Pacific RISE

Pacific Readiness for Investment in Social Enterprise

Australian Aid

Pacific RISE – The Design of a Power Dynamics Framework

May 2020

How biasing of traditional finance models in the Pacific affected deal-making

Background

Pacific RISE was designed around a traditional impact investment model, evolving to partnering with impact investment organisations to test different financing structures in Pacific island countries.

By May 2020, Pacific RISE had a portfolio of 14 existing deals – at various stages of the investment process – that had used a variety of social finance models and capital types in framing impact investments. In late 2019, in partnership with the Criterion Institute, we analysed each of the deals – 'deal mapping' – and the portfolio overall to identify important learnings and possible leverage points for Pacific RISE to intervene and better ensure a deal's success.

The deal mapping process reviewed core deal documents and held interviews with businesses, intermediaries and investors. For each deal, we outlined:

» the type of capital, deal history and scoping processes

» key stakeholders and the relationships across and within stakeholder groups

» how gender analysis was conducted[1]

» due diligence and deal dynamics

» business, financial and operational risks.

The deal map immediately showed power dynamics were evident between intermediaries and enterprises that either worked for or against actors in the various scenarios.

The portfolio analysis looked at the role of funders (including investors, donors and foundations), how they valued knowledge, relationships, time frames and capital models, and how they denoted specific patterns of success or failure across deals.

At the same time as working with Pacific RISE, the Criterion Institute – in partnership with the Government of Canada – was developing a set of process metrics that support social equity investment goals for the Canadian Social Finance Fund. Criterion applied the Pacific RISE power analysis to its research on other social finance and impact investment process models, developing additional insights into the investment process that helped deepen our understanding of power dynamics in the Pacific RISE portfolio.

The portfolio analysis found that traditional finance models are underpinned by a deeply held cultural value that **those who hold the most capital deserve the most power:**

» investor risk profiles are privileged over entrepreneur and community risk

» preference for high-growth scalable equity opportunities is normative

» deal terms are often sourced from finance-first models rather than being contextualised, and can be inappropriate in social investment contexts.

By shifting away from traditional finance models, organisations were able to make more equitable deals that were ultimately more successful.

The analysis led to the design of a power dynamics framework that Pacific RISE will use to assess current and future deals.

Pacific RISE power dynamics framework

Pacific RISE's research found that the overarching power dynamic is the privileging of traditional funding models in social finance, setting many norms and expectations around the investment processes.

From the analysis, we developed a framework identifying seven power dynamics that manifested during the Pacific RISE deals. How these power dynamics played out was critical to the success of social investment, whether capital moved at all, and whether the money helped the business. Table 1 outlines the power dynamics, provides examples of how the dynamics manifested in deals, and discusses what implications – both positive and negative – the dynamics had on deal-making.

[1] All Pacific RISE intermediaries were given gender lens training and were supported to use gender analysis alongside financial analysis in deal-making. We analysed how or whether they used the analysis.

The seven power dynamics and their implications for Pacific RISE deals

Power dynamic	How this dynamic manifested in Pacific RISE deals	How this had positive (+) or negative (–) implications for deal-making	Portfolio-level implications
Knowledge – which skills and experience are valued? *Across social finance, this dynamic often manifests as privileging financial expertise over local cultural and social expertise.*	Across multiple deals, Australian or other 'Westernised' investors and financial intermediaries without expertise in the Pacific's unique risks and opportunities were brought into deals as decision-makers. For example, many investment committees had limited or no Pacific Islander members, preferencing finance experts from outside the Pacific.	– Not prioritising Pacific-based or Pacific-experienced investor knowledge resulted in ill-matched deal-making in multiple cases and wasting of resources. – Financial intermediaries' knowledge of equity investments and preference for scalability were privileged over enterprises' knowledge of their needs for debt and regionally focused expansion. – An intermediary's opinions on what steps a business should take were prioritised as 'better informed', resulting in the enterprise feeling the deal didn't suit its context appropriately and deciding not to move forward. + Deals were more successful where the intermediaries or investors held a deep commitment to local partnership and valuing regional context, which they translated into contextualised expectations for partners.	If the capacity building and fundraising had catered to the enterprises' stated needs, rather than what was viewed as 'best' for expanding internationally, Pacific RISE's intervention may have been more successful in some cases.
Access – who is considered 'worthy' to access capital and resources? *Recipients of traditional investment capital, such as angel investment, trend significantly towards being male, white, and Western-educated.*	Entrepreneurs from the Pacific, regardless of their unique business context and needs, are often still held against the standards of traditional investment capital, being viewed as needing extensive 'capacity building' in order to be considered 'investment ready' for Australian funds.	– In some cases, the approach of identifying social enterprises that fit the characteristics of more traditional Australian or New Zealand businesses – including a preference for high-growth scalable businesses when providing access to capital – resulted in a narrower pipeline and lost opportunities. – Access dynamics became a greater challenge when there were no clear criteria for who 'qualifies', and when intermediaries had primary control over determining what qualification looks like, without being accountable in adhering to particular standards of access. + Partnerships with Pacific networks and non-traditional finance actors were able to rethink 'investment ready' outside of the traditional finance or business model, which enabled inclusivity and investment in informal businesses.	Connect to how enterprises are identified and how investor pitches are structured.

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Decision-making – who holds power across each phase and process? *Decision-making is most often monopolised within deals by the capital holders, who are viewed as holding the most essential resources above the enterprises creating a social impact.*	Within Pacific RISE, this dynamic manifested in multiple ways. Intermediaries, investors and funders dominated decision-making around pipeline inclusion, design and financing of capacity building, and approval of program-level activities. Flexibility in deal decision-making tended to see more success.	– Even before investors became involved with specific deals, this dynamic emerged as intermediaries were tasked with building the capacity of enterprises according to the intermediaries' own standards. – The design of the scoping rounds meant intermediaries held primary decision-making power over which enterprises were scoped and to what extent. This also meant that the intermediaries were controlling what came through the pipeline for all potential deals that Pacific RISE would see. + Where strong relationships and in-country partnerships existed between investors, this tended to lead to dual decision-making and trust across investment partners. – Enterprises were not empowered to decide which intermediaries were the best fit for them or who they would prefer to work with. This also impacted on what type of capital was offered. + Where an intermediary was investing in a range of businesses in a sector or theme, more attention was paid to the needs of the enterprises as they were able to opt in or opt out of finance.	Representative decision-making structures ensure not simply that other stakeholders have access to decision-making, but that control is effectively shared. Decision-making dynamics determine who holds power across each process.
Timing – whose time frame matters most and sets the pace? *It is often a tension within traditional investment that investors have the luxury of time to draw out process, while entrepreneurs struggle to manage fundraising alongside maintaining business operations.*	Pacific RISE found the consideration of an enterprise's timeline needs to be prioritised to ensure deal success. The Pacific is ripe with commodity supply chains, and markets for those commodities can shift quickly. Sensitivity to the timing of a business's needs is essential.	– In some deals, the drawing out of due diligence, decision-making and approval processes, with little communication around timing, put significant financial strain on some intermediaries and enterprises. + We saw cases where intermediaries learned from previous experience about when to approach an enterprise. One intermediary began to factor the harvesting period into their investment timeline to ensure this key period for the enterprise wasn't negatively affected.	Expectations around approval and due diligence processes can be better managed to have more positive outcomes.

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Transparency – who gets to know what, when? *The traditional model for investment puts pressure on enterprises to reveal as much information as possible to investors, while the capital holders are not required to provide the same level of openness to enterprises to reassure them of the ability to provide capital or relevant advice/expertise.*	Within the Pacific RISE portfolio, when investors were transparent about expectations with enterprises, the processes were more positive.	+ Transparency on the due diligence process led to clarity around enterprise and investor needs and time frames. – In a state of limbo (and at times with an expectation of receiving capital or funding), enterprises were frustrated with protracted due diligence without an explanation. – Unclear criteria and expectations around capital raising, approval processes and decision-making steps resulted in frustration and confusion on the side of enterprises, who had spent time preparing for investment and believing it was possible. – Pacific RISE had little visibility into how intermediaries were communicating with targeted businesses and investors. Often the investment discussions were anonymous.	A core set of transparency principles and practices is essential in building trust in social finance deals.
Risk sharing – whose risks are prioritised and mitigated? *Typically, the risks of investors are privileged over recipients of capital, with extensive resources spent on evaluating investor risk, while scenarios of risk to communities or other stakeholders are rarely modelled.*	Risk-sharing dynamics emerged not only around Pacific RISE deals, but also between program stakeholders – the Department of Foreign Affairs and Trade (the funder), Coffey (the managing contractor) and the Pacific RISE team.	– Pacific RISE program design and contracting disincentivised risk to the funder by preferencing safer deals and shifting the risks to the managing contractor. – In many cases, entrepreneurs were not paid to work with intermediaries, and enterprises spent time, money and effort on investment discussions without a promise or guarantee of capital. – Investors often remained uninvolved until a 'ready' opportunity was presented. + In cases where the intermediary became the 'guarantor' for the finance to the enterprises – particularly in the informal economy – the risk analysis had greater valuation of the business risk and support to navigate these risks.	Risk sharing is a moral imperative when social funders enter into marginalised communities.
Alignment/incentives – who is structurally incentivised to do what? *How contracts are drafted can either support or undermine social financing goals, as it is the terrain where expectations are set around fulfilling social impact obligations versus meeting financial or other program-specific targets.*	Pacific RISE's process provided incentives through forms of funding to intermediaries to carry out scoping missions. We also saw that some intermediaries were contractually obligated with funding milestones to move capital towards enterprises, while others were not.	– Intermediaries were paid for their time and travel, while enterprises were not. +/– Structuring financial incentives into contracting can play out in either positive or negative ways – an urgent incentive to move capital can result in rushed deal-making, or a lack of milestones or incentive can lead to deals not moving forward. + Within one deal, a 'mission lock' was included in a contract clause, which gave the enterprise leadership the power to veto certain business recommendations of investors if they were deemed to compromise the enterprise's social mission. Such contractual terms align both leadership and investors behind the social mission, putting a 'check' in place.	Paying attention to the contractual obligations of intermediaries to pursue the best interests of enterprises is essential in building trust and sustainable connections.

How Pacific RISE is adapting to these implications

Based on this analysis of power dynamics, Pacific RISE is shifting its strategy from a 'top-down' to a 'bottom-up' approach with the following characteristics:

- **Pacific-led, rather than led by traditional finance models** – intermediaries focus on planning for business and community needs, instead of entering a deal with a specific type of capital already determined.
- **Scaling and capacity building** – no assumption that, for the investment to work, the enterprise must scale or somehow be 'fixed' with technical assistance.
- **Positive manifestations of power dynamics in deal-making** – the most successful deals, or those with the potential to be successful, are exhibiting power dynamics that support positive social investment outcomes.

Pacific RISE's power dynamics framework has become part of the program's early-stage due diligence process for new partners and opportunities. We are using the framework to examine where challenges can arise and how to find better financing options for the Pacific.

Case Study

Investing for a good return

Australian non-profit organisation Good Return designed an impact investment model to catalyse investment and growth in the Pacific impact investment ecosystem. The model equips entrepreneurs with the resources they need to grow their business, and matches them with the partners best placed to help, including local financial service providers and technical partners.

Good Return identifies technical partners to help link social entrepreneurs to markets, and provides access to funding, financial products, business tools and technical support. They also leverage Australian funds to underwrite risk, incentivising Pacific banks to fund underserved businesses.

Through its work, Good Return is building the case for why investing in women entrepreneurs is a smart investment, and how increasing workplace equity can benefit organisations.

To date, Good Return has supported over **65 Pacific small and medium-sized enterprises** (SMEs) and smallholder farmers. Pacific SMEs have received **$198,615 in loans** and finance, alongside financial literacy training, business advisory services, and support to fill in loan applications.

Good Return is also launching a $1 million social impact fund to scale their work globally.

Pacific RISE is supporting the design of new investment vehicles that package finance specifically for a set of enterprises in the Pacific. We are working with partners that have stronger connections to the Pacific, such as diasporas and non-government organisations, rather than 'repackaging' traditional equity-heavy finance models.

Case Study

Designing a finance vehicle for menstrual health trade in the Pacific

Pacific RISE's engagement with the region's menstrual health enterprises demonstrates how moving from a traditional finance model to a contextualised social impact model can create investment opportunity for a group of enterprises.

What started as a direct enterprise-level investment through an early-stage financing opportunity has now been redesigned into a coordinated ecosystem-level investment.

The menstrual health enterprises didn't want to scale, knew their businesses and capabilities, and wanted to provide their communities with safe, affordable and accessible menstrual health products. The enterprises' main barriers to achieving their business goals were supply chain issues. Materials were very expensive, unreliable and hard to find locally due to transport and other logistics problems.

Pacific RISE is now working with a collective of ecosystem players – financial intermediaries, international NGOs, suppliers and, of course, the menstrual health enterprises themselves – to create an investment opportunity that will support removing supply chain barriers and benefit a whole market of producers.

For more information please contact

Amanda Jupp
Facility Manager, Pacific RISE
amanda.jupp@pacificrise.org

www.pacificRISE.org