

**Written Assignment for the Selection of EIB-GDN Fellows**  
06 July, 2017

**Part I: Basic Analytical Knowledge**

**1. Program Impact**

- a) A project aimed at increasing household's monthly income was implemented using pure random participation selection. The following equation represents an outcome estimation equation.

$$Y_i = a + b \cdot T_i + e_i$$

where Y is household's monthly income, T is a microfinance intervention (T=1 if the household gets the intervention and T=0 if the household does not get the intervention), and e is the error term.

Under pure randomisation designed and implemented properly, what is the expected household income for households that did not get the intervention?

- b) The following table shows the mean income pre and post intervention (i.e. before and after the program) for program participants and non-participants.

Outcome	Treated (Participants)	Control (Non-participants)
Pre-intervention	80	70
Post-intervention	110	90

What is the impact of the program using difference-in-difference?

**2. World Bank Development Indicators:**

The primary World Bank collection of development indicators, compiled from officially-recognized international sources. It presents the most current and accurate global development data available, and includes national, regional and global estimates.

Please download the data from –

<http://data.worldbank.org/data-catalog/world-development-indicators>

- What is the mean and standard deviation of GDP per capita (constant USD) and Literacy rate, Female (15 and above) in 1995? And in 2015?
- Regress Illiteracy rate, Female (15 and above) on GDP per capita in 1995. What is the coefficient? Is it significant (report its t-statistics)?
- How does the relationship (coefficient and significance) look like in 2015?

### 3. Hypothesis Formation

You are interested in finding answer to the question “Why do the poor have so many children?” How would you test the following hypotheses (data requirement and statistical method/ regression equation)?

- i) Poverty causes them to have more children. OR
- ii) They are poor because they have so many children.

## Part II: Knowledge of Evaluation & Impact Assessment

4. The attached document, downloadable from the Global Impact Investing Network<sup>1</sup>, is a case study of a multi-stakeholder capitalization of an agricultural fund in Africa. Please write a note on the three following points:
- 1. A summary of the investors' rationale in supporting this initiative;
  - 2. The methodological and data challenges you might face in evaluating the impact of this initiative; and
  - 3. Two major managerial problems that you foresee in running such an evaluation.

Be concise - your entire response should not be longer than two (2) A4-sized pages, font 11, single spaced.

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<sup>1</sup> Homepage: [www.thegiin.org](http://www.thegiin.org). The document can be downloaded from: <https://thegiin.org/assets/documents/pub/diverse-perspectives-shared-objective.pdf>

CASE STUDY



# **DIVERSE PERSPECTIVES, SHARED OBJECTIVE**

Collaborating to Form the  
African Agricultural Capital Fund

JUNE 2012

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The African Agricultural Capital Fund, managed by Pearl Capital Partners,<sup>1</sup> primarily invests in small- and medium-sized agricultural enterprises to improve the livelihoods of smallholder farmers in East Africa. In September 2011, four members of the Global Impact Investing Network’s Investors’ Council<sup>2</sup>—the Bill & Melinda Gates Foundation, the Gatsby Charitable Foundation, J.P. Morgan, and the Rockefeller Foundation—closed a USD 25 million impact investment into the fund. The United States Agency for International Development provided a 50 percent debt guarantee to J.P. Morgan’s investment, as well as a grant-funded technical assistance facility for the fund’s investees. The transaction is unique, evidenced by its detailed negotiation process, in which all four investors and the fund manager jointly developed a capital structure and social impact governance mechanisms that satisfy each of their social and financial goals.

The negotiations were time and resource intensive, but the various perspectives and expertise brought to the deal will help guide the African Agricultural Capital Fund’s (AACF) investments toward social impact while mitigating risk. The four investors and the fund manager established portfolio-level social impact targets using Impact Reporting and Investment Standards (IRIS)<sup>3</sup> to manage towards benefiting smallholder farmers. They also created a formal impact committee to help evaluate prospective investments’ ability to generate social impact. To mitigate potential risks, the five collaborators increased the fund manager’s resources and helped ensure access to business support for AACF’s investees via the technical assistance (TA) facility funded by the U.S. Agency for International Development (USAID).

This case study gives an overview of the fund, describes its capital structure, its primary impact governance mechanisms, and the stakeholders’ key risk mitigation strategies. To provide additional insight into the motivations and decisions that shaped the impact investment, interviews with representatives of the four investors and the fund manager are included.

## Fund Overview

AACF operates with a defined social impact goal: to improve the livelihoods of smallholder farmers by primarily investing in agricultural small- and medium-sized enterprises (SMEs) that provide improved access to goods, services, quality employment opportunities, and markets. The fund’s investments are intended to facilitate the growth of these businesses so they can scale their engagement with smallholder farmers through procurement or sales strategies. The fund aims to use debt, quasi-equity, and equity—emphasizing self-liquidating structures<sup>4</sup> in light of the limited liquidity and exit environments in the nascent formalized East African agricultural sector.

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All four investors and the fund manager developed a capital structure and impact governance mechanisms that satisfy each of their social and financial goals.

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<sup>1</sup> Pearl Capital Partners is a Mauritian Fund Manager. It has an advisor in Kampala called PCP Uganda. Pearl Capital Partners manages this African Agricultural Capital Fund, as well as the African Seed Investment Fund, formed in 2010 with capital of USD 12 million. Pearl Capital Partners’ original investment company, African Agricultural Capital Ltd., was formed in 2005 with USD 9 million.

<sup>2</sup> The [Global Impact Investing Network \(GIIN\)](#) is a nonprofit organization dedicated to increasing the scale and effectiveness of the impact investing industry. The [GIIN Investors’ Council](#) is an exclusive membership program that serves as a platform for leading, active impact investors to share experiences, learn about emerging sectors, explore opportunities for collaboration, and contribute to industry development.

<sup>3</sup> The [Impact Reporting and Investment Standards \(IRIS\)](#) is an initiative of the GIIN. IRIS is a set of metrics that can be used to measure and describe an organization’s social, environmental, and financial performance.

<sup>4</sup> Self-liquidating structures such as debt and quasi-equity are those that are able to produce cash readily or at regular intervals. Quasi-equity is a category of debt that has some equity-like traits, such as having flexible repayment options and higher rates of return, and being unsecured.

Pearl Capital Partners plans to invest in approximately 20 agricultural enterprises and seeks gross financial returns of at least 15 percent across the portfolio. It will focus on making investments ranging from USD 200,000 to 2.5 million. AACF has a ten-year life, with an option to extend for an additional two years; it has investment periods of up to five years with investment hold periods of five to seven years. The fund manager's fee is the greater of 2 percent of committed capital or 2.5 percent of invested capital during the investment period, and 2.5 percent of invested capital thereafter. The fund manager receives a carried interest of 20 percent of all distributions after full return of the investors' principal capital, plus a preferred return of 6 percent per year.

## AFRICAN AGRICULTURAL CAPITAL FUND PROFILE

### Fund Information

**FUND MANAGER:** Pearl Capital Partners

**INCEPTION YEAR:** 2011

**GEOGRAPHIC FOCUS:** At least 85% in East Africa (Tanzania, Kenya, and Uganda); up to 15% in neighboring countries

**FUND TERM:** 10 years, with an option to extend two years

**FUND IMPACT THESIS:** Improve the livelihoods of smallholder farmers by investing in agricultural enterprises that provide improved access to goods, services, and markets

**IMPACT MEASUREMENT AND ASSESSMENT:** IRIS metrics to track and report smallholder farmer outreach; will obtain a GIIRS rating\*

**INVESTEES TECHNICAL ASSISTANCE:** Provided to AACF's investees as needed through a USAID grant-funded facility

**FUND ASSETS UNDER MANAGEMENT:** USD 25 million

**INVESTMENT INSTRUMENTS:** Debt, quasi-equity, and equity

**INVESTMENT PERIOD:** Maximum of 5 years

**INVESTMENT SIZE:** USD 200,000–2,500,000

**TARGET GROSS PORTFOLIO RETURN:** At least 15%

**TARGET NUMBER OF INVESTEES:** Approximately 20 agricultural enterprises

**FUND MANAGEMENT FEES:** 2.5% fee, 20% carry

\*The Global Impact Investing Rating System (GIIRS) is a comprehensive and transparent system for assessing the social and environmental impact of companies and funds with a ratings and analytics approach analogous to Morningstar investment rankings and Capital IQ financial analytics.

### Fund Capitalization

**LIMITED PARTNERS:** The Bill & Melinda Gates Foundation and the Rockefeller Foundation, using concessionary capital in the form of program-related investments, and the Gatsby Charitable Foundation, on equal terms

**SENIOR DEBT INVESTOR:** J. P. Morgan in commercial capital at a below-market rate, guaranteed 50% by USAID



## Forming the Impact Investment

The Gatsby Foundation committed USD 5 million to AACF in 2009, but it was contingent on Pearl Capital Partners' ability to raise an additional USD 10 million or more in financing. As the fund manager began seeking capital with a target close of USD 25 to 30 million, it encountered a tough fundraising environment given the global economic downturn. Around the same time, the three U.S.-based investors—the Gates Foundation, J.P. Morgan, and the Rockefeller Foundation—were brought together by a series of discussions convened by USAID that explored ways to channel private sector investment into African SMEs. The GIIN helped these three Investors' Council members assess the African agricultural impact investment landscape and facilitated their early collaboration. The investors evaluated a number of funds, including AACF. They found that Pearl Capital Partners' first fund, which also focused on East African agricultural SMEs, made deals that mitigated risk and protected downside, but may not have captured maximum upside. However, Pearl Capital Partners had shown significant potential and was appealing in terms of its potential social impact.<sup>5</sup> They ultimately decided to join the Gatsby Foundation in funding AACF.

In typical fundraising scenarios, the fund manager designs an offering memorandum,<sup>6</sup> identifies target investors, and negotiates on specific terms as needed with each investor. However, when the four investors confirmed their interest in AACF in August 2010, they worked with the fund manager to collectively redraft the original offering memorandum and term sheets,<sup>7</sup> structuring the investment and all of its terms anew through five-way negotiations to accommodate their varying financial and social objectives. This unique process, though lengthy and resource intensive, produced a design that sufficiently mitigates each investor's perceived risks and utilizes different types of investment capital aimed at generating social impact and financial returns.

The Gates Foundation, the Gatsby Foundation, J.P. Morgan, and the Rockefeller Foundation collectively closed their USD 25 million investment in AACF in September 2011. The capital structure has two tranches, each earning different rates of financial return aligned with the risk taken or instrument used. J.P. Morgan invested USD 8 million in commercial capital as senior unsecured debt at a below-market rate. USAID provided a 50 percent guarantee at its standard fee for J.P. Morgan's investment. USAID also contributed a USD 1.5 million grant to fund a TA facility that will support AACF's investees, and may be able to extend additional capital to the facility if needed. The Gates Foundation (with USD 10 million), the Gatsby Foundation (with USD 5 million), and the Rockefeller Foundation (with USD 2 million) provided equity capital on a *pari passu* basis.<sup>8</sup> The two U.S. foundations, Gates and Rockefeller, employed program-related investments (PRIs) to complete the deal.<sup>9</sup> Per U.S. tax code, PRIs are primarily intended to help foundations address their charitable purpose and cannot be primarily designed to generate income. They therefore typically seek below-market rates of financial return.

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The investors worked with the fund manager to collectively redraft the original offering memorandum and term sheets, structuring the investment and all of its terms anew to accommodate their varying objectives.

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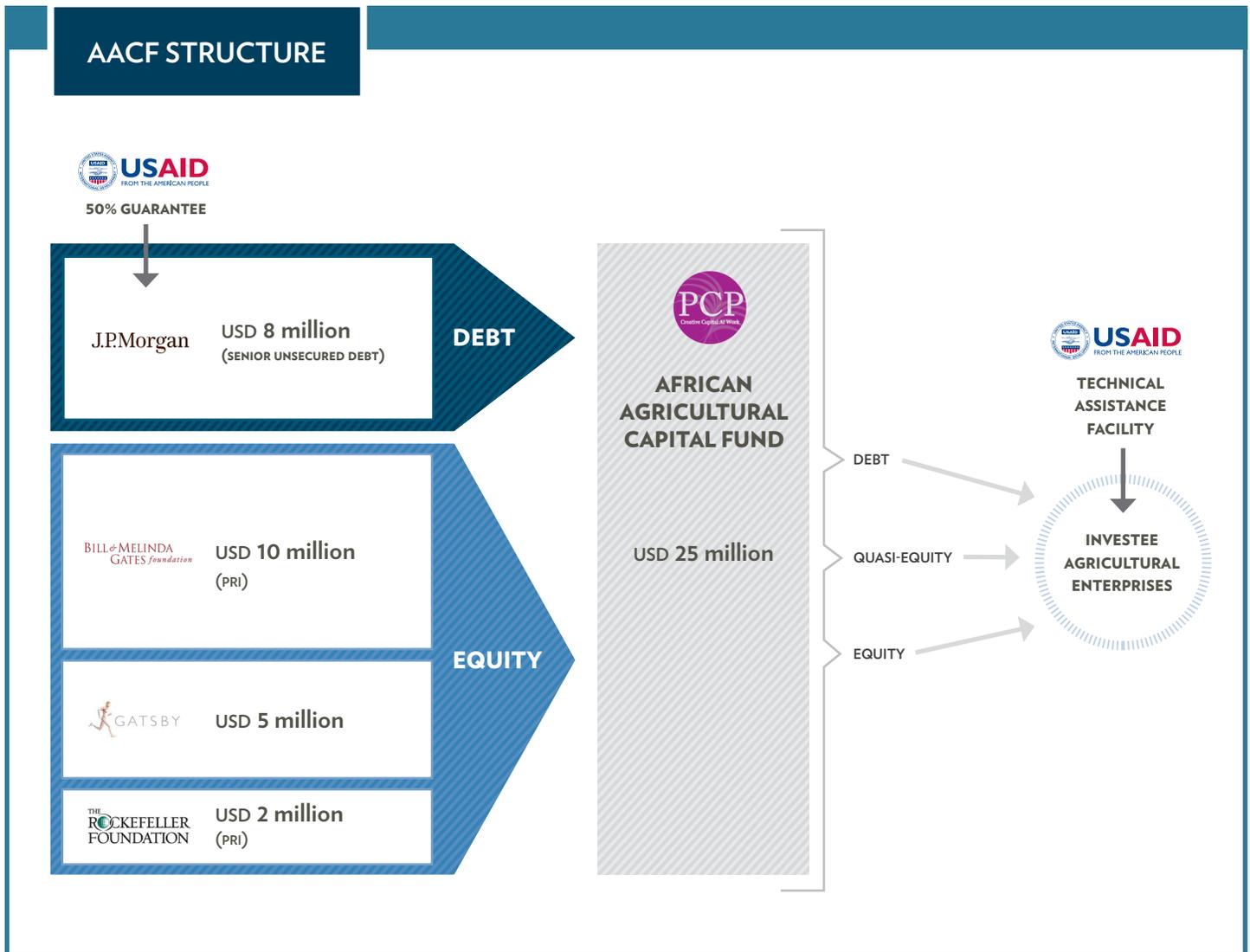
<sup>5</sup> Pearl Capital Partners has published a report, with the support of the Gatsby Foundation, evaluating the social impact and financial returns of five investees from its first fund. It is available on the Gatsby Foundation [website](#).

<sup>6</sup> An offering memorandum is a legal document stating the objectives, risks, and terms of investment involved with a private offering. It is also often referred to as a private placement memorandum.

<sup>7</sup> Term sheets are non-binding documents, often used to develop, or in conjunction with, an offering memorandum, which set forth the basic terms and conditions under which an investment will be made.

<sup>8</sup> *Pari passu* is a phrase used to describe classes of shares that have equal rights of payment or equal seniority.

<sup>9</sup> In the U.S., foundations are mandated by law to disburse at least 5 percent of their assets towards their charitable purpose each year. This payout is typically in the form of grants, but the PRI tool allows foundations to make charitable investments and to count these towards their 5 percent disbursement requirement. An investment can qualify as a PRI if it: 1) is primarily intended to help the foundation address its programmatic/charitable purpose; 2) is not primarily designed to generate income, and 3) is not intended to lobby or engage in political processes otherwise forbidden to private foundations. More details are available on the Mission Investors Exchange [website](#).



## Implementing Mechanisms to Ensure Social Impact

During deal structuring negotiations, the investors and fund manager sought to ensure that smallholder farmer livelihood improvement would be a priority in all of AACF’s investments. Pearl Capital Partners’ original offering memorandum called for the fund manager’s compensation to be tied to the fund’s measurable impact on smallholder farmers. The five stakeholders ultimately decided not to pursue an impact-based compensation model<sup>10</sup> because they determined it could not create focused incentives for the fund manager. The investors wanted to focus social and financial incentives on investee business growth, as they anticipated issues around collecting precise smallholder farmer data and AACF’s lack of long-term influence on investees’ smallholder farmer engagement due to its limited use of majority equity instruments. In lieu of an impact-based compensation model, the stakeholders established fund governance mechanisms to help prioritize investments with high potential for social impact.

<sup>10</sup> To learn more about impact-based compensation models, see “[Impact-Based Incentive Structures](#),” a 2011 issue brief by the GIIN.

## STAKEHOLDER PERSPECTIVES

## What were your organization's key motivations for making this investment?

## IAN ANDERSON

*Africa Program Manager  
Gatsby Charitable Foundation*

In 2004, the Gatsby Charitable Foundation played a key role in creating African Agricultural Capital Ltd., one of the earliest SME funds in East Africa and still one of the only SME funds focused on agriculture. In turn, we helped create the management team that now operates under the name of Pearl Capital Partners. With this AACF investment we were looking to scale Pearl's work, because we believe that it will enable them to improve the lives of a large number of smallholder farmers. The African agriculture sector has the ability to absorb commercial capital aimed at creating social impact. However, because few have made investments to date, the sector's financial viability isn't yet proven and the market lacks those with the skill sets needed to make effective investments. For us, therefore, our support for Pearl aims to have a direct impact on a large number of smallholders; to demonstrate to the investor community that there is opportunity in this sector; and to build this fund manager's capacity to manage investments for both impact and financial return.

## AMY BELL

*Vice President, Social Finance  
J.P. Morgan*

J.P. Morgan's Social Finance unit pursues impact in two ways. The first comprises investments that intend to improve the lives of poor and vulnerable populations, for example by empowering them to access markets or goods and services. The second piece of impact for us is a catalytic or additive one. We ask, "Does our investment create a demonstration effect and open the door for more traditional, private sector capital to come in?" We view part of our role as acting as a market leader in impact investing. Our motivation in pursuing the AACF deal was related to showcasing the viability of this type of transaction to create a new template for investment. Any deal we created together could serve as a precedent for the impact investment industry by illustrating how investors with different risk/return profiles can come together to create a new investment solution.

## DANA BOGGESS

*Program Officer  
Bill & Melinda Gates Foundation*

The Gates Foundation recognizes the importance of nascent agricultural enterprises. They are critical to connecting smallholder farmers to the inputs, knowledge, and services they need to increase their productivity, and to markets where they can convert their outputs into income. While we provide grant funding to a range of organizations supporting smallholder farmers, we also wanted to explore using other financial instruments. In this deal, we saw a relatively efficient commercial financing tool for deploying capital into these businesses that would allow them to scale while maintaining our focus on smallholder farmers. Our belief is that these enterprises will be able to serve and source from a larger number of smallholder farmers if they have access to capital to grow their businesses. We hope that AACF's investees will demonstrate that business models relying on smallholders are commercially viable, and that the fund manager will generate sufficient financial returns to prove the fund's viability.

## JUSTINA LAI

*Associate, Impact Investing and Program Related Investments  
The Rockefeller Foundation*

The non-transparent impact investment market creates fundraising challenges for impact investment funds and intermediaries. One of the key challenges in the impact investing industry is that the supply side of capital needs support to efficiently deploy capital into sectors with high potential to generate impact. One of the key strategic priorities within our impact investing initiative is focused on supporting the scaling of innovative impact investment intermediation vehicles<sup>11</sup> to build the field. Our programmatic rationale for pursuing this investment was at the systems level—focused on industry development and creating a partnership that could demonstrate a viable and potentially replicable investment structure. In addition, through our work with AGRA<sup>12</sup> and other initiatives, we have a history addressing agriculture and food security issues in Africa, and so it was natural to think about working with other investors to create a platform to invest in that sector. We supported Pearl Capital Partners' first fund through a grant. By investing in AACF with a PRI alongside more commercial forms of capital, we could enable it to continue to build track record while demonstrating the market and social potential of the agricultural sector in Africa.

<sup>11</sup> A financial intermediary channels investments between the sources and recipients of capital. Examples include banks, insurance companies, loan funds, and private equity funds.

<sup>12</sup> The Alliance for a Green Revolution in Africa (AGRA) seeks to achieve a food secure and prosperous Africa through the promotion of agricultural growth based on smallholder farmers. AGRA was created by the Bill & Melinda Gates Foundation and the Rockefeller Foundation.

They created two mechanisms:

1. Portfolio-wide smallholder farmer social impact targets to track the fund's impact
2. An impact committee to help evaluate prospective investments' potential for impact

#### SMALLHOLDER FARMER SOCIAL IMPACT TARGETS

### AACF Portfolio-Level Social Impact Targets

Improve the lives of at least **250,000** smallholder farmer households

Within five years of the fund's investment, each affected household should realize an increase of at least **USD 80** in annual income

Pearl Capital Partners, in discussion with the investors, established AACF's portfolio-level targets of improving the lives of at least 250,000 smallholder farmer households and helping them realize an increase of USD 80 in annual income within five years of an investment. They are based on the following assumptions:

- Seventy-five percent of AACF's portfolio value will be allocated to post-harvest agricultural enterprises, and 25 percent to input agricultural enterprises<sup>13</sup>
- Investees providing smallholder farmer suppliers with post-harvest access to markets are assumed to engage at least 500 smallholder households per USD 100,000 of investment
- Investees providing inputs and services to smallholder clients are assumed to reach at least 2,000 smallholder households per USD 100,000 of investment

The assumptions originate from an evaluation of the social impact achieved by five investees of Pearl Capital Partners' first fund, for which it kept rough figures on smallholder farmer engagement. The investors and fund manager acknowledge that the targets are based on scientifically untested assumptions. However, they provide guidance to the fund manager as it evaluates potential investments and establishes investment-level social performance goals that work toward the fund's portfolio-level targets.

By using the portfolio-level targets as a starting point, the fund manager can invest in business models that engage smallholder farmers in various ways and have different financial return and social impact profiles. This approach helps diversify the fund's portfolio, reducing its risk; maximizes the set of potential investments within its sector and geography mandate; and helps develop the formal East African agricultural sector as a whole in the long run.

<sup>13</sup> Post-harvest companies provide services for the stages of crop production that follow a harvest, such as cleaning, cooling, sorting, storing, and packaging. Input companies provide resources that are used in farm production, such as chemicals, energy, equipment, feed, fertilizer, and seed.

### *Data Quality and Collection*

Collecting and verifying data on AACF's impact on smallholder farmers may be difficult, as some investees may not be able to provide precise data on smallholder farmer engagement. For example, a business providing services directly to smallholder farmers may keep detailed records of the number of farmers served or the types of services provided, while one engaging smallholder farmers with sales through a distributor may not. In addition, many investees will not have the resources, capacity, or systems in place to collect rigorous data. Due to the complex agricultural value chain and nascent formalized East African agricultural market, data will be imprecise but directionally correct.

Understanding these difficulties, and given that the targets are based on assumptions from Pearl Capital Partners' first fund, the investors and fund manager view any deviation from the targets as a learning opportunity. The Gates Foundation and the Gatsby Foundation plan to commission an external third-party impact assessment to examine a subset of AACF's investments and collect social performance data. They will use these data to further learn about the potential for investments targeting agricultural SMEs to improve the lives of smallholder farmers.

### THE IMPACT COMMITTEE

In addition to setting social impact targets, the investors and fund manager established an impact committee to screen potential investments during the investment review process. The committee filters out enterprises that lack a strong social impact thesis and helps ensure that impact remains an integral part of the fund's investment decisions. Financed by Pearl Capital Partners, the committee has three independent voting members with investment veto rights and two non-voting observers from the Gates Foundation and the Gatsby Foundation. The three voting members, selected for their expertise working with smallholder farmers, have experience managing outgrower schemes<sup>14</sup> across Africa, providing grassroots-level agronomic<sup>15</sup> training to smallholder farmers and TA to scale agricultural enterprises, and enabling farmer access to inputs and business skills training.

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The impact committee filters out investments that lack a strong social impact thesis and helps ensure that impact remains an integral part of the fund's investment decisions.

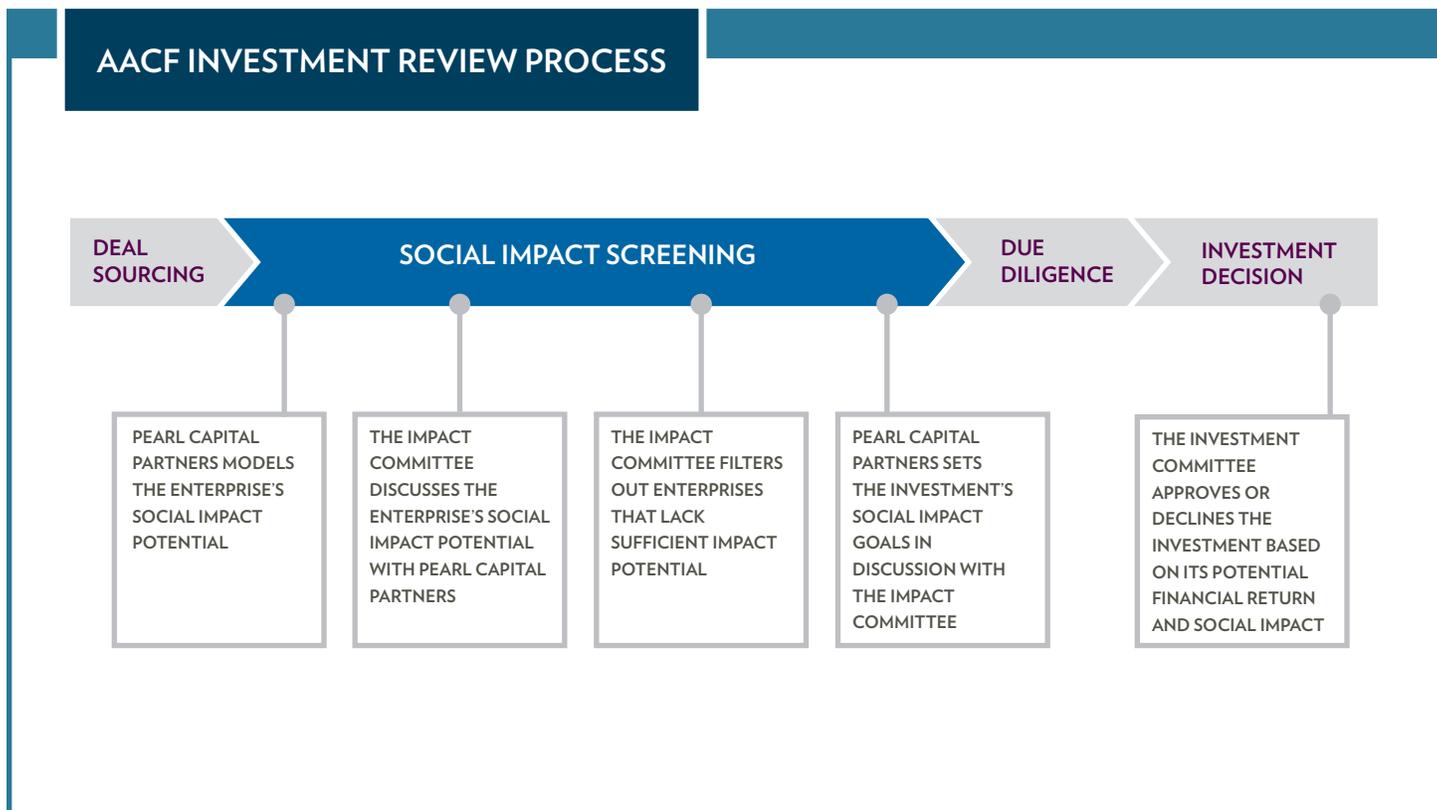
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### *The Investment Review Process*

After Pearl Capital Partners identifies a promising investee, it presents the business model and theory of change to the impact committee to demonstrate how the business aligns with the fund's social impact goals. The committee reviews scenarios of business growth, risks, projected smallholder farmer impact, and potential challenges to its ability to scale its engagement with smallholder farmers. The impact committee and fund manager discuss the prospective investment to address uncertainties around impact assumptions. If the investment has sufficient potential for social impact, the committee helps Pearl Capital Partners determine its social impact goals to ensure they build towards the fund's portfolio-level targets. The investment then moves on to financial due diligence, and if it presents appropriate potential for financial return, the fund's investment committee evaluates the transaction as a whole.

<sup>14</sup> Outgrower schemes are contractual partnerships between farmers or landholders and another entity for the production of specific products. There is wide variance in the extent to which inputs, costs, risks, and benefits are shared between the farmers and the formal entities as well as in the time frames of arrangements.

<sup>15</sup> Agronomy is the application of soil and plant sciences, as well as other sciences such as ecology, chemistry, genetics, and meteorology, to soil management and crop production.



Pearl Capital Partners can project social impact scenarios via relatively straightforward business strategy evaluations, whereas due diligence is time-intensive and costly given the amount of data and analysis required. As the investors did not want the fund manager to build sensitive relationships with prospective investees until they appeared adequate in terms of social impact, investments are screened for impact prior to undergoing due diligence. This process minimizes the fund’s pipeline risk and the fund manager’s time and resource costs.

### Mitigating Risk

In addition to implementing social impact governance mechanisms during negotiations, AACF’s stakeholders worked to mitigate investment risk at both the fund and investee levels.

### FUND MANAGER CAPACITY

Pearl Capital Partners attracted the investors because it was one of the few fund managers with experience investing in East African agricultural SMEs. However, the investors were aware that its track record was not substantial—an issue reflected in a 2011 J.P. Morgan-GIIN survey of impact investors who cited lack of track record as a key barrier to deploying impact capital<sup>16</sup>—and that the sector as a whole lacked a long history of impact investment.

<sup>16</sup> Saltuk, Yasemin, Bouri, Amit, and Giselle Leung. *Insight into the Impact Investment Market*. J.P. Morgan and the GIIN. December 2011.

## STAKEHOLDER PERSPECTIVES

### What social impact and financial elements were critical to your organization going into the deal structuring negotiations?

#### TOM ADLAM

*Managing Partner  
Pearl Capital Partners*

We needed a management fee of at least 2.5 percent per year to cover management costs, plus a long-term carried interest in fund performance. We were unwilling to first-close the fund with less than USD 15 million. In social terms, we want to achieve what we and our investors jointly feel is an appropriate set of portfolio-level social impact targets—in fact, we shall be disappointed if we cannot significantly surpass them.

#### IAN ANDERSON

*Africa Program Manager  
Gatsby Charitable Foundation*

We did not have a specific financial requirement. Our aim was to close an investment that would show that social impact can be achieved through a fund that makes commercial sense, to scale up the concept of financial intermediaries focused on agricultural SMEs. In terms of impact requirements, we wanted impact targets in place upfront but did not want to create fixed numbers that would signify “success” or “failure,” because we are still learning about the potential for investment to create smallholder farmer impact. Rather, we wanted to create clear impact expectations for the fund manager. We do not assume that investment creates impact simply by channeling capital into deals of a certain size and nature in East Africa. We want to make sure that the deals AACF pursues are explicitly intent on and targeted at creating social benefit for smallholder farmers.

#### AMY BELL

*Vice President, Social Finance  
J.P. Morgan*

We do not have a specific mandate to reach smallholder farmers, but it was important to establish the fund’s governance structures to ensure that impact was a primary consideration for all of its investments. It was also critical that the impact objectives be focused, documented, and built into the fund’s mission. We saw these as steps towards making our accountability to impact as rigorous as that to financial returns, and sought to implement them in a way that was minimally burdensome on the fund’s investees. We were excited about the investment opportunity, though we were also cognizant of the risks posed by the geography and political environment, the agriculture sector’s seasonality and dependence on climate factors, the fund manager’s limited investment experience, and the investee profile. We determined that a debt instrument was the most appropriate tool for this investment, though we are forsaking upside in exchange for more downside protection.

#### JUSTINA LAI

*Associate, Impact Investing and Program Related Investments  
The Rockefeller Foundation*

On the impact side, the investment needed to be deemed charitable in order to comply with U.S. tax law for a PRI. In addition to these requirements, concessionary financing, which is limited in supply, should be used strategically to achieve catalytic or leveraged impact. We were also looking to make an investment with a fund manager dedicated to social impact, such as Pearl Capital Partners. Finally, given our role as an impact investing field builder, it was important that the fund use IRIS metrics and obtain a GIIRS rating. We seek to help create market standards for impact measurement and assessment, ease the reporting burden of the fund’s investees, and ensure consistent definitions for the target population of poor smallholder farmers.

#### DAVID ROSSOW

*Program Investment Officer  
Bill & Melinda Gates Foundation*

We wanted to co-invest in a fund of a sufficient size to be economically viable, and did not want our investment alone to drive the fund’s economics. It was important to have a locally-based fund management team that could build relationships and the knowledge base necessary to make sound investment decisions. The PRI charity requirements made it critical for us to find a fund manager seeking to create a fund focused on benefiting smallholder farmers, thoughtful about how its investments create impact, and willing to commit to targets specifically focused on smallholder farmer impact. The impact committee and smallholder outreach targets emerged as appropriate accountability mechanisms, given that we were not comfortable with an impact-based compensation model for the fund manager. These mechanisms were designed to align the fund manager’s social and financial incentives, and to allow Pearl to prioritize investments based on their potential to deliver impact through their growth, and then focus on promoting that growth during investment management.

The investors and fund manager took two measures to address these risks and increase the latter's capacity. First, the investors conducted extensive due diligence on the fund manager, which was more qualitative and heavily weighted on the investment team than would be for a typical investment. They spent several days in East Africa to gain insight into Pearl Capital Partners' team dynamics, decision-making processes, and due diligence strategies. This assessment reinforced their confidence in the fund manager's abilities and its dedication to improving the livelihoods of smallholder farmers.

The investors also encouraged Pearl Capital Partners to hire two medium-term employees to increase its capacity as the investment process begins. Their cost will be borne by the investors and fund manager. One employee has deal structuring expertise, helping apply lessons learned from Pearl Capital Partners' first fund to craft deals that effectively capture financial returns. The other will provide operating support to the fund and will help manage the relationship with the TA facility.

#### AN "INTENT VS. USE" CLAUSE

Pearl Capital Partners plans to focus on debt and quasi-equity investments and is unlikely to take a majority stake in any equity investments. Thus, it will have limited influence over its investees' long-term strategy. To help ensure its investments generate their intended social impact, AACF's agreements with investees will incorporate an "intent vs. use" clause. This clause allows the fund to withdraw investments if enterprises use them in ways that undermine their engagement with smallholder farmers.

#### THE TECHNICAL ASSISTANCE FACILITY

The USAID-funded TA facility will help mitigate risk for AACF's investees, the fund manager, and the investors by allocating resources to sustain investees' operations and commercial viability. Due to the emerging nature of the formalized East African agricultural sector, AACF's target investees are likely to be under-resourced and may not have skills or systems necessary to adapt to business or market challenges.

Pearl Capital Partners and the investee will jointly determine if TA is necessary and will draft the scope of assistance. USAID and the third-party TA provider contracted to manage the facility will assess the proposal. The TA provider or a sub-contractor with relevant expertise will support the enterprise in continuing to procure from, or supply to, smallholder farmers. Assistance may include procuring agronomic or post-harvest expertise, business and financial training, or investee-specific help to adapt to business environments. USAID's initial allocation for the TA facility is USD 1.5 million, and if necessary it may be able to procure additional funding, subject to U.S. Congressional approval.

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The investors conducted extensive due diligence on the fund manager and encouraged Pearl Capital Partners to hire two employees to increase its capacity.

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## STAKEHOLDER PERSPECTIVES

**This investment required willingness by all parties to compromise and be open to constructive problem-solving throughout the negotiation process. What were the key ways in which you chose to be flexible in the interest of closing the deal?**

### TOM ADLAM

*Managing Partner, Pearl Capital Partners*

When we began fundraising in 2009, it was in a very uncertain economic climate. Initially, progress was slow: we were not targeting a fund size large enough to attract development finance institutions and we did not communicate the social case in a way that was powerful enough to attract foundation investment. Learning from this experience, next time we will articulate our offering more precisely upfront so the social impact proposition is clearly represented. In addition, the negotiating process was not typical—as a fund manager operating in a pre-emerging market, we ideally would have identified an anchor investor with whom we would negotiate a draft Investor Agreement rather than enter five-way negotiations. We learned a few lessons from this process. As a relatively unproven fund manager, we were prepared to compromise on some conditions in the Investor Agreement around investor termination, which are atypical. We are bearing some expenses above normal fund management costs, such as that of the impact committee, but again we recognize we are offering a double bottom-line fund and charging a management fee at the high end of a typical scale.

### IAN ANDERSON

*Africa Program Manager, Gatsby Charitable Foundation*

I think we ultimately made the right decision by not including target-based financial incentives for the fund manager. Smallholder farmer engagement is difficult to measure and is not routinely tracked by every agribusiness. Plus, for some agribusinesses, the impact on smallholders is indirect. So while it is important to capture the number of farmers affected to get guidance on the magnitude of our impact, we cannot compensate the fund manager based on data that are imprecise. Ideally, Gatsby would have liked to pursue the conversation further to see if it could be made to work in agriculture, as it has done in other impact investment funds. However, given the breadth of deal structuring discussions, we felt it was more important to close the investment with its innovative impact governance mechanisms than to insist on a complex manager reward structure. Secondly, we would have liked to see the partnership extended to other investors to give AACF a more diverse investor base. However, as we neared deal close, we worried that doing so would delay the close and so decided not to pursue that route.

### AMY BELL

*Vice President, Social Finance, J.P. Morgan*

When we started this process in 2009, impact investing was a very new concept within the firm. There is a tremendous amount of support for impact investing work within the organization, but the specifics of this transaction required significant education for our internal investment

committee, because they needed to be confident in the full merits of the transaction for it to be approved. In addition, our firm had not participated in a guarantee with USAID before, so we needed to learn and appreciate its nuances. This deal was resource and time-intensive, though due more to the co-structuring of the entire deal with multiple parties rather than anything related to it being an impact investment. Because this market is new, we were happy to be in a partnership with others willing to act as leaders and take the time required to set an example for others to take creative approaches to delivering capital to sectors where it can have impact.

### JUSTINA LAI

*Associate, Impact Investing and Program Related Investments, The Rockefeller Foundation*

By its nature, the agricultural sector is risky, so we were initially interested in pursuing an investment in a fund that was heavily, but not exclusively, focused on agriculture to help diversify those risks. However, we were comfortable being guided towards a 100 percent agriculture-focused fund by the Gates Foundation and the Gatsby Foundation, which have mandates to focus on smallholder farmers. We were interested in seeing a diverse set of partners come together in a unique investment structure to create a signaling effect for the impact investing industry and spur additional investment. With that goal in mind, it was critical for our investment to leverage commercial capital, though it was not needed to close the deal. To demonstrate ways in which different forms of capital could come together in other, perhaps larger, fund structures, we were willing to take on more risk than if we were only interested in capitalizing the fund itself.

### DAVID ROSSOW

*Program Investment Officer, Bill & Melinda Gates Foundation*

Each investor contributed certain areas of expertise, and their attendant priorities, to the investor group. There were varying perspectives related to risk/return trade-off, measurement and evaluation frameworks, the depth of focus on smallholder farmers, and the degree of LP direct influence on fund governance. We, like each of our co-investors, made concessions. Luckily, throughout the structuring and documentation discussions, each valued the perspectives of its peers and employed consensus building and governance frameworks that prioritized diversity of opinion over capital contribution. Though the process was time consuming and expensive, we think the resulting fund reflects the goals, priorities, and expertise of the broad investor group and is stronger for it. Importantly, we also believe that the fund will positively impact our target population of smallholder farmers and demonstrate the viability of SMEs affecting smallholders as investible options.

## Conclusion

The African Agricultural Capital Fund's goal is to improve the livelihoods of smallholder farmers by investing in agricultural enterprises that engage them in their business models. Through five-way deal structuring negotiations, the investors and fund manager worked to proactively support the fund in sourcing investments with commercial viability and high potential to generate social impact. They established innovative impact governance mechanisms for the fund and sought to mitigate risk by establishing the USAID-backed technical assistance facility and strengthening fund manager capacity. Though the process was resource intensive, it demonstrates how diverse stakeholders—a fund manager operating in East Africa, a U.K. foundation, two U.S. foundations, a U.S. government agency, and a global commercial investor—worked together to create an investment that accommodates each of their financial and social objectives.

## The Stakeholders

### THE BILL & MELINDA GATES FOUNDATION

**BILL & MELINDA  
GATES foundation**

The Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives. In developing countries, it focuses on improving people's health and fighting hunger and poverty. In the United States, it seeks to significantly improve education so that all young people have the opportunity to reach their full potential.

### THE GATSBY CHARITABLE FOUNDATION



The Gatsby Charitable Foundation, endowed by Lord David Sainsbury in the U.K., has more than 40 years of grant-making history. Gatsby has funded programs in Africa since the mid-1980s with the aim of stimulating economic growth. The Foundation's work is focused on promoting economic development that benefits the poor through support to key sectors and markets in East Africa. In 2004 Gatsby created African Agricultural Capital, a venture capital fund that invests in agriculture-related SMEs in East Africa, with a goal of unlocking opportunities in agricultural value chains.

### J.P. MORGAN SOCIAL FINANCE

**J.P.Morgan**

JPMorgan Chase & Co. is a global financial services firm with assets of USD 2 trillion. J.P. Morgan Social Finance was launched in 2007 to service the growing market for impact investments, meaning those investments intended to generate positive impact alongside financial return. There is growing recognition that innovative business models can complement limited public sector and philanthropic resources by delivering market-based solutions to low-income and excluded communities in a sustainable and scalable way. The Social Finance business is dedicated to servicing and growing this nascent market through principal investment, thought leadership and client advisory.

### PEARL CAPITAL PARTNERS



Pearl Capital Partners is an independent agriculture investment management firm domiciled in Mauritius and licensed by the Mauritian Financial Services Commission. It has an advisory subsidiary based in Kampala, Uganda. It invests in growing small and medium sized businesses in the East African agricultural sector, typically using a combination of equity, quasi-equity, and debt instruments. It was established to address the lack of financing available to these enterprises, which have the potential to develop value chains, deliver social impact, and produce competitive financial returns.

### THE ROCKEFELLER FOUNDATION



The Rockefeller Foundation, a global philanthropic organization based in New York City, supports work that expands opportunity and strengthens resilience to social, economic, health and environmental challenges. The Rockefeller Foundation realizes that there is not enough public and charitable capital to solve the world's social and environmental problems. In response to this, the Foundation created a USD 42 million Harnessing the Power of Impact Investing initiative, which gives grants to catalyze the leadership that this emerging industry needs at this crucial stage in its development. The Foundation also oversees a USD 25 million program-related investment (PRI) portfolio, in the form of loans, equity, and guarantees, which aligns with the Foundation's issue areas.

### U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT



For 50 years, the American people, through the U.S. Agency for International Development, have provided economic development and humanitarian assistance to people around the world. By creating the conditions to help countries move from poverty to prosperity, USAID serves both the American public and millions of people living in developing countries, countries affected by natural disasters, and countries in transition.

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## Global Impact Investing Network

The Global Impact Investing Network (GIIN) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. The GIIN's programs center around four key initiatives. The GIIN Investors' Council is a diverse, global membership group comprised of leading impact investors with a goal of enabling rigorous impact investments, efficient and enhanced social and environmental performance, and deployment of private investment capital to address social and environmental challenges. The Terragua Working Group within the Investors' Council is focused on impact investing in sustainable agriculture in sub-Saharan Africa. The Impact Reporting and Investment Standards (IRIS) is a set of metrics that can be used to measure and describe an organization's social, environmental, and financial performance. ImpactBase is the online global directory of impact investment vehicles. It reduces search costs for investors and fund managers, and brings order and transparency to the previously opaque impact investing marketplace. The GIIN Outreach initiative elevates the profile of impact investing by highlighting industry progress and best practices.

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