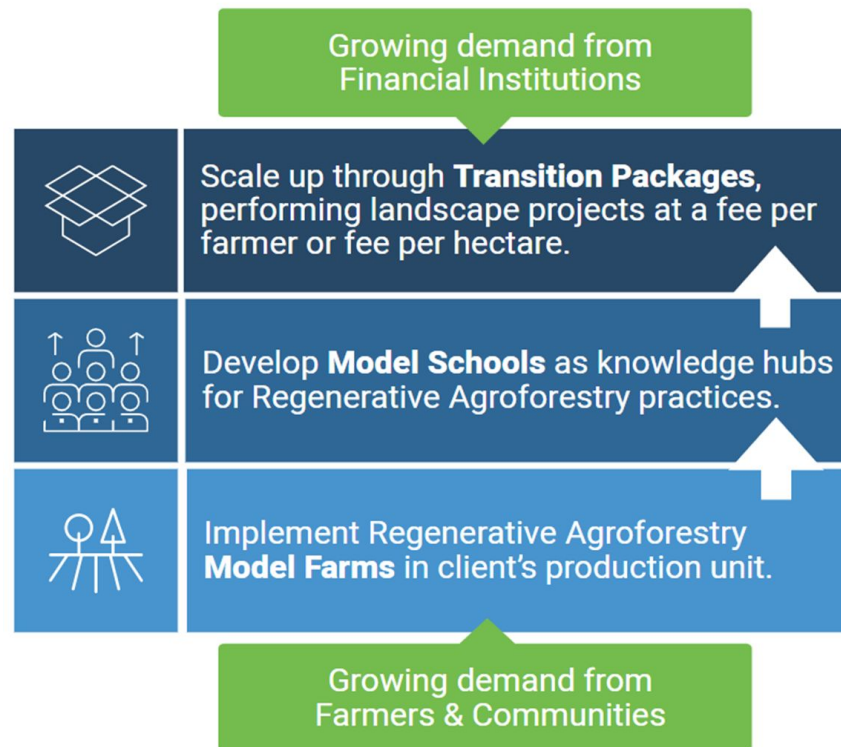
Business model



Track record

Seeding Example

reNature promotes, designs and implements regenerative agroforestry to bring nature back into agriculture, restore landscapes, secure the economic resilience of farmers and tackle climate change



How is it concessionary?

Unproven model with 2 pilot farms. High scalability risk because reNature had to build pilot farms on every client's site

How does it differ from commercial expectations?

Commercial investors rarely invest in companies with very limited proof of concept

Why is it needed?

Pilot farms explain practically to farmers how to adopt regenerative practices

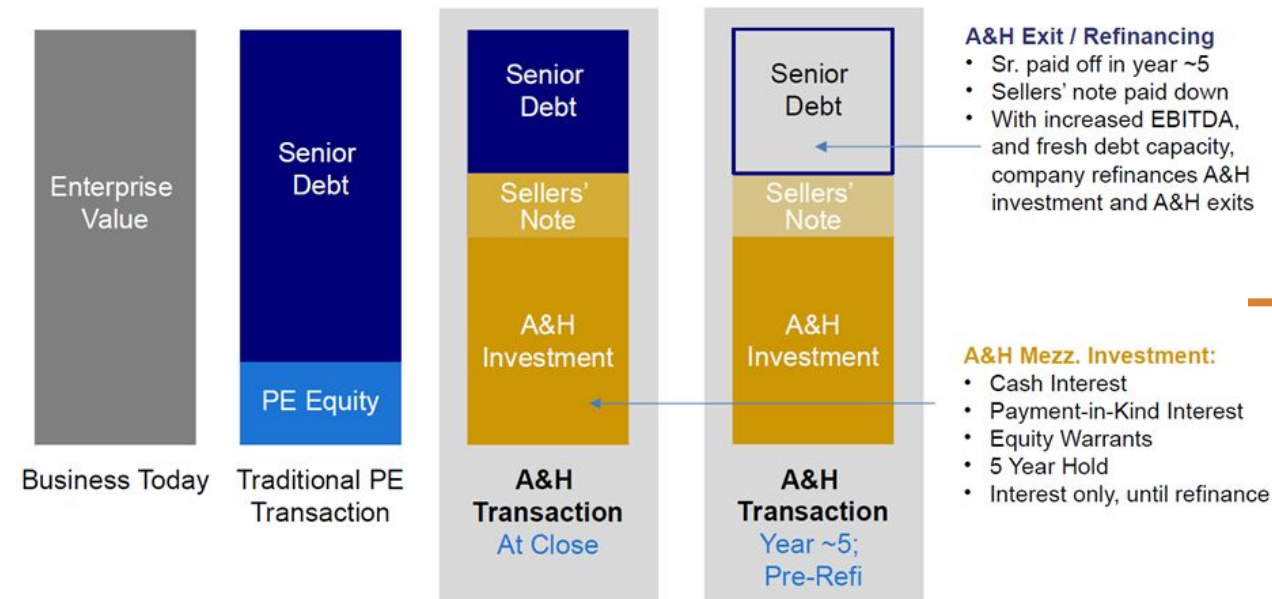
What impact does it catalyze?

It validates a new model. At the time of the investment only 2 pilot farms, and 2 years later the company projects all over the world

Seeding Example

Apis & Heritage Legacy Fund I buys companies with large workforces of color and turns them into 100% employee-owned businesses, creating wealth for the people who earned it: the workers

Illustrative Transaction Structure Comparison



How is it concessionary?

Employee Stock Ownership Plan model not validated in the impact investing space

How does it differ from commercial expectations?

This model takes on risks that are not compensated with extra returns

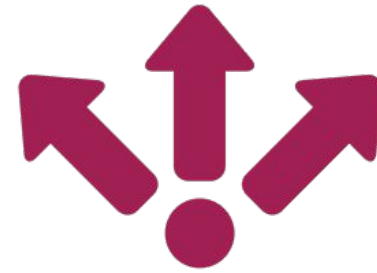
Why is it needed?

There is a significant wealth gap in the retirement savings for communities of color in the United States, addressing historical structural barriers to wealth

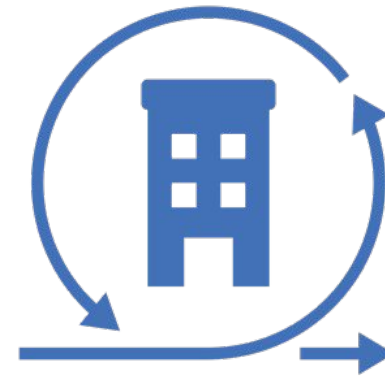
What impact does it catalyze?

It reaches an underserved population and validates a new approach

Scaling



Expand their business or strategy



Replicating models and strategies to reach further situations, population segments, and geographies



De-risk and mobilize additional investment from mainstream investors

Scaling Examples - Expansion and Replication

Goodwell Investments is a venture firm focused on financial inclusion, fintech and inclusive growth in sectors providing basic goods and services and income generation opportunities to the underserved

uMunthu PORTFOLIO (October 2021)

IMPACT



33 country footprint across Africa

19 investees

Serving over 322 million people

Creating 2,000+ direct jobs

GEOGRAPHIC DIVERSIFICATION

Africa

SECTOR DIVERSIFICATION

- 35% Financial inclusion
- 25% Agriculture
- 15% Mobility and Logistics
- 25% Other impact sectors

FINANCIAL INCLUSION



OTHER IMPACT SECTORS



AGRICULTURE



How is it concessionary?

It directs capital towards underserved geographic areas and beneficiaries

How does it differ from commercial expectations?

Commercial investors would not invest in companies serving people at the bottom of the economy pyramid

Why is it needed?

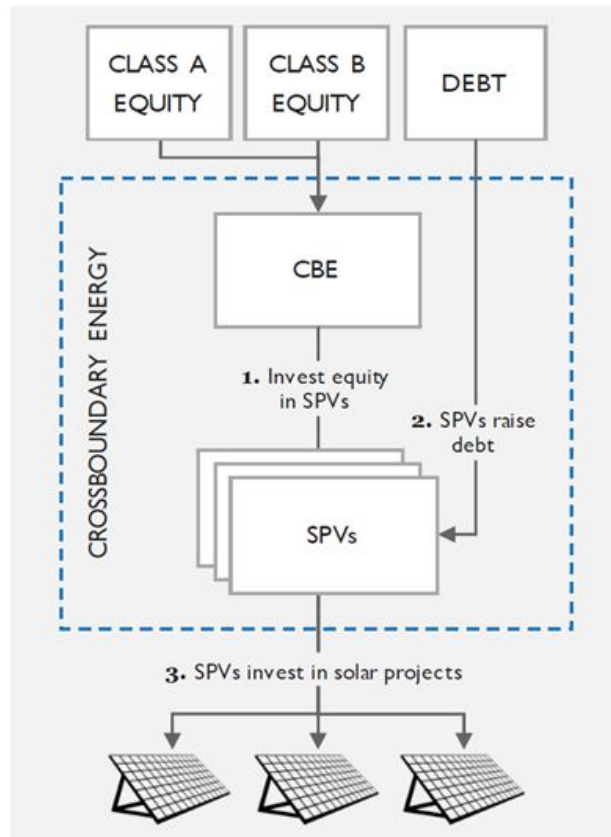
It fills a capital gap by deploying capital in underserved geographies

What impact does it catalyze?

Scale up successful approaches and companies

Scaling Examples - De-risking

CrossBoundary Energy finances construction, operations, and maintenance of solar projects for commercial and industrial businesses in sub-Saharan Africa. In 2016, CBE reached a final close at USD 8.8M.



How is it concessionary?

Class B has an uncompensated junior position compared to class A

How does it differ from commercial expectations?

Commercial junior investors would demand higher returns

Why is it needed?

Class B catalyzes additional capital of Class A investors

What impact does it catalyze?

Fills a capital cap by financing solar projects in Sub Saharan Africa

Sustaining



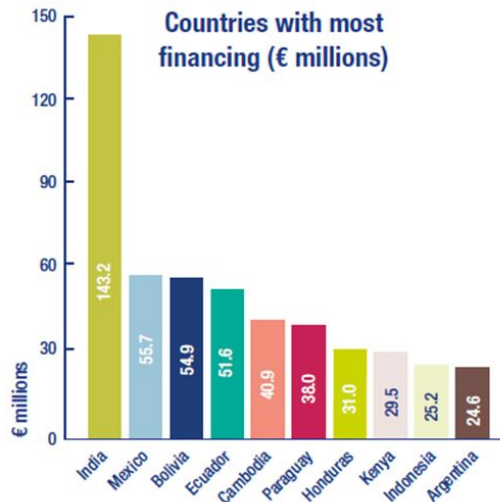
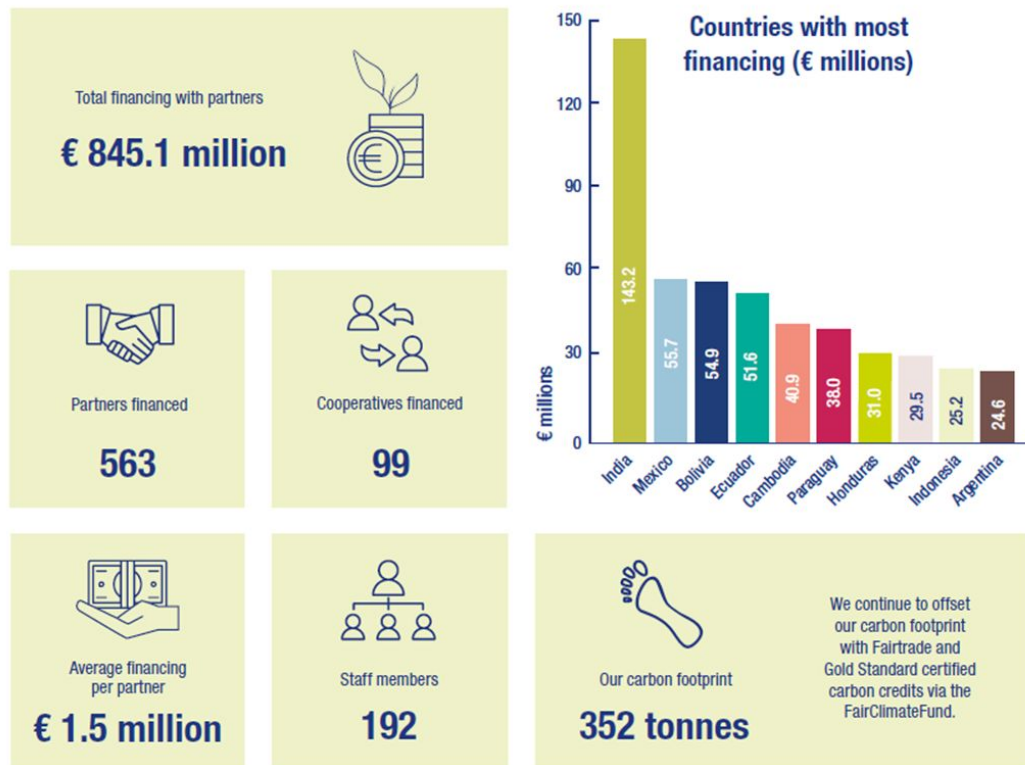
Long-term or permanent need for catalytic capital



Hard-to-reach beneficiaries or business model that will not achieve full commercial viability

Sustaining Examples - Microfinance

Oikocredit International provides loans to more than 600 local partner organizations with a social objective, in about 60 countries worldwide. Focus on individuals in low-wage countries, who normally do not have access to loans, access to appropriate financial resources



How is it concessionary?

Pays subcommercial returns to investors

How does it differ from commercial expectations?

Mainstream microfinance returns are higher than Oikocredit

Why is it needed?

With lower interest rates, Oikocredit can provide low cost loans to their borrowers maximizing their impact

What impact does it catalyze?




It sustains an approach that needs ongoing subsidies to serve people living in poverty

Sustaining Examples - Community Development Finance Institutions

LIIF is a CDFI in the United States engaged in lending, grant making and technical assistance with the mission of alleviating poverty. It focuses on affordable housing, child care centers, education, health, and transit-oriented development

OUTCOMES

As of July 2020

LIIF Investment	Enhanced Community Spaces	Total Invested in Communities
HOUSING \$1.4 billion	82,000 homes 	\$6.4 billion
CHILD CARE \$168 million	273,000 child care slots 	\$484 million
EDUCATION \$686 million	98,000 spaces at schools 	\$1.4 billion
COMMUNITY FACILITIES \$438 million	38 million square feet of community space	\$1.2 billion
TOTAL \$2.5 billion		\$13.8 billion

How is it concessionary?

Subcommercial returns. In 2019, their note ranged from 1% of 6 months lockup, to 4% for 10 years lockup

How does it differ from commercial expectations?

Fixed income investors in private market can expect higher returns with shorter lockup

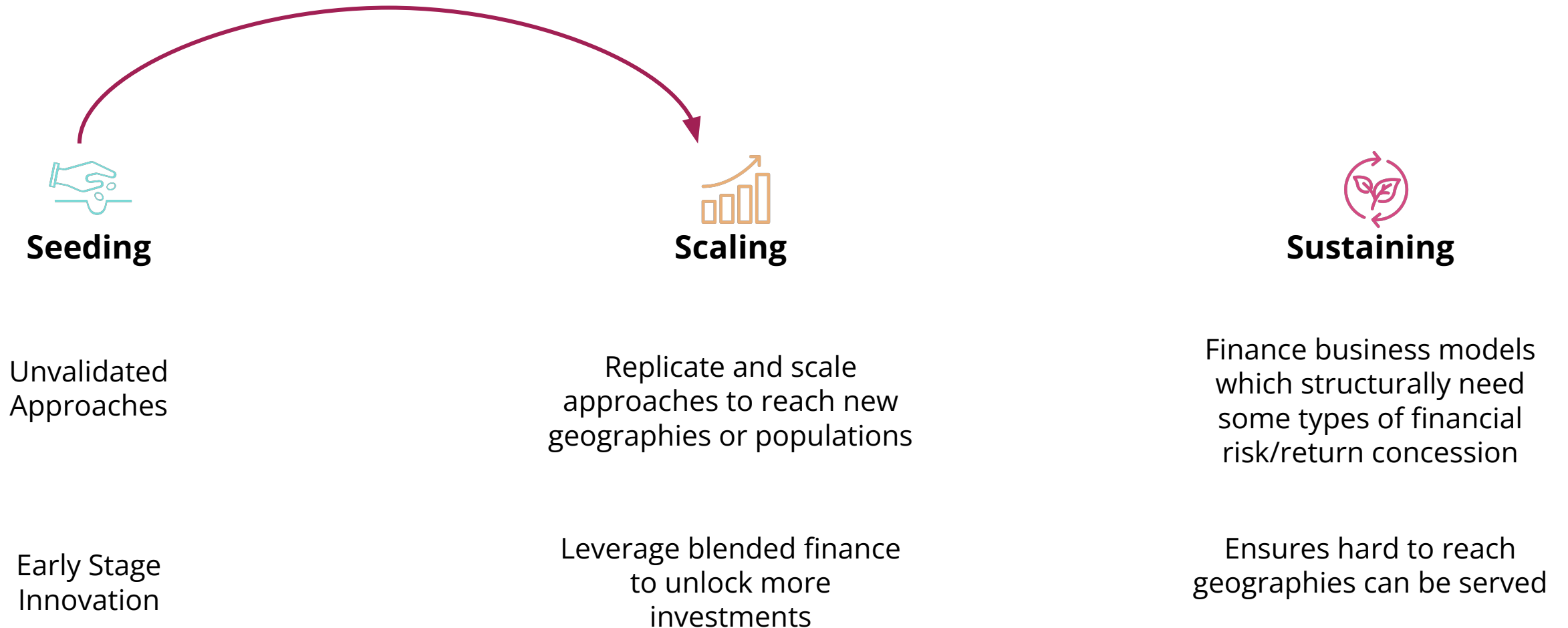
Why is it needed?

It fills a capital gap by investing in low income communities

What impact does it catalyze?

It sustains access to housing, child care, education for underserved low income communities

Conclusion



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Lesson 4: Challenges of the Seeding stage of catalytic capital

Challenges that Investors Face in the Seeding Stage



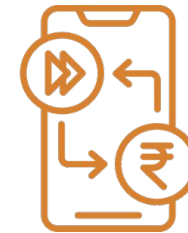
STRATEGY



UNDERWRITING



CAPITAL RAISING



STRUCTURE & TERMS

Source: [Advancing Practice in Catalytic Capital Guidance Note 1](#)

Addressing Seeding Challenges - Strategy



Define objectives

- Financial parameters
- Sector/thematic/geographic focus
- Requirements around impact additionality
- What new aspects are to be de-risked
- Preferred “role” in deals



Alignment of strategy with the market

- Fit for purpose strategy
- Strategies that are broad to adapt to deal flow



Community of practice

- Learn about others’ strategic priorities
- Identify collaboration opportunities



Addressing Seeding Challenges - Underwriting



Due diligence

- Alternatives to performance and deployment track record
- Past collaboration between individual team members
- Single manager and key person risks
- Provide pilot funding for proof of concept phase



Clarity on underwriting information needs

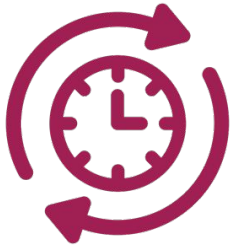
- Identifying must-haves and differentiate them from nice-to-haves
- Communicate them early in the process



Clarity on process, timely communication, and transparent feedback

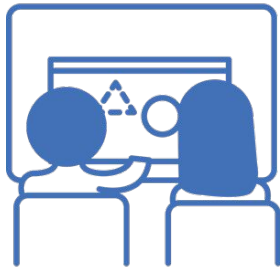
- Outline of the internal decision-making process
- Key people involved
- Capacity constraints

Addressing Seeding Challenges - Capital Raising



Clarity on catalytic capital powers

- Terms
- Timing
- Quantum



Bringing in more than investment money

- Reputation
- Network
- Share due diligence
- Feedback
- Providing grant funding



Clarity on “leading” and “following” roles and cooperation

- Role to play
- Identify leaders
- Cooperation towards closing

Addressing Seeding Challenges - Structures & Terms



Clarity on risk-return appetite

- Clear communication
- Explain if risk mitigant giver or taker
- Quantum



Efficient capital structures and ratios

- Identify risks embedded in a transaction
- Translate them into capital ratios
- Minimum amount of risk-mitigating capital needed
- Engage to align interests



Reducing use of catalytic capital over time

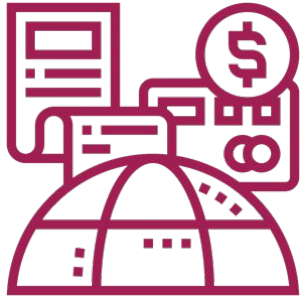
- Clarify the nature of the capital gap: temporary or structural?
- Identify transition pathways



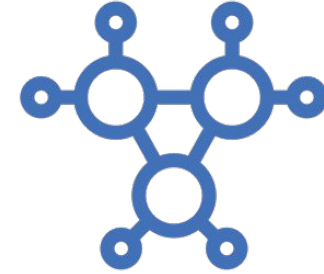
Landing a deal that works for all

- Avoid the adoption of a “me too” attitude
- Flexibility to close the deal

Conclusion



At the transaction level, investors can help a catalytic investments succeed and reach their intended impact



At an ecosystem level investors can have systemic impact beyond a single investment

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Conclusion

Topics We Discussed

- 1 Defining Catalytic Capital
- 2 Forms of Catalytic Capital
- 3 Roles and Stages of Catalytic Capital
- 4 Challenges Related to the Seeding Role

Exercise

Reflect on a previous catalytic capital investment that you have made or that you have considered

- Try to define the forms of catalytic capital involved: price, patience, position, pledge, or purpose
- Identify the reasons why those forms were necessary to make the business model and capital structure work
- Define the stage of the investment: whether it was in the Seeding, Scaling, or Sustaining stage
- Reflect if the fundraising process could have been improved by:
 - having more clarity on the investors (both you and co-investors) strategic objectives and priorities
 - using more comprehensive due diligence checklists
 - approaching the capital raising phase more collaboratively among investors
 - providing greater clarity on the structure and terms that were necessary (including first loss positions)

Modules in This Mini-series

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Implement

How to set your portfolio up for catalytic capital, structure, analytical questions, and implementation

Thank you

Feedback form

<https://www.surveymonkey.com/r/catalyticcapatialm5>

