A streamlined approach to impact investing in Sub-Saharan Africa

Due diligence in developing markets

TRAIN Due Diligence Tools: Process Guide

October 2019

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The 'TRAIN' partnership launched in 2017 with a focus on enabling early-stage investment in Africa

TRAIN aimed to catalyze more investment into high-impact SGBs in East and Southern Africa, demonstrate the power of local talent to unlock investments in SGBs, and show the effectiveness of streamlined due diligence processes to reduce transaction costs.

- The TRAIN partnership (2017-2019) was formed between USAID, Open Capital Advisors (OCA), and seven Africa-focused impact investors
- TRAIN's initial target was $5.25 million in capital deployed to small & growing businesses (SGBs): >$24 million was raised by the program end in 2019
- Key TRAIN objective to develop and test streamlined due diligence approach to accelerate SGB investments in Africa; this approach was developed through 2 years of iterations with our investors
- Resulting knowledge tools shared publicly: see "TRAIN Due Diligence Tools"
- This document is a process guide to introduce and share context to better enable usage of the TRAIN Due Diligence Tools
- Intended audience: SGB investors & ecosystem support players in public & private sectors

$5.25 million TRAIN investment target

$24.1 million TRAIN investments achieved

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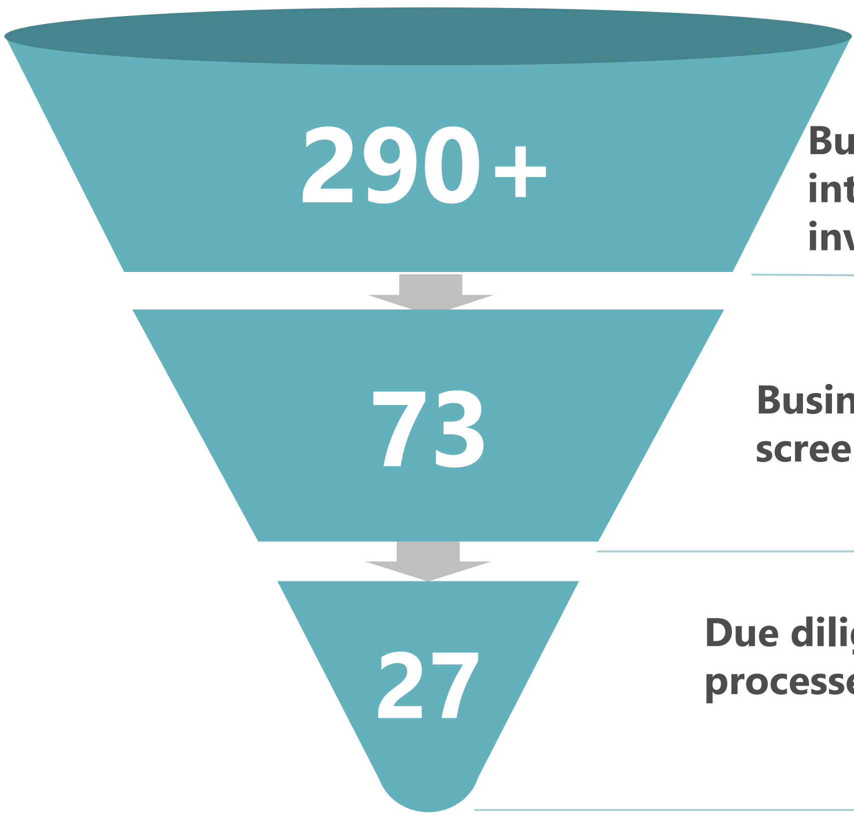
TRAIN's process focused on 3 step 'filter', working individually with each of the seven TRAIN investors

Streamlining facilitated quick decision making



Businesses introduced to investors

Businesses screened

Due diligence processes

$24.1M **Raised in new capital**

Key process features

- Process aimed at getting investors to "quick yes/no" at each stage to focus only on companies that fit core criteria
- Screening involved 2 pagers, due diligence focused on streamlined but robust process
- Key streamlining efforts on efficient data gathering: enabled more informed due diligence, and faster decisions

Observation: with sufficient information at screening stage, "full" due diligence process had significantly higher conversion rate than expected

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Frontier markets present unique challenges which complicate due diligence efforts

Limited data to inform decision making	• Many SGBs in developing markets are early stage, with limited traction to accurately project growth • Growth is often projected based on limited company and market data, with investors placing a strong bet on management's ability to drive strategy
Investment readiness support gap	• SGBs struggle to meet investor requirements including financial models, market segmentation, and prioritization of growth strategy • SGBs have limited access to accelerators and incubators to advise on capital raise • Difficulties in articulating business impact and needs creates the perception that early stage businesses are risky investments
Small investment relative to transaction cost	• Many of the SGBs in developing markets seek small capital investments, often under $1 million to accelerate growth • Transaction costs are therefore high relative to investment deals, limiting the amount of deployable capital in the region
Limited market and expertise	• Many international investors see opportunity in developing markets but lack local presence, limiting their ability to fully understand the market • This includes market size and trends, technology, and impact of macro-level social and economic factors on businesses

In these markets, knowledge gap between businesses and investors is a significant constraint

Investment constraints among businesses

- Difficulty preparing business and strategic growth plans
- Challenges with identifying accurate capital need and projecting growth
- Limited understanding of how equity investments work, and the supporting documents required
- Seeking small capital investments, often under $1 million

Due diligence constraints among investors

- Gathering sufficient information to guide decision-making is time consuming
- High transaction costs relative to small investment deals in the region
- Informality of businesses, hence challenges developing equity structure
- Limited market data available to remotely assess and understand landscape

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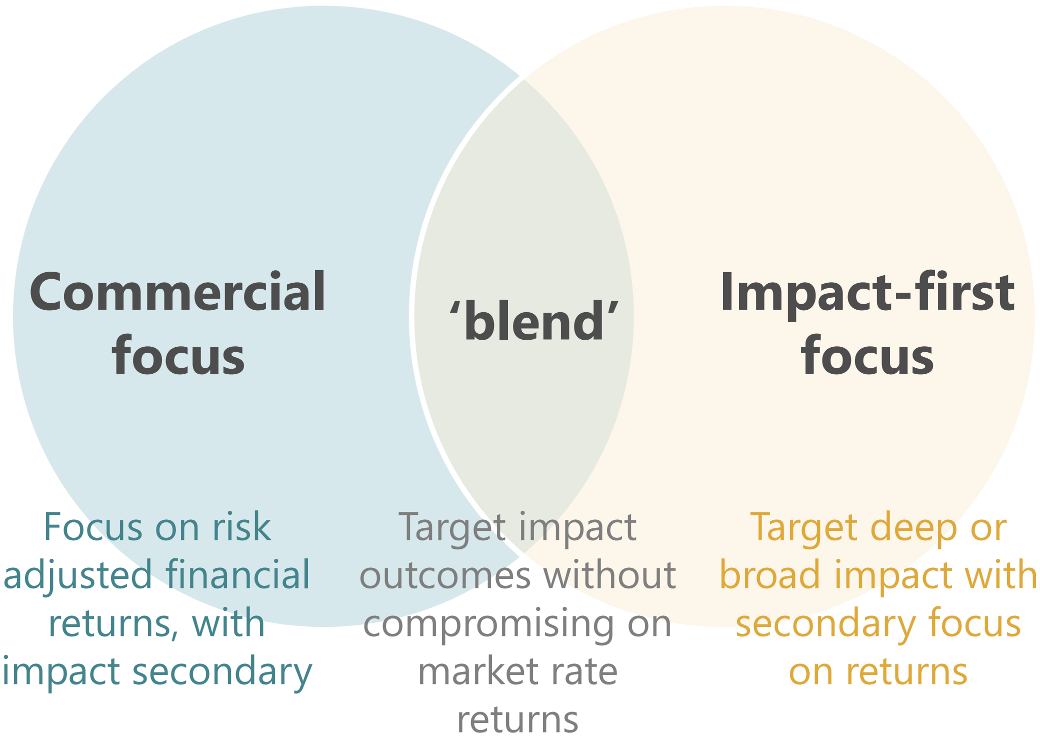
- Early stage businesses may not entirely meet investment readiness expectations, and often struggle to speak the same language as investors
- Conventional due diligence process is also not adapted to suit local market dynamics, hence investors miss out on great investment opportunities in the market

While investment thesis and due diligence processes differ among investors, many core criteria are the same

Investor Thesis



All TRAIN investor diligence criteria aligned on several factors:

- Value proposition and business model viability
- Management competency and effectiveness of organization structure
- Market landscape assessment, e.g., demand, competition, market share
- Internal systems, reporting and controls across functions
- Strategic growth plans and projections
- Financial performance and capital need

A core TRAIN goal was to create a "menu" approach to due diligence that could be shared across investors, but enabled different 'deep dives' based on individual criteria

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TRAIN iterated with investors to streamline each step of the DD process, while recognizing the need for a robust review

Timing	Step	Description	Streamlined approach	Targeted outcome
0-2 weeks	Sourcing	Quick review of businesses through internal or external leads	Presented tailored pipeline based on investor's criteria and fit	Increased potential pipeline, often broaden investment criteria
2-5 weeks	Screening	High-level assessment on operations, team, market prospects and strategy	Brief conversation with business to build 2-pager memos	Answered key questions to get to a quick yes/no under a few weeks
4-8 weeks	Due diligence	Targeted assessment of business model, and areas of concern from screening	Menu approach to selecting 2-4 key areas for due diligence	Improved decision-making through deep-dives in critical areas
	Investment	Review of findings from due diligence, capital need and structure assessment	Provided support on investment structuring and closing	Support innovative investment structures
	Post-investment support	Talent-enabled post-investment support model to reduce investor risk	Provided embedded support where necessary based on key findings	De-risked investment by providing support in key areas of the business

Through TRAIN's streamlined process, average time taken from initial screening to final decision was reduced from 4 to 2 months

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The TRAIN DD Tools were designed to support investors to lead their own streamlined processes, where resources allow

Screening	Due diligence	Investment decision
✓ **Comprehensive document request list** to simplify requests for businesses[1] ✓ **01 Two-pager screening memo** to highlight opportunities and risks	✓ **02 DD planner** to set meetings, track files, and select focus areas ✓ **03 DD questionnaire booklet** to guide interviews ✓ **04 DD platform** to guide assessment areas and presentation of findings	• **05 Scorecard and investment decision tool** to provide scores against investment criteria • Includes areas to highlight strengths and weaknesses

Note:

- While the "TRAIN Due Diligence Tools" facilitate the due diligence process, a firm understanding of markets, deal assessment and risk analysis is crucial to assess opportunities and advise investors
- Tools are designed to help DD teams to quickly gather relevant information and reduce the level of effort from the businesses to streamline the process
- Success of the DD process relies heavily on the team's ability to ask the right questions and tailor an approach to acquire relevant facts and generate insights to inform decision making

Note: [1]Comprehensive document request list is included in the Due diligence planner for ease of reference throughout the screening and due diligence process; due diligence teams should consider sharing a preliminary list with businesses, containing only documents required for initial screening at this stage, and build up requests during due diligence as required

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It is critical for the due diligence team to guide the entrepreneurs through the process, building trust

SGBs often have limited documentation to comprehensively assess financial and operational performance	Hold calls to make process less arduous on business, identify data they can easily access and understand strategy during screening
Entrepreneurs are often apprehensive about sharing data earlier on in the screening process	Seek to determine business model viability and get a quick read on management's vision and ability to deliver on strategy
Capital need articulated may vary significantly from true need due to limited analysis or unrealistic projections	Aim to understand rationale for their stated capital need, breaking down each bucket of needs to granular levels to guide estimation

Deep market knowledge and extensive experience of the due diligence team is key to a successful process

Deep market knowledge

Existing local market knowledge will build trust faster with entrepreneurs, ask tailored questions that gather data faster, and develop key diligence insights earlier

Analytical capabilities

Requires comfort conducting analysis with limited financial and operational data, focused instead on scenarios, cross-checks, and understanding relative important of risks

Strong interviewing skills

Teams must ask the right questions to gather input to populate the DD Tools: tools pre-empt many of these questions, but they must still be tailored to each business context

An effective team can break down expectations into granular data and relatable questions that early stage businesses can relate to and is able to derive insights from available data.

For example, a business may not have a financial model, but sales data and budgets can be used to provide insight into performance and growth prospects.

Successful due diligence streamlining requires close collaboration with key decision-makers

Commitment to get to "no" quickly

- Most investors will say no to most opportunities: when it's a "no", the goal is to arrive at this outcome as quickly as possible
- Upfront understanding of investor priorities enables quicker decision on when to stop the process

Defining key decision points upfront

- Identifying the most critical areas to diligence, enabled by use of the menu approach
- Focusing on high risk areas based on deal breakers

Risk appetite to make decisions with limited data and bet on management team

- Understanding that early stage businesses have limited traction to definitively prove business case hence a strong team is essential
- Leveraging due diligence expertise and market learnings in the region to understand the business' market and ecosystem

Learning from other investors and providing follow on support to de-risk investment

- Collaborating on deals to share transaction costs and leverage learnings from previous investments across the region
- Providing post-investment support to address key challenges noted during due diligence