STRUCTURED FUNDS

A balancing act between financial sustainability and development impact

Executive Summary

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EXECUTIVE SUMMARY

It is estimated that up to 4.5 trillion US dollars in global investment are needed every year to achieve the Sustainable Development Goals (SDGs) in developing countries (UNCDF, 2018). Even a substantial increase in official funding deployed and recognised as Official Development Assistance (ODA) by the members of the Development Assistance Committee of the Organisation for Economic Cooperation and Development (OECD-DAC) would not even come close to meeting this financial requirement. For example, an increase in ODA by the OECD-DAC donor countries to 0.7% of their gross national income (GNI) in line with the so-called ‘0.7% target’ would mobilise an additional 175 billion US dollars, and thus only cover part of the financing gap (Move Humanity, 2018).

Against this backdrop, the involvement of private actors in development cooperation is becoming increasingly important. Involving private actors offers opportunities not only for closing the financing gap, but also for sustainable economic development in developing countries. Nine out of ten jobs in developing countries are provided by the private sector (World Bank, 2013), and small and medium-sized enterprises (SMEs) make up the largest share of all enterprises in the formal sector in developing countries. On average, SMEs account for more than 30 per cent of private sector employment and for about 4 to 16 per cent of total employment (EUIFI, no date). At the same time, many small and medium-sized enterprises in developing countries still lack access to finance. The demand for financing among micro, small and medium-sized enterprises (MSMEs) is estimated at 8.9 trillion US dollars – the current credit supply, on the other hand, at only 3.7 trillion US dollars (IFC, 2017). This means that some 40 per cent of microenterprises and 44 per cent of SMEs in developing countries are credit constrained.

In the Addis Ababa Action Agenda 2015, donor countries argued for greater use of innovative financing mechanisms to involve the private sector in development finance (UN, 2015). ODA should be used strategically to mobilise additional private financial resources for sustainable development, and to support investment that drives social, environmental and economic progress in partner countries. The financing mechanisms thus also target commercial private investors that have not yet invested in these areas and expect market-standard risk-return profiles (WEF and OECD, 2015).

Structured funds, which are the focus of this evaluation, are one such financing approach.

Box 1 Structure and decision-making in the funds

In development cooperation, structured funds are a financing approach that aims to mobilise additional private capital to finance SDGs in developing countries. These funds usually combine budgetary resources of the German Federal Government, and capital market funds of the KfW Development Bank and/or other financial institutions, with investments from private investors. The official donors in the fund assume a large part of the investment risk, thus reducing the risk for private investors.

The funds' capital (i.e. the liabilities side) is usually split between three tranches and notes[1]. The so-called waterfall structure distributes the risks and returns of a fund to the investors in a fixed order (tranches and notes in order of decreasing risk: junior, mezzanine, senior and notes). The riskier tranches then serve as a risk buffer for investors in less risky tranches. Official donors typically invest in the risky junior tranche, thus assuming a major part of the investment risk. The junior tranche is also called the first loss tranche, as it is the first to bear any losses incurred.

The roles and responsibilities for decision-making in the funds are clearly distributed between the individual investors and the funds’ official bodies. The official bodies safeguard the strategy of a fund, including its development objectives. The Board of Directors is responsible for all overarching fund matters,

[1] Similar to an asset class that investors can invest in

while the Investment Committee decides on the fund's investments, based on proposals from the fund manager.

The structured funds financing approach aims to support three main development objectives: 1) to promote the establishment of stable and inclusive financial systems by providing local financial institutions, the so-called financial intermediaries (FIs), in the partner countries with funding and technical assistance (TA); 2) to reduce under-capitalisation in the partner countries, especially of MSMEs, as supported FIs issue a higher number of loans, thereby creating access to financing; 3) to shape and expand the portfolio of FIs in favour of sub-borrowers with particularly high financing needs.

The number of structured funds involving German development cooperation has risen sharply since 2005. Most of the structured funds evaluated here were established between 2009 and 2012. Furthermore, Germany's Federal Ministry for Economic Cooperation and Development (BMZ) plans to ramp up its investment in structured funds with a focus on SMEs as part of the Emergency COVID-19 Support Programme, in order to bridge liquidity shortages and preserve jobs in partner countries. However, little is known about the impact of structured funds on development objectives. The financing approach faces a trade-off between its aim of financial sustainability and market conformity, and the aforementioned development objectives. This evaluation examines these conflicting priorities from various perspectives.

Objectives of the evaluation

In light of this question, the German Institute for Development Evaluation (DEval) conducted an evaluation of the structured funds financing approach. This evaluation examines structured funds on several levels: the level of development objectives, the level of the financing approach and its structure, the level of the FIs and the level of the sub-borrowers. It also focuses in particular on the circumstances under which structured funds are additional to existing financing approaches in development cooperation (additionality criterion).

It pursues the following aims:

- Relate structured funds to the objectives of German development cooperation
- Analyse the implementation of development principles (division of labour, donor harmonisation, strengthening of regional actors)
- Analyse the financial sustainability and efficiency of the funds
- Analyse the contribution made towards mobilising additional capital
- Analyse the characteristics of FIs and sub-borrowers that are reached and the impact of the funds.

Methods

The evaluation was based on a theory of change (ToC) developed specifically for structured funds. The ToC models the causal relationships and change processes that are assumed to occur when structured funds are used, based on social science theories. Applying the reconstructed ToC, the evaluation team identified the focal areas of the evaluation and formulated the evaluation questions. These can be clustered under the following three sets of questions:

Set of questions	No.	Evaluation question
Alignment with German development-policy objectives and development principles	1	To what extent do the objectives of structured funds match the strategic objectives of the BMZ? To what extent are structured funds a suitable financing approach for achieving these objectives?
	2	To what extent do structured funds promote a division of labour, donor harmonisation and the strengthening of local actors?
Mobilisation of additional capital/financial sustainability	3	To what extent are structured funds effective and efficient in leveraging private capital and the capital of (development) financial institutions?
	4	To what extent do structured funds create sustainable financing structures?
Effects on FIs and MSMEs/employment	5	To what extent do grants spent on TA help achieve the structured funds' objectives?
	6	To what extent do structured funds affect the portfolio of FIs and their success in reaching new target groups?
	7	To what extent do structured funds affect MSME development, employment, income security and self-employment?

In answering the evaluation questions, the OECD-DAC evaluation criteria[2] were considered and the additionality of the financing approach was also assessed at various levels (see Table 4 and Sections 4.3, 5.4 and 6.3).

To answer the evaluation questions, sources and methods were triangulated. The data sources include semi-structured interviews, fund and BMZ documents, secondary data on financed financial intermediaries (FIs) and specialist literature. In total, 122 interviews were conducted with representatives of the BMZ, the KfW Development Bank, investors, the fund bodies, the fund managers, the FIs, the sub-borrowers and experts. Part of the data was collected using a survey among FIs as well as case studies in Tunisia, Cambodia, Nigeria and Serbia. The country cases were selected using a two-step indicator-based procedure.

Following a mixed-method approach, the evaluation applies and integrates qualitative and quantitative methods of analysis. For all evaluation questions, a qualitative content analysis of the 122 interview protocols and approximately 500 fund and BMZ documents was used. Elements of process tracing were applied to assess the quality of this evidence. In addition, a Qualitative Comparative Analysis (QCA) examined the factors that encourage or hinder private investment in the funds to answer evaluation question 3. The answers to evaluation questions 5, 6 and 7 are based on a causal analysis and are limited to the funds operating in the

2 The evaluation criteria were discussed and agreed on with the reference group prior to the reform of the DAC criteria in 2019 (which now also include the criterion of coherence).

field of MSME financing. For this purpose, a contribution analysis based on the ToC was carried out. To test the underlying assumptions and risks of the contribution analysis, the evaluation combined the qualitative analysis of semi-structured interviews with the quantitative analysis of secondary data on the FIs. In addition, a logistic regression analysed what factors influence the selection of countries and FIs to be financed. Finally, the evaluation analysed the effects of fund financing on the portfolio development and lending terms of the financed FIs using a quasi-experimental design (differences-in-differences approach).

Findings

The findings of the evaluation provide answers to three overarching questions:

1. When is a structured fund appropriate for achieving development objectives? (appropriateness)
2. To what extent can the approach mobilise private capital? (mobilisation)
3. How do the funds affect FIs and to what extent do they reach sub-borrowers? (impact)

Appropriateness of the approach for achieving development objectives

To understand how best to use structured funds in German development cooperation, DEval analysed under which circumstances this financing approach is appropriate for achieving development objectives, and in which cases other approaches may be preferable. Both the financial and the development perspectives were considered, which can conflict with each other.

Financial sustainability

The financial sustainability of the financing approach was assessed in the evaluation using a rating scale. This scale measures the financial sustainability of a fund through its ability to cover costs, its use of the official capital on a revolving basis and the efficiency of the risk-return structure (see Section 4.1 for a detailed description of the rating scale). When a fund is able to cover its costs and uses the official capital on a revolving basis, the evaluation team considers it to have achieved financial sustainability. Where an efficient risk-return structure is also in place, the evaluation team considers the financial sustainability requirement to have even been surpassed.

The majority of the evaluated funds break even within a few years of their establishment, and use the official capital on a revolving basis. Most of the funds are therefore considered financially sustainable. To be able to cover all costs, a fund requires a sufficiently large size and opportunities for diversification. Financing volumes far below 100 million US dollars or overly severe restrictions on diversification usually have an adverse effect on the business development and therefore the financial sustainability of a fund.

The use of country windows in the junior tranche of some funds, which provide for investments in certain countries, leads to partial efficiency losses. The way the country windows have been designed on the liabilities side of the funds so far has meant that the income and losses for the investments in the junior tranche are distributed by country of investment rather than across funds. This not only causes additional costs, thus reducing the efficiency of the funds, but also increases the complexity of the structure. This is why the financial sustainability requirement can be considered to have been surpassed in only a few cases. On the asset side, the country windows also restrict the funds' diversification options.

In most cases, official capital in the examined funds is deposited in the junior tranche of the funds with unlimited duration. With few exceptions, for this capital there exists neither an exit strategy that defines the timing and nature of the exit, nor fixed mechanisms for regularly reviewing the continued need to use official capital in the fund. Thus in many cases it is not sufficiently clear what long-term options for exiting the funds are available to the official donors.

The structure of the funds enables them to issue small-scale loans as well as local currency loans and to cooperate with private FIs: Most of the funds issue mainly small loans of less than 10 million US dollars. They also issue individual larger loans that address, among other things, the needs of large local FIs or project financing in the area of renewable energy. In addition, nearly all funds offer local currency financing to a certain extent. However, most financing continues to be in hard currency (US dollars, euros). Whether grants are issued in local or hard currency depends on the risks that the funds can bear and the needs of the financed FIs. For example, larger, more formalised FIs often have no need for local currency financing.

Development orientation

The development orientation of the structured funds is highly consistent with the objectives of the 16 BMZ strategies for which a thematic or geographical link to the structured funds was identified[3]. The funds aim to create access to finance for sub-borrowers who have thus far had insufficient access to it, and to support the stability of the partner-country financial systems. They are thus designed to help implement the BMZ sector strategy for financial systems development in particular. However, there is relatively little interaction between the objectives and activities of the structured funds, and the bilateral portfolio/country division, with respect to private sector and financial systems development. So far the BMZ has thus made barely any proactive use of potential synergies between funds on the one hand, and the bilateral portfolio or country division on the other. Implementation of the BMZ 2030 reform process and the intended prioritisation of reform-minded partner countries and core areas (also within the framework of regional projects) mean that the BMZ will need to discuss the future orientation of new funds in line with these priorities. The coronavirus pandemic might also necessitate a change of direction in order to provide greater support to countries and sectors that are particularly hard hit.

At the same time, the structure and regional setup of the funds allow them to meet financing needs in partner countries that are not covered by other approaches of bilateral Financial Cooperation (FC). As well as the possibility of offering small loan sizes and local currency financing, this also includes the financing of private FIs. In this way the funds make a development contribution to building stable and inclusive financial systems and to creating financing opportunities for groups with previously limited access to sources of finance. They can thereby demonstrate a high degree of additionality to other financing approaches. Moreover, their structure enables them to ensure continuity in times of crisis, such as the current coronavirus pandemic, by meeting financing needs in markets that are considered risky.

Setting the strategic direction of a fund when it is created is crucial for its development orientation, as the BMZ's options for exercising political management become limited thereafter. Once a fund has been set up, strategic adjustments usually require complex coordination processes and a change in the issue document to ensure the agreement of all investors. There are three main points at which the BMZ is able to exercise political management: when the fund is being set up, when the Ministry decides on additional funding and when the Ministry comments on the reports. However, a lack of capacities at BMZ and the way the responsibilities for the funds are organised within the Ministry are preventing better management of the development impact.

In operational decision-making for the funds an important role is played by the members of the official bodies, in particular a fund's Board of Directors and the Investment Committee. These bodies ensure compliance with a fund's strategy, including its development objectives, for instance by deciding on which FIs to select for support. The responsibilities of each of the bodies are clearly defined and demarcated. However, a few individuals are members of both the Board of Directors of a fund and the Board of Directors of an FI financed by the fund, which can lead to a conflict of interests in the selection of FIs to be supported. Although each of the funds has a defined process for managing such conflicts, the regulations governing exclusion from voting in risky cases are not uniform.

Overall, the structured funds are thus a financially sustainable and largely efficient financing approach that pursues as development objectives the stability of the local financial markets and FIs as well as broad access to finance. The pursuit of one development objective – reaching the targeted sub-borrowers – has not been monitored to a sufficient degree thus far.

3 See list of strategies in Annex 9.5.

Mobilisation

In the period up to 2018, the evaluated structured funds mobilised more the 700 million US dollars in additional private capital. The BMZ financed the funds with approximately the same amount of budgetary resources. In principle, structured funds are therefore a suitable financing approach for mobilising private capital to achieve the funds' objectives. The waterfall structure of the funds enables them to involve investors with different risk-return profiles. Furthermore, when making investment decisions, more and more private investors are taking social and ecological aspects into consideration in addition to their expected returns. Such investors find the development objectives of the funds appealing.

However, the funds are not yet fully exploiting their potential for mobilising private capital. In some cases, the funds reach a 'natural' limit to their capacity for mobilising private investment once the risk buffer is exhausted. In these cases it is not possible to increase the share of private investment without increasing the financing volume, i.e. the capital provided by the official donors and (Development) Finance Institutions ((D)FIs). Furthermore, in a few funds there is no need to mobilise private capital since the required financing volume is provided entirely by official donors and (D)FIs.

In some cases, the lack of an acquisition strategy to attract private investors and the complex structure make it difficult to mobilise private capital. A large number of different types of private investors with different investment motives, investment strategies and risk profiles invest in the funds. It is not evident that the mobilisation of private investors follows a clear strategy. Moreover the structure of the funds, which usually comprises various tranches and notes, increases the complexity of the financing approach and makes it less attractive for institutional investors. This is why there is a trend towards a less complex structure with only two tranches (junior and senior tranches) or towards only different note categories, to better serve the investment needs of private investors.

Most of the private capital mobilised by the structured funds can be considered additional because private investors would not make comparable investments without the funds. The structured funds enable private investors to invest in regions where purely private microfinance funds have been mostly absent so far. However, financial sustainability and development objectives also need to be weighed against each other in the mobilisation of private capital. The mobilisation of private capital is lower in sectors and regions where the investment risk is higher and the financing needs of MSMEs are often not covered. For example, the funds mobilise less private capital in sub-Saharan Africa, a region of particular developmental relevance, where the investment climate is often difficult. On the other hand, funds investing in regions and sectors with lower risk were able to mobilise more private resources, thus ensuring the financial sustainability of the funds.

Impact

The analysis of the effects on the FIs and sub-borrowers of the four evaluated MSME funds demonstrates the trade-off between development impact and financial sustainability. The funds select financial intermediaries that address the targeted sub-borrowers through an existing business segment (in this case MSME financing). Among those, most selected FIs have a high degree of financial stability. Similarly, the funds invest in countries that are predominantly considered risky, but mostly belong to the middle income category. This selection of FIs and countries reduces the likelihood of losses, thus safeguarding the financial sustainability of the funds. At the same time, however, it limits the funds' additionality because these countries/FIs tend to also have other financing options. To a small extent, portfolio diversification also allows the funds to invest in riskier, least developed countries (LDCs) and riskier (for example smaller or younger) FIs.

Regarding development objectives, the funds provide the financed FIs with reliable access to financing and promote the stability of the partner-country financial system. The funds reach the targeted sub-borrowers because an existing business segment for this target group is a criterion for selection of the FIs to be financed. The fund financing enables the financed FIs to increase their investment volume and expand their portfolios in absolute terms, so that more sub-borrowers can be reached. Beyond that, however, the FIs do not make it any easier for the envisaged target groups to access financing. Usually, for example, the FIs neither modify their lending terms for the envisaged target groups (with the exception of local currency financing), nor do they increase the share of target-group-related business segments, e.g. for microenterprises, female sub-borrowers or sub-borrowers without collateral, relative to their portfolio as a whole.[4]

In accordance with the strategy of the funds, the FIs' lending terms are market-based in order to avoid any distortion of the market. Thus, they do not differ from the lending terms of FIs not financed by the funds. As a result, the funds reach very few sub-borrowers who previously had no access to official financial products.

The TA provided by the funds is highly effective. The findings indicate that the interventions are highly demand-oriented and useful. Although other investors also offer TA, around 40 per cent of the interventions address the sector level, which other providers cover either to a lesser extent or not at all. DEval therefore assumes that the interventions are additional despite their low average financial volume. In the some cases the total lack or only minimal use made of all financing channels, particularly the contributions by the funds, limits the sustainability of the TA.

Overall, the analysis of the structured funds' effects on FIs and sub-borrowers shows that in the balancing act between financial sustainability and development impact, the funds pursue development objectives to the extent that they are able, given the imperative of financial sustainability.

Conclusions

The structured funds financing approach aims to achieve three main development objectives:

1. to promote the development of stable and inclusive financial systems by financing FIs
2. to improve access to finance, especially for MSMEs, by enabling the supported FIs to grant a larger number of loans
3. to shape and expand the portfolio of FIs in favour of sub-borrowers with particularly high financing needs.

To achieve these goals, structured funds should mobilise capital from private investors.

Impact (achievement of development goals)

The present evaluation on structured funds shows that the financing approach contributes to the stability and financial sustainability of FIs in the field of MSME financing by providing long-term funding, partly in local currency. They facilitate access to capital for sub-borrowers by increasing the volume of lending and providing TA. However, improvements in lending terms or easier access for groups that previously had no access to financing were rare.

The achievement of the funds' development objectives is influenced significantly by the selection of FIs to be supported. While the funds finance FIs that reach the targeted sub-borrowers, they prioritise those that are low risk. In the trade-off between financial sustainability and development impact, the funds thus focus on financial sustainability when it comes to reaching the target groups. This focus also influences the achievement of development objectives: Promoting predominantly financially stable FIs helps to build a stable financial system and improve access to financing. However, the third objective of increasing the FIs' orientation towards particularly vulnerable groups is made more difficult by the funds' focus on financial sustainability, as this would require the issue of riskier loans.

[4] This is not to be expected for microfinance institutions, since they are already focused almost exclusively on the microfinance business segment, for which there is barely any scope for expansion. Commercial banks, however, do have scope to expand the business segments for the target groups.

Mobilisation

As of 2018, the examined structured funds had mobilised a total of more the 700 million US dollars in private capital in order to achieve the development objectives. The BMZ invested approximately the same figure in budgetary resources. The funds are thus a suitable financing approach for providing additional capital to achieve the above-mentioned objectives. However, less private capital is mobilised in regions and sectors where there is a higher investment risk, and where the financing needs of MSMEs are often not met.

Appropriateness of the approach for achieving development objectives

The stronger focus on financial sustainability distinguishes structured funds from other development finance approaches. Structured funds are a market-oriented financing approach that delivers loans on standard market terms. This has clear advantages for attracting private investors. On the other hand, as long as the premise of market conformity needs to be met this approach is unlikely to elicit a willingness to finance target groups that are more risky, even if they are highly relevant for achieving development objectives. For example, as described above, as part of the risk diversification strategy structured funds promote only a small number of riskier countries and FIs, and allow only limited control at the level of the sub-borrowers. The approach should therefore be seen as complementary to other approaches and instruments. To finance LDCs, and for interventions whose impact at target group level needs to be managed directly, other instruments can be considered. The traditional choice is grants. For financing that is to be provided on concessional terms that do not reflect market conditions, FC uses instruments such as development loans. In these loans, the official resources are used to reduce the costs for borrowers by offering more favourable terms, while in structured funds they are used as a risk buffer for private investment.

Outlook

The structured funds were established partly in response to the financial crisis in 2018, in an environment characterised by severe liquidity shortages and an urgent need for stable and inclusive financial systems. Between then and the beginning of the coronavirus pandemic in early 2020, liquidity was available on the markets and microfinance institutions were already formalised in some of the regions examined in this evaluation. However, there is still a high demand for funding, especially in markets that tend to be less formalised and structurally weak. In many African countries in particular, there is still a very large financing gap for MSMEs that cannot be covered by purely private sector investment in the short to medium term. In addition to financing MSMEs, younger funds also address sectors such as education, the environment and climate change, and FIs are starting to include new financial products for these sectors in their portfolios as a result of the fund financing. In these sectors the financing approach can help to create markets.

The coronavirus pandemic has already aggravated the existing liquidity bottlenecks. As early as March 2020 private investors withdrew 83 billion US dollars from developing and emerging countries. Even in previously liquid regions and markets, financing gaps arose within the first two months of the outbreak of the pandemic. This affects MSMEs in particular, as they often have fewer reserves than large companies.

Taking into account the recommendations listed below, structured funds are in principle suitable for meeting both financial and development needs. The recommendations indicate how the funds should be designed in order to make better use of their potential, particularly regarding development objectives.

Recommendations

Based on the findings and conclusions outlined above, the following recommendations of this DEval evaluation are addressed to the BMZ and the KfW Development Bank as its implementing organisation. DEval acknowledges that decisions at the fund companies require the agreement of all shareholders and cannot be made by the BMZ and KfW Development Bank alone. In these cases, however, the BMZ and/or KfW Development Bank should work towards implementing the respective recommendation.

The following recommendations do not always apply to each one of the ten funds examined. This is the case for instance where a particular fund is already being implemented as proposed, or because the recommendation does not apply to the specific case of one of the ten funds. Instead, the recommendations should be understood as guidelines for the general design of the financing approach, whether in the further development of existing funds or when setting up new funds.

Financial sustainability

Recommendation 1

The BMZ and the KfW Development Bank should ensure the additionality and efficient functioning of the funds and, once the funds have been established, their financial sustainability.

Implementation guidance for recommendation 1

Financial sustainability, additionality and efficient functioning can be ensured by setting up and managing a fund in such a way that it

- has a sufficiently high financing volume in the long term
- can invest in an appropriately large number of countries for diversification purposes
- does not have country windows on the liabilities side of the junior tranche for efficiency gains
- extends its loans in local currency according to the financial intermediaries' (FIs') needs and the risks involved
- extends part of its loans in small ticket sizes to the FIs.

Recommendation 2

The BMZ and the KfW Development Bank should define the long-term options for official donors to exit the funds as part of an exit strategy.

Implementation guidance for recommendation 2

The exit strategy should

- define the timing and nature of the exit of the official donors, or
- define processes to review the relevance of the official capital for the funds at regular intervals.

Management of developmental impact

Recommendation 3

The BMZ should ensure more effective management of the development impact of the funds.

Implementation guidance for recommendation 3

More effective management of the development impact should

- include long-term capacity building for structured funds within the BMZ to enable strategic management, especially when the funds are set up and through reporting, and
- use synergies in the field of financial market development. To this end
  - the responsibilities for the funds should lie within the BMZ division with a sectoral or regional focus to account for the regional nature of the funds
  - there should be increased exchange with the activities of the sector divisions and the bilateral financial market development programmes (especially for larger funds), for example when country programme strategies are designed.

Recommendation 4

The KfW Development Bank should work towards ensuring that in the event of conflicts of interest of mandate holders, who are represented both in the official bodies of funds and the boards of the financed FIs, abstention from relevant votes is stipulated in the regulations (in this case the Conflict of Interest Policy).

Implementation guidance for recommendation 4

In order to ensure a more effective pursuit of development objectives, the management of conflicts of interest should provide for

- notifying the Board of Directors of the conflict of interest
- abstention by persons who are represented both on the board of the fund and on the board of a financed FI, in cases where a vote could involve a conflict of interest, such as votes to fund that particular FI.

Mobilisation of private capital

Recommendation 5

The KfW Development Bank should work towards ensuring that the structured funds develop mechanisms which will enable them to make better use of their potential to mobilise private capital in the future.

Implementation guidance for recommendation 5

The mechanisms should include a regular review of the risk buffer and risk appetite of private investors by the Board of Directors. Depending on the circumstances, there are three options for adjustment:

- If the risk buffer is almost exhausted, the possibility of reducing the share of the risk buffer should be considered, taking into account the risk appetite of private investors.
- If there is sufficient financing by official donors and (D)FIs, a reduction of the mezzanine tranche should be considered.
- If private investors have a stronger risk appetite, the possibility of enabling private investment in riskier tranches should be considered.

Recommendation 6

The KfW Development Bank should work towards developing and regularly updating a clear acquisition strategy for each fund for private, particularly institutional, investors.

Implementation guidance for recommendation 6

To facilitate the mobilisation of private capital, an acquisition strategy should be developed based on the following two points:

- identify selected target investor types
- identify the requirements of these selected investor types.

The fund managers should be responsible for designing the respective acquisition strategies.

Effects on target groups

Recommendation 7

The BMZ and KfW Development Bank should work towards using and monitoring the selection of FIs more effectively as the key point of leverage for ensuring development impact of the funds.

Implementation guidance for recommendation 7

When defining the eligibility or selection criteria for the institutions to be financed, an assessment should be made of the extent to which the risk profile allows for

- earmarking a minimum percentage of the portfolio for investment in riskier, possibly younger FIs with a high potential for reaching the target group
- sectors with high development potential to be addressed, especially where the funds help establish a market (e.g. by financing FIs that issue financial products for the education, environment and climate change sectors).

Recommendation 8

The BMZ and the KfW Development Bank should work towards making lending to FIs conditional on the expansion of thematic areas that are key to development – in line with the BMZ 2030 strategy.

Implementation guidance for recommendation 8

To strengthen development impact at sub-borrower level,

- financing should be made conditional upon the expansion of business segments, financial products or sectors relevant to the target group
- appropriate indicators should be included in the reporting to measure and ensure that target groups are reached
- the question should be addressed of whether further issues that are key to development policy, such as climate change, can be integrated into existing funds.