TERMS OF REFERENCE

EXPANDING EARLY-STAGE FINANCE FOR CLIMATE ADAPTATION: TANZANIA MARKET STUDY

1 INTRODUCTION

Climate change is already starting to impact across economies. Furthermore signs of breakdown across ecological systems point to threats from loss of biodiversity, pollution, diminishing fresh water resources and degradation of land. Successful adaptation to achieve ecological sustainability puts the question of how most firms and farms across economies innovate and manage change centre stage. Finance has a critical role in enabling competitive markets to generate, adopt, adapt and scale effective solutions throughout the economy. As well documented there is a significant shortfall in all forms of financing for adaptation, but most especially in relation to private sector financing. The market failures already prevalent in Africa's financial systems are themselves exacerbated by climate change. Bolder solutions are needed to meet the imperative for change. Crucially public and other concessionary resources need to leverage private flows at much greater multiples than has been achieved thus far by addressing the systemic opportunities and constraints.

Early-stage finance for enterprise is a crucial first step in realising change. Global experience suggests it is often the most difficult. While the returns from pioneering investment can be very high, identifying and realising these opportunities is often commensurately hard even in contexts where the broader enabling environment for enterprise is strongly supportive. Despite significant volatility, the venture capital industry has driven a worldwide expansion in the formalisation of early-stage finance. Venture capital is now gaining significant traction in Africa even if volumes remain small as a proportion of global investment. However much of the attention is focused on a small number of high potential markets – notably Kenya, South African, Nigeria and Egypt. In the less favourable conditions which characterise many African markets, venture capital is weak and overall low levels of early-stage investment are believed to be a significant constraint in effective adaptation to climate change. While weaknesses in the macro, policy, legal and regulatory enabling environment are certainly likely to contribute to low investment, these factors alone are unlikely to foreclose all opportunity - few country growth success stories start with ideal conditions. Expanding early-stage financing could be a potentially key part in opening up investment and shifting the incentives for changes in the enabling environment. Where risk perceptions are unfavourable, there may be a case for using concessional finance in order to lay the foundations for further growth and demonstrate where investable opportunities could lie for commercial capital.

FSD Africa and Climate-KIC share an objective of stimulating innovation and expanding investment in climate change adaptation across the continent. Just how early-stage financing markets are performing beyond the 'top tier' markets in Africa is far from clear. A better understanding of these markets is needed in order to ascertain if there is indeed potential and how this could potentially be unlocked. Rather than attempting to survey multiple markets with the risk of producing a superficial analysis, FSD Africa and Climate-KIC will initially undertake a deep-dive into a single market which is positioned firmly between the 'top tier' and the fragile and conflict affected states on the continent facing more severe challenges.

2 OBJECTIVES

The objectives of this assignment are to:

(i) assess the current market and development potential for early-stage enterprise finance in a single context (Tanzania) relevant to climate change adaptation

(ii) based on this analysis identify potential strategic interventions to build the early-stage finance market in support of climate change adaptation in Tanzania and across a broader range of economies in Africa.

3 SCOPE OF WORK

Early-stage finance here is understood to relate largely to the investment necessary to develop scalable and ultimately commercially viable business adaptations to climate change. It may involve funding operational or capital expenditure. The inherent novelty of these business adaptations introduces an intrinsically greater risk than the conventional financing of well-established business operations.

It is expected to relate most strongly to start-ups. Within the start-up journey of high-growth ventures several stages of finance are commonly identified (from pre-seed to seed and series A ,B etc). These stages are often understood to correlate with moving from initial ideation to development of minimum viable product and from there to product-market fit. Beyond this point the enterprise is anticipated to be moving towards scaling. However high-growth start-ups only represent once source of private sector innovation and growth relevant to climate adaptation. Growth potential and aspirations vary and existing businesses of various sizes and maturities will see opportunity and strategic necessity in investing to respond to climate change. The premise here is that there will be both commonality as well as important distinctions between the needs and challenges of early-stage financing of investment in climate adaptation across smaller-scale businesses. While the focus will be on start-ups, consideration will also be given to the financing needs of existing smaller-scale businesses. Outside scope will be larger-scale businesses which have the balance sheet capacity to finance early-stage investment.

3.1 Segmentation

There are multiple ways in which the landscape for early-stage growth finance can be segmented. The aim here is to highlight the crucial dimensions necessary to understand basic market functioning and concentrate on developments relevant to climate change adaptation.

Much can be expected to be driven by the nature of the real-economy sectors targeted. The needs, opportunities and constraints for climate adaptation will vary widely by sector. A comprehensive analysis is beyond the scope of this exploratory study and the focus will be on a limited number of sub-sectors (such as within agriculture) for which there is already compelling evidence and consensus on need and opportunity.

The primary segmentation will be around different prospective enterprise growth pathways. Adaptation here is seen as a necessary intrinsic part of enterprise growth and development. This should drive the analysis throughout. Thus rather than focusing simply on where enterprises are starting the emphasis needs to be around where they realistically aim to reach in the medium-term.

The taxonomy suggested by the Collaborative for Frontier Finance[1] is useful here, suggesting quite distinct growth and adaptation pathways and thus financing needs (see figure 1 below).

Figure 1: Taxonomy of smaller-scale enterprises and growth paths

Using this as a broad framing, a growth path segmentation appropriate to the Tanzania context needs to be developed. Case studies of representative enterprises should be used to illustrate the different growth paths. Indicative quantification of relevant variables (such as around total capital employed or workforce) should be explored but without the expectation that it will be feasible to produce definitive figures. More important is to capture the diversity. The focus in this study is on the first three categories of enterprise above - de-emphasising the assumed numerous livelihood-sustaining enterprises which characterize Africa's economies.

3.2 Demand for early-stage finance

The starting point here is to determine where there is currently expressed demand from entrepreneurs for early-stage growth finance (according to prospective growth paths). However this will only provide a crude indication. Leaving aside the shortfalls on the supply-side (ie: the ability of existing providers to finance viable projects) many entrepreneurs will misjudge the opportunity or viability of enterprise growth. Furthermore there can be a bandwagon effect – conspicuous success attracts many replicators even after the market opportunity has been largely met. Conversely potentially resolvable non-financial barriers may constrain entrepreneurial response and thus understate realisable demand.

Assessing demand is methodologically challenging and a highly eclectic approach is assumed necessary, triangulating from multiple sources of evidence and the perspectives of various stakeholders. At this stage any primary research is envisaged to be limited to case-studies. No entrepreneur/enterprise surveys are contemplated. The emphasis is on illuminating currently expressed demand and potential latent, realisable demand. Finding useful cases can be tackled in part through working with current providers of early-stage finance (looking at both those financed

[1] Collaborative for Frontier Finance (2020) *Closing the Gaps: Finance Pathways for Serving the Missing Middles*.

and those rejected). However it will be important to look beyond this and seek cases from other key informants – notably those with strong real-economy engagements.

For this initial landscaping study, the focus will be on identifying the key sources of demand within these growth paths. Market sizing will necessarily be highly conjectural and while useful to estimate the prospective orders of magnitude, more detailed projection is beyond the scope of this initial exercise.

3.3 Supply of early-stage finance

A broad canvas is needed at the outset to explore the supply-side. There is growing diversity in the formal sources of early-stage finance with a particular emphasis around pre-commercial venture building and seeding. However the recent emphasis on specialist early-stage funds and institutions may obscure the role of others and place a disproportionate emphasis on high-growth ventures alone. Global experience shows that much early stage growth financing comes from a variety of informal or semi-formal sources. This encompasses a spectrum from the entrepreneur's immediate social network through to business angels and informal investment groups. Embedded finance in which suppliers or off-takers in a value chain may provide investment is also often underplayed. A comprehensive high-level mapping of current sources of early-stage finance in Tanzania is needed.

Each of the major sources of finance should be explored to determine the primary characteristics: the enterprise growth pathways targeted, sectors, instruments, level of activity, degree of concessional resourcing etc. High-level information can be garnered on at least some of the formal sources using on-line resources (such as Crunchbase) and from key informants. More detailed case studies should be used to understand how key sources operate in more depth. The aim should be initially to understand the current supply – what sources of demand can prospectively be addressed – alongside its likely viability. While there are innovations in the supply of early-stage finance – notably with the emergence of new local capital providers – many of these are also at an early-stage with unproven business models.

Again for this initial landscaping study, the focus will be on identifying the key sources of supply for each growth path. While it will be valuable to estimate the relative orders of magnitude of supply from different sources and growth aspirations more detailed projection is beyond scope.

3.4 Market context

Multiple factors will shape the market for early-stage finance. It is useful to consider both those which impact on the demand-side – ie: the start-ups and enterprises seeking early-stage finance and the finance market functioning itself. Within the former considerable attention is paid to the non-financial enablers of successful venture creation and growth. Venture studios, builders and accelerators have proven effective in delivering bespoke services increasing the prospects of success in moving along the venture development journey. Meanwhile multiple elements from the policy, legal and regulatory environment through to supporting markets and infrastructure will shape the functioning of the early-stage finance market. Some of these will be quite generic – the cost and reliability of the commercial justice system, others more specific to the needs of typical early stage finance – tax treatment of capital gains or skills availability in investment.

Attempting a comprehensive analysis of all relevant elements of the market context would again be infeasibly complex. The aim should be identify what appear to be the key elements of the current market context which impinge most on market functioning – both as enablers and constraints. This can be addressed by drawing on the case studies and key informant interviews, probing those elements for which there is evidence of impact. Comparative analysis with other contexts may be useful here – most obviously somewhat similar countries in the region where market functioning appears stronger (such as Kenya).

3.5 Analysis of market constraints and opportunities

A preliminary analysis is required of the state of early-stage finance in Tanzania providing an overview of current market functioning, highlighting the evidence of constraints and the potential opportunities for development. It is important to acknowledge the challenges in the analysis here. What causes low levels of investment in growth? Is it a supply-side problem – the frequent opinion of would-be entrepreneurs – or a demand-side issue – the complaint of investors or bankers looking for viable projects? The approach sought here is one of careful critical analysis and nuance. Multiple factors may be at work and different growth paths and real-economy segments are likely to face differing challenges.

3.6 Market building interventions

FSD Africa and Climate-KIC's ambition in undertaking this study is to subsequently implement experimental, pilot initiatives to test and advance relevant ideas to develop early-stage financing in Tanzania and/or other comparable markets across the continent. Building on the analysis of market functioning together with the insights and ideas derived from key informant interviews, potential interventions should be identified. These initiatives should in the first instance be relevant to FSD Africa and Climate-KIC's core capabilities but recommendations need not be limited by this. The aim should be to identify opportunities for developing a well-functioning, sustainable and scalable early-stage financing market. While substitution for market gaps or absent functions by development actors such as FSD Africa and Climate-KIC can have a role in pump-priming, it is important that there is some credible pathway to crowd in other resources. The role of concessional, state or other non-commercial resourcing should be considered. Both climate change and innovation are subject to significant market failures necessitating the use of non-commercial resources. These resources need to be used in a way which most effectively leverages (rather than displaces) private sector capital and activity.

4 METHODOLOGY

In preparation for the field phase it will essential to draw on what has already been learnt both from existing studies and the insights of key informants in the Tanzania market. A broad literature review relevant to the study objectives should be undertaken examining material relating to the Tanzania market but also considering similar markets. Key informants with practical knowledge of working in the venture development space in Tanzania should be consulted. Based on this the study design, for which this terms of reference presents a preliminary outline, should be finalized.

The objective of this work is firmly around gaining insights into current market functioning as a basis for interventions to support market development. Methodologically this can be addressed more effectively through case studies and interpretative approaches rather than surveys and quantitative analytics. This should form the core of the field phase. The first step in the field phase will be to develop a broad initial tentative landscaping of demand and supply. This will involve an open, cascading, network following approach – following leads from key informants initially. Based on this the next round of interviews should be developed. The approach will need to be iterative, as new leads are found then further interviews will be undertaken. Case studies should be undertaken into key actors targeting prospectively representative entrepreneurs and start-ups at various stages of their venture development journeys alongside identified current or prospective sources of early-stage finance.

The study will be exploratory in nature and therefore an adaptive approach is needed. Constraints and opportunities for information and data gathering together with the emerging findings will influence how the study should best be implemented in order to achieve the overall objectives. In order to support this effectively the study will be overseen by a small steering group which will support the research implementation process, providing guidance on implementation and feedback on findings. The steering group will be composed of the study team lead and representatives from FSD Africa and Climate-KIC.

5 INDICATIVE DELIVERABLES AND TIMELINES

Project Stages	Activity	Output	LOE/Timeline
1. Existing information collection, literature review	• Literature review • Secondary data collection • Identification of key questions for stakeholder consultations • Consult with key informants (accelerators, development organizations investors etc) • Identify potential revision to study design and develop detailed plan for fieldwork	Short summary of literature review & findings from key informant interviews Full final study plan including fieldwork	2 weeks Feb - Mar 2024
2. Field phase	• Identify successive waves of respondents on supply and demand sides • Interview market participants • In-depth data collection for case studies • Interview respondents relating to wider market context	Summary insights from field notes	6 weeks Apr – Jun 2024
3. Analytics and case study creation	• Development of illustrative case studies of the different stages of growth for start-ups/early-stage SMEs in Tanzania, highlighting access to early stage finance challenges and opportunities. • Development of case studies on early-stage financing models • Workshop on preliminary findings and case studies • Development of report on start-up access to finance in Tanzania.	Workshop Market analysis report & case studies document	2 weeks Jul 2024

Project Stages	Activity	Output	LOE/Timeline
4. Reporting, recommendations & intervention development	• Workshop on recommendations for interventions to develop early-stage finance market in Tanzania • Final report synthesising recommendations and workshop inputs	Workshop Report with outline proposals for experimental initiatives	2 weeks Aug 2024

6 INVITATION TO TENDER

FSD Africa is inviting tenders from suitably qualified consultants. Your proposal should include:

a. Names and CVs of lead consultant(s) including qualifications and relevant experience in providing the kind of services required and an outline of team structure (tailored CVs, no more than 3 pages each).
b. A short description of your understanding of the role of the Consultant as outlined in these terms of reference.
c. An outline of the methodology you intend to use to deliver the assignment.
d. A description of how you intend to fulfil the services and your proposed timelines; and confirmation of your ability to meet those proposed suggested timelines
e. A detailed fee and direct cost-based financial proposal, with applicable taxes itemised.

Your proposal which should not exceed 10 pages, excluding annexures (e.g., CVs, company brochures etc.). The successful consultant will prepare an inception report that confirms the approach proposed to be used to deliver this assignment. The report will be informed by discussions held with FSD Africa and submitted within 2 weeks from the signing of the contract.

Your proposal should be sent by email to FSD Africa at bids@fsdafrica.org by 27 March 2024, 1200 EAT

7 BASIS OF AWARD

FSD Africa will award a contract to the consultant based on the following criteria and using the most economically advantageous tender approach.

Mandatory requirements
Relevant expertise and experience in early stage finance and enterprise development in Africa or comparable emerging economy markets.
Experience in carrying out market analysis and advisory assignments of a comparable nature with at least three such assignments within the last five years

Assessment criteria	Weighting (%)
Relevant, demonstrated experience and capacity of the consultant	30%
Demonstrated understanding/interpretation of the task set out in the TORs	20%
Content, quality and originality of proposed response to the ToR	30%

Assessment criteria	Weighting (%)
Fee basis and total costs FS = 20% x LB/BP where: FS = is the financial score LB = is the lowest bid quoted BP= is the bid of the proposal under consideration. The lowest bid quoted will be allocated the maximum score of 20%. **Fee quoted must be inclusive of applicable withholding tax**	20%
Total	**100**

8 APPLICABLE TAXES

As per Kenya's tax law, FSD Africa will pay the Consultant after withholding the appropriate taxes at the applicable rate between Kenya and the Consultant's country of tax residence, considering any tax treaties in force. It is the responsibility of the Consultant to keep themselves apprised of these applicable taxes. However, the table below provides guidance on the applicable rates as per tax regimes.

Country	WHT Rate
Kenya	5%
United Kingdom	12.5%
Canada	15%
Germany	15%
Zambia	15%
India	10%
Non-resident rate for citizens of EAC member countries (member countries attached)	15%
All other countries	20%

9 CONTACTS

Questions or comments in respect of these terms of reference should be directed by email to: bids@fsdafrica.org on or before 12 noon (EAT) 18 March, 2024 and feedback will be provided by 20 March, 2024 5pm (EAT).