2 Views from the field: Guest contributions

This chapter contains a curated set of guest pieces by practitioners and experts working in the blended finance space – including from representatives of multilateral development finance institutions, a private impact investor, a research institute, a local intermediary, and a non-governmental organisation.

The evidence and viewpoints that emerge from these pieces add colour and nuance to the analysis in the previous chapter by showcasing the opportunities and challenges of applying blended finance solutions in LDCs and in particular sectors. They also raise a number of important questions about how best to deploy blended finance solutions in LDCs.

2.1. Mobilising private finance for agricultural investments in developing countries

Bettina Prato and Dagmawi Habte Selassie

As an international financial institution dedicated to eradicating rural poverty, and specialised in designing and co-financing public programmes for agricultural and rural development, the International Fund for Agricultural Development (IFAD) has traditionally engaged private investors primarily through its support to the public sector. Its three main focus areas have been: 1) supporting public programmes targeting small farmers and other small rural entrepreneurs (their productivity; their access to key services, finance, and technology; and their access to markets); 2) facilitating public-private-producer-partnerships (4P) in agricultural value chains; and 3) strengthening the institutional and policy environment for private investment.

In recent times, IFAD has sought to build on this experience and to deepen its capacity to engage with the private sector directly, including via a new Private Sector Engagement Strategy. This aims, first, to expand investments in small-scale agricultural and rural enterprises; and second, to develop markets, income and job opportunities for poor rural women and men, notably youth. How will IFAD expand investments in small-scale enterprises? Its approach is to use traditional and not-so-traditional financial instruments to attract and scale up funding from a range of financial institutions. Traditionally, IFAD-funded programmes have used, among others, lines of credit and risk-sharing arrangements with banks and non-bank financial institutions. The fund is now developing new financial products and collaborating with new blended facilities and impact funds serving this market. IFAD's interest in blended finance is growing and the fund has initiated and catalysed some new initiatives in this space. For example, it sponsored the Agribusiness Capital Fund (ABC Fund) that was launched in Rome in mid-February 2019. This impact fund is managed by Bamboo Capital Partners in partnership with Injaro Investments, with an initial first loss capital of EUR 50 million from the European Union and African, Caribbean and Pacific Group of States (ACP), the Government of Luxembourg and the Alliance for a Green Revolution in Africa (AGRA). It has a fundraising target of EUR 200 million. The ABC Fund will provide loans of less than EUR 5 million to local financial intermediaries and make direct investments of below EUR 1 million in small and medium-sized agribusiness enterprises in ACP countries.

In 2017 IFAD also initiated the Yield Uganda Investment Fund in partnership with the European Union. The Yield Fund is an innovative social impact investment fund targeting agricultural SMEs[1] and producer groups in Uganda that are part of the unbanked "missing middle" (see Box 1.2 in Chapter 1). It uses grant resources from the European Union to finance first loss protection capital in the fund and a cost-sharing business development services technical assistance facility to bring on board financing from other investors. It offers patient risk capital products such as equity, quasi-equity and debt funding to small and growing agribusinesses, investing between (USD 250 000 and USD 2 million) in companies that offer a solid social impact proposition with attractive financial returns. The fund is managed by Pearl Capital Partners, a Uganda-based manager with extensive experience in agricultural investments.

The Yield Fund was established as a Ugandan company. This was partly to support the development of the country's financial sector, which remains relatively underdeveloped, as does its legislation supporting the operation of equity funds. Most similar funds choose to register themselves in third countries, which allows for the smooth transfers of funds, taxation and potential dispute resolution.

Partly due to the specific challenges of this context, as well as those related to the target sector, the fund initially found it hard to attract new capital. Investors were put off by its one-country, one-sector targeting; its relatively small ticket size; and the local legislative challenges. However, the combination of the business opportunities in the sector and the fund's risk-sharing grant resources eventually convinced three investors to contribute a total of EUR 10 million. One of the investors is the National Social Security of Uganda, which committed EUR 2 million. This is particularly significant, illustrating how this sort of instrument can attract the growing volume of assets managed by pension funds in Africa which are struggling to find the right vehicles that match both their countries' development needs and their clients' return expectations. Their contribution helped attract the other EUR 8 million from international impact investors.

The Yield Fund has made five investments to date in various value chains, including coffee, soya and moringa. While the investee companies offer great potential to meet the return objectives of the Yield Fund, which has an expected 7% internal rate of return, they tend to have capacity gaps in their operations. The fund's business development services facility has helped to address these through training and capacity building, while also promoting compliance with environmental, social and governance (ESG) standards.

What lessons do we take from our first 18 months of work?

- **Agricultural SMEs lack adequate and affordable capital**. There is indeed a "missing middle" in SMEs' access to the capital they need to grow, as neither commercial banks nor micro-finance institutions have the capacity or products that match their requirements.
- **Even impact investors have limited appetite for risk**. Many potential investors found the Yield Fund too small and risky because of its single-country, single-sector focus, even in the presence of first loss protection. But the mixture of opportunities and grant funding did help to crowd in private finance.
- **Local presence is important**. The Uganda-based location of the fund manager has proved to be an important factor for the success of the Yield Fund. In-depth local knowledge opens the door to a wealth of information on potential risks associated with individual investments. Constant presence and proximity enable investees to benefit from sustained capacity support.
- **Technical assistance plays a key role**. Strengthening investees' capacity – including in areas like ESG compliance, improved operational efficiency, and building smallholder farmer supply networks – was critical for mitigating risk and increasing investor confidence. The technical assistance facility of the fund involved a linked model, contracting a third party (KPMG Uganda) to assess the company's operational and ESG compliance gaps to feed into an independent assessment of financial and developmental value added and to support pipeline development.
- **Co-ordination between financiers is necessary for success.** It is important for the various types of financing (grant, concessional loans, impact capital and commercial capital) to be well aligned, and for financiers to take responsibility for not unduly distorting markets - including in LDCs and fragile contexts.

Box 2.1.About the authors: Bettina Prato and Dagmawi Habte-Selassie

Bettina Prato is the Senior Coordinator of the Smallholder and Agri-SME Finance and Investment Network (SAFIN) and a Senior Global Engagement Specialist at IFAD. She has almost 20 years of experience in international policy engagement and advocacy, strategic planning, and policy research, spanning the United Nations, the NGO and think-tank communities. At IFAD, she has covered a range of policy issues, including responsible private investment, gender equality, post-conflict transitions in rural contexts, and the global architecture of development co-operation for food security. She holds a PhD in Political Science from the University of California at Berkeley, a Masters in International Affairs from The George Washington University, and an undergraduate degree in Oriental Languages from the University of Venice (Italy).

Dagmawi Habte-Selassie has over nine years of professional experience working in private finance and international development. Most recently, he was the technical specialist working in setting up the Smallholder and Agri-SME Finance and Investment Network (SAFIN), which aimed to foster a more effective and inclusive ecosystem for agri-SME finance. He is now leading IFAD's engagement in the Yield Uganda Fund in Kampala. He also held various positions at the institution in Rome, South Sudan and Ethiopia, including as task manager for the RUFIPII project in Ethiopia, a USD 252 million partnership between IFAD, commercial banks and the Government of Ethiopia. Prior to development work, Dagmawi spent a number of years working in the private sector in pension administration as well as retail management in Canada. He holds a Graduate Diploma in International Business Management from McGill University and a Masters Degree in Management of Development from the Università degli studi di Torino.

2.2. Ensuring blended finance respects national ownership

Andrea Ordóñez

The past decade has been marked by significant progress on promoting development effectiveness. It is now clear that to ensure sustainable development that meets local needs we must keep in mind how programmes and projects are designed and implemented. The principles of country ownership, transparency and accountability have become central to development co-operation. The new wave of blended finance has brought with it the question of which principles should guide these operations. As last year's instalment of this report emphasised, where ODA is involved, blended transactions should meet these long-standing development effectiveness principles. One aspect that is often overlooked in both practice and research is how to ensure that blended finance supports national ownership of the development agenda.

Southern Voice[2] recently reviewed the relevance of the development effectiveness principles in different country contexts. This revealed that country ownership is a decisive principle for co-operation, underpinning all the other effectiveness principles. Ownership of development projects encompasses a variety of dimensions. First, it entails an active role for national actors in planning and enunciating the need and demand for development projects. Second, ownership during the implementation of projects means that project beneficiaries have the opportunity to make tangible contributions, such as co-investing in projects, or providing in-kind support. Finally, it involves national actors being committed to and supporting a project's success over the long term, so that its impacts are sustainable.[3] This means that national actors advance strategies to implement projects and deals that are aligned with their objectives and needs. This not only requires the involvement of the government, but also other actors in society, including civil society and affected communities. In practice, this means there is a negotiation in which different interests are balanced.

When it comes to blended finance deals, ensuring ownership can be complicated. Blended transactions can involve multiple partners, including development co-operation agencies or development banks, commercial partners, national governments, and the domestic or international private sector. There are concerns that blended finance may be used as a back door to increase the use of tied aid. Significant government involvement, especially when a government does not have private transaction experience, may be a deterrent to private investors seeking to move quickly.

So how can ownership work in the context of these complex arrangements?

Southern Voice carried out four scoping studies on blended finance in 2018, on Bangladesh, Nepal, Senegal and Uganda. These case studies shed light on some of the key ingredients for ownership in the case of blended finance. Three issues are worth highlighting.

First, LDC governments need **more consistent and better organised information** on who is deploying blended strategies and the practices and opportunities for accessing concessional finance through blended transactions. This will help them to assess when and where blended finance can best be used. The scoping studies suggest that LDC officials are often unaware of blended finance approaches. While each beneficiary government could invest in researching the sector, making this knowledge publicly accessible to all governments through a common platform would help create a better understanding of how blended finance fits within their integrated financing frameworks for meeting the SDGs.

Second, it is important for LDCs to establish the right **institutional frameworks** that will allow them to analyse and structure blended transactions that share risks and rewards fairly; and to deploy blended strategies where and when they are appropriate and in line with high environmental, social and governance standards. The scoping studies found that in some countries the institutions that are currently in place are usually in the context of public-private partnerships (PPPs); these may therefore need to be updated in terms of their skills, capacities, and mandates to cover blended transactions more broadly. Some governments are already moving in this direction. In other countries, it is not clear which institution would be a natural leader for blended finance initiatives – clarifying this would be an important first step. Providers of concessional finance and development partners overall can also help to build the capacities of national and subnational authorities to engage meaningfully in the design and implementation of blended finance deals.

Third, governments need to be able to **co-ordinate** different development initiatives and ensure their coherence. For example, blended finance initiatives to provide credit lines to sectors that have been traditionally underserved require well-functioning credit reference bureaus to ensure that the various financing offers do not all reach the same beneficiaries. Concessional finance providers can help with this, by engaging more systematically with LDC governments – and other key national stakeholders – to ensure that projects support national development goals.

If blended finance is to be used more and more to leverage private investment for reducing the SDG financing the gap, beneficiary countries must be able and supported to exercise ownership effectively. Practical knowledge and capacities relevant to the practices of blended finance are essential for them to take the lead and to put in place the right institutional frameworks and arrangements to ensure that blended finance deals align with national priorities and are deployed appropriately.

Box 2.2. About the author: Andrea Ordóñez

Andrea Ordóñez is Director of Southern Voice, a network of think tanks devoted to bringing research from the Global South to international debates on the development agenda. She co-edited the book *Southern Perspectives on the Post-2015 International Development Agenda*, which lays out an agenda for sustainable development by researchers in Africa, Latin America and Asia. Her work focuses on linking researchers from the Global South with their counterparts in other countries, strengthening their presence in international debates and fostering policies that promote sustainable development. She is also a board member of Publish What you Fund. Andrea has developed projects on public finance, natural resource wealth management, and financing for development.

2.3. The potential of blended finance for global health

Priya Sharma

The world has signed up to ambitious health goals – but recent trends in the health financing space threaten to limit our ability to achieve them. Development assistance for health reached an all-time high in 2014, but has since plateaued. This, along with increasing but still insufficient government spending on health, has resulted in a USD 134 billion annual health funding gap in low-and middle-income countries. If funding trends continue, this gap is expected to reach USD 371 billion annually by 2030 (USAID, 2019[11]).

Importantly, growing interest from the private sector in investment opportunities in the health sector in low- and middle-income countries is offering donors and governments an opportunity to fill this gap in innovative ways. Blended finance, for example, can allow donors and governments to use their existing resources more strategically and catalytically to leverage new resources for health. However, despite increasing interest in blended finance on the part of key stakeholders, a number of unresolved issues and challenges must be addressed if blended finance is to achieve its full potential for health.

First and foremost, it is important to remember that blended finance is a means to an end, and not an end in itself. Blended finance alone with not help fill the funding gap—more domestic public sector resources will be needed to do so. Blended finance is also not intended to replace development assistance for health, but rather to complement it by expanding the toolkit available to donors and country governments for funding the health sector and improving health outcomes. Ideally, blended finance is used to attract private investment into areas where the private sector can function adequately, freeing up limited public and philanthropic resources for those areas where traditional grant funding is still needed. As health is a public good, and market failures often leave the poor and vulnerable at highest risk, donors, the private sector, and governments have to be aware that blended finance strategies will not be appropriate in all circumstances.

A related criticism often levelled at blended finance has to do with equity: the most "investable" opportunities in health tend to benefit the middle or upper classes rather than the poor. This has been the case with a large portion of blended finance transactions focusing on health infrastructure projects or investing in tertiary and specialty care facilities. But this need not be the case – there could be deals that focus on the poorest segments of society that are also investable, such as in the social enterprises and SMEs that predominantly provide health services to the poor. In any event, this criticism highlights an important potential tension embodied in blended finance transactions in the health sector: the trade-off between financial return and ensuring no one is left behind. Unfortunately, most assume there is no trade-off, and that it is possible to make impact-first investments and still earn a competitive rate of return. While this might be true in sectors such as energy, infrastructure and agriculture, it is not always so in health. Resetting expectations, especially among private investors, will be important. Addressing social equity considerations may also require greater levels of concessionality in blended transactions – so that the prices set for health services are affordable and do not exclude the poorest segments of society.

This might mean that many large or more commercially oriented investors will be less inclined to work in the health sector. But those investors and foundations that are more intentionally impact-focused will still be interested. These types of investors are also more likely to share definitions of impact, as well as metrics and methods for measurement and evaluation. Commercially oriented private sector investors will often define and measure impact according to the needs and demands of their primary stakeholders. In some cases, this definition is at odds with how the public sector may be thinking about impact and outcomes. For example, the public sector might focus on more outcome-related indicators, i.e. reduction in mortality or disease prevalence, while the private sector might be looking at their return on investment or dollars mobilised. Both sets of indicators are needed to provide a holistic picture of the impact of a blended finance transaction, but all parties need to agree at the outset of the project on the indicators for monitoring a specific transaction.

Another complication is that in health it can take a long time for impact to be felt. Often proxy indicators or measures are used to estimate impact and additionality. Also, data collection, monitoring and evaluation are costly, and differing expectations of what *can* be measured versus what *should* be measured can further complicate matters; if private actors are required to undertake the monitoring, they may also require extra returns to offset the cost of ESG compliance and impact measurement. Thus, careful partner selection, a focus on aligning interest and outcomes, and agreeing on roles and responsibilities for data collection, can help ensure that future blended finance transactions do not exclude the poorest and most vulnerable, and instead benefit them specifically.

There is real opportunity to use blended finance to achieve our health goals if we are mindful of these limitations, and thoughtful and strategic in our use of public finance to mobilise additional resources for global health. At USAID's Center for Innovation and Impact, a new report, *Greater than the Sum of its Parts: Blended Finance Roadmap* (USAID, 2019[12]), lays out a six-step framework to help global health practitioners determine when blended finance might be more appropriate than traditional grant-based aid, and to fully understand the implications and trade-offs between the two. By being more deliberate in our approach, this roadmap can help donors, governments, and the private sector harness the full potential of blended finance and improve the health of millions around the world.

Box 2.3. About the author: Priya Sharma

Priya Sharma is a Senior Policy and Innovative Financing Advisor working for CAMRIS International, Inc. in USAID's Global Health Bureau's Center for Innovation and Impact. In her current role, Priya uses innovative and blended financing mechanisms and market-shaping interventions to accelerate development, introduction and access to life-saving commodities, and leverage private sector funding to achieve global health goals. She currently manages USAID's first global health development impact bond, and co-authored Investing for Impact, an educational resource for development practitioners interested in learning more about trends and non-traditional approaches to financing global health. Priya also led the development of a Blended Finance Roadmap, designed to provide guidance to the Global Health Bureau and missions interested in using blended finance to implement health programmes.

Priya received her MSc in International Health Policy (with Health Economics) from the London School of Economics and Political Science, and she completed her undergraduate studies at Tufts University.

2.4. Blended finance in Nepal's cities: challenges and prospects

Maniram Singh Mahat

Over 59% of Nepal's population lives in its 293 urban municipalities, which together contribute more than 60% of GDP. The pull exercised by cities stems from aspirations for jobs and a better life. However, urban centres with poor infrastructure cannot live up to their potential as engines of economic growth. According to the Municipal Finance Framework 2016, the capital investment needs for basic urban infrastructure in Nepal's municipalities were equivalent to NPR 2.3 trillion (some USD 20 billion) over 15 years (Government of Nepal, 2016[13]). This is about double the resources available for capital investment. Blended finance could be one way to cover this deficit.

There are several financing challenges in Nepal. At the macro level, the growing balance-of-payments and trade deficits, and decreasing current account surplus, have constrained the investment capability of Nepal's public sector. Commercial funding from domestic sources is limited as the banking sector suffers from a dearth of loanable funds.

Nepal's new federal constitution grants borrowing rights and significant tax autonomy to municipalities, along with a subnational borrowing regulatory framework, to mitigate chances of fiscal crises caused by defaults. The key institution that finances municipalities in Nepal is the Town Development Fund (TDF) – a domestic financial intermediary that lends subject to debt ceilings and project viability. TDF was set up to provide long-term financing for municipal infrastructure, but has limited capital, stressed loan assets and low earnings. At present, TDF functions more as an agent for on-lending multilateral loans for pre-selected municipalities and projects, rather than as a lender of significance. It accounts for less than 5% of annual municipal capital spending.

Nonetheless, TDF has financed municipal bus terminals, vegetable markets and several other revenue-generating projects where private companies manage the operation and maintenance of facilities. TDF's big success has been in the water sector, with over 70 towns supported through blended financing. In this arrangement, TDF provides 30-50% of the project value in the form of a loan, 5% of the project value is an upfront cash contribution from water users and the remaining 45-70% of the project involves a grant from the Government of Nepal. Thanks to this model, 87% of Nepal's population has access to safe drinking water and basic sanitation facilities, sustainably run by water users and sanitation committees. This type of financing will contribute immensely to the achievement of SDG 6 (Ensure availability and sustainable management of water and sanitation for all).

Expanding TDF's support depends on a number of factors. First, TDF needs to establish debt financing as the main option for municipalities to finance investments, instead of depending on their current revenues alone. This shift would allow municipalities to complete bankable projects more quickly than when depending on their own funds. This will be especially true while they still have very low debt ratios, giving them scope for future borrowing. Municipal bonds could possibly be a future source of financing, but issuing such bonds requires an assessment of the financial strength of municipalities as well as the ability of TDF to service long-term debt. Looking ahead, TDF is helping certain municipalities to obtain credit ratings and is itself preparing to get credit rated to tap into capital markets in the near future. Action on this front also calls for municipalities to be able to identify and design projects that generate revenues, so that investors can make a return.

The second critical area is reforming the municipal finance system. Municipalities need to have the incentives and support to build their capacities to manage projects better and to collect taxes. For example, fast-growing land values in Nepal offer a source that could be tapped to mobilise revenue. A fast-growing tax base would mean municipalities will be better able to pay off debt in the medium to long term.

Finally, TDF has drafted a public-private partnership (PPP) financing policy as part of its investment policy, which needs to be approved to allow TDF to finance municipal PPP projects in the near future. This framework could build on TDF's recent collaboration with the Government of Nepal, municipalities, private operators and other stakeholders to finance urban utilities, including the public transport sector. Specifically, TDF helped 61 individual bus operators create a so-called special purpose vehicle (the Sustainable Transport Co. Ltd.) which was able to replace the fleet of older three-wheelers, minibuses and microbuses with modern buses. The new buses were jointly financed by TDF (80% as a subsidised loan) and private capital (20% as equity investment). This blended finance approach has unlocked the possibility of upgrading public transport and improving levels of service.

These measures will help provide the financial resources that municipalities need to grow in ways that are sustainable and inclusive. As municipalities seek to access funds from a wide variety of sources, blended strategies can help crowd-in private investments into localities where they otherwise would not go. In the process, it is important to ensure that the debt burden of municipalities is carefully managed as blended approaches grow in use, and that domestic financial intermediaries such as TDF are supported to help mobilise public and private resources for development.

Box 2.4. About the author: Maniram Singh Mahat

Maniram Singh Mahat is the Executive Director of the Town Development Fund (TDF), Nepal. He has worked extensively in the areas of urban policy making; investment decision making; urban development; municipal finance and property tax management; PPPs: project development; conflict and development; local economic development; and planning, monitoring and evaluation. He has conducted research on urban finance, conflict and development, fiscal federalism, housing, property taxation, subnational governance and infrastructure financing. He has served as Director, Planning, Monitoring and Evaluation at the TDF for about six years, and as an Advisor, Senior Program Officer, Municipal Finance Expert, Multi-disciplinary team Coordinator and Planner with the Urban Development through Local Efforts Program of GTZ, Nepal and the Subnational Governance Program of GIZ, Nepal for about 20 years. He received his Masters degree in Geography from Tribhuvan University, Nepal, and his post-graduate diploma in Urban Development Finance from International Housing Studies, Erasmus University Rotterdam.

2.5. Blended finance - Uniting the yin and the yang

Jean-Philippe de Schrevel

In the last 20 years spent building two impact-investing companies – BlueOrchard and Bamboo – I have been confronted an endless number of times with the same situation when talking to potential investors (be they a family office, a corporation or a pension fund). I would hear from the investment team: “Sorry, we love what you do, this is very commendable, we see the potential, but this is too risky, there is not enough track record and the expected returns are clearly too low for us given the risks you are taking, why don’t you talk to our foundation?”. I would then turn to the foundation and hear: “Sorry, we love what you do, this is truly exciting and clearly impactful, but you are taking an investment approach and we are a charity, so we must give out money without expecting any sort of return or capital back, why don’t you talk to our investment team?”. And nothing would move.

Fortunately, an increasing number of institutions and people, especially younger generations, are beginning to align how they invest with their values. They have understood that our world is facing major problems and that traditional philanthropy alone will not be up to the challenge. They recognise that many solutions will have to come from sustainable, scalable and profitable companies where private capital will have to be invested, and that making those investments is actually much less risky than not investing at all. Think, for example, of climate change. The risk of inaction far outweighs the risk of investing in clean solutions.

This is where a small but growing group of investors – so-called impact investors – step in, intending to generate sustainable development impacts alongside financial returns. In addition, more and more investors are interested in sustainable investing and in reflecting impact frameworks in mainstream investment products. But there is a long way to go to align sufficient private investments with the Sustainable Development Goals.

Blended finance offers an exciting way forward: it is a tool which can help solve the commonly-observed paradox described above. The idea is in fact pretty simple – when structuring a fund, for instance, one can create several layers of risks and returns, with a “first loss layer” and then “senior layers” on top. All layers share the same investment portfolio. But if there is a loss, the first loss takes the hit first, thereby protecting the senior layers of investors.

So what does this do? Well, first, one could argue that the first loss should be appealing to traditional donors. Instead of investing a dollar in a cause they support, they can now invest in a first loss of an impact fund dealing with that very same cause, but they will have a major catalytic effect by attracting other investors. This way they can grow the overall resources for the cause they support. On top of this, if the investment manager has done a proper job, this concessional dollar may actually not be lost and could even generate a return, meaning the donor gets to invest it again. This is truly efficient philanthropy.

Second, investors coming in to the senior layers will not expect the same level of financial returns as they would have otherwise, because they are protected by the first loss, and the apparently somewhat lower returns generated by the investment portfolio suddenly meet their risk-return requirements. This can help overcome a major barrier to investment by institutional and other investors with strict fiduciary responsibilities who will generally consider expected financial returns to be too low for the perceived risk.

Third, by having a first loss layer funded by concessional money, the return required from the overall portfolio is considerably lowered, enabling the investment manager to take a riskier and less extractive approach when dealing with its portfolio target companies. This means, for instance, that more investors may be willing to invest in enterprises in the missing middle in least developed countries – deals that they otherwise would likely have overlooked.

Blended finance is an exciting approach for both philanthropists and investors as it allows for their efficient collaboration towards a common objective while respecting their own capital attributes. This also means that both will have to track not only the financial returns generated, but also the extent to which the intended social or environmental impact has been realised. And this will be at the heart of what we do, and not just an add-on. Every impact investor should therefore have a theory of change laying out clearly why investing in a particular fund or company will produce outputs which will eventually be conducive to the intended outcome. Much progress has been made in standardising the impact metrics today, allowing the industry to speak the same language and to make meaningful comparisons. But a lot of work remains to be done, in particular on a method for linking basic output results collected from individual portfolio companies to the broader results at the institutional or market level. Today, most investors still rely on common sense and general inference between outputs and outcomes. Measuring outputs is in itself good progress, and transparency about outputs achieved is a great step forward. We now need to push further research and seek to link outputs observed and desired outcomes.

By combining public and private resources, blended finance can raise additional resources for development. This is not to say blended finance will be the right approach in every situation – official development assistance (ODA) should continue to support services with public good features, and pure philanthropy should still be pursued (it should actually be increased). Nor is this to suggest that impact investing must always take a blended finance approach – it can work without it in some instances. But, where appropriate, this blending of several types of capital within one single investment vehicle can increase the scale of the beneficial impacts. For this reason, Bamboo is now working with CARE USA, the International Fund for Agriculture Development, and UNCDF, and soon many others, in structuring impact investing solutions using a blended finance approach. As these and similar types of approaches grow in popularity, we need to make sure that we have the right metrics and tools in place to track and measure impact – so that we can be confident that the resources we help catalyse will contribute to leaving no one behind.

Box 2.5. About the author: Jean-Philippe de Schrevel

Jean-Philippe de Schrevel is the founder of, and a managing partner at, Bamboo Capital Partners, an impact-investing company. He has dedicated most of his career to developing the “impact investing” field, in which he is considered to be a global pioneer, having launched eight investment funds and raised over USD one billion to date across a variety of asset classes (fixed income, private equity, venture capital, structured finance) and many sectors (microfinance, energy, healthcare, education, agribusiness, affordable housing). Jean-Philippe’s journey began with his early personal exposure to extreme poverty while travelling, working and living in Eastern Europe, Africa, Asia and Latin America. His work objectives are driven by his deeply rooted faith and values and an ambition to contribute to solving at scale some of the most critical problems of our planet. Realising “investments that matter” is the path he chose to follow some 20 years ago. In 2001 Jean-Philippe notably co-founded BlueOrchard Finance (a pioneer commercial lender to microfinance banks) and has worked for McKinsey & Co, the United Nations as well as various NGOs. He holds an MBA from the Wharton School of Business and speaks French, English and Spanish fluently.

2.6. Investing to overcome fragility

Izabella Toth and Romy Miyashiro

In states that are fragile and affected by conflict, ODA plays an essential role. It helps increase access to essential services, develop national capacities and support policy reforms that, among other objectives, can help to boost economic development. ODA can also help attract private finance to these states, such as through blended transactions. However, blended approaches here must be especially transparent and accountable, and must of course do no harm.

People often assume that foreign investment is always good for the economies of fragile and conflict-affected states. This can certainly be the case when investments aim to diversify the local economy, and retain value in the country in an inclusive and equitable way. Investments – whether through blended strategies or otherwise – can be development-friendly in certain conditions: when they respect national ownership, align with national priorities, and where the country's legal framework protects workers' rights and includes guarantees that foreign investors will support the local economy. This can be achieved through local content rules, sharing know-how with local actors, ensuring that linkages are built with local suppliers and entrepreneurs, etc. But it does mean that fragile countries need to have a certain level of preparedness to allow investments to contribute to leaving no-one behind.

Supporting sustainable and equitable outcomes also means that those launching blended transactions should consult with the communities affected, that robust accountability and transparency mechanisms are attached to deals, that risks and rewards are shared fairly between private investors and project beneficiaries, and that relevant local organisations can participate in a meaningful way.

Cordaid Investment Management BV (CIMBV) is the asset management branch of the Netherlands-based Catholic Organization for Relief and Development Aid (Cordaid). CIMBV has been a frontrunner in opening markets to impact investment since 1997. Recently, CIMBV has reinforced its promise of investing to overcome fragility. For this purpose, and in order to guide its decisions in the coming years and to further increase its social impact, CIMBV has strengthened its mission statement: "CIMBV invests in decent job creation, sustainable economic development, and building resilient communities; by deploying growth capital and technical assistance to MFIs and SMEs [microfinance institutions and small and medium-sized enterprises] in the most underserved fragile and emerging communities; catalysing system change, opening up markets in which organisations otherwise wouldn't have access to finance; supported by like-minded investors who balance financial return with social impact, with the help of a highly skilled and committed team".

CIMBV serves small-scale entrepreneurs and often tier 2 and tier 3 (smaller or medium-sized) microfinance institutions. It applies concessional terms on a case-by-case basis. For instance, CIMBV might invest in small-scale entrepreneurs with limited financial needs (a minimum of EUR 100 000) that are not attractive to other lenders. It can also operate in situations that other lenders consider to be too risky. CIMBV's long experience in investing in fragile contexts means it is well positioned to selectively take more risk than other lenders. For instance, CIMBV lends in local currency whenever possible and has used royalty-based or revenue participation repayment restructuring at times when inflation or depreciation rates are very high. Over the last two decades, CIMBV has benefitted more than 2 million microentrepreneurs and provided financing to more than 250 MFIs and small and medium-sized enterprises (SMEs) globally.

One important lesson CIMBV has learned from its work in fragile countries is that the capacities of investees are often weak. Therefore, in some cases CIMBV accompanies its financial investments with non-financial support, such as technical assistance or access to networks. In terms of its financial investments, CIMBV provides either senior and/or subordinated debt, or equity. Equity investments are made in specific scenarios, such as to help reinforce the balance sheet of the investee (such as an MFI) as requested by the regulator. By combining financial support with non-financial support, CIMBV aims to increase the social impact of the investee, support their growth in a sustainable manner and de-risk the investment so as to encourage others to invest.

For example, Hekima is a small MFI in the Democratic Republic of the Congo, focusing on poor women market traders, artisans and teachers. Hekima has 11 000 clients (74% of them women). In 2017, CIMBV provided over EUR 250 000 in equity to support Hekima's portfolio expansion, and to strengthen its equity and governance position so that it could transform into a public limited liability corporation. This small injection of cash helped Hekima to become a deposit-taking institution, meaning it could attract less expensive funding and continue to expand. Its stronger equity position enabled Hekima to attract additional international funding. As a result, Hekima will be able to expand its portfolio, and especially further support its low-income female clients – often the main earners in the household – by offering them a safe place to save.

Similarly, WARC in Sierra Leone is an SME with three lines of business, including rice and maize production (and a training farm). CIMBV was the only lender who dared to support WARC in post-Ebola Sierra Leone, initially approving a loan of EUR 140 000 to help it expand its rice production. CIMBV also worked together with WARC to develop its environmental, social and governance action plans – on occupational health and safety, and community stakeholder consultation. As the first international lender, CIMBV played a catalytic role, helping WARC obtain grants from USAID as well as an international equity investor. More recently, CIMBV approved two follow-up loans to expand WARC's rice production still further, also boosting its position with other international lenders. These investments will not only allow WARC to create over 170 jobs, especially for women and young people, but will also help to increase food security in the country.

Building on 20 years of experience as an impact investor, CIMBV now aspires to increase its social impact. It has recently designed the Stability Impact Fund Africa. This aims to create jobs and spearhead inclusive economic growth in selected countries in sub-Saharan Africa. The fund uses a blended model, as its focus is on fragile countries where actual risks are higher. In order to absorb the higher risk and attract investors, the anchor investor, Cordaid Foundation, is committing up to EUR 4 million as a first loss tranche. CIMBV is also seeking like-minded investors that are willing to accept capital preservation in order to create significant social impact in these areas.

Undoubtedly, the risks of investing in fragile and conflict-affected states are high, including through blended transactions. To mitigate these risks, using blended finance effectively in challenging markets requires a mix of concessional finance and non-financial (technical assistance); tailoring financing instruments to the deal at hand; respecting country ownership and aligning deals with national priorities; and focusing on transactions with strong development impact. While the risks are higher in these contexts, the return on investment could potentially be higher and the impact greater, as access to finance can contribute to inclusive local economic development and hence to greater stability. This is where blended finance can truly make a difference – by attracting investors to deals they would otherwise overlook.

Box 2.6. About the authors: Romy Miyashiro and Izabella Toth

Romy Miyashiro, Investor Relationship Manager, joined Cordaid Investment Management BV in March 2017. Romy is responsible for fundraising and managing investor relationships. She has 13 years of experience in commercial banking at Banco de Crédito del Perú. Romy holds an MBA from Cranfield University, UK, and a Business Degree from Pontifical Catholic University of Peru.

Izabella Toth, Senior Strategist at Cordaid in the Netherlands, has an academic background in Humanities (ELTE University in Budapest, Hungary) and Dutch Law (ERASMUS University in Rotterdam, the Netherlands). In 1998, she joined Cordaid/Memisa, first as Policy Advisor for Institutional Funding, and later as Senior Strategist, with portfolios on Strategic Relation Management with the

European Institutions and the World Bank. External mandates include six years as a board member in CONCORD, the European NGO Confederation for Relief and Development in relation with European institutions; and European region representative on the CPDE (Civil society Partnership for Development Effectiveness) Coordination Committee.

2.7. Bringing private investment to challenging environments: lessons from the World Bank Group's Private Sector Window

Federica Dal Bono and Barbara Lee

In April 2017, as part of the 18th replenishment of the International Development Association (IDA – the fund for low-income countries), the World Bank Group created the IDA18 International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) Private Sector Window[4] to catalyse private sector investment in the world's poorest countries (i.e., only those eligible for IDA funding).[5] The Private Sector Window is based on the recognition that the private sector is central to achieving the Sustainable Development Goals, yet private investment is difficult to attract to the most challenging environments. It is an integral part of the World Bank Group's effort to ramp up its support to attract private investment to IDA and fragile and conflict-affected countries. It complements IDA's work with the public sector to strengthen the business environment and support sector policy reform, IFC's support for private-sector capacity building and investments, and MIGA's guarantees against non-commercial risks. It helps mitigate the uncertainties and risks for specific high impact private investments, and is an option when there is no fully commercial solution or when the World Bank Group's other tools and approaches are insufficient. The initial three-year allocation for the Private Sector Window totalled USD 2.5 billion, with USD 2 billion allocated to IFC and USD 500 million to MIGA.

The Private Sector Window is a blended concessional finance instrument that helps to enable investments that are aligned with the World Bank Group's country strategies. It does not fund private investment on its own. It deploys IDA's concessional funding to backstop or blend with IFC investments or MIGA guarantees to support private sector investments through four facilities:

1. A Risk-Mitigation Facility to provide project-based guarantees without sovereign counter-guarantee to crowd-in private investment in large infrastructure projects and public-private partnerships supported by IFC.
2. A MIGA Guarantee Facility to expand the coverage of MIGA guarantees through shared first-loss and risk participation akin to reinsurance.
3. A Local Currency Facility to provide long-term local currency investments through IFC in countries where capital markets are not developed, and market solutions are not sufficiently available.
4. A Blended Finance Facility to blend Private Sector Window support with pioneering IFC investments across sectors with high development impact, including SMEs, agribusiness, health, education, affordable housing, infrastructure, and climate-change mitigation and adaptation.

In short, the Private Sector Window makes strategic use of IDA's public resources together with investments and guarantees from IFC/MIGA's own capital, and taps synergies across IDA, IFC and MIGA to de-risk or provide concessional support to specific transactions in the most difficult markets.

The Private Sector Window leverages IFC's and MIGA's business models and client relationships, working *upstream* to identify development challenges and private sector solutions, *midstream* to structure deals, and *downstream* to process the actual investment. To ensure that the Private Sector Window is well-targeted, the World Bank Group has developed eligibility and prioritisation criteria, governance arrangements, and a performance and results framework to monitor performance and outcomes. Each potential transaction is reviewed through a rigorous process applying the five concessional blended finance principles developed by the development finance institutions' working group, led by IFC:[6] 1) rationale for blended concessional finance and additionality of the project; 2) crowding in and minimum concessionality; 3) commercial sustainability; 4) reinforcing markets; and 5) promoting high standards.

Over the initial two years of the Private Sector Window pilot, the fund deployed some USD 540 million to support about USD 1.3 billion of IFC investments and MIGA guarantees – in turn expected to mobilise an additional USD 1.7 billion of external financing for projects. To date, the Private Sector Window has supported small local businesses, renewable energy projects, agribusiness, infrastructure, housing development, equity funds, bonds and projects in other job-generating sectors, with support for SMEs and housing finance emerging as the most prominent sectors. Engaging local sponsors has been a key feature of the Private Sector Window; many of IFC's Private Sector Window projects directly support local financial institutions and businesses, and MIGA's projects include linkages to local contractors, suppliers and businesses. There is also strong demand for local currency financing from the Private Sector Window. Some examples of investments are described here:

- In West Africa, an estimated 94% of the population lacks access to housing finance. The Private Sector Window's Local Currency Facility enabled an IFC investment of up to USD 18 million in local currency to support a mortgage refinance company (CRRH) to expand the availability of mortgage finance by up to USD 500 million in the eight countries of the West African Economic and Monetary Union. To complement this, the Local Currency Facility will also provide up to USD 45 million for the construction and purchase of approximately 2100 affordable housing units in Côte d'Ivoire. The IFC investment, in the form of a cross-currency swap, will provide long-term local currency developer mortgage finance to two local banks for on-lending to developers and buyers to increase both supply and demand for affordable housing.
- In order to support SME financing and create local private equity markets across Africa, IFC is investing USD 7.5 million from its SME Ventures Program together with USD 7.5 million from the Private Sector Window in an African entrepreneurs' investment fund (IPAE2). The investment has increased IPAE2's investment capacity to EUR 75 million to support investments, primarily targeted to African countries with significant equity-financing gaps.
- In Afghanistan, an investment in the Rikweda Fruit Processing Company will help expand the country's raisin processing capacity, help 3 000 small-scale raisin farmers improve yields and incomes and create 50 new jobs. IFC is providing a working capital facility of up to USD 2.5 million and a long-term loan of up to USD 500 000. MIGA is providing guarantees, with Private Sector Window support, against the risk of war and civil disturbance to cover the investors' equity and quasi-equity investments of up to USD 7.8 million.

Efforts to develop the internal infrastructure and initial projects for the Private Sector Window during its start-up phase have resulted in a robust pipeline, with projects identified under all four facilities to be delivered in the coming one to two years.

A number of lessons are emerging from the Private Sector Window's early experience:

- **Blended concessional finance must be well-designed** and used only when there is a strong rationale. The rationale for using the Private Sector Window is grounded in the blended finance principles mentioned above. Awareness building and developing familiarity with these principles – which are not applicable to traditional IFC and MIGA transactions – have been needed across a broad segment of World Bank Group staff. The concepts of "additionality", "minimising concessionality" and building the economic case for using blended finance are complex and require discussion and judgement. Establishing a minimum subsidy level is especially difficult, as it must be demonstrated to be "just enough" but "not excessive" and the beneficiaries of the subsidy must be clearly justified. Data are also key to determine levels of concessionality; for instance, IFC and IDA use benchmarks from projects in comparable sectors in similar country contexts and benchmarks from equity and debt provider returns to ensure that there is no profit windfall for IFC, the co-lenders or the private sector sponsors.

- **Strong governance is required**, with the decision-making process and team managing the concessional funds operating independently from the teams investing for IFC's and MIGA's balance sheets. This ensures that the blended finance principles are applied without regard to other institutional incentives for traditional IFC/MIGA projects.
- **Dropped projects are a fact of life** for blended finance. Many projects identified at the upstream stage have not resulted in Private Sector Window financing, largely due to ineligibility. This can stem from factors such as the lack of an economic case for concessionality; the ability of IFC and MIGA to undertake the project on their own; and the lack of project viability despite the Private Sector Window's potential support. In addition, projects can be dropped by the potential private investor due to perceived insufficient de-risking or inadequate pricing subsidies being offered by the Private Sector Window.
- **Using programmatic approaches to deploy the Private Sector Window helps to enhance efficiency** by reducing processing costs and leveraging economies of scale. Programmatic approaches provide financing indirectly to multiple smaller projects (such as SMEs and microfinance institutions) through pooled or platform solutions rather than directly to each small business or microfinance institution.
- **Higher risk tolerance is needed** to support blended concessional finance. The Private Sector Window supports projects that are riskier than non-subsidised commercially viable projects. All Private Sector Window projects undergo a risk analysis to determine the level of overall risk as the portfolio of investments grows. The Private Sector Window is likely to expose IDA as an institution to higher levels of financial risk; these must be weighed against the greater development impact likely to be achieved. Additional controls and the offsetting of any potential losses with loan-loss provisioning has also been critical in the use of the Private Sector Window.

The World Bank Group is bringing many of these early lessons to the blended finance community, governments and think tanks to inform discussions on modalities and good practice in deploying blended finance.

Box 2.7. About the authors: Federica Dal Bono and Barbara Lee

Federica Dal Bono is currently a Lead Strategy Officer in the Development Finance, Corporate IDA and International Bank for Reconstruction and Development (IBRD) Department of the World Bank Group. Her responsibilities include managing the implementation of the Private Sector Window. Prior to joining IDA, Federica was a Senior Underwriter in the Multilateral Investment Guarantee Agency, the insurance arm of the World Bank Group. In this capacity, she was responsible for project origination and execution in the energy and extractive industries, with a focus on power generation and gas distribution. Federica holds a BA/MA in Political Science from the University of Bologna, Italy, and an MA in International Relations and Economics from the School of Advanced International Studies of Johns Hopkins University.

Barbara Lee is an economist with over 30 years' experience in development policy and finance. She currently serves as a consultant, including on organisational strategy and impact, global programmes and partnerships, results-based financing and blended finance. She is also a member of the Board of Instiglio. She previously served in a variety of managerial and senior advisor positions at the World Bank, working on corporate strategy, polices, instruments and partnerships, as well as with country clients on issues such as privatisation, investment climate and infrastructure regulation. She holds a PhD and an MA in Economics from the University of Uppsala (Sweden), and a BA from Tufts University (USA).

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Notes

[1] The Yield Fund defines SMEs as companies with a turnover of less than USD 5 million, having fewer than 150 employees and needing capital in the USD 250 000 to 2 million range.

[2] Southern Voice is a network of 50 think tanks from Asia, Africa and Latin America. The case studies highlighted in this article can be read at www.southernvoice.org.

[3] Summarised from (Gibson et al., 2005[25]).

[4] For further information, see: (World Bank, 2019[27]) https://ida.worldbank.org/replenishments/ida18-replenishment/ida18-private-sector-window

[5] There are some 75 countries currently eligible for IDA resources on highly concessional terms. IDA eligibility depends on a country's lack of creditworthiness, as well as on its level of development, defined as a per capita gross national income below a threshold that is updated annually (USD1 165 in fiscal year 2018). Countries transitioning out of IDA Regular status are designated as Gap and Blend countries and are not eligible for Private Sector Window financing.

[6] For details, see (DFI Working Group on Blended and Concessional Finance, 2017[28]) https://www.ifc.org/wps/wcm/connect/30635fde-1c38-42af-97b9-2304e962fc85/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations_Summary+R....pdf?MOD=AJPERES

From:
Blended Finance in the Least Developed Countries 2019

Access the complete publication at:
https://doi.org/10.1787/1c142aae-en

Please cite this chapter as:

OECD/United Nations Capital Development Fund (2019), “Views from the field: Guest contributions”, in *Blended Finance in the Least Developed Countries 2019*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9c5deac6-en