Pre-intervention investment toolkit:

The challenge of achieving impact at scale in market systems development (M4P) interventions

Toolkit

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Introduction

What is the aim of the toolkit?

Market systems development (MSD) projects often select and design interventions to facilitate business innovation – new supplies, new demand or new business models (new ways of producing and distributing supply, or new ways of producing and aggregating to meet demand) designed to allow poor people to participate more advantageously in markets. However, the challenge facing MSD project managers is to identify business innovations that really can change the way that markets work.

This toolkit emerges from our research on achieving impact at scale through market systems development interventions, which shows that many MSD projects base their investment decisions on some form of pre-intervention due diligence, but the focus tends to be more on the developmental impact of interventions than on the likelihood for long-term commercial success. As a result, there is considerable variation in the quality of such analysis, and much can be left to chance or wishful thinking.

This toolkit is designed to provide a framework for MSD projects to analyse and assess potential private sector partnership interventions. Using the toolkit will help MSD projects working with and through the private sector, by bringing structure and rigour to intervention investment decisions – focused on the intervention's potential to achieve impact at scale.

Who is it for?

The toolkit is intended for anyone who is concerned with maximising the value for money (VfM) of MSD interventions implemented in partnership with the private sector. Our research shows that many MSD projects are already using a number of investment decision making methodologies, but that there is considerable variation of approach across projects. The toolkit incorporates observed best practices from MSD programmes, along with some of the key practices from the world of commercial investment, to create a structured and rigorous approach tailored to the specific needs of MSD practitioners. The toolkit will also be useful for the partner private enterprises, as it will support a more detailed assessment of plans and forecasts before significant resources are committed to investment projects.

A working knowledge of the principles of MSD, business planning and investment finance is assumed, but the toolkit is designed to be user-friendly, and support and training can be provided to allow MSD project managers to use it to best advantage.

How should it be used?

The toolkit is designed to guide the selection and design of MSD interventions. Before a project commits significant financial or non-financial support to a partnership, the due diligence process reflects the intervention manager's role as a potential co-investor.

The toolkit supplements the Operational Guide for Making Markets Work for the Poor (M4P) Approach. As with the Operational Guide, the toolkit does not claim to offer a simple formula for success, nor to deter any additional steps project managers may consider necessary, but it does provide a useful framework, rooted in financial due diligence, for pre-intervention investment analysis and assessment.

What is pre-intervention due diligence?

Pre-intervention due diligence is undertaken before investing in a pilot. The process outlined in this toolkit:

- Introduces an additional step and more structure to the intervention planning and selection phase
- Combines a commercial and developmental mind-set in the pre-intervention assessment
- Adapts and applies tried and tested tools and techniques used by private investment managers to a development setting.

By undertaking a structured pre-investment due diligence, programmes will be able to provide reassurance to funders that a planned intervention has the potential to achieve impact at scale, before committing programme resources to a pilot intervention.

Why is pre-intervention due diligence worthwhile?

In our research, we found that MSD programmes often develop business innovations to solve problems faced by target beneficiaries. They then test the solution by recruiting private sector intervention partners and encouraging them to co-invest in pilot interventions largely developed by the MSD project. Those pilots that appear to be successful become candidates for further scaling up interventions, while those that are less successful are written off to experience.

Overall, this approach has proved to be both inefficient and ineffective. There are too many failed or perpetual pilot interventions and too few MSD interventions have created impact at scale. Experimentation is an essential feature of the MSD approach. However, if this takes the form of a "scatter gun" approach, it can be counter-productive with considerable opportunity costs.

The due diligence process described in the toolkit provides an analytical framework that MSD projects can use to assess the scale potential of business innovations in advance of the pilot, allowing resources to be targeted more effectively.

Who benefits from pre-intervention due diligence?

Pre-intervention due diligence recognises that business innovations require investment and/or risk-taking by both public and private partners. Rigorous pre-intervention due diligence will increase the chances that investments by each of these public and private partners will deliver the intended commercial and developmental returns on the investment, including the:

- **Intervention partner(s):** The firm(s) driving market systems change by investing in a new supply, demand or business model;
- **Target beneficiaries:** The individual poor people who respond to the new opportunities created by market systems change as the suppliers, workers or customers of the intervention partner(s); and
- **Intervention enablers:** The enterprises which provide the infrastructure or the services that link the intervention partner to the target beneficiaries.

Tools and techniques

The toolkit introduces a series of assessments within each section, drawing on tried and tested commercial investment methods, but gives them a MSD “twist”. The value of the toolkit is that it brings together developmental and commercial investment principles to provide practical guidance.

The assessments focus on four key questions of MSD intervention investment decision making: will the project be commercially successful at scale, is the partner able to deliver the project and manage the business at scale, will large numbers of the intended target beneficiaries adopt the business innovation, and is there an indirect impact potential?

The answers to these four questions feed into an initial concept assessment, and for those projects that pass this test, into a full intervention investment plan. Information is presented in the following ways:

Main text: provides context, introduces key principles, tools and techniques, identifies common intervention challenges and explains how to address them.

Reality check
Elaborates key points from the main text and the practical implications these may have.

Example
Real (anonymous) examples from the field that illustrate practices described in the main text.

Tool or technique
The specific methodology suggested at each step.

Definition: Essential terminology is defined in the main text

A note of caution

Using the toolkit is not a substitute for exercising careful professional judgment. The output from the assessments will only be as good as the input and the quality of the analysis, and the best outputs only guide decision making.

The toolkit will not provide a definitive answer as to whether a particular intervention represents a good investment or not. However, the intention is that by applying the tools and techniques introduced in the toolkit, practitioners will be able to reach more informed conclusions on the scale potential of a proposed MSD intervention before committing project support.

Creating impact at scale

Defining impact at scale

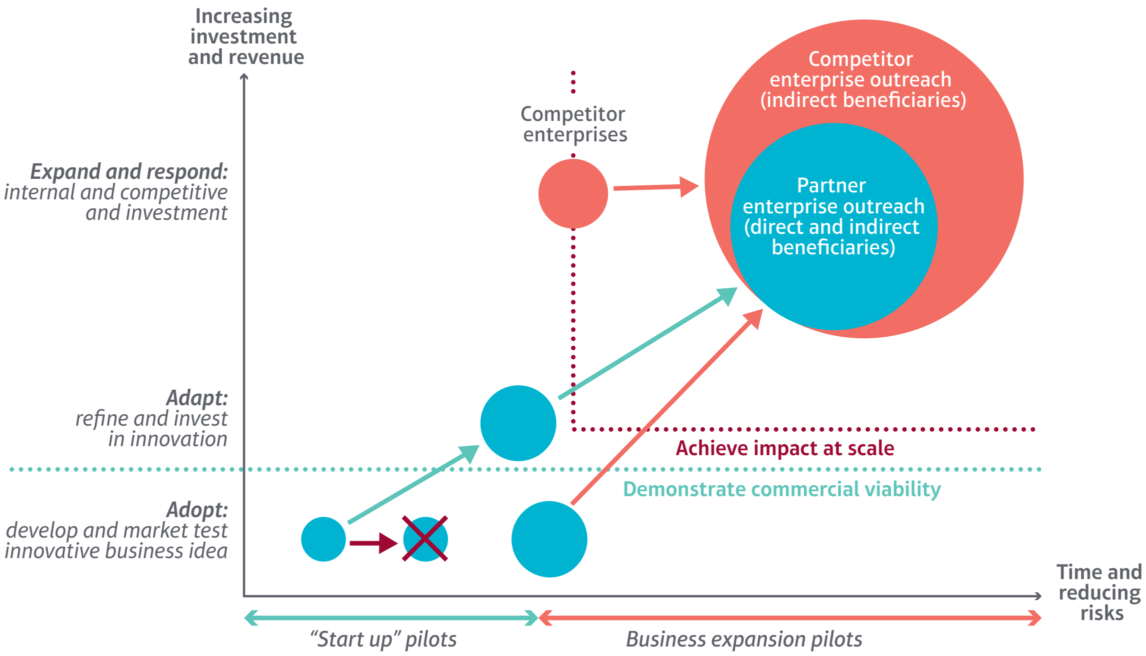
There are four groups of market players whose investment is required to achieve, and so defines, impact at scale:

- **The intervention partner:** The pilot intervention partner commits further investment to adapt and develop the business innovation, demonstrating that it can continue to "work" in the absence of support from the MSD project;
- **Their competitors:** Beyond the intervention, private sector market players with significant aggregate market size and share invest directly or indirectly to expand the business innovation;
- **Response by enablers:** Non-competing firms that provide relevant supporting functions within the market system invest in response to the business innovation; and
- **Indirect target beneficiaries:** A large number of a project's target beneficiary group (especially those not directly benefiting from interventions) invest in and benefit from uptake of the business innovation, allowing significantly improved participation in the relevant market system.

> **First movers and competitors:** By intervention partners, we mean the first mover enterprises that co-invest with the MSD programme in the business innovation. The AAER framework makes a crucial distinction between these first movers who lead innovation supported by the MSD project intervention, and their competitors who respond to the innovation inspired by the demonstration of scale potential.

Reaching impact at scale

Moving along the desired trajectory (represented by the green arrow in the diagram below) and reaching impact at scale (the expanding circle, representing outreach) depends on a series of investment decisions by each of the four groups identified above.



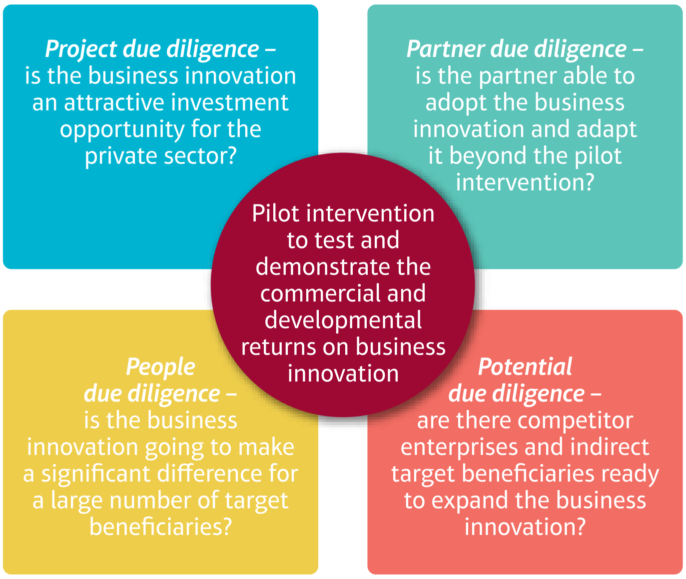
Too many pilots stay as pilots (the red arrow in the diagram) because these market players could not or would not make the investment necessary for the intervention to scale up. Understanding what lies behind such decisions and the logistical and financial factors that make investment, supply and uptake possible is of critical importance for any MSD programme as they select and design interventions.

This is where the toolkit comes in. It provides programmes with a structured due diligence framework to assess proposed interventions against a series of questions designed to indicate the intervention scale potential. Our research has identified an association between the answers to these questions and the chances of eventual success in terms of achieving impact at scale.

What the toolkit covers

The due diligence process helps MSD projects to understand and adapt to the environment in which they are planning the intervention. The pre-intervention due diligence process covers four key strategic MSD intervention challenges:

1. **Project:** Identifying and promoting investment in a business innovation that is commercially viable, scalable and financially viable.
2. **Partner(s):** Identifying and providing cost-effective support to first and second mover partners ready and able to invest in the business innovation.
3. **People:** Identifying and understanding the needs, capabilities, constraints and market environment of the intended target beneficiaries.
4. **Potential:** Assessing the sector level uptake and competitive potential of the business innovation – will crowding in and copying happen?



The toolkit provides the means for projects to ask and answer a series of questions:

Project: Is the business innovation an attractive investment opportunity for the private sector:

- Commercially viable – will the business innovation be competitive in the market and deliver sufficient profit to the partner enterprise?
- Scalable – do efficiency gains mean that revenues will grow faster than costs as the business expands to the target markets and/or competitors are encouraged to pick up the innovation and develop it further?
- Financially viable – will the investment generate the risk adjusted returns to justify the investment and is affordable investment and working capital finance available in the market?

Partner: Is the intervention partner broadly 'willing and able' [1] to adopt the business innovation and adapt beyond the pilot intervention, or would be with realistic levels of support from the MSD project:

- Management and operations capacity – does the partner have the management and operating structures and systems in place necessary to scale?
- Financial capacity – does the partner have the financial strength to access the investment and working capital required to achieve and operate at scale?
- Market reputation and credibility – does the partner have the market presence (brand strength) to sell the product or service in the target market?

People: Is the business innovation going to make a significant difference for a large number of target beneficiaries:

- Relevance – is the product or service addressing a need that is felt by a large number of target beneficiaries in a way that is substantially better than any available alternative?
- Affordability – is the price point (the initial cash outlay) of the product or service within the means of target beneficiaries?
- Accessibility – can the product or service be delivered profitably to large numbers of target beneficiaries?

The toolkit as part of the project design and implementation process
The foundation for any MSD intervention is the sector selection and market analysis process. Sector selection will be based on an assessment of the factors that determine the inclusive growth potential of a specific sector or sub-sector. It will consider issues such as concentrations of target beneficiary groups and the economic gain potential. Our research found that very few projects consider the sector level commercial potential of business innovations – an essential step in determining the scale potential of the innovation.

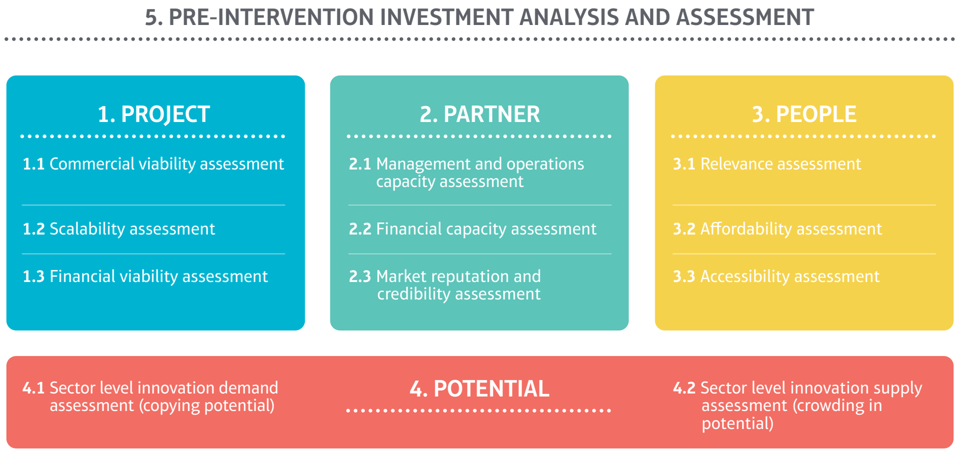
Market analysis drills down into specific parts of the sector value chain to identify and understand the binding constraints in sector market systems that prevent or limit the equitable participation of target beneficiary groups in sector growth. We have developed a new version of the classical market systems "donut", including finance as a third component of the analysis alongside supporting services and rules.
Once market constraints are understood, the challenge is to identify 1) who might have a commercial incentive to address the constraint, and 2) an innovative product, service or business model that could overcome the constraint.

This toolkit is designed to be used at this stage of the MSD process, once a potential intervention partner is identified and a solution is conceptualised, but before launching a pilot. We recommend a two-step approach, first developing a project concept, covering the essentials of the business idea, and secondly, a full-scale development business plan.

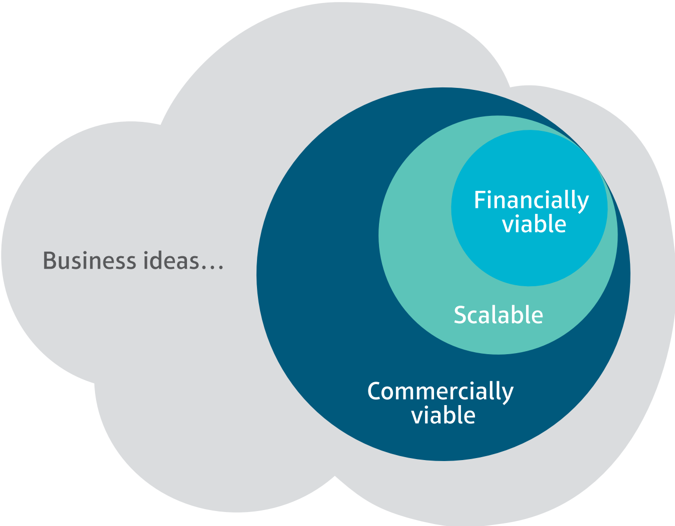
1 The M4P operational guide offers a useful 'will-skill' framework to help assess the willingness and ability of potential partners. It divides potential partners into four groups:
1. High will, low skills scenario
2. Low will, high skill scenario
3. High will, high skill scenario
4. Low will, low skills scenario
Partners may have only the will or skills, both or none of both. MSD interventions should be tailored in such a way that it targets which of the dimensions is missing.For a detailed description of the 'will-skill framework' see, 'The Operational Guide for the making markets work for the poor (M4P) approach', (2014). https://beamexchange.org/resources/167/

Structure of the toolkit

The toolkit is structured according to the process of pre-intervention investment appraisal. Section 1 deals with the investment project itself, Section 2 addresses the partner's capability to deliver the investment project, Section 3 looks at the product or service from the target beneficiaries' point of view, and Section 4 examines the potential for crowding in by competitors and copying by indirect target beneficiaries beyond the intervention. Section 5 then sets out a suggested investment decision making process incorporating the pre-intervention assessments and analysis.



1. Project due diligence



The challenge facing MSD programme managers is to identify those business ideas – ideally from among proposals made by potential partners, rather than generated by the programme itself – that are most likely to achieve commercial success at scale. Demonstrable commercial success is the main foundation of sustainable private sector driven change in market systems, which in turn is an essential precondition of developmental impact at scale.

The objective of the project due diligence is therefore to narrow down the business ideas you are considering to those that are most likely to achieve commercial success by applying three layers of project assessment:

- Commercial viability
- Scalability
- Financial viability

Taken together, the findings from these assessments should provide a firm basis for deciding whether a particular project is likely to be successful and should be supported by your programme – or not.

1.1 Commercial viability

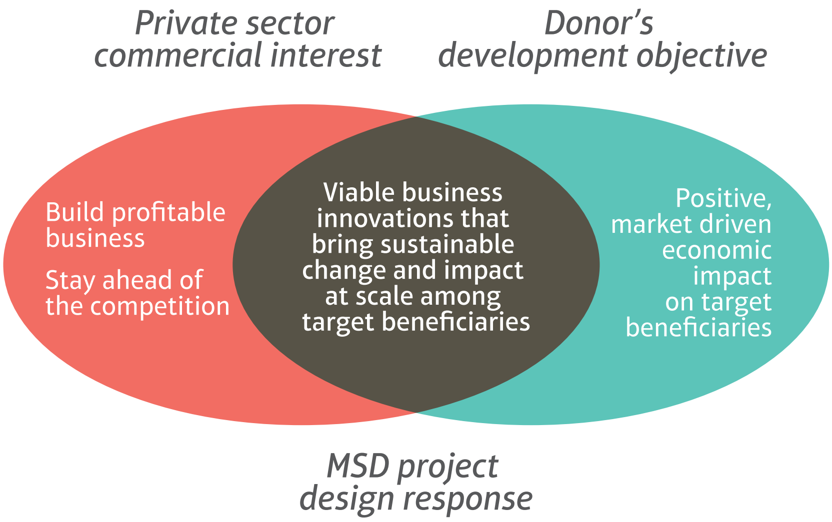
The most fundamental question regarding any proposed business innovation is whether it is commercially viable or not. If the private sector does not believe that an innovation will be profitable, it will not invest. To assess commercial viability, you will need to answer one deceptively simple question: can the product or service be delivered at a price that the customer is willing to pay while still making a profit for the partner enterprise?

For business innovations that supply a new product or service to target beneficiaries: First, you need to calculate how much it will cost to supply the product or service, considering direct and indirect costs, and the profit margin that will need to be borne by the consumer. The next step is to compare the costs of the planned product or service with 1) the absolute value of the risk-adjusted benefit to your target beneficiary, and 2) the relative costs of substitute products or services that could deliver a similar benefit.

> **Risk-adjusted benefit:** Innovation requires a change of practice by the target beneficiary consumer or the supplier (e.g. from buying one kind of input to buying another, or from subsistence to cash crop). This will involve a degree of risk, which is amplified for poor people because of their economic vulnerability. The theoretical benefit is a promise for the future, and persuading people to adopt new practices requires an understanding and “pricing” of the risk associated with that promise not materialising. The higher the perceived risk, the greater the downward adjustment to the theoretical benefit.

For business innovations that create new demand for production from target beneficiaries: The first step is to calculate the input cost that the intervention partner can bear. This requires that you work backwards from the product's selling price and the partner's target profit margin, calculate production costs and arrive at a maximum input price. You then model the production costs of the target beneficiary suppliers to understand whether they are likely to regard this as an attractive opportunity.

Regardless of whether you are looking at the supply or demand of a business innovation, there is an additional dimension to the commercial viability analysis for MSD programmes. This is because any business innovation supported by your project has to be connected to the needs of a specific market segment – in development terms, the "target beneficiaries". You therefore need to additionally determine whether the target beneficiary market segment represents a sufficiently attractive business opportunity in its own right. Otherwise the danger is that the private sector partner will adjust the investment project towards more attractive market segments (e.g. wealthier potential customers or more easily accessible suppliers).



This assessment requires that projects compare the commercial and the developmental targeting of the business innovation – if target beneficiaries are the primary consumers/suppliers in a business innovation, this points to a more sustainable developmental impact. There should be no conflict between the commercial and the developmental objectives, the most successful MSD interventions are clearly at the intersection of both. We discuss target beneficiaries in more detail in Section 3.

1.2 Scalability

Not all commercially viable business ideas are scalable. Our research has shown that many pilot interventions get "stuck" at the sustainable adopt stage – showing that while commercially viable at a small-scale, often the business innovations supported by the project interventions are not scalable. This can be due to many reasons, but one of the most important is the nature of the business innovation itself.

So having analysed the commercial viability of the business innovation, we turn to its commercial scalability.

Although related to impact at scale, commercial scalability is not the same as developmental scalability. It is more narrowly concerned with the way that the revenues and costs associated with the business innovation change as supply/demand increases.

Understanding the scalability of a business innovation requires understanding how revenues and costs change at different levels of production and sales in order to arrive at an assessment of the scalability inherent to the business innovation. A scalable business model is typically characterised by profit margins that grow as the business grows.

To illustrate this point, consider two types of products:

1. **Intangible product** (e.g. mobile application): there is significant investment required upfront to develop the product, but once developed, the product can be sold in unlimited quantities at virtually no marginal cost to the producer – a highly scalable business innovation; and
2. **Physical product** (e.g. agricultural inputs): the costs of production and distribution/aggregation increase broadly in line with sales/purchases, additional margins can only be achieved through efficiencies of scale, but are limited by production and distribution capacity, or further investment in improved logistics – a less scalable business innovation.

Recognising the commercial scalability challenges associated with the business innovation is critical to developing an effective scaling strategy. Assessing the commercial scalability of a business innovation should encourage innovative thinking around the business model, as well as the supply or demand itself. New methods of distribution or aggregation might open scaling opportunities that would not otherwise exist.

The relevance of this assessment is at a sectoral level as well as the partner firm level (see Section 4.2 Crowding). Crowding in is only likely to happen if the target market is large enough for competitors to supply at the same or lower cost of the first mover, while maintaining adequate profit margins to justify their own investment.

1.3 Financial viability

Even if a business innovation is commercially viable and scalable, it is also important to understand whether it is financially viable to achieve scale in the prevailing market environment.

Your financial viability assessment should first look at whether the market currently provides the affordable investment and working capital finance necessary for the partner enterprise and direct beneficiaries to make the initial investment required to adopt the business innovation.

Beyond the pilot scale of operations, you should also seek to understand whether the partner and its competitors, and indirect beneficiaries will be able to access affordable finance for further investments in order to adapt and expand the business innovation and create impact at scale. The financial viability assessment is structured around the finance function component of the market analysis (see box below) and the commercial viability of the financial model, looking at:

1. The availability and cost of finance to each market player for business investment and business expansion associated with the business innovation; and
2. The financial profile, risks and returns associated the business innovation (e.g. payback period, net present value of cash flows).

By examining how the finance function works within the market system, you will understand how each market player is impacted by different financial opportunities and constraints. You will also be able to arrive at a realistic assessment of the optimum mix of debt and equity finance for investment and working capital available to each market player.

Availability and cost of finance
Having determined the level of investment and working capital required, for each market player, the next step is to assess the availability and cost of finance (e.g. debt, private equity or impact investment equity, or public grants).

This assessment helps you to understand how the partner enterprise and the direct target beneficiaries will finance the investment and working capital required to adopt the business innovation.

Larger enterprises requiring access to significant amounts will typically rely on a combination of their own equity and bank borrowing, while target beneficiaries will be more likely to need access to micro-finance or local savings and loans associations to supplement their own, typically very limited, resources.

Understanding the finance function is particularly important because, however great the eventual profit or benefit, each market player will need to be able to afford the initial outlay and/or the additional working capital requirement associated with adopting the business innovation.

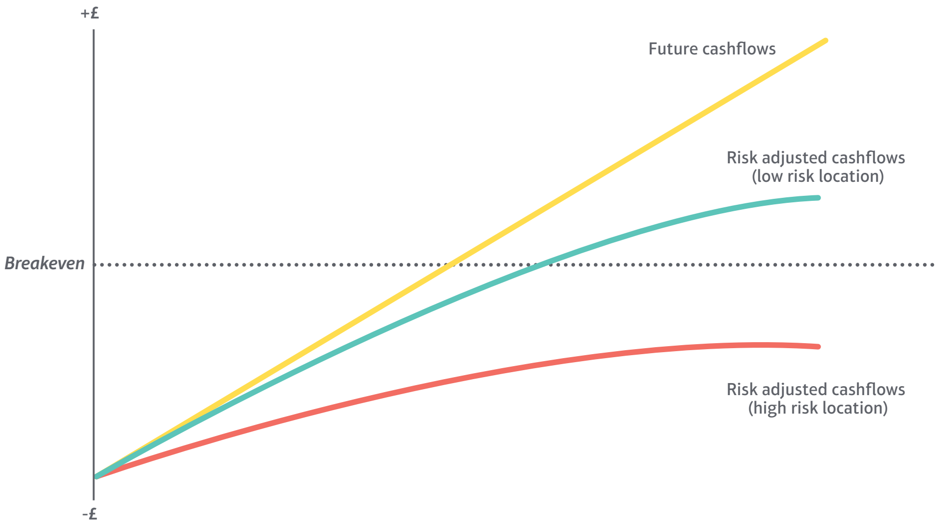
The second part of the financial viability assessment looks at the project financial forecast.

Using the commercial viability financial model, you can assess the cashflows and returns on investment associated with the project. This feeds into a calculation of the project's Net Present Value (NPV) to determine the financial viability of the business innovation based on an estimate of the overall cost of financing.

The higher the cost of capital (which correlates with risk), the higher the return on the investment that is required to make the project financially viable.

A business innovation that is financially viable in one, low risk location, may turn out to be non-viable in another, higher risk, location even if the project cashflows are exactly the same in both locations.

This is because (as illustrated in the diagram) the future cashflows associated with the project are discounted for risk, to reflect the uncertainty of actually achieving those future cashflows. The higher the risk associated with investing in any location, the higher the discount that you should apply to the anticipated future cashflows.



To simplify things somewhat, the business risk variable between different countries and locations explains why many high risk countries export raw materials and import the same materials once processed rather than investing in and building up domestic processing capacity.

The input costs of commodities are largely consistent, the processing costs will be broadly comparable, the finished product may even have a cost advantage due to lower logistics costs. But the risk adjusted return renders investment in processing capacity non-viable.

Your role as a co-investor is to assess whether the project will generate a positive NPV in the particular business environment in which you are planning your investment.

Understanding the finance function within the market analysis framework
We have looked carefully at the classical market analysis framework, and based on experience, we recommend that projects add a third dimension of finance alongside supporting functions and rules.

The thinking behind this integrated approach is that finance (for investment and for transactions) is critical to the functioning of all non-financial market systems, but is distinct from other types of supporting services as it is the very means of investment and transaction.

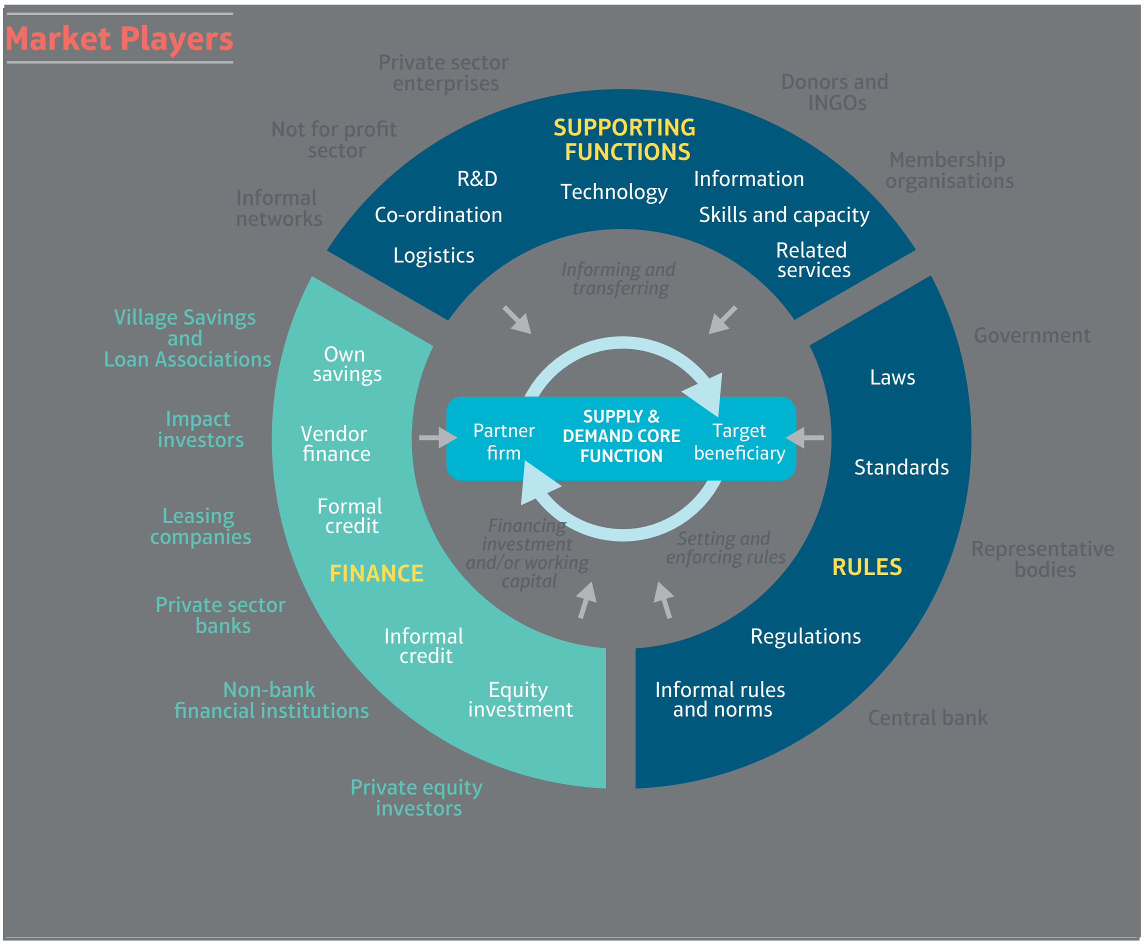
Frequently, a lack of affordable finance, or a lack of access to financial services, stand in the way of business innovations that would allow poor people to participate in markets – in the same way that a lack of skills or capacity, or over-burdensome regulation can impose constraints.

Bringing finance into the market systems analysis recognises this problem and allows projects to consider the specific finance and financial constraints as they impact the core transaction in the target market system, rather than thinking of the financial market as a separate market system.

Any significant business innovation will require investment, and expanding any business requires access to working capital as well as the means to transact (make and receive payments). This applies equally to each type of private enterprise: the partner enterprise(s), the enabling enterprise(s) and the target beneficiaries.

Finance – or the lack of it – on both sides of the core function is a common impediment to achieving impact at scale. Partner enterprises and enabling enterprises often find it difficult to access affordable investment finance and even more difficult to access working capital. Target beneficiaries typically face issues of affordability for even the smallest investment or additional cost, because they do not have access to savings or cannot borrow the money required.

The approach we have developed to analysing the finance function is in essence the same as that applied to the other components of the market system. It looks at the types of finance and financial services available in the market, compares these to what is required to enable the supply and demand core function, and asks which market players are currently operating – or could operate – within the market system.


Market Players
Private sector enterprises
Donors and INGOs
Not for profit sector
Membership organisations
Informal networks
SUPPORTING FUNCTIONS
R&D
Technology
Information
Co-ordination
Skills and capacity
Logistics
Related services
Informing and transferring
Village Savings and Loan Associations
Government
Own savings
Laws
Impact investors
Vendor finance
Partner firm
SUPPLY & DEMAND CORE FUNCTION
Target beneficiary
Standards
Leasing companies
Formal credit
Financing investment and/or working capital
Setting and enforcing rules
Representative bodies
FINANCE
RULES
Private sector banks
Informal credit
Regulations
Non-bank financial institutions
Equity investment
Informal rules and norms
Central bank
Private equity investors

2. Partner due diligence

Many MSD projects report problems with identifying appropriate intervention partner enterprises. Some of this problem may be down to the supply driven approach – the project itself designing a business innovation and then trying to "sell" the idea to potential partners.

But the other issue that projects face is with identifying partners who are genuinely 'willing and able' [1] to co-invest and deliver the pilot and subsequently scale up a business innovation. In more developed economies a corporate credit rating provides investors and lenders with a reasonably reliable indication of the strength of a company seeking to raise finance, but comparable facilities are rarely available in the countries where MSD projects operate. In any case, there are few small and medium sized enterprises (SMEs) – which form the bulk of intervention partners – with external credit ratings.

In the absence of credit ratings as a basis for judging a potential partner's reliability as a co-investor, you should consider three partner capability dimensions critical to successfully achieving impact at scale:

- Management capability;
- Financial capability; and
- Market reputation.

Even with the most promising business innovations, the intervention will only be successful if your partner enterprise has the capability to deliver the pilot successfully and subsequently manage the expanded business.

Partner enterprise or partner enterprises?
The private sector involvement in a pilot MSD intervention need not necessarily come from a single partner enterprise. Rather, experience shows that often there are two or three concurrent partner enterprises usefully involved at the pilot stage. Indeed, there are even instances where many small and medium enterprises are successfully involved. For the sake of simplicity of exposition, this section refers to choice and appraisal of a (single) partner enterprise. But the selection process need not necessarily narrow the choice down to one enterprise, even though it may do so. Provided the indicated due diligence principles are applied, two or more partner enterprises may well emerge from the process. And it goes without saying that this requires that each potential partner enterprise should be assessed on its own mix of capacities and constraints, not against some standard template.

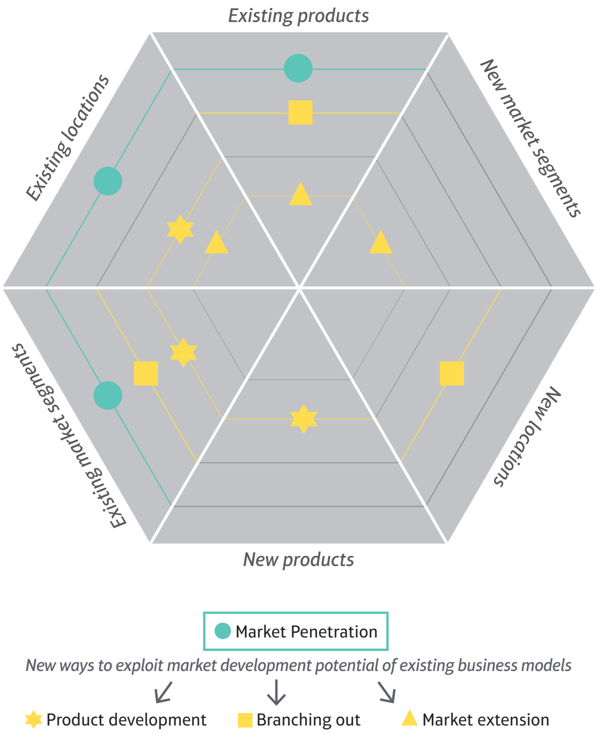
The partner due diligence process allows you to undertake a structured assessment of the potential partner enterprise's capacity to deliver impact at scale. This does not necessarily mean that you should only co-invest with the strongest potential partners, rather it allows you to develop an intervention strategy understanding and mitigating the risks associated with co-investing with the partner enterprise according to your proposed partner's strengths and (almost inevitable) weaknesses.

2.1 Management capability

Some of the most successful MSD interventions have been in partnership with enterprises that

1 For a detailed description of the 'will-skill framework' see, 'The Operational Guide for the making markets work for the poor (M4P) approach', (2014). https://beamexchange.org/resources/167/

have proven capability to manage a large-scale business. And frequently, failure to achieve impact at scale is because the partner enterprise lacks the management capability – the people and the systems – to operate at scale or even to demonstrate that a business innovation is scalable.



The first part of the management capability due diligence looks at the management and operating structures and systems of your partner enterprise to determine the enterprise's capacity to implement the business innovation project and then to manage and grow the business.

The next question is whether existing management and operating systems capabilities are applicable (transferable) to the proposed business innovation. The further removed that the business innovation is from the existing business, the less likely that this is the case, and the higher the management risk associated with the innovation.

Small businesses frequently face significant obstacles to scaling up, so to be a credible co-investor your chosen intervention partner enterprise should have an established, existing business in an area related to the business innovation. From an investment and business risk perspective, there are three realistic business innovation strategies (represented by the yellow symbols in the diagram above).

- **Market extension:** When the partner enterprise takes an existing product and adapts it to target a new market segment in the country or region where it has an existing business (e.g. supplying seeds in smaller packaging so that they become affordable for poorer farmers);

- **Product development:** When the partner enterprise develops a new product targeted at existing market segments in the country or region where it has an existing business (e.g. a new mobile financial service targeting and meeting the needs of existing customers); and

- **Branching out:** When the partner enterprise takes an existing product designed for the same market segment and enters a new geographical market (e.g. expanding supply of pay-as-you-go domestic solar panels).

It is worth emphasising that often, the most successful business innovations are actually incremental changes to existing businesses already operating at scale, rather than ambitious or radical innovations that take an enterprise into wholly uncharted territory.

Management capability assessment
A management capability assessment covers both the people responsible for the partner enterprise (the owners and managers – frequently the same people) and the systems that they have in place to manage the enterprise.

It looks at the owners and managers of the partner enterprise, but focuses on the capabilities of the individuals within the management team who will be directly responsible for delivering the business innovation (demonstrated by experience and expertise) to assess management strength. It also considers the adequacy of the structure and the degree of delegated authority of the management team.

The management capability assessment also examines corporate capabilities (demonstrated by track record of successful growth in the past) to determine whether the partner enterprise has the systems in place to manage expansion of the business innovation to scale. It looks at both the documentation of systems and how they are implemented within the enterprise.

Finally, the management capability assessment also examines the potential partner's current business activities to understand the strategic fit of the proposed business innovation.

2.2 Financial capability

The financial capability of the partner enterprise – which underpins its ability to borrow or attract investment to finance growth through business innovation – is equally critical to the success of the intervention.

While the market may be able to provide affordable investment and working capital finance, not all companies will be able to access that finance – banks and equity investors are typically risk averse, and will be looking for financial strength before lending or investing.

And unless the partner enterprise is able to finance growth to scale through a combination of debt or equity, the intervention is unlikely to move beyond the successful pilot stage (the sustainable adopt).

Incomplete financial records
MSD programmes typically operate in countries where there is widespread business informality and limited implementation of requirements for audited financial statements. This can make obtaining reliable financial data problematic, forcing programmes to look for "work around" solutions that allow them to generate an approximate financial picture.

Such work around solutions could include creating proforma financial statements based on an assessment of the physical capacity/utilisation of plant and machinery, combined with an estimate of operating costs of production and distribution, and the MSD project's knowledge of market quantities and prices.

While such an approach will not give a wholly accurate picture of profitability, it will at least allow a project to reach general conclusions on the partner's financial performance. It will also allow the project to "stress test" the likely impact on investment and working capital needs created by expanding production.

The main challenge for MSD project when assessing the financial capability of a potential partner enterprise is that due to prevailing levels of informality typically encountered by MSD projects, many companies which could make perfectly acceptable intervention partners in all other respects, do not have reliable financial statements on which to base co-investment decisions driven by credit ratio analysis.

The financial capability assessment is designed to cope with this problem through observation and discussion with the management team, rather than formal financial statements.

Financial capability assessment
In the absence of reliable financial statements, the financial capability assessment allows you to reach an informed conclusion on the potential partner's ability to finance innovation and growth.

The assessment covers the history of the business – looking at how long the enterprise has been operating and its business growth record to date.
It also covers the capital structure of the enterprise, looking at how the company has been financed and whether it has successfully borrowed (and repaid borrowing) in the past.

It also covers the capital structure of the enterprise, looking at how the company has been financed and whether it has successfully borrowed (and repaid borrowing in the past.

The assessment asks questions about the company's relationship with its current bank – for example, do the owners maintain a separate bank account for the company, how long has the company had its account with its main bank, how well has it managed its relationship with the bank?

The assessment uses proxy measures such as operating capacity and utilisation to highlight problems that there may be with past over-investment or lack of working capital.

2.3 Market reputation

The final element of the partner due diligence is less tangible, but a vital component of the partner due diligence. It is focused on the reputation – the brand – of the potential partner enterprise. This assessment is not just about protecting the interests of the MSD project and the financing donor, it is also a useful indicator of the attractiveness of the potential intervention partner as a transaction partner for target beneficiaries, and therefore of the company's ability to achieve impact at scale.

The assessment will also provide useful insights into the potential for crowding in – will competitors "believe" what they see, and will they feel comfortable competing with the partner enterprise? Although largely subjective in nature and prone to gossip and rumour, the results from the reputational assessment should identify any "red flags" that need to be investigated further before entering into a co-investment partnership and through triangulation, used to arrive at a final, balanced conclusion on the company's reputation.

Market reputation assessment
The market reputation assessment looks at the potential partner enterprise from the point of view of its suppliers, its customers and its peers. It asks questions about the company's standing in the market – does it have the market presence and credibility to introduce and encourage widespread uptake of the business innovation?

3. People due diligence

The third strand of the due diligence process is focused on the target beneficiaries themselves. To achieve the desired developmental impact at scale, there has to be widespread uptake of the business innovation among the target beneficiary group.

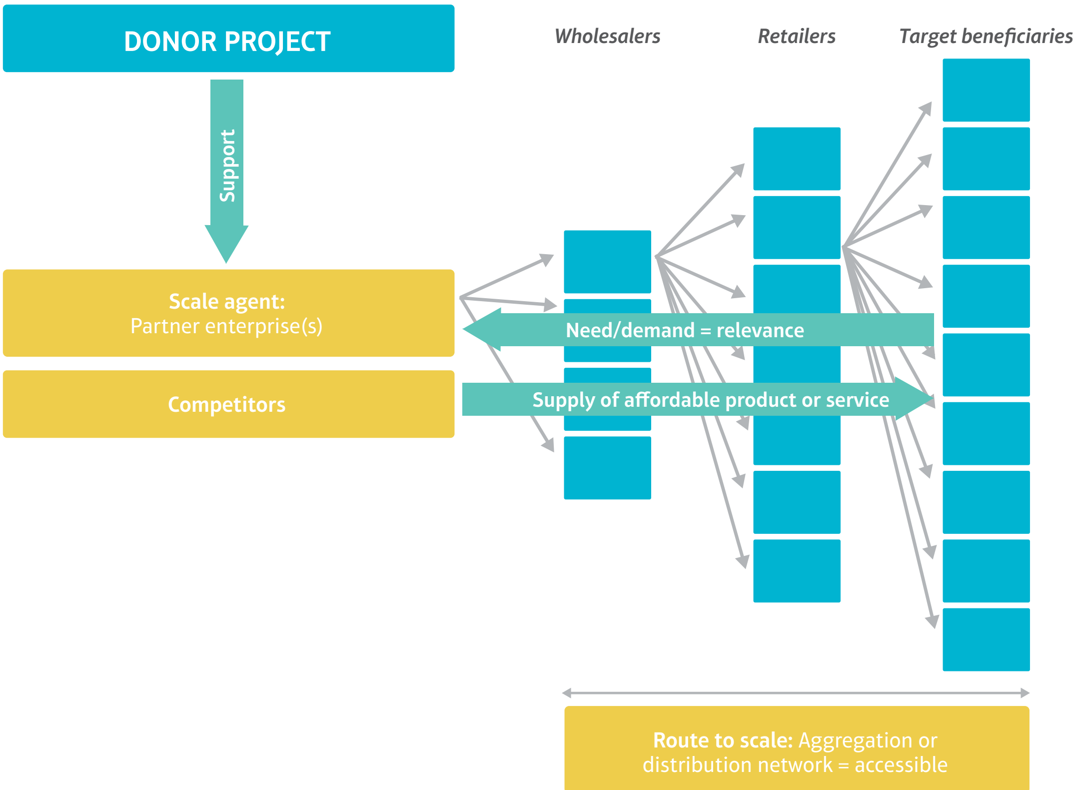
Our research indicates that the main determining factors for impact at scale among target beneficiaries can be summarised as:

- Relevance
- Affordability
- Accessibility

We also found that most MSD projects pay more attention to the viability of the target beneficiary side than they do to the partner enterprise side of the core supply/demand function. Nevertheless, we believe that there is room for further development of the people due diligence that would result in more consistent impact at scale.

In particular, we note that target beneficiaries do not form a homogeneous group – individuals face a myriad of different factors, and combinations of factors that exclude or limit participation in market systems. The people due diligence is therefore very much focused on understanding the specific circumstances and constraints affecting the target beneficiary group that the business innovation is trying to reach.

We present the interaction of each relevance, affordability and accessibility in the diagram below.



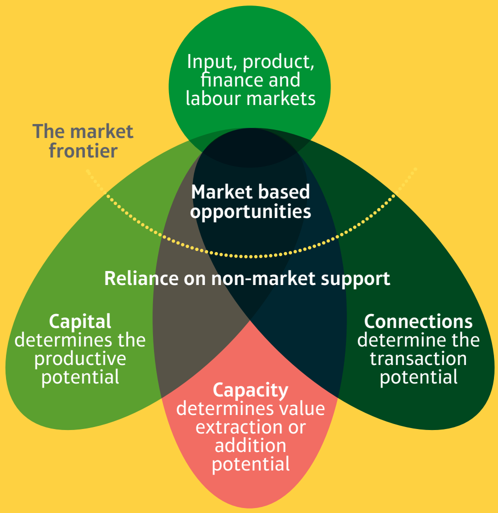
But before looking at the components of the people due diligence process, we introduce the concept of the “market frontier” as a means for MSD projects to assess whether target beneficiaries can actually be reached by market based interventions.

The market frontier

The inclusive market systems development approach is based on the premise that by identifying and addressing binding constraints in market systems, vulnerable and marginalised groups can benefit from improved access to innovative products and services that will improve their economic situation.

Introducing business innovations that change the way that markets work has the potential to deliver benefits, but the challenge is to create sustainable, market based opportunities for the most vulnerable and marginalised men and women so that they can realise an equitable share in these potential benefits.

To better understand the causes of exclusion, we have developed the concept of the market frontier – a way of looking at and addressing the limitations of market interventions to increase inclusion. Our research and our experience of implementing MSD projects is that for vulnerable and marginalised people to participate in market systems or move into employment requires that they are sufficiently endowed (individually or in organised groups) with a combination of essential foundations of market participation:



- **Capital:** The quality and the quantity of the public (e.g. infrastructure) and private (e.g. land, livestock or machinery) physical and financial assets that an individual can access or owns, and the personal attributes of the individual (e.g. age, health) determine productive or employment potential.
- **Capacity:** The level of skills and knowledge that an individual possesses and the ability of groups of individuals to organise at a local level determine the amount of value that can be extracted from assets, added to primary production, or derived from employment.
- **Connections:** The functionality of networks (e.g. aggregation of products, distribution of inputs, or personal networks providing links to labour markets) determine the transaction potential – in other words, is it physically possible and commercially viable for an individual to purchase inputs, take products to market, or take up employment.

The presence or absence of capital, capacity and connections is not binary. Accumulation of each is a process in which there is a “tipping point” – the point at which it becomes viable at a community or household level to transact in product, service or labour markets. Once this tipping point is achieved, the stronger the foundations and the closer the alignment of the foundations, the greater the rate of progress out of poverty open to any individual and the more sustainable the escape from poverty is likely to be. We refer to this tipping point as the “market frontier”.

The market frontier is a crucial concept for the design of MSD interventions. It marks a boundary within which an individual can take advantage of market based opportunities to transact, but beyond which an individual will either continue to be reliant wholly or in part on non-market based support (e.g. subsidy or social assistance) to access equivalent products and services.

MSD projects aim to design business innovations that allow poor people to cross the market frontier either 1) by accumulating capital (at a household level) or collectively organising (at a community level), or 2) by pushing the market frontier outwards to include households with lower levels of capital, capacity and connections (e.g. through improved aggregation or distribution networks). Either way, the effect will be to allow more poor people to participate in market systems and take advantage of the market opportunities provided by MSD project supported investments.

3.1 Relevance (and capacity)

The first question you should ask about a proposed business innovation is whether it is relevant to the felt needs of the target beneficiary population.

This question is partially answered by the initial market analysis that will have identified the constraints in the market systems that prevent or limit the participation of the intervention target beneficiaries.

By examining the proposed business innovation from the target beneficiary point of view, MSD projects should be able to answer two fundamental questions that help to determine whether or not there is likely to be widespread uptake:

- Is the need supposedly answered by the innovation sufficiently strongly felt; and
- Are the benefits of adopting the innovation sufficiently compelling?

But the assessment needs to go further than this and look at the current and potential capacity of the target beneficiaries to respond to the innovation. Do the target beneficiaries possess, or can they access, the skills and knowledge required to take advantage of the business innovation?

Relevance assessment
The relevance assessment helps MSD projects to look at the business innovation from the target beneficiaries' point of view. It recognises that for many target beneficiaries, life is precarious and there is a strong risk aversion that stands in the way of adopting business innovations.

It asks questions about how the target beneficiaries perceive the needs and the benefits associated with the innovation. The risk is that the innovation is solving a problem that doesn't really exist, or that the benefits associated with the innovation are so marginal or remote in time that they do not justify the risks associated with changing practices.

It also looks at where the target beneficiaries are positioned in relation to the capacity dimension of the market frontier. The assessment asks whether the target beneficiaries have the skills and knowledge necessary to adopt and make best use of the innovation. If they don't, can such skills and knowledge be acquired and are the incentives to do so sufficiently strong? Is there a need for a secondary intervention to introduce specialist service providers as a means to inject the required capacity to make widespread uptake possible?

3.2 Affordability (and capital)

The next part of the people due diligence process is to consider the affordability of uptake. This is an important consideration as, regardless of the need and benefits associated with the business innovation, if uptake is unaffordable to target beneficiaries, the business innovation will not lead to impact at scale. We consider affordability in three ways:

- Absolute cost to income: looks at the financial means of the target beneficiary purchasing unit, typically an individual household or some organised group of beneficiaries (e.g. a cooperative);
- Relative cost to substitute(s): considers the available or potentially available alternatives to the proposed business innovation; and
- Proportionate cost to utilisation: examines whether the target beneficiary purchasing unit can utilise the business innovation at optimal efficiency.

Affordability assessment
The affordability assessment looks at absolute, relative and proportionate costs in turn from the point of view of the target beneficiary group. It answers three sets of questions:

- Is the initial outlay and the delay before the benefit associated with adopting the business innovation, and are the costs of continuation (e.g. maintenance of an asset), within the financial means of the target beneficiary group?

- Are the costs of adoption less than any viable substitute that would deliver equivalent or similar benefits?

- Do the target beneficiaries, either individually, or collectively if such organisation exists, possess the capital (e.g. the land holdings) to make efficient use of the business innovation?

Pay-As-You-Go (PAYG) off-grid domestic solar panels
The story of off-domestic grid solar power illustrates the issues around affordability very neatly. The need for domestic electricity supply is obvious and the benefits of access to a reliable electricity supply for communities not serviced by grid power are clear. The one issue that stood in the way of widespread adoption was affordability – in this case, even though the relative cost is lower than alternatives such as diesel generators or non-electric light, the up-front cost prevented most target beneficiaries from purchasing the panels.

The solution to this problem was found by introducing a secondary innovation in the form of a PAYG model. Taking advantage of existing mobile phone infrastructure, panel suppliers found a remote means to monitor usage and collect payments. This allowed the purchase cost of the panels to be spread over a longer period – creating a payment structure within reach of the target beneficiary group without compromising the commercial viability of domestic power supply.

3.3 Accessibility (and connections)

The final part of the people due diligence takes you back to one of the key findings from our research concerning the importance of the transaction (distribution/aggregation) network (we call this the "route to scale") that links the partner enterprise with large numbers of target beneficiaries. While relatively straightforward to assess, it is probably the most complex problem to solve if such a ready-made network does not exist, and many MSD interventions have failed to achieve impact at scale because they under-estimated the complexity of the task of establishing networks within the intervention.

The route to scale can be a commercial physical network (e.g. a distribution network of wholesalers and retailers, supported by transport service providers), or a commercial "virtual" network (e.g. a mobile phone network that allows information services to be disseminated and payments to be collected), or an institutional network (e.g. the provincial and district offices of a chamber of commerce). The crucial factor is that the partner enterprise has reliable and cost-viable access to such a network appropriate to the specific characteristics of the business innovation.

Unintended consequence: creating a monopoly
From the point of view of assessing scaling up impact, it is also worth considering whether the partner enterprise has a monopolistic control, or by virtue of the intervention itself, could acquire monopolistic control of the route to scale – this would be a most unfortunate unintended consequence of the intervention as it would hinder or prevent crowding in by competitors.

From the outset, your project should consider how the intervention will expand beyond the initial private sector partnership in the event that the pilot is successful. Will the pilot partner be able to create barriers to entry that would disadvantage competitors seeking to crowd in beyond the pilot phase? Warning signs might include the kind of exclusive rights or agreements with suppliers or customers that many pioneer enterprises might seek.

Accessibility assessment
The accessibility assessment recognises that many target beneficiaries live in remote communities and that poor infrastructure and the costs associated with aggregation and distribution stand in the way of adopting business innovations.

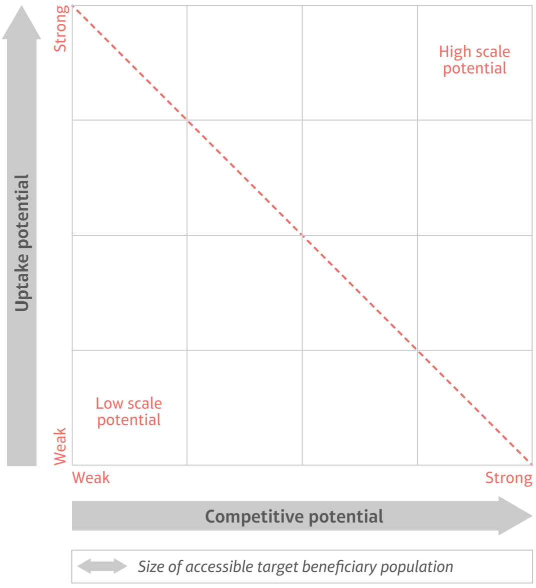
It is the accessibility assessment that addresses the "last mile" problem – how to deliver products or services to remote communities in a cost-effective manner.

The assessment starts with a mapping of the target beneficiary groups relative to the potential intervention partner and asks whether a business innovation that requires links between the two can be commercially viable given current infrastructure.

It asks questions about the existence, quality and control of routes to scale that can be used – or adapted for use – by the partner enterprise in order to encourage widespread take up of the business innovation by target beneficiary groups.

The assessment also considers the potential for efficiency gains by organising target beneficiary groups themselves to achieve lower cost aggregation or distribution.

4. Partner due diligence



The final component of the due diligence process, building on the initial sector selection analysis, takes you to the heart of the impact at scale challenge.

Looking at the sectoral context of the intervention, it allows you to consider the supply and demand aspects of the potential for Expansion (further investment by the partner enterprise) and Response (non-competitive investment inspired by the demonstration effect of the original intervention)[1]:

- Uptake potential (copying): Are there large groups of target beneficiaries within the market frontier, and willing and able to invest in the business innovation?
- Competitive potential (crowding in): Are there other market players ready to invest to expand and in response to the pilot intervention, taking the business innovation to scale?

Our research[2] has shown that this sectoral level analysis is probably the most neglected aspect of the due diligence process – despite impact at scale being a key claim of the MSD approach. We have included this sectoral level assessment in the pre-intervention investment analysis because we have observed that many MSD projects struggle to move beyond the sustainable adopt stage, either because:

- Commercially, there is insufficient sector level demand for innovation or there are no viable competitors likely to respond to innovation influenced by the commercial success demonstrated through the original intervention; or
- Bureaucratically, the problems of delay and attribution of such effects relative to the original intervention discourage donors and project implementers from either aiming for, or reporting such effects.

By introducing a structured framework for assessing the copying and crowding in potential and results of an intervention, the selection of interventions will be better informed by considerations

1 For definitions of Expansion and Response, see 'The Operational Guide for the making markets work for the poor (M4P) approach', (2014). https://beamexchange.org/resources/167/
2 See Keddie, Dr. J, Blewett, J. Van Hummelen, S. (2016) Impact at scale: The challenge of moving from pilot interventions to sustainable and widespread change https://beamexchange.org/resources/865/

of indirect effects, and donors and implementers will be more inclined to support more ambitious impact strategies and look for the (at least, early) signs of predicted indirect effects beyond the pilot intervention. Such a shift would return impact at scale to its rightful and central place in the implementation of the MSD approach.

4.1 Sector level uptake potential assessment (copying)

The copying potential assessment helps you to understand the aggregate sector level actual and potential economic role of target beneficiaries. The objectives of the assessment are to:

- Determine the potential for indirect effects associated with copying – the spontaneous, or near spontaneous – adoption of the business innovation by people meeting the criteria for target beneficiaries, but not targeted (e.g. because of geographical focus on one particular sub-group) by the original intervention; and
- Contribute to an outline scaling up strategy that takes account of the sector level analysis.

Copying potential assessment
The copying potential assessment expands on the original sector selection analysis (which will have covered the overall sector size, growth trends and likely future demand patterns, the potential for increased income opportunities (frequently based on international examples) for target beneficiaries through increased productivity or value addition).

The assessment focuses on the opportunities and strategy for innovation diffusion – who, when and how – and the regional or circumstantial variations that may accelerate or hinder such diffusion among target beneficiaries untouched by the original intervention.

4.2 Sector level competitive potential assessment (crowding in)

The crowding in potential assessment looks at the place of the intervention partner in the sector and the aggregate, sector level, potential private sector investment in the business innovation by competitors of the original intervention partner. The objectives of the assessment are to:

- Determine the potential for indirect effects associated with crowding in – the competitive response to the business innovation supported by the intervention – by the intervention partner's competitors; and
- Contribute to an outline scaling up strategy that takes account of the sector level analysis.

Crowding in potential assessment
The crowding in potential assessment looks at the place of the intervention partner in the sector and the sector level, potential private sector investment in the business innovation by competitors of the original intervention partmer.

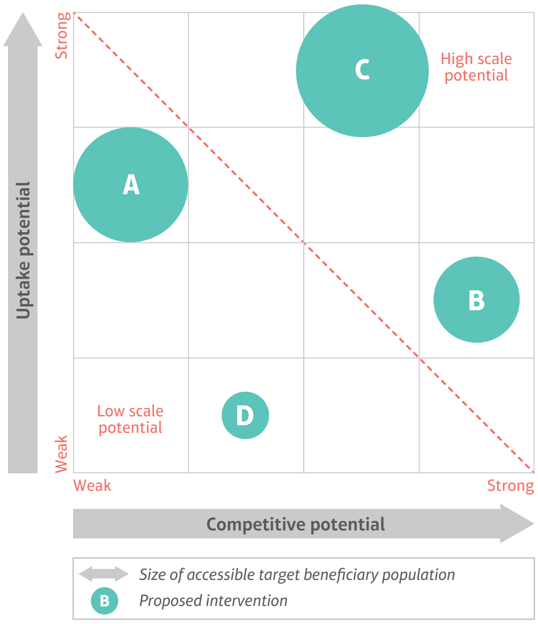
It looks beyond the original intervention partner to assess the state of competition within the sector and the likelihood of competitors responding to the business innovation introduced through the MSD project intervention.

The assessment maps the sector and identifies the competitor companies most likely to be affected by the business innovation (potentially losing business in the short-run).

Also the assessment needs to consider:

- Why are markets - in this context, the potential crowding-in competitor enterprises - not already tuned in to this innovation (implying a partial market failure)?
- What is ´in it´ for these private investors, the entrepreneurs of the country, whether they are already operating in the sector or not?
- Are there political economic constraints to operating the innovative business model at considerable scale?
- What are potential crowding-in investors´ management and financial capacities, commercial norms, motivations, and risk postures considered vis-à-vis this innovation and alternative opportunities such as further investment in traditional or ´popular´ investment lines?

4.3 Mapping the intervention



Bringing together the three key dimensions, you should be able to plot each intervention on the graph above:

- Competitive potential (crowding in)
- Uptake potential (copying)
- Number of potential beneficiaries (outreach)

We have plotted four examples on the matrix above to illustrate how this tool works:

- **Intervention A:** Attractive to target beneficiaries, but despite a relatively large target market, there are few competitors in the market and the returns are unlikely to attract new entrants (this is the situation that frequently characterises the sustainable adopt strategy);

- **Intervention B:** Attractive to competitors, but less so to a relatively small number of accessible target beneficiaries – could be viable, but less justifiable from a development impact point of view;

- **Intervention C:** Very attractive to a large number of accessible target beneficiaries and market well placed to provide competitive response, offering significant impact at scale potential – essentially the “ideal” intervention; and

- **Intervention D:** Not at all attractive to target beneficiaries, who are few in number, and not particularly attractive to competitors.

Based on this analysis, it becomes possible to understand and prioritise potential interventions according to their likely impact at scale, to develop pathways to scale that clearly demonstrate the potential for scale and explain how the project will build on a successful pilot through supplementary interventions – designed around the factors that led to the conclusions on competitive/uptake potential.

5. Pre-intervention assessment and analysis process

In the preceding sections, we have described the four components of the pre-intervention investment analysis due diligence. In this section, we give an overview of how we recommend that this process is managed. The process that we have in mind is iterative and flexible, building on the original sector selection analysis and the modified market analysis framework that we have set out earlier in the toolkit as partnerships are formed and plans become clearer.

To maximise efficiency of process, we suggest that pre-intervention assessment and analysis is completed in two stages:

- An intervention concept note that covers the assessments set out in the toolkit at a reasonably high level, allowing an initial screening of potential interventions to exclude those that do not appear to show potential to achieve impact at scale; and (for those concept notes that pass the screening.

- An intervention investment plan that goes into each assessment in more detail, allowing a final decision to be taken on co-investing in an intervention with a given partner.

5.1 Intervention concept note

The intervention concept note will evolve during the early stages of sector engagement as potential intervention partnerships emerge and intervention project ideas start to crystallise. The starting point of the analysis and assessment process is likely to be elements of the People, Potential and Project due diligence components – based on the findings from the sector selection and market analysis and potentially from prior experience from similar projects in other countries.

This initial synthesis of ideas and information will allow the project to put together a briefing note that outlines what it considers to be a business opportunity (stated in the form of a problem that could have a commercial solution) designed to capture the attention of private enterprise partners, or citing the interest of those potential partners who have conceived the innovation.

MSD practitioners may have their own ideas for private sector intervention projects that could address the constraints identified in the market analysis, however, it makes little sense to seed such ideas if there is reason to believe that they could work in the current circumstances. However, it makes little sense to develop projects in any detail before a serious partnership opportunity is identified. Those projects that have tried to develop their own solutions and then to “sell” projects to partners have either struggled to find a credible partner and/or seen resulting interventions failing to achieve impact at scale.

Keeping things business-like
Of course, MSD projects are designed to achieve developmental impact, and that is their primary concern. However, because they are seeking to support projects which are at the intersection of developmental and commercial objectives, there should be no conflict between the interests of the MSD project and of its private sector partner. It is important that the project is presented as a commercially attractive business opportunity rather than a development project from the outset. Talking about “target beneficiaries” or “poverty reduction” can send confusing signals to private sector partners who may sense incentives to respond to what they perceive to be the primary concern of a potential finance provider, at the expense of focusing on the commercial aspects of the project.

Following initial contacts with potential partners, it is possible that more than one project idea/ potential partnership may emerge, but it is also possible that at first glance, the project fails to identify any convincing ideas or potential partnerships.

Assuming that some kind of potentially attractive project/partner combination does come out of initial contacts, the intervention project is best developed as a partnership. The project is after all, a kind of joint venture between two co-investors with complementary strategic objectives.

The quality of the eventual concept note will inevitably suffer if the analysis and assessment is skewed either towards commercial or towards developmental considerations.

5.2 Intervention investment plan

The same principles apply to the process of working up the intervention investment plan as to the concept note. It is crucial to the eventual success of the intervention that the private sector partner is convinced (on their own terms – i.e. profitability) of the merits, and retains "ownership" of the proposed project from a commercial perspective.

The intervention investment plan is essentially a detailed investment proposal, summarising the findings of each of the due diligence components and presenting verified data to support conclusions and recommendations.

It should be sufficiently robust to justify the commitment of public and private funds, and it should be able to withstand the test of time. The decision to invest may or may not turn out to be justified by the developmental and commercial results, but the analysis that informed the decision should be sound.

Walking away from the deal
MSD projects should always be ready to walk away from a potential partnership at any stage of project development. While it may be frustrating to see a project fail to get off the ground, there are two key principles that should be kept in mind:

- Fail fast and fail cheap – while there is a balance to be maintained, the sooner that the decision to walk away from a failing project partnership is taken, the less time and resources that the project will spend on developing a project partnership that will almost certainly fail at a later stage. Encouragement of this principle is derived from our research, which indicates that if an intervention (innovation) is destined to achieve success at scale, there are usually strong signs of that quite early in the intervention.

- Sunk cost – past investment of time and resources to develop a failing project partnership is no justification for continuing to give more time and resources ("throwing good money after bad").