CSIS BRIEFS

How Can the U.S. International Development Finance Corporation Effectively Source Deals?

By Daniel F. Runde, Romina Bandura, and Janina Staguhn

OCTOBER 2020

THE ISSUE

The U.S. International Development Finance Corporation (DFC) is an important agency for advancing U.S. foreign policy interests, creating jobs, and fostering the private sector in developing countries. As part of its new authorities designated in the 2018 Build Act, the DFC can now carry out equity investments and technical assistance and is mandated to work increasingly in low-income and lower-middle income countries (i.e., LICs and LMICs). During the first six months of operations, nearly **75 percent** *of the total amount of projects DFC approved were in LICs, LMICs, or fragile states.*

In order to be able to identify and source investible transactions in these more difficult environments, the DFC must increase its presence on the ground. Since the institution has a small staff of over 300, mostly located in Washington D.C., the DFC will need to be more creative in sourcing deals by forging stronger relationships with U.S. development agencies and other donors. The DFC will have to rely on the U.S. Agency for International Development's (USAID) field presence, as well as that of the State Department, and find innovative models to source transactions.

INTRODUCTION

Many development finance institutions (DFI) have a significant field presence. The largest DFI—the International Finance Corporation (IFC), part of the World Bank Group—has committed **$8.9 billion** in 2019 (double the amount of the DFC) with a total staff of 3,744—**54 percent** of which work outside the United States. Within USAID, the DFC can collaborate with the Office of Private Capital and Microenterprise (PCM) and related mechanisms (such as the INVEST and CATALYZE programs) to increase private investment in developing countries (Box 1). The DFC will also have to coordinate with the U.S. Trade and Development Agency (USTDA), the U.S. Export-Import Bank (EXIM), and other agencies for greatest impact.

The DFC must recognize the value of having representatives on the ground in geostrategic regions. Companies and institutions consider face-to-face interactions to be valuable and necessary for business dealings. The DFC could have a more local presence using different approaches. Most recently, in July 2020, the DFC launched the **Africa Investment Advisor Program**, establishing a regional team based in Africa to advance investments and expand its portfolio in this priority region. According to this model, investment advisors will be based across East Africa, West Africa, Southern Africa, and the Horn of Africa. The team will be tasked with sourcing projects across the region, working together with U.S. embassies and USAID missions, and supporting the DFC staff based in Washington by providing on-the-ground project due diligence and monitoring. These positions will be funded by the U.S. Department of State.

BOX 1: USAID'S PROGRAMS FOR MOBILIZING PRIVATE CAPITAL

The **Office of Private Capital and Microenterprise (PCM)** was born out of the need to increase USAID's capacity to mobilize private capital and expertise to fund and support developmental projects across the world. PCM has demonstrated USAID's commitment to create partnerships with private investors for developmental priorities. PCM provides investors with a variety of tools and expertise to guide them through investments in the developing world. Tools include risk management, support from USAID offices to accelerate transactions, and transaction structuring for blended finance models. Among other activities, PCM created the INVEST program in 2017 to unlock private capital by helping USAID work with investors in developing countries. The program is managed by DAI and carries out market assessments (helping USAID understand market conditions and identify investment opportunities), structures funds and financial products, and helps link capital suppliers to businesses that need investment to grow. As of May 2020, INVEST has built a network of over 250 partners and galvanized **$160 million** in private capital for development.

Similarly, USAID launched the **CATALYZE** program in 2019 to mobilize $2 billion in blended finance by 2027 targeting social sectors in high risk countries. The program helps develop commercially viable business. It has created a platform of local and international finances to help develop a pipeline of bankable projects, link investors to projects, structure funds and close complex transactions, support financial and non-financial intermediaries, and facilitate the use of blended finance and private capital in development. CATALYZE has funded projects in education, women's economic empowerment, and agriculture.

USAID also seeks opportunities to foster coordination with DFC to expand its **Private Sector Engagement** initiatives. Specific collaboration includes transferring money to DFC to **expand their budget and capabilities**, increasing personnel and idea exchanges to increase the mutual understanding of internal processes (i.e., fellows programs paid by USAID), and funding DFC agriculture specialists to help with USAID's **Feed the Future program**. On the ground, USAID also aims to have more DFC liaisons at missions to make technical expertise available and provide business intelligence for the private sector in order to generate better deal flows.

AN OPPORTUNITY FOR GREATER COLLABORATION AND IMPACT

The predecessor to the DFC, the Overseas Private Investment Corporation (OPIC), usually originated **project development** from independent requests by U.S. businesses. **OPIC** relied heavily on clients to propose projects through its application process. Consequently, projects did not always have a development focus. Nevertheless, **OPIC** has attempted to augment its outreach programs through measures such as the expansion of insurance tools, workshops, a streamlined application process, and larger business development programs.

OPIC had a series of limitations in supporting private investment abroad. The agency was constrained in its transactions as it was mandated to solely support United States citizen-owned business projects and initiatives in accordance with congressionally mandated statutory requirements monitored by OPIC's Office of Investment Policy (OIP). OPIC could only support U.S. small businesses and companies that were at least 25 percent U.S. citizen-owned. This prevented OPIC from investing in potentially worthwhile development projects, and additionally, decreased its ability to compete with other DFIs that did not have the same restrictions.

Moreover, the type of assistance it could provide was also a limiting factor for collaborating with other DFIs on deals since OPIC could only provide debt financing (e.g., direct loans and loan guaranties), political risk insurance, and support for private equity funds. Under OPIC, the United States was only able to participate in deals as a senior lender and thus paid first if the deal went south. This was a disincentive to other DFIs and deterred them from doing deals with OPIC.

The DFC presents a new opportunity, not only to function as a DFI on a larger scale and scope, but to also work with other U.S. agencies and allies abroad. With its new authorities designated under the 2018 Build Act, the DFC acquired a seven year authorization period and **expanded its capabilities and tool offerings** from OPIC in order to engage in LICs, LMICs, and higher-risk markets. With a larger credit limit of $60 billion, DFC is also expected to increase its project threshold and overall impact,

particularly within the difficult contexts of working in LICs and LMICs as well as the challenges presented by the Covid-19 pandemic. The DFC can now maximize its internal strategies, provide local currency lending and guarantees, conduct feasibility studies, provide **technical assistance**, and engage in **private equity investments**. These last two new capabilities are significant because they enable and require the DFC to pursue deeper and more numerous partnerships with other U.S. government agencies and allied partners. No longer bound to a United States only sponsor requirement, the DFC has also increased its ability to identify priority projects, re-designed its project score evaluation framework, prioritized core development initiatives, and increased partnerships and project opportunities.

The DFC presents a new opportunity not only to function as a DFI on a larger scope and scale, but to work with other U.S. agencies and allies abroad.

A number of enhancements in terms of tools and capabilities allow the DFC to be able to expand its sourcing of deals and partnerships. The DFC can now make equity investments as a minority investor in any entity or in investment funds. Many companies in the developing world are at the incubator stage. Such companies may want a "true partner" investor as their company grows; therefore, equity may be preferred over alternate forms of financing. Equity authority provides the DFC a better chance to partner in a deal with other DFIs on an equal footing. The DFC eases the U.S. sponsorship requirement to a preference, thereby allowing the DFC to better operate in areas where American investors refuse to go. Moreover, unlike OPIC, the DFC can offer loans in local currencies, which is important for small and medium sized enterprises (SMEs), infrastructure, and service-related sectors. Local currency loans will be very useful to partner with local investors. The DFC will also make changes to risk-sharing loan guarantees on projects; whereas OPIC needed other parties to bear at least 50 percent of the risk of loss on a project, the DFC will reduce this threshold to 20 percent, thereby greatly reducing another barrier to partnerships. Through its enhanced toolbox, the DFC has an opportunity to collaborate more effectively with U.S. allies such as Canada, Japan, and the United Kingdom.

The Build Act also mandates the DFC to seek out more collaboration opportunities with other DFIs, multilateral development banks (MDBs), and U.S. government agencies, but specifically with USAID and the U.S. State Department. This not only fosters interagency "jointness" but gives the DFC access to a larger scope of resources and relationships, especially in the face of budget restraints and limited personnel additions. Overall, the DFC's enhanced capabilities enable it to better operate and identify more opportunities in its target markets. Nevertheless, DFC's mandate to work in more difficult contexts makes it harder to identify high impact projects as oftentimes they require additional technical assistance, pose challenges in project preparation, and may even require macroeconomic and institutional policy reforms to be able to execute projects, especially within the context of the Covid-19 pandemic.

THE DFC'S FIRST YEAR

The DFC is quickly trying to grow its **partnerships, projects, and initiatives** and maximize the efficiency of its internal structure. Some of the internal revisions implemented at DFC are the creation of the Office of Strategic Initiatives, which focuses on foreign policy objectives (e.g., women's empowerment, health and prosperity initiative), and the Chief Development Office, which focuses on increasing overall impact in developing countries within specific sectors (e.g., energy, food security, financial inclusion and opportunities, water services, infrastructure and communication).

Moreover, the new DFC Mission Transaction Unit has been established to incorporate the functions of the former USAID Development Credit Authority (DCA) and now, with a larger toolkit offering, it is able to increase interaction with local banks and widen its geographic operational scope. The DFC has also implemented faster streamlined application processes for projects while maintaining quality standards, increased virtual training programs, and increased technical assistance and commercial development impact operations. Lastly, the DFC has established new strategy priorities—such as its Global Health and Prosperity initiative—to address the impacts of the **Covid-19 pandemic**, specifically regarding women's empowerment.

Although the DFC has been equipped with enhanced development tools and capabilities, the agency experiences

resource and budget limitations which hamper its ability to achieve its mandate. DFC's current resource limitations require increased coordination with other U.S. agencies. For example, one of DFC's priorities is to generate a larger overseas and field presence to better facilitate projects and work with local businesses. Therefore, the DFC will need to rely on other established U.S. government agencies, (e.g., **USAID** and U.S. State Department), with overseas missions in order to seek out more project opportunities, access established relationships, and achieve a higher developmental impact. The DFC's new Office of Strategic Initiatives will allow for increased collaboration with other U.S. agencies on foreign policy initiatives, while still honoring their requirement to work with the private sector. USAID will assist with budget management in ensuring that DFC contributes to U.S. foreign policy goals and is able to produce measurable and effective results.

An acclaimed example of efficient collaboration between various U.S. agencies and development organizations is the **Power Africa** initiative developed by the Obama administration in 2013. This initiative utilized the strengths of various agencies to close 141 power sector deals as of June 2020 and bring electricity to 74 million people. At the same time, the new **Prosper Africa** initiative will focus on increasing U.S.-Africa trade by helping to facilitate transactions and lower risk for private sector actors; nonetheless, collaboration on the Prosper Africa initiative is still under discussion. Meanwhile, DFC is also seeking to expand on relationships with USTDA and EXIM for sourcing deals, collaborating on feasibility studies and technical assistance, collaborating on overlapping interests, and sharing best practices. Additionally, the DFC is developing in-person and virtual training and inter-agency fellowship and exchange programs to improve mutual operational understanding (e.g., DFC's work supporting foreign, private sector investment in developing countries) and facilitate better partnerships.

In addition to increasing partnerships with other U.S. entities, the DFC has sought opportunities to collaborate with multilateral and regional institutions, as well as with other DFIs and international finance institutions (IFIs)—especially with European Development Finance Institutions (EDFI) and most recently, the **DFI alliance**, a group of 16 DFIs jointly responding to the Covid-19 global pandemic. Thus, the DFC hopes to identify potential projects of mutual interest through increased liquidity and revised financial terms. This is particularly important due to the operational limitations caused by the Covid-19 pandemic. Accordingly, the DFC has worked with many institutions to decrease the amount of in-country work required to complete deals during the pandemic and beyond. In a reduced travel environment, the DFC has also collaborated with IFI and DFI field staff to share due diligence and legal work where appropriate.

Collaboration can also avoid unnecessary competition and duplication of aligned projects. DFIs are sometimes chasing after the same few deals which leads them to undercut each other. As an example of such collaboration, the DFC and the InterAmerican Development Bank (IDB), assigned a **2019 Memorandum of Understanding** to increase private investments for the Latin America and Caribbean region by working together on business development, due diligence, and ongoing monitoring of jointly supported projects. The institutions aim to invest a combined $3 billion in order to mobilize between $6 billion to $10 billion with the private sector.

LEVERAGING NEW PARTNERSHIPS GOING FORWARD

In order to source investable transactions in tougher markets, the DFC will have to leverage a deeper and new kind of partnership both with U.S. development agencies and like-minded DFIs going forward. In order to do so, there must be formalized coordination between agencies, which includes sharing budgets, personnel, and training. The DFC must work across actors in more difficult investment environments by completing finance with upstream work (such as project preparation) and policy reform carried out by other development organizations. Finally, the DFC must be made more accessible to possible partners, which includes providing clear guidance on how it works with other agencies.

FORMALIZING COORDINATION AMONG U.S. DEVELOPMENT AGENCIES

The key to increasing interagency cooperation on deal sourcing is to formalize a working relationship among U.S. agencies. In the case of USTDA, staffers had strong informal relationships with OPIC staff, and this relationship has in many cases transferred to the DFC. Although these interpersonal relationships are helpful, it is also important to have formal channels of communication and directives on how to work together. A good way to do this would be to have monthly meetings of relevant agency leadership (DFC, EXIM, USAID, State Department, USTDA, and MCC) to discuss each agency's

pipeline and identify possible areas of coordination. By meeting regularly, agency leadership can present policies and solutions jointly creating a sense of urgency and importance around their priorities. Establishing more unity in agency efforts will create stronger impacts and partnerships and prevent duplicative efforts.

The key to increasing interagency cooperation on deal sourcing is to formalize a working relationship among U.S. agencies.

To further encourage cooperation rather than competition, the development community could build more formalized institutional linkages through a "development focused" **Gold-Water Nichols Act**. With China becoming increasingly competitive through its Belt and Road Initiative in gaining support throughout the developing world, the United States' soft power capabilities are vital to its national security. Through such institutionalized coordination, all U.S. agencies involved in development will be more successful in working towards aligned foreign policy goals.

SHARING BUDGETS, PERSONNEL, AND TRAINING

Sharing budgets, personnel, resources, and tools with other agencies will enable U.S. development work to expand reach and impact. For example, USTDA has previously shared offices and resources with DFC overseas and by doing so, developed a mutual understanding of individual functions and practices that could potentially lead to stronger partnerships and future collaboration. Further, through funds transferred for particular initiatives that engage interagency collaboration (e.g., Power Africa), agencies can enhance formalized cooperation and ensure that funds are effectively spent on shared but not overlapping priorities.

To improve collaboration efforts, the DFC should also seek to provide more training and learning opportunities (e.g., virtual trainings during the Covid-19 pandemic), forums, and personnel exchanges between U.S. agencies to better facilitate partnership opportunities and ability to collaborate. The DFC has already instituted a fellow's exchange program with USAID and a junior staff rotation program with the State Department that allows staff of various agencies to better understand the others' capabilities and challenges. Through a strong exchange program, staff will also be able to return to their agencies and be better equipped to identify opportunities for coordination. Trainings for DFC staff on what other agencies do are also vital in identifying possible areas of coordination through extensive knowledge of other agencies' capabilities. Finally, interagency fora on various topics allows staff to gain personal relationships with each other that will eventually result in increased coordination and will improve the ability of various agencies to identify U.S. priorities and goals.

COLLABORATING IN THE UPSTREAM STAGE

The DFC has been mandated to work increasingly in countries, which in many cases do not have the existing pipeline of projects or private investment environment needed to complete entire deal processes. Without a strong presence on the ground, the DFC will need to rely on other agencies as well as other DFIs and MDBs for successful investments. In order to accomplish this, the DFC should coordinate with its allies in technical assistance (as it was mandated to do) and collaborate on the upstream phases of projects.

Technical Assistance (TA) is expert advice given to private sector actors to help current investments mature or prepare future deals for financial and development success. It can **consist of** sharing information, skills training, transmission of knowledge, and consulting services—working towards optimizing and maximizing project implementation and overall impact. Although the DFC has the mandate to conduct TA, it does not have significant TA resources itself and therefore needs to work with other agencies.

The DFC should also institute collaboration mechanisms during the upstream phase of projects. **Upstream work** involves the private sector, agencies, and multilateral institutions getting involved early in the project process to find solutions for existing challenges and opportunities for investments. Upstream work **consists** of pre-investment work that establishes project foundations and facilitates future transactions. The IFC's new corporate strategy focuses specifically on these upstream processes and formalizing partnerships (see Box 2). Again, without a strong presence on the ground, the DFC needs to work with other donors and agencies to support early phases of project implementation.

BOX 2: IFC'S CORPORATE STRATEGY FOCUS ON UPSTREAM PROCESSES AND FORMALIZED PARTNERSHIPS

IFC's new corporate strategy (**IFC 3.0**) helps further one of two World Bank Group overarching goals to promote shared prosperity, and emphasizes creating economic markets, mobilizing private capital and investment, and providing aid and economic support to address development needs. A critical aspect of this strategy is the implementation of "upstream" **procedures** which runs pre-investment work, identifies needs and project opportunities, and enables the creation of markets. These ultimately facilitate future transactions, create replicable and country specific development solutions, and provide technical assistance and capacity building for institutions and the private sector, as well as overall support for initiatives. In part, the operationalization of upstream delivery is conducted through IFC's **Global Upstream Units (GUUs)**, which exist across industry departments to implement the upstream process and locate opportunities, properly direct resources, and coordinate programs and initiatives.

The IFC has also established the **Joint Collaboration Agreement Framework (JCFA)** to further its goals and maximize upstream project development, preparation capacity, and collective strengths of formalized partnerships. This joint venture aims to create a singular voice for multilateral development banks and DFIs and **emphasizes** a greater global development impact by collaborating on market creation and co-financing arrangements, mobilizing private sector investment and support for economic activity, and implementing recovery efforts specifically regarding the Covid-19 pandemic. It seeks to lay foundations to attract investment in development countries and find more opportunities to combine and consolidate funding from both donor and commercial sources for projects. Presently, more than 25 development finance institutions have signed the agreement and have begun increasing information sharing, joint due diligence, fund sourcing, and investment agreements between members. The JCFA's **Covid-19 specific agenda** concentrates on providing support and resources to healthcare institutions, SMEs and strengthen global supply chains. IFC also looks to collaborate more and formalize its partnership with DFC in the upstream phase and on overall development strategies within fragile low-income and conflict-affected countries.

IMPROVING COMMUNICATIONS

The DFC can improve its communications and various elements of its interface with the private sector to further encourage good deals and forge investment partnerships. One step towards making the DFC more accessible to partners is by creating a friendlier website that is easier to navigate. This could include creating online tools which check eligibility and requirements for projects. The website could also include graphics and charts which explain the DFC's work and impact, thereby allowing businesses to better navigate the DFC's process and establish partnerships. Finally, the website should contain information on how the DFC works with the rest of the U.S. government and how each agency can partner with the DFC at different phases of the investment process. Communication and branding are essential components of successful and impactful initiatives and programming. Following the example of Power Africa, the DFC must have clear messaging to have more effective partnerships, mutual understandings, and a higher project impact.

CONCLUSION

The Covid-19 pandemic has put severe strains on families, businesses, and institutions and threatens to derail development achievements of the past 30 years. This crisis has also shown that good communication, coordination, and collaboration across government agencies is vital for a speedy health and economic recovery. Enabling the private sector to restart and create jobs is even more imperative in LICs, which are devoid of financial resources, know-how, and business climate, making it harder to bounce back. During these challenging times, coordinated response from donors, DFIs, and MDBs become more pressing. In this context, the DFC has the opportunity to be a champion in supporting the private sector in the developing world. Given its budgetary and staff constrains, the DFC must work with other U.S. government agencies, DFIs, and MDB's to amplify its efforts. Additionally, many of these countries lack the necessary investment infrastructure and business environment for the private sector to flourish. For this reason, collaborating in technical assistance and upstream work will become increasingly

more important to identify and source investable transactions in the future. ■

Daniel F. Runde *is a senior vice president, director of the Project on Prosperity and Development, and holds the William A. Schreyer Chair in Global Analysis at the Center for Strategic and International Studies (CSIS) in Washington, D.C.* ***Romina Bandura*** *is a senior fellow at the Project on Prosperity and Development at CSIS.* ***Janina Staguhn*** *is the program coordinator for the Project on Prosperity and Development and Project on U.S. Leadership in Development at CSIS.*

This brief is made possible with the generous support of DAI.

CSIS BRIEFS are produced by the Center for Strategic and International Studies (CSIS), a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author(s). *© 2020 by the Center for Strategic and International Studies. All rights reserved.*

Cover Photo: Adobe Stock