



# Blended Finance 2.0

## Giving voice to the Private Sector

Insights from a BlueOrchard survey on Private Investors, October 2018

## Abbreviations

ASEAN	Association of Southeast Asian Nations	R&D	Research and Development
ADB	Asian Development Bank	REFFA	Regional Education Finance Fund for Africa
BMZ	German Federal Ministry for Economic Cooperation and Development	RE/EE	Renewable Energy and Energy Efficiency
BOMF	BlueOrchard Microfinance Fund	SDGs	Sustainable Development Goals
CAF	CAF Development Bank of Latin America	SDIP	Sustainable Development Investment Partnership
CDC	UK's Development Finance Institution	SIDA	Swedish International Development Cooperation Agency
DAC	Development Assistance Committee	SME	Small and Medium Enterprise
DFI	Development Finance Institution	SSF	Swiss Sustainable Finance
EBRD	European Bank for Reconstruction and Development	TA	Technical Assistance
EU	European Union	TAF	Technical Assistance Facility
EIB	European Investment Bank	UMR	Union Mutualiste Retraite
ESG	Environmental Social Governance		
FMO	Dutch Development Bank		
HNWI	High Net Worth Individual		
JAWEF	Japan ASEAN Women Empowerment Fund		
JICA	Japan International Cooperation Agency		
JBIC	Japan Bank for International Cooperation		
KfW	German Federal Development Bank		
IDB Group	Including IDB Invest, InterAmerican Development Bank, and MIF		
IDB Invest	Private sector arm of the IDB Group		
IFC	International Finance Corporation		
IFI	International Finance Institution		
IIF	InsuResilience Investment Fund		
LDC	Least Developed Countries		
MDB	Multilateral Development Bank		
MEF	Microfinance Enhancement Facility		
MFI	Microfinance Institution		
MIGROF	Microfinance Growth Fund		
MIF	Multilateral Investment Fund, IDB's Group Innovation Lab		
MIFA	Microfinance Initiative for Asia Debt Fund		
MSME	Micro Small and Medium Enterprise		
NMI	Nordic Microfinance Initiative		
OeEB	Austrian Development Bank		
OECD	Organization for Economic Cooperation and Development		
ODA	Official Development Assistance		
ODI	Overseas Development Institute		
OFID	The OPEC Fund for International Development		
OPIC	Overseas Private Investment Corporation		
PPP	Public Private Partnership		
PPPPP	Public Private Partnership for the People and the Planet		

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# Executive Summary


Blended finance aims at enhancing the concept of partnership between the public and private sector by maximizing synergies while setting clear impact targets towards sustainable development. The capability of blended finance to mobilize additional finance from the private sector has been increasingly recognized by the international community as a way to help bridge the estimated annual USD 2.5 trillion investment gap to achieve the Sustainable Development Goals (SDGs). The current blended finance market is still dominated by public sector actors. However, in order to reach the SDGs, it is essential to catalyze and upscale private capital investments. To successfully unlock private capital at scale, blended finance structures must be customized to meet the needs and expectations of private investors.


As an impact investment manager dedicated to fostering inclusive and climate-smart growth in developing countries for almost 20 years, BlueOrchard has unparalleled expertise in mobilizing private capital and in designing, structuring, and managing blended finance mandates. The majority of the funds managed since the company's inception back in 2001 are blended finance structures. This paper builds on BlueOrchard's long-standing experience with blended finance funds. It examines how to shape blended finance structures in order to ensure the contributions of different investors and to unlock private capital at scale to achieve the SDGs.


BlueOrchard conducted a survey among its private sector investors to identify the underlying motivations for private investors to use blended finance as an investment mechanism. The main findings of the survey show: I) the desire of private investors for blended finance mandates, and II) their requirements and preferences in regards to a number of variables that can be tailored to ensure the broader participation of the private sector.

We have elaborated a new vision of blended finance: "Blended Finance 2.0" by I) building on these findings and on the testi-

monials from a large group of stakeholders (including public and private sector representatives, policy leaders and think tanks), and II) leveraging BlueOrchard's extensive experience in blended finance. The mobilization of private capital takes the center stage within this new framework. [The main components of Blended Finance 2.0 include:](#)


 **Leverage** both the capital of private investors as well as their sectoral and their technical experience


 **Open** up access to a larger base of private investors


 **Achieve** comparability with other offerings in the market


 **Increase** transparency to better meet private investors' internal eligibility criteria

 **Simplify** blended finance mandates

 **Standardize** impact measurement to ensure more efficient communication

 **Crowd** in local investors and utilize their expertise, insights, resources and network

 **Involve** private investors early on in the design of blended finance instruments

 **Provide** technical assistance to de-risk investments and/or prepare future investments

BlueOrchard is committed to driving Blended Finance 2.0 forward by developing improved blended finance structures and by engaging closely with private sector investors to ensure that blended finance mandates become a cornerstone of their investment universe.

# I. Introduction

In September 2015, the United Nations General Assembly established a vision for 2030 by adopting the 17 Sustainable Development Goals (SDGs).<sup>1</sup> The SDGs are a comprehensive set of objectives that aim to globally end poverty, ensure that basic needs of all people are fulfilled, and to protect the planet and the environment. The 17 Goals have been linked with 169 measurable targets, and if all are reached, the 2030 Agenda would see a just, peaceful and sustainable world free of poverty, hunger and discrimination. However, there is currently an annual shortfall of USD 2.5 trillion in developing countries (despite the combined amount of private capital flows, personal remittances, official development assistance (ODA) and private grants), which could work against achieving the SDGs in these countries.<sup>2</sup> Blended finance has proven to be a possible solution to this problem.

Blended finance has quickly become a key instrument to catalyze investments towards the SDGs. It enhances the concept of partnership between the public and private sector by maximizing synergies and leveraging the contributions of these two groups of investors, while setting clear impact targets in terms of improving people's lives, and the planet they live in. Consequently, blended finance is increasingly being recognized by

the international development community as one of the ways to solve this financial disparity. The clear fit between the “new” funding structure of blended finance products and the mission pursued by its sponsors brings an impact dimension into financial space. This unique relationship contributes to the realization of the SDGs.

However, the potential of blended finance has yet to be fully attained. In fact, the de-risking features and crowding-in effect of the private sector into blended finance structures should result in a higher funding catalytic effect. We believe one of the reasons behind this is the need for a more active involvement of the private sector.

For nearly two decades BlueOrchard has structured, developed, and/or managed as many as nine blended finance mandates. Building on this long-standing experience and a recent survey conducted on BlueOrchard's private investor base, this paper I) examines how blended finance must be shaped to unlock private capital at scale for the achievement of the SDGs, and II) presents BlueOrchard's vision of Blended Finance 2.0.



<sup>1</sup> United Nations Sustainable Development Knowledge Platform. 2015. *Transforming our world: the 2030 Agenda for Sustainable Development*. [ONLINE] Available at: <https://sustainabledevelopment.un.org/post2015/transformingourworld>. [Accessed 7 August 2018]

<sup>2</sup> Convergence and Business & Sustainable Development Commission. 2017. *The State of Blended Finance* (Working paper). and OECD. 2018. *Making Blended Finance Work for the Sustainable Development Goals*. OECD Publishing. Paris.

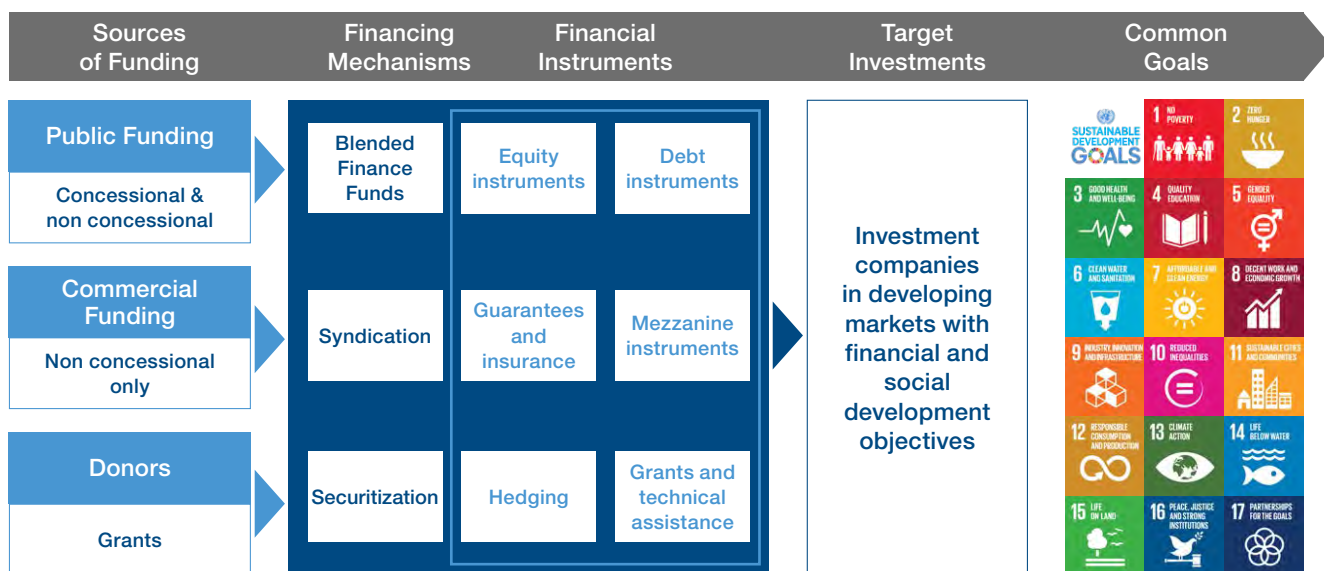
## II. Defining Blended Finance

“Blending” in development finance has been on the rise since 2008, as a result of the financial crisis and the abrupt lack of liquidity for many private sector investors. A considerable amount of literature has been published on blended finance since then. However, even after 10 years, there is no uniform understanding and definitions of blended finance vary across sectors and actors.<sup>3</sup> Stakeholders such as the Organization for Economic Co-operation and Development (OECD)<sup>4</sup> and Convergence, a global networking platform for blended finance,<sup>5</sup> have led the way in establishing and standardizing a comprehensive understanding of the terminology and framework in the emerging blended-finance field. However, BlueOrchard

has developed its own definition, based on our long-standing experience and track record in managing, structuring, and designing blended finance mandates (see Figure 1). We define blended finance as:

*“Funding by development finance institutions (DFIs), multilateral development banks (MDBs), bilateral governments, and foundations (e.g. endowments and philanthropists) in de-risking instruments (e.g. guarantees, first loss or risk sharing capital, technical assistance and capacity building) to crowd in private capital in frontier and emerging markets in order to accelerate the achievement of the SDGs by scaling-up activities.”*

**Figure 1: Blended Finance Components**



<sup>3</sup> Cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*.

<sup>4</sup> Cf. OECD. *Making Blended Finance Work for the Sustainable Development Goals*.

<sup>5</sup> Cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*. Pg 1.

**The definition emphasizes the most decisive features of blended finance:**



**Investors:** broad range of public and private investors with different risk-return targets, impact objectives, investment horizons, and investment capabilities



**Investment Instruments:** wide spectrum of instruments, ranging from debt and equity, to a series of de-risking features that effectively leverage the initial seed capital provided



**Impact:** objective of accelerating the achievement of the SDGs by scaling up activities and by setting impact driven investment goals



**Inclusiveness:** aspiration to attract a wide range of investor types, considering their different needs and effectively including them to unlock private capital and contribute to closing the SDGs financing gap

In our experience and understanding blended finance constitutes an impact driven extension of Public-Private Partnerships (PPPs). The novelty in blended finance is the expansion of traditional PPPs by two further “Ps”: People and the Planet (see Figure 2).

Blended finance is therefore an advancement, aligning investors and investment instruments for a common set of financial and impact objectives in line with the guiding principles set by the SDG framework.

**Interview with Paul Horrocks**  
Head of Blended Finance at OECD

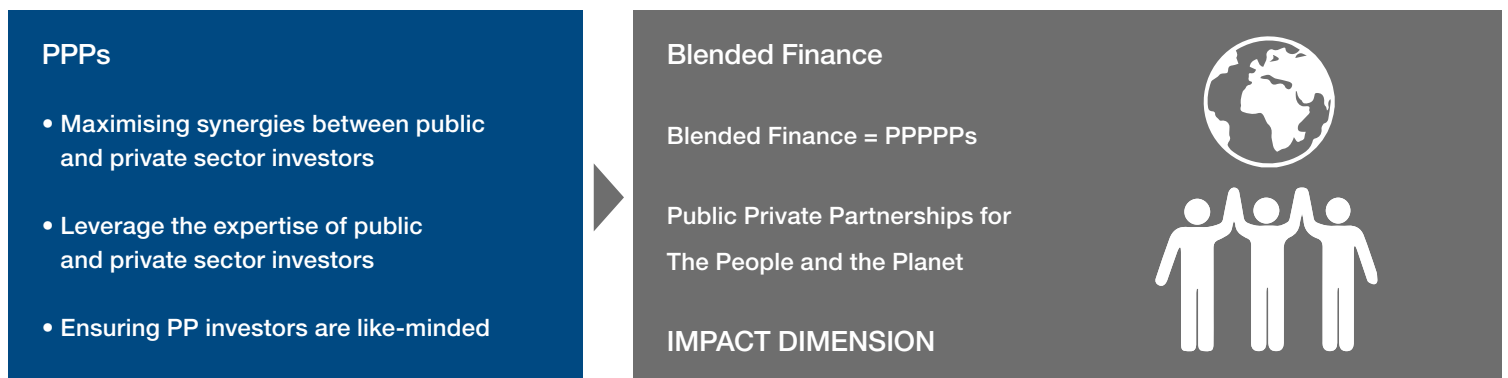


OECD has been leading a number of important activities in blended finance and has successfully raised the profile of blended finance among its member countries as well as in the DAC. Some milestones have been achieved creating a common language on what is blended finance and why it makes sense. A first set of principles, “OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs,” have also been endorsed.

**Paul, what is your view on Blended Finance 2.0? How would the role of OECD change?**

*“Blended Finance 2.0 could be a game changer if institutional investors actively invest in blended finance structures. They have the scale to invest massively in joint initiatives with DFIs and can bring best practice and relevant sector expertise (e.g. in private equity), and could complement the financing instruments of donors and DFIs. Local private sector investors could also provide the sought-after local currency in particular in frontier markets. The role of the OECD would be in prompting constructive peer-reviews among its member countries, enhance transparency to measure funds mobilized, and improving market dynamics by opening more opportunities to unlock private capital.”*

**Figure 2: The 5 Ps of Blended Finance**



# III. Market Size, Accountability and Additionality of Blended Finance

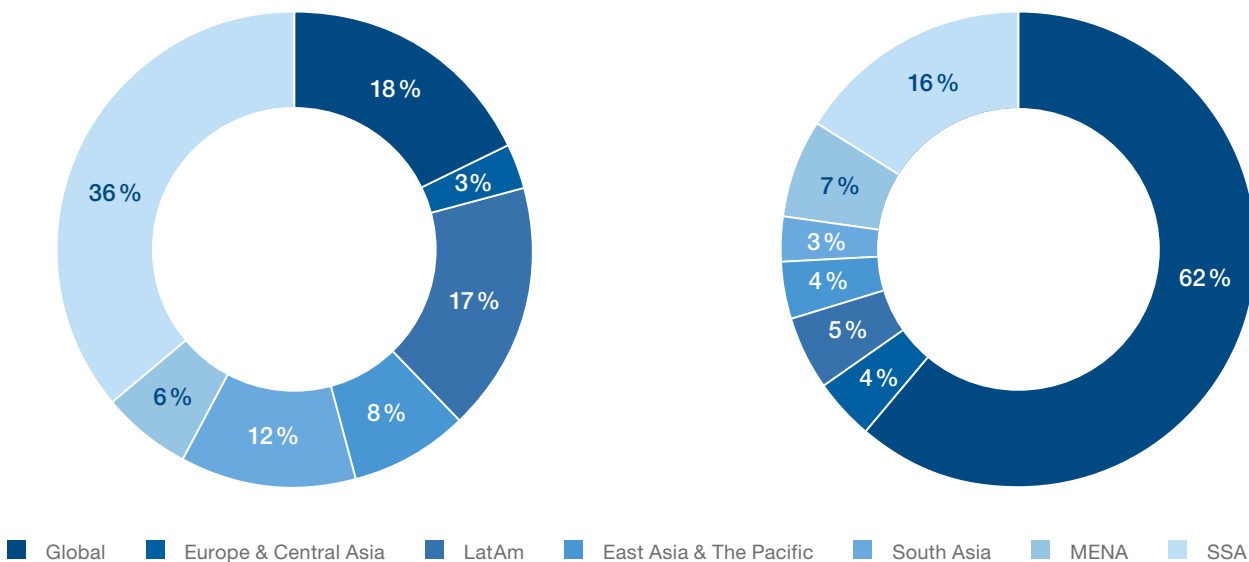
Blended finance is gaining traction in the world of development finance and impact investing. It has the remarkable power to both enhance public spending and mobilize commercial resources. Given that governments are struggling to close the annual SDGs funding gap of USD 2.5 trillion and that private capital is crucial to growth, it is not surprising that blended finance is building momentum in the debate surrounding the SDGs.

According to the Business and Sustainable Development Commission, and the Convergence Network, “the number of blended finance deals executed each year is growing significantly, as more actors begin to adopt blended finance as one tool in the development toolbox.”<sup>7</sup> In their study ‘The State of Blended Finance,’ published in 2017, the authors look into 187 deals, which are to be understood as “funds and facilities or projects and that have contributed to the achievement of the SDGs by investing USD 51.2 billion across the globe.”<sup>8</sup> Convergence even states that public or philanthropic funding used to scale up private sector funding in developing countries “can lead to as much as ten-fold increase in [overall] investment.”<sup>9</sup> The OECD’s Development Assistance Committee (DAC) reports that 17 of their 23 members have engaged in blended finance deals with the aim of unlocking private capital in emerging markets.<sup>10</sup> According to the report “blended finance has generated over USD 81 billion for development goals in four years” and “167 facilities were launched to pool finance for

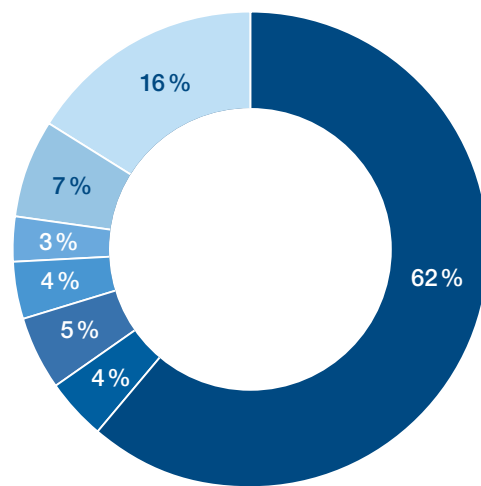
## Market Size

It is challenging to gauge the market size for blended finance due to the various definitions of what a blended finance vehicle actually is. It is also important to note that the ways in which blending occurs may differ significantly, as blended finance instruments take several forms, e.g. traditional loans and grants, impact bonds, securitizations and more.<sup>6</sup>

**Figure 3: Deals by Region**



**Figure 4: Capital Mobilized by Region**



Source: cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*. Pg 5.

<sup>6</sup> Business & Sustainable Development Commission and SYSTEMIQ. 2018. *Better Finance, Better World: Consultation Paper of the Blended Finance Task Force*.

<sup>7</sup> Cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*. Pg 4.

<sup>8</sup> Ibid

<sup>9</sup> Convergence. 2016. Convergence – About. [ONLINE] Available at: <https://convergence.finance/about>. [Accessed 7 August 2018].

<sup>10</sup> Cf. OECD. *Making Blended Finance Work for the Sustainable Development Goals*. Pg 16.



blending between 2000 and 2016.”<sup>11</sup> The Blended Finance Taskforce, a Business & Sustainable Development Commission initiative launched in 2017 to understand how can blended finance funding be used more effectively, claims even that the market has reached a global value of more than USD 50 billion<sup>12</sup> and that “in the last 5 years the blended finance market doubled in size with the launch of more than 50 blended finance funds and facilities.”<sup>13</sup>

Besides the global growth and absolute market size, where various sources show sometimes significantly different figures, there seems to be a general agreement on geographic and sectorial tendencies in blended finance. Convergence performed an analysis on its database of 187 blended finance deals. Sub-Saharan Africa stands out for being the region with the highest number of deals (36%) and capital mobilized (16%, excluding the globally focused deals), followed by Latin America (17% of total number of deals), and South Asia (12% of total number of deals) (see Figures 3 & 4).

When analyzing the sectoral bias financial services, clean energy and climate finance receive the most funding. They account for almost one out of two deals together, and 45% of cumulatively mobilized capital (see Figure 5).<sup>14</sup>

## Accountability and Additionality

There is one fundamental challenge that needs to be addressed when measuring the size, outreach and financial and social contribution of the blended finance market: how to define “accountability” and “additionality,” in both financial and social terms.

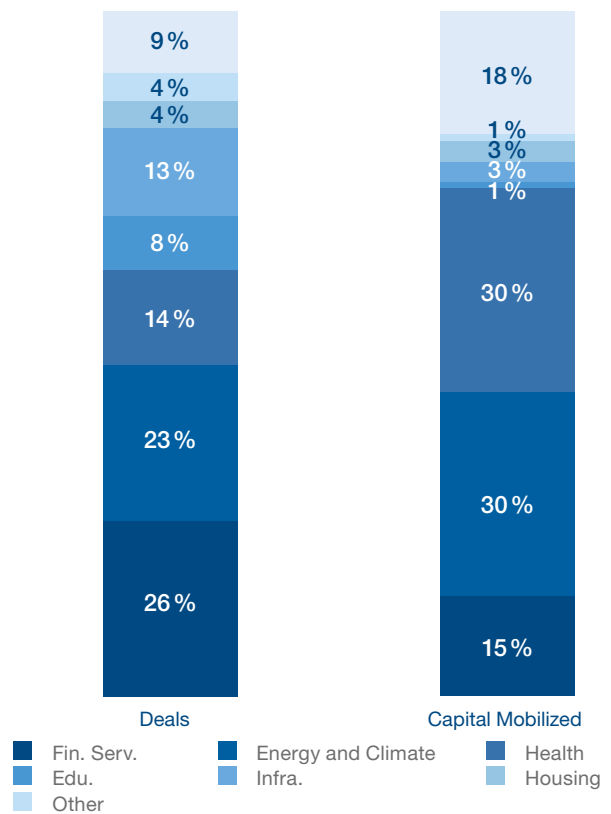
**Accountability** is a very important indicator when trying to capture the private capital mobilized or catalyzed by public funding into blended finance structures. The question of how to correctly define accountability and measure the flows into blended finance instruments, while avoiding double counting as a result of commercial funding being mobilized via the “same” public funding sources remains an open one. Today there are no industry-wide accepted definitions and methodologies for how to best tackle this issue. The numbers currently presented are the result of an aggregate effort of active platforms that gather data primarily via the proactive input of blended finance actors. The market is probably much larger than what is shown by the official figures. Moreover, if we in-

clude technical assistance and its capacity to leverage funding after the capacity building has taken place in an investee, for instance, the mobilization factor could even further increase.

**Additionality** is more specifically related to whether the capital provided gives added value financially and/or socially. Financial additionality comes from the distinctive capital mobilized in the market by private and public institutions following the injection of ODA funding into blended finance products. However, the concept of additionality is often overestimated and can be displaced by DFIs that provide funding by substituting rather than complementing the sought-after private capital.

In terms of social additionality, expectations are high. Investors are interested in knowing what impact they have achieved with their investments. However, the techniques used so far

**Figure 5: Number of Blended Finance Deals and Capital mobilized by Sector**



Source: cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*. Pg 5.

<sup>11</sup> Cf. OECD. *Making Blended Finance Work for the Sustainable Development Goals*. Pg 16.

<sup>12</sup> Cf. Business & Sustainable Development Commission and SYSTEMIQ. *Better Finance, Better World: Consultation Paper of the Blended Finance Task Force*.

<sup>13</sup> *ibid.* Pg 43.

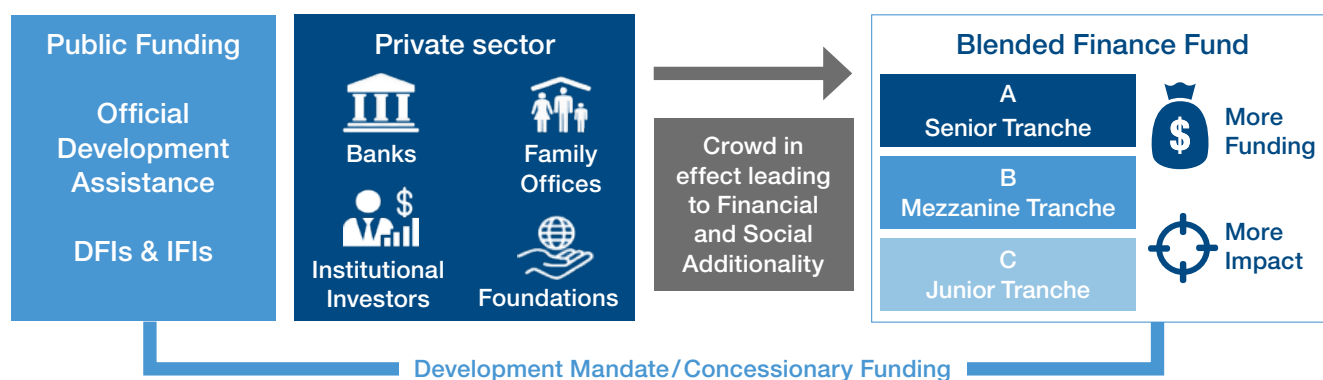
<sup>14</sup> Cf. Convergence and Business & Sustainable Development Commission. *The State of Blended Finance*. Pg 5.

are either too “sophisticated” or too simplistic to provide comparative analyses at market level. We have identified a growing role of commercial investors in blended finance. As these investors often have obligations towards their own clients (private banking clients, family offices, and also pensioners) to report on social and environmental impacts, they can push the boundaries of measuring the social additionality of blended finance. Measurement and monitoring of impact in a standardized manner is key in demonstrating the effectiveness of blended finance products. This is one area where

the complementarity of public and private actors can play a pivotal role (see Figure 6).

In conclusion, the blended finance market is growing. There needs to be a concerted effort of all investors to increase transparency in data gathering, measure additionality, accountability, and the financial and social impacts achieved. If investors, fund managers and all other stakeholders succeed in doing this then scalability and replicability of successful blended finance transactions will become a reality.

**Figure 6: Financial and Social Additionality**



## Interview with Chris Clubb Managing Director at Convergence



In 2015, the international development community agreed on the need for an entity to build the blended finance field in order to attract private investment to the Sustainable Development Goals. Convergence was established, and the Canadian Government stepped up to provide initial funding for the organization. Today, Convergence stands as an independent, not-for-profit institution dedicated to building the blended finance market. Convergence’s mission is to make the SDGs investible. Convergence generates blended data, intelligence, and deal flow to increase private sector investment in developing countries.

### Chris, what is your view on Blended Finance 2.0? What would be the role of Convergence?

“Blended finance has been far too fragmented, implemented at small scale and low leverage. In Blended Finance 2.0, we believe there needs to be consolidation on fewer transactions that can achieve scale and higher leverage of development capital. Portfolio approaches (e.g. IFC-Sida co-lending portfolio) and blended finance funds – like the ones managed by BlueOrchard – are exactly what is needed in the market.

*In ‘Making Blended Finance Work for the SDGs’ the OECD describes (at a high level) the changes needed for blended finance in order to mobilize private sector capital. As an example, best estimates are that current financial flows of blended finance with private sector co-investment are USD 7–12 billion. These amounts are too low if the world is to make a substantial dent in the SDG investment gap. As an example, if the 30 OECD DAC members allocate an amount equal to 10% of their ODA commitments to blended finance, and those amounts mobilize 6–7 times private capital, this would produce an extra USD 100 billion of private sector investment in developing countries.*

*Convergence’s vision for blended finance is to mobilize USD 100 billion of additional financing per annum to low and middle-income countries. In Blended Finance 2.0, the development finance community needs to create capital market assets that appeal to institutional investors. Convergence works to transform blended finance from the margins to the mainstream – both within the development community and the investment community. We plan to play a connecting and catalytic role in Blended Finance 2.0.”*

# IV. How Does Blended Finance Work?

Blended finance products offer multiple unique features to investors where financial and social returns, risk, and protection against capital loss are adjusted to meet their requirements. BlueOrchard's experience has been mainly with one type of structure that has now almost 15 years of track-record and 13 funds built based on the same business model. These are multi-layered blended finance funds where typically a DFI takes the lead in structuring, sponsoring, and seeding the fund. They have effectively tested the appetite of mainstream commercial investors for blended finance. These funds have been built with a strong public sector influence, and have been proposed as investment opportunities to a large range of commercial investors. They have been able to mobilize mainstream investors who otherwise would not have invested in this asset class. Private investors have been provided with a unique opportunity to invest in emerging and frontier markets and in a distinctive illiquid asset class thanks to some key fund components (see Figure 7).

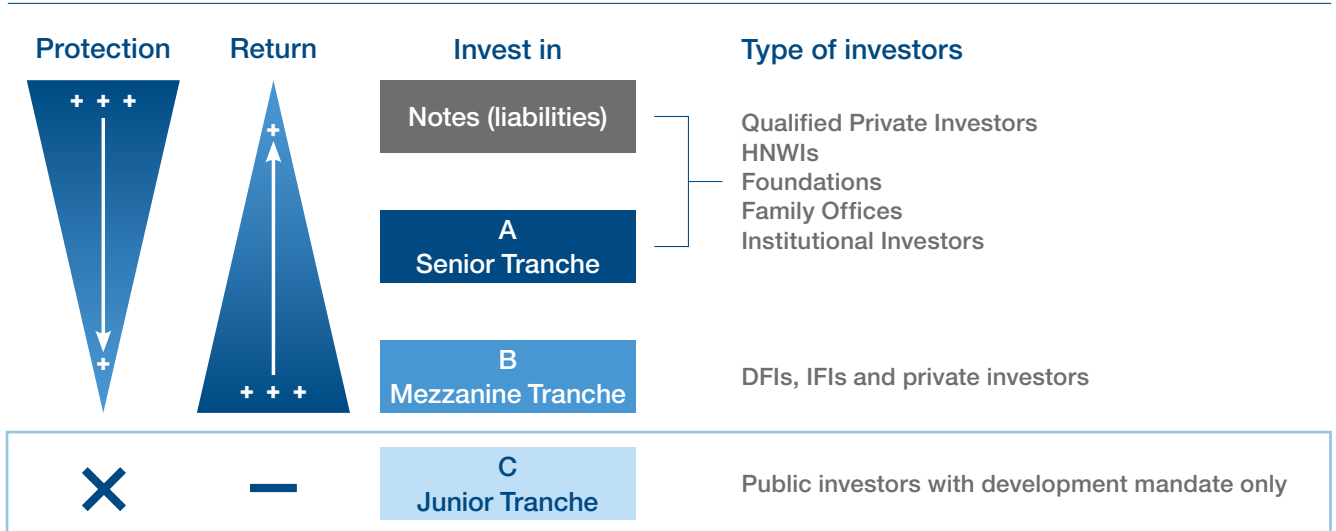
On the one hand, commercial investors have benefited from a significant credit enhancement as public investors and DFIs have subordinated their capital and their returns to the returns of private investors. The objective of public investors and DFIs has been to focus on: a) achieving impact (e.g. improved Small

Medium Enterprises' (SMEs) access to finance) by being additional in the local context; and b) mobilizing private sector capital (e.g. increase the total fund size and investment capacity to scale-up the financed activities). The subordination of public investors and DFIs has acted as de-risking mechanism for private investors, as investors in different tranches benefit from higher or lower levels of capital protection depending on their level of seniority in the fund structure.

On the other hand, the junior tranche (the building block of these structures) has been based on a pure private equity rationale (i.e. first in line with respect to credit and sometime currency losses) but with a return expectation based typically on the principle of capital preservation. In addition, these structures have benefited in some instances from additional credit enhancement when technical assistance facilities (i.e. pure grant funding) have financed capacity building activities that have further reduced the risk of investment and provided additional monitoring opportunities to ensure portfolio quality.

In this context, all stakeholders (private, public and DFIs) find a suitable risk-return positioning and can jointly achieve a developmental agenda.

**Figure 7: Example of a Multi-layered Blended Finance Fund Structure**



The Junior Tranche has low returns and no protection, but thanks to it all other investors achieve higher impact.

## The following features are particularly important in multi-layered blended finance fund structures:

- I Junior tranche capital is often mobilized at least in part at fund inception and its coupons are fully capitalised during the fund life, which means that during the investment period the cushion for mezzanine and senior investors can grow if there are no capital losses;

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- II Private sector fundraising starts actively only after the ramp-up of the fund as investors typically seek to be engaged after the proof of concept stage and need a track-record in terms of portfolio quality and fund break-even;

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- III Private investors are mainly invited to invest only in the senior tranche, and rarely are offered the opportunity to invest in the mezzanine tranche;<sup>15</sup>

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- IV Investors with limited risk appetite can choose not only to be senior to other investors in the mezzanine and junior classes, but can also participate as debt providers by investing in the fund debt or note instruments;

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- V Waterfall structures between different share classes have often been operationally complicated as a number of added features – like country or region-specific junior tranches, multi-currency senior shares, mixed of floating and fixed coupons to investors, and tranches with different investment periods, as well as strict capital calls rules – have demanded extensive simulations to ensure implementation is in line with the fund documents; and

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- VI Public investors and DFIs are at the center of the corporate governance of these funds, drive the decision-making at fund level, guard for the achievement of development and impact objectives, and are sometime also involved in taking portfolio investment decisions.

There are, of course, many variations of this model. BlueOrchard has also managed funds where private investors are in the same tranche as public investors (e.g. the Microfinance Growth Fund), or where the junior tranche is provided only by private investors (e.g. Japan ASEAN Women Empowerment Fund).

Further blended financing mechanisms to mobilize private capital include syndications and securitizations. For instance, BlueOrchard has leveraged capital provided by DFIs at the deal level by participating in a number of syndications via its fully private flag-ship fund, the BlueOrchard Microfinance Fund (BOMF).<sup>16</sup> The blended finance aspect of syndications is that the lender of record benefits from a special status (preferred creditor status), arranges the overall transaction, and therefore shares these investment opportunities with commercial investors.<sup>17</sup>

BOMF and its private and institutional investors have also been pivotal in securitizations of financial institutions' portfolios. In these cases (e.g. securitization of ProCredit Ecuador<sup>18</sup>) commercial investors have bought the securitized portfolio allowing for further growth of these financial institutions' SME portfolio. When commercial funds like BOMF purchase financial institutions' securities, this unlocks private capital in other markets (e.g. in India) where dedicated securitizations structures with first-loss cushion and collateralized portfolios have proliferated and provided attractive investment opportunities for both local and international investors.

<sup>15</sup> There are exceptions to the rule in recent multi-layered funds where DFIs have effectively reduced their investment in the mezzanine tranche to allow institutional investors to partake in it.

<sup>16</sup> BlueOrchard Finance. 2018. BlueOrchard Microfinance Fund. [ONLINE] Available at: <http://www.blueorchard.com/investment-solutions/investment-fund/>. [Accessed 7 August 2018].

<sup>17</sup> IFC Syndication: IFC. 2018. IFC Provides \$77 Million to Support Small and Medium Entrepreneurs in Indonesia. [ONLINE] Available at : <https://ifcextapps.ifc.org/ifcext/pressroom/ifcpressroom.nsf/0/6E187EF9E43C4A41852582290024BB68?OpenDocument>. [Accessed 8 August 2018]

FMO Syndication: FMO. 2017. FMO arranges USD 200 million syndicated loan facility for Ecobank Transnational Incorporated. [ONLINE] Available at: <https://www.fmo.nl/news-detail/e8a51122-ac7c-4970-95af-c9e0b35ab52c/fmo-arranges-usd-200-million-syndicated-loan-facility-for-ecobank-transnational-incorporated>. [Accessed 8 August 2018].

<sup>18</sup> BlueOrchard Finance. 2017. *SMEs and SDGs: Supporting small and medium enterprises to achieve the sustainable development goals – Insights from a BlueOrchard Survey*. Pg 21.

## V. BlueOrchard Footprint in Blended Finance

BlueOrchard's core expertise has included blended finance since its inception in 2001. Out of the 13 funds that the company has managed since 2001, 9 have been blended finance structures. Additionally, BlueOrchard and its commercial investors have leveraged public sources of capital via syndications and securitizations.

BlueOrchard's unique capability of bringing together funders from both the private and the public sector towards the same development goals is the result of nearly two decades of restless, persevering and conscientious work.

BlueOrchard's track-record in designing, structuring, fundraising, managing, and completing successful blended finance mandates has made the company a trusted partner for many stakeholders in the blended finance space.

Furthermore, BlueOrchard's ability to connect its distinctive network of commercial investors with renowned DFIs and government agencies at both fund and project levels, depending on their risk-return expectations (e.g. banks, pension funds, family offices, foundations), makes the company a unique player in the market.

BlueOrchard has blended a wide range of de-risking instruments to unlock commercial capital, mitigate the perceived risks, and ultimately accelerate and scale-up impact initiatives that contribute to the achievement of the SDGs, depending on the features of the different blended finance vehicles (i.e. fund investors, mix of public and private funders, impact objectives, geographical coverage, investment themes, and market conditions).

Today, BlueOrchard manages or acts as investment adviser for 5 blended finance mandates (see Figure 8).



Figure 8: Managed Funds, Technical Assistance and SDGs at BlueOrchard

Fund	Inception	Sponsors/ Fund Initiators	Sector and Mandate	Technical Assistance (TA)
Microfinance Enhancement Facility (MEF) <sup>19</sup>	2009	     	Financial Inclusion – provision of finance to micro-enterprises via financial institutions	
Microfinance Initiative for Asia (MIFA)	2012	   	Financial Inclusion (targeting Tier 2 and Tier 3 MFIs) as well as supporting green finance	✓
Regional Education Finance Fund for Africa (REFFA)	2014	  	Education Finance – unlocking potential through affordable and good quality private education	✓
InsuResilience Investment Fund (IIF)	2015	 	Climate Insurance – contributing to climate change adaptation for SMEs and micro- entrepreneurs	✓
Japan ASEAN Women Empower- ment Fund (JAWEF)	2016	 	Financial Inclusion and Gender Lens Investing – Striving for women empowerment and entrepreneurship	

<sup>19</sup> BlueOrchard is one of the four Investment Advisors and manages more than 50% of the portfolio as of 31 March 2018.

## SDGs Addressed



## Interview with Claudia Arce

Chairperson of the Supervisory Board of the Microfinance Initiative for Asia Fund (MIFA)

KfW is probably the DFI with the longest track-record in structuring, sponsoring and managing multi-layered blended finance funds. KfW's role has been unique in the blended finance sector as, jointly with the German Government (e.g. the Federal Ministry for Economic Cooperation and Development), it has often acted as "Initiator" and sponsor of these structures. KfW has essentially developed a new business model in the impact investing and financial inclusion asset class.

**Claudia, what is your view of what Blended Finance 2.0 could look like? Will blended finance mandates remain still at the centre or will other instruments take over?**

*"The one aspect that I think will further develop is the importance of retail investors in blended finance. This could be realized with the further digitalization of finance and the increasingly predominant role played by fin-tech companies and crowd-funding platforms. A combination of retail investors and institutional investors in these mandates would open the 'democratization' of blended finance. More importantly this could be combined with the 'localization' of investors in line with the development of a larger market of HNWIs in Asia and Africa where a growing middle class is seeking impact investing opportunities in their own markets. Of course, the current blended finance mandates offer a variety of advantages and will not disappear. But thinking out of the box in a changing eco-system, Blended Finance 2.0 should allow for design and structural changes to have a wider outreach, have a higher local representation, and overall be more inclusive in terms of unlocking a wider range of private capital resources to address the SDG financing gaps."*

# Microfinance Growth Fund – MiGroF

7 years of impact in Latin and Central America



**Objectives:** MiGroF was created in March 2010, under the lead of the InterAmerican Development Bank (IDB) Group. The Fund’s objectives were to lend medium/long-term sources of finance to microfinance institutions (MFIs) to help rebuild their capacity to lend after the 2008 financial crisis and to increase the supply of finance for micro/small businesses in Latin and Central America.

**Capital Structure and Investors:** The Fund had a unique financial structure – USD 30 million equity tranche was held by 8 public and private investors and leveraged by a USD 125 million loan provided by the Overseas Private Investment Corporation (OPIC). Investors included the Multilateral Investment Fund (MIF) and IDB Invest (members of the IDB Group), Citibanamex, Corporacion Andina de Fomento (CAF)

Development Bank of Latin America, Nordic Microfinance Initiative, Accion International, and the fund manager. The Fund reached its target size of USD 150 million.

**Financial and Social Achievements:** MiGroF reached 13 Latin and Central American countries, 43 MFIs, and about 4 million entrepreneurs (67% female clients, and 40% rural clients) for a total volume of more than USD 300 million of financing since inception. The Fund provided senior loans in as many as 10 currencies. Hedged local currency loans represented 40% of total assets. At final maturity in 2018 the fixed income Fund delivered an IRR to investors of 5.8% in USD. Portfolio losses were below 0.8% of total assets over the fund life, and the average loan amount disbursed to investees was USD 1.8 million.



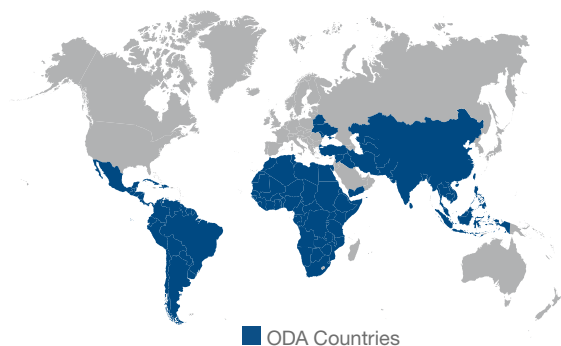


# InsuResilience Investment Fund – IIF

Supporting climate adaptation

**Objectives:** IIF was initiated by KfW, the German Federal Development Bank, on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ). The Fund aims at facilitating the adaptation to climate change by improving access to and use of climate insurance solutions in developing countries. The ultimate goal being improving the resilience of poor and vulnerable households as well as micro, small and medium enterprises (MSMEs) to weather events. IIF finances qualified corporates along the value chain of insurance (e.g. insurers, brokers, aggregators) with main operations in ODA recipient countries.

**Target Markets:** Countries eligible to receive ODA funding as defined by the OECD.



IIF is contributing to business innovation by

- I. leveraging microfinance institutions with extensive presence in rural areas and desire to extend their product range into climate risk insurance,
- II. using parametric insurance to provide an affordable alternative to indemnity insurance for a broad range of risks (for example crop insurance), and
- III. using mobile technology to bridge gaps in infrastructure.

**Capital Structure and Investors:** The Fund combines private debt and private equity investments in two separate sub-funds. Junior tranches – financed by BMZ – provide credit risk enhancement to senior tranches dedicated to private investors. Among the private investors the fund accounts institutional investors.

**Technical Assistance:** Investees are eligible to receive support from a TA facility (TAF) funded by BMZ. The TA finances the development and distribution of climate insurance products and is managed by CelsiusPro, a pioneer in weather risk management.

BMZ  Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung

KfW

 BlueOrchard  
Impact Investment Managers

CelsiusPro   
Professional Weather Protection

# Regional Education Finance Fund for Africa – REFFA

Unlocking potential through education








**Objectives:** REFFA is the first fund to exclusively support the development of the education sector in Africa. Its main objective is to increase equal access to primary, secondary, vocational and higher education as well as enhance the quality of education. The fund achieves these objectives by developing an education finance portfolio of selected African financial institutions supporting local private education providers, learners and students.

**Capital Structure and Investors:** REFFA's capital structure is split in three tranches: senior, mezzanine and junior. BMZ investment in the junior tranche has been catalytic in attracting financing from other like-

minded investors such as development financial institutions in the mezzanine tranche and private impact investors like foundations and family offices in the senior tranche. Both the junior and mezzanine tranches are fully subscribed.

**Technical Assistance Facility:** Public and private grants enhance institutional capacity of REFFA's investees and provide market information to foster innovation. Since the TAF's inception in 2013, EUR 4.5 million have been committed. Typical projects include the development of education finance products that are tailored to the financial management needs of private education providers as well as learners and their families.

Senior Tranche	Funded by private sector	
Mezzanine Tranche	Funded by DFIs	  
Junior Tranche	Funded by BMZ	 

**Financial and Social Achievements:** The total education portfolio financed by the investees amounts at USD 33 million. The Fund distributed 49% of its loans to school, 31% to learners from families with salary income, 14% to students, and 5% to learners and families with MSME income. The total number of students financed is 4,058. The Fund has provided funding to 719 schools in Africa which used the loans mainly for fixed assets (54%) and working capital (44%).

# Microfinance Initiative for Asia – MIFA

Promoting shared prosperity through financial inclusion in Asia



**Objectives:** MIFA is part of a larger joint International Finance Corporation (IFC) and KfW initiative and the first microfinance initiative of its size to exclusively target financial inclusion in Asia and Central Asia. The Fund provides financing via senior and subordinated loans, mainly in local currency, to a wide range of financial intermediaries. The ultimate goal is strengthening financial intermediaries, encouraging them to lend to MSMEs and low-income households, as well as fostering responsible finance principles in the region while further developing the local financial market.

**Capital Structure and Investors:** Its capital structure is composed by senior, mezzanine and junior tranches, blending private and public capital throughout the mezzanine and senior tranches. 50% of the Fund's contributed capital comes from the private sector (mainly institutional investors). The fund is closed-ended and a fund extension in 2018 has prolonged it from 2021 to 2026, showing shareholders' satisfaction with the achievements to date.

**Technical Assistance Facility:** The main focus of the fully grant funded TAF by the German government is to directly provide support to local financial institutions, especially the less mature ones (i.e. Tier 2 and Tier 3). The TAF offers capacity building in the form of

advisory services, training, product and systems development. A special window is earmarked for green financing (renewable energy and energy efficiency loans). BlueOrchard is the TA Manager.

**Financial and Social Achievements:** Since inception, MIFA has disbursed 133 loans for USD 285 million to 62 financial institutions in 15 Asian countries. The total number of micro-entrepreneurs reached by the Fund's investees is 12.7 million (78% female, 66% rural clients).<sup>20</sup> Hedged local currency loans represent 57% of the total portfolio. Coupons to all investors have been paid in line with the target returns.

<b>Senior Tranche</b>	Fully funded by private sector, including pension funds, insurance companies, foundations, and family offices	
<b>Mezzanine Tranche</b>	Funded by DFIs & private sector	
<b>Junior Tranche</b>	Funded by BMZ and the European Union (EU)	

<sup>20</sup> BlueOrchard Finance. 2018. Regional Education Fund for Africa. [ONLINE] Available at: [www.blueorchard.com/investment-solutions/blended-finance-mandates/refa/](http://www.blueorchard.com/investment-solutions/blended-finance-mandates/refa/). [Accessed 7 August 2018]. Data as of 30 June 2018.

# Japan ASEAN Women Empowerment Fund – JAWEF




Striving for women empowerment



**Objectives:** JAWEF is the first impact fund to fight poverty by specifically empowering women in Asia and with a focus on the ASEAN region. JAWEF finances with senior and subordinated loans financial intermediaries targeting female entrepreneurs and having specialized lending products and services for this large group of the workforce.

**Capital Structure and Investors:** The Fund is a multi-layered fund with senior, mezzanine and junior tranches. The sponsors are the Japan Bank for International Cooperation (JBIC) and the Japan International Cooperation Agency (JICA). Japanese institutional investors are in the senior tranche, while private investors and the fund manager are invested in the junior tranche.

**Financial and Social Achievements:** Since inception, the Fund disbursed 34 loans for a total of USD 110 million to 19 financial intermediaries in 7 countries. The total number of micro-entrepreneurs reached by the Fund investees is 4.8 million. All investees financed by the Fund have at least 60% of female clients with an average of 92%, the highest among BlueOrchard’s funds. Moreover, the Fund has a high rate of penetration in remote areas with 71% of investees’ clients being rural. Finally, 46% of the Funds’ loans are in local currency (hedged or unhedged).

Senior Tranche	Funded by private investors	
Mezzanine Tranche 1	Funded by public and DFI investors	
Mezzanine Tranche 2		
Junior Tranche	Funded by private investor	

# VI. BlueOrchard Blended Finance Survey on Private Investors

The majority of publications on blended finance have largely focused on the rationale for public funders to adopt blended finance, exploring their motives, funding allocations, sectoral focuses, preferred regions, most-used financing instruments, and targeted impact objectives. There is, however, only limited research available on the primary objective of private investors, although understanding their motivations is pivotal in order to successfully design and improve blended finance vehicles and thus unlock private capital.

We have therefore conducted a survey among BlueOrchard's private investors, exploring their views, objectives and expectations on blended finance funds. In the subsequent section we present the results of this survey.

We aim to give voice to BlueOrchard's broad and diverse private investor base, which ranges from family offices to foundations to institutional investors.

We attach high and equal importance to each investor's perspective, regardless of size and type. In our opinion, the participation of different investor groups in the blended finance space is highly desirable and we intend to cater for their specific needs via a broad product offering.

The survey was carried out in the second quarter of 2018 and conducted on a diverse sample of BlueOrchard's private investors. Among the survey participants, pension funds were the largest group (47.4%), followed by banks (10.5%), family offices and private banks (both around 15.8%) (see Figure 9). Respondents also included endowment funds and advisors of institutional investors.

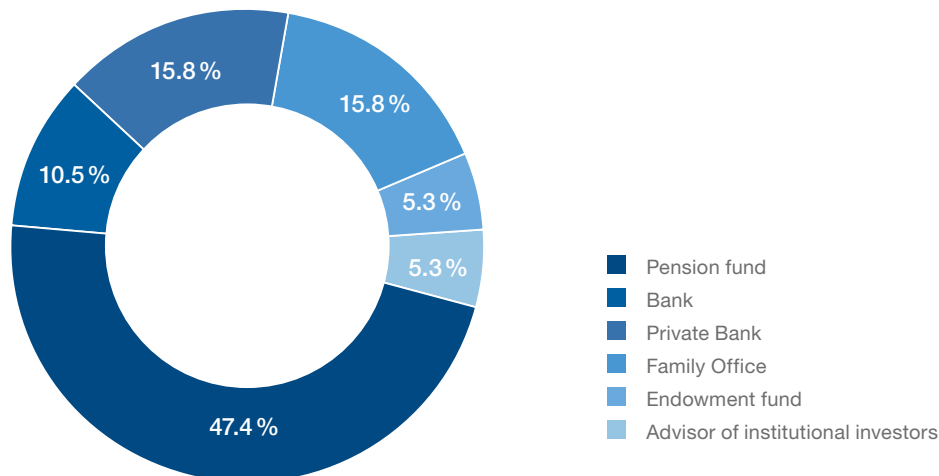
## Findings

Of all the respondents to the survey, only 37% stated to have already invested in blended finance vehicles. Respondents which had not yet participated in a blended finance deal were asked to answer the survey questions with regards to how they plan to invest or preferably would invest.

## Regional and sector preferences

Global blended finance transactions that do not have a regional focus are preferred by the largest proportion (68.4%) of respondents. Blended finance vehicles targeting Sub-Saharan Africa and Central and Eastern Europe are in second place (see Figure 10). The responses show the wide sectoral

Figure 9: Type of Investors in the BlueOrchard Survey



reach of blended finance, including financial inclusion, infrastructure, climate finance, health, education finance, agriculture, affordable housing and insurance. Financial inclusion (63.2%), sustainable infrastructure (57.9%) and climate finance (42.1%) are the preferred sectors by the respondents (see Figure 11).

The strong preference for financial inclusion could be biased by BlueOrchard’s investor base, which includes investors in BOMF, the flag-ship microfinance and SME financing fund fully funded by private investors and today the largest financial inclusion fund in the world. It might also be correlated with the significant offering of blended finance vehicles in this sector (e.g. microfinance and SME funds) and their track-record (almost 15 years in some cases).

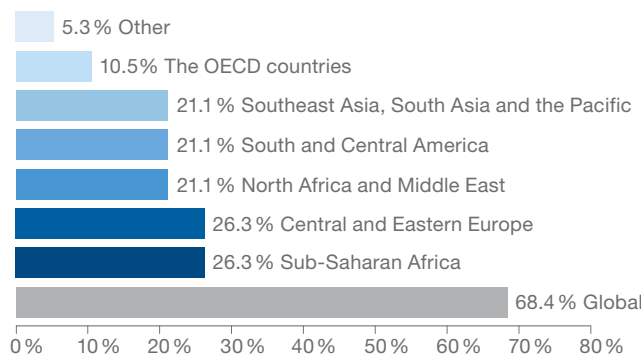
### Investment horizons and asset class preferences

With respect to the investment horizon, the majority of the respondents (63.2%) prefer an investment period between 3 and 7 years (see Figure 12). This means that if investors participate in blended finance funds after the initial ramp-up period, they can then match the terms of investments in most blended finance close-ended funds. In terms of asset class preferences, there is a strong inclination for private debt (66.7%), with some respondents being also in favour of a mix of debt and equity (28.3%) (see Figure 13).

### Expectations placed on public investors

We find that surveyed investors seek the following types of credit enhancement in blended finance vehicles: downside protection and/or 1<sup>st</sup> loss. These factors are both crucial as-

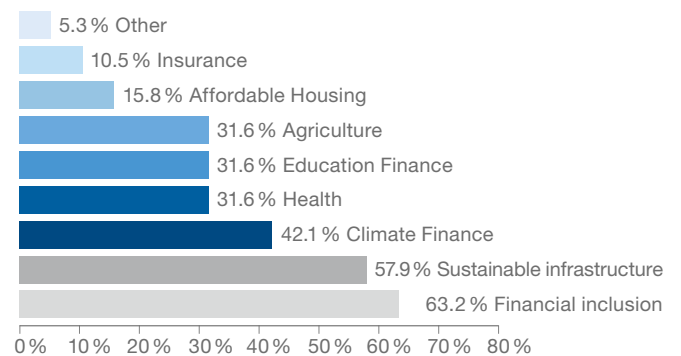
**Figure 10: Regional Preferences<sup>21</sup>**



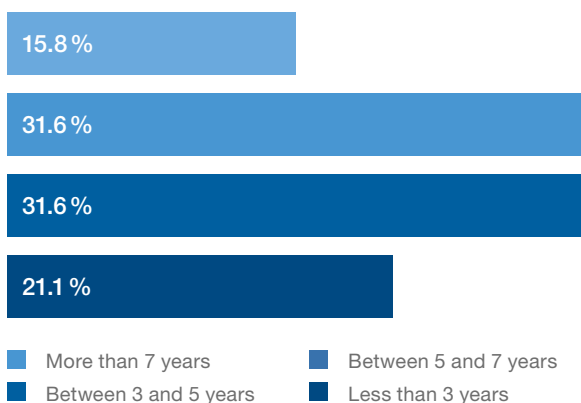
*Regional preference survey question: What region(s) is/are the PPP(s) you are invested in targeting? Or, if you are not a current PPPs investor, what region would be of your interest?*

*Sector preference survey question: To which sectors is/are the PPP(s) you are invested in contributing? Or, if you are not a current PPP investor, which target sector would be of your interest?*

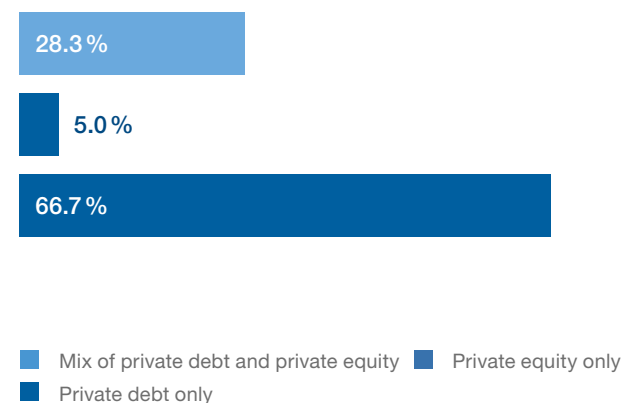
**Figure 11: Sector Preferences<sup>21</sup>**



**Figure 12: Investment Term Preferences**



**Figure 13: Asset Class Preferences**



<sup>21</sup> Some questions are open to multiple answers. Totals therefore exceed 100%.

pects for investors' participation in these structures. However, private investors do not seem to necessarily expect public investors to be subordinated at concessional rates. Furthermore, they tend to be ready to engage in blended finance funds when the investment has passed the proof of concept stage. Aspects like capacity building and technical assistance, generally targeted to develop investment ready opportunities and mitigate investment risks, are also important for the surveyed investors (see Figure 14).

### Return expectations and liquidity requirements

While we find that de-risking benefits are an important aspect for private investors when investing in blended finance funds, we cannot conclude that they would waive for this reason expected financial returns. This is an assumption often alluded

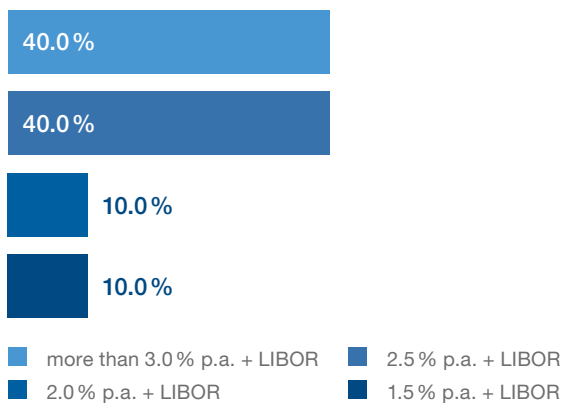
by public sector investors. On the contrary, we find that the majority of the surveyed investors (80%) expect market-returns (see Figure 15). Given that blended finance should take root as a long-term and sustainable investment strategy, it is only logical and desirable that private investors seek and achieve market-rate returns when they invest in blended finance funds.

The lack of redemption capacity in most blended finance close-ended vehicles limits investors that have shorter investment cycles and have short-term source of funding in their own terms (e.g. family offices and private banks). 64.3% of our surveyed investors, for example, expect annual payments (see Figure 16). Coupon payments could be a way to create liquidity during the life of the close-ended mandates and better cater to liquidity-constraint investors.

**Figure 14: Expectations on Public Investors**



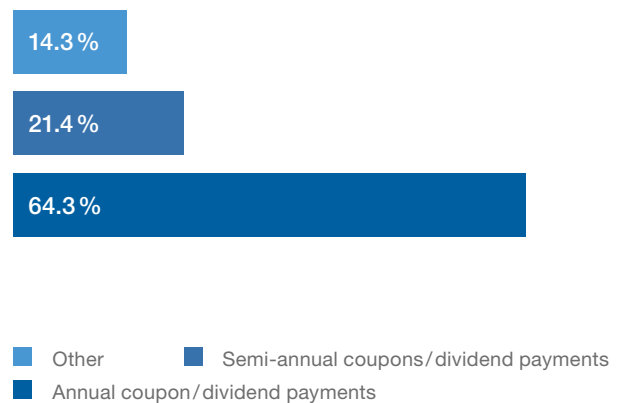
**Figure 15: Return Expectations**



*Return expectation survey question: Assuming that as a private investor you invest in the Senior tranche (20% protected) of a Public Private Partnership targeting emerging markets for 5 years, what is your minimum return expectation for a debt only product (spread over Libor)?*

*Liquidity requirements survey question: Do you have specific liquidity requirements when investing in a close-ended product? What would be your expected cash flows over the life of a Fund?*

**Figure 16: Liquidity Requirements**

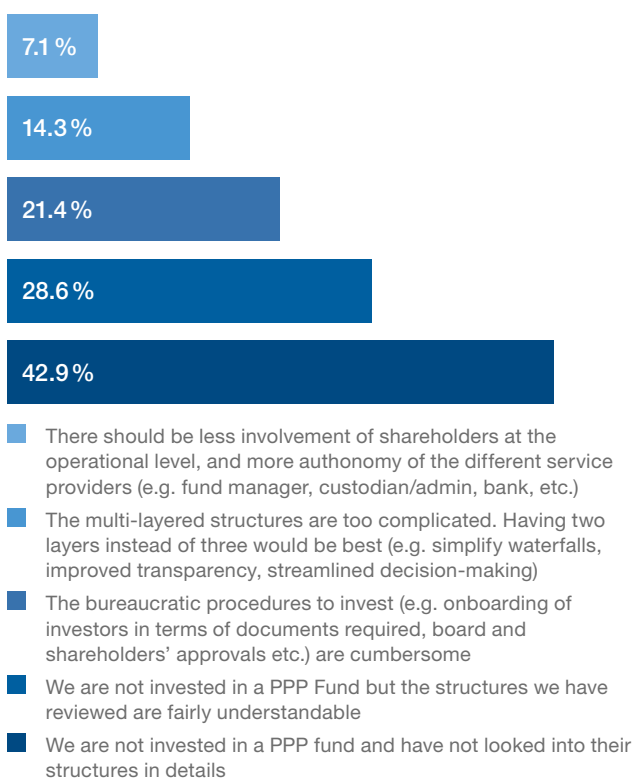


## Complex structures

A significant number of the surveyed investors that have already invested in blended finance funds seek more simplicity in these vehicles (see Figure 17). A greater simplicity could be achieved by simpler liability structures (e.g. two tranches instead of three), easier operational aspects (e.g. a simpler waterfall guiding the sequencing of payments to different type of investors), as well as more private-sector friendly administrative procedures (e.g. documentation, approval requirements).

These findings suggest that private investors prefer to be less involved at the funds' operational and organizational levels.

**Figure 17: Feedback on the Complexity of Blended Finance PPPs**



*Complexity of blended finance PPPs survey question: If you have experience with blended finance PPPs, do you find these structures too complicated? If yes, why? Multiple answers possible.*

**Figure 18: Corporate Governance – Should the Private Sector be more Involved?**



*Corporate governance and private sector involvement survey question: As an investor, would you like to be involved in the corporate governance of the PPP Fund you would invest in? Would you like to take decisions with regards to matters that are not impacting the Fund strategy?*

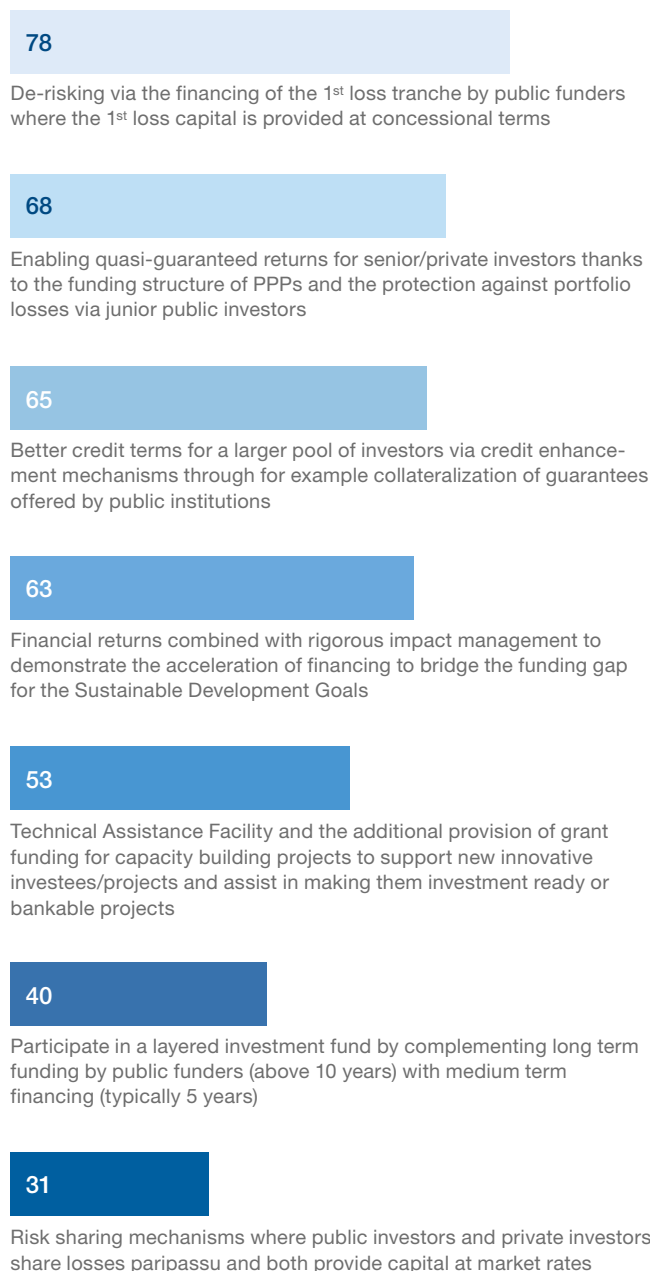
This is also reflected by their limited desire to be involved in the blended finance mandates' corporate governance structures (see Figure 18). Some respondents asserted that it was due to lack of time, whilst others explained that they did not feel they had the required expertise.

## Conclusion

Lastly, we asked the survey respondents to rank several blended finance funds' features in order of importance on a scale from 1 to 100. The most relevant features for these investors are the following: I) the provision of 1<sup>st</sup> loss capital at concessional terms, II) the protection against portfolio losses, III)

**Figure 19: The Best Rated PPP Features**

How attractive are these PPP features according to you? (0–100 scale)





the collateralization of guarantees offered by public institutions, and IV) financial returns combined with rigorous impact management to accelerate the achievement of the SDGs.

Overall, the results of the survey indicate that private investors are ready to step up their involvement in blended finance. Commercial investors can benefit from the features provided by blended finance vehicles and are ready to invest or in-

crease their current investments as long as the blended finance offering is shaped in a “commercial investor-friendly manner.”

This potentially means that commercial investors could push for a consolidation and simplification of the blended finance market and be central in the determination of the main features required to have the billions following the millions.

## Giving Voice to the Private Sector: Interview with Philippe Rey Chief Investment Officer, Union Mutualiste Retraite



Union Mutualiste Retraite

Union Mutualiste Retraite (UMR) is a leading institutional investor invested in blended finance funds managed by BlueOrchard. With EUR 9.1 billion of assets as of end 2017, UMR is a leading provider of complementary pension and insurance solutions in France. In its Environmental Social Governance (ESG) report of 2017 the UMR defines its ESG objectives and concretely specifies how its investment policy not only has a so-called exclusion list, but also proactively focuses on supporting companies that can make a difference (e.g. renewable energy and energy efficiency investments, and socially driven companies). The participation of UMR in blended finance is not accidental, but is linked to a proactive stance and policy-driven investment strategy developed to follow the requests of its members.

### Philippe, why has UMR selected a blended finance investment like the Microfinance Initiative for Asia Fund (MIFA) among other investment opportunities?

*“In 2013, UMR was looking for investment opportunities that would have both financial and social impact. We looked at the micro-finance asset class and we also looked at the possibility of supporting financial intermediaries that can play a role in financing the base of the pyramid. In addition, Asia was on our radar screen as 60% of the world lives in that region and many have limited access to financial services to grow their business activities. We realized that microfinance was a growing asset class with a long-track-record and that BlueOrchard had more than 15 years of experience as an asset manager in this sector via its flagship fund (BOMF). We found that this investment opportunity was matching our return expectations and our investment horizon. The presence on the ground of BlueOrchard’s investment team and its mission of bridging the gap between capital markets and micro-entrepreneurs in emerging markets was a perfect complement to our main activities.”*

### The fact that UMR has decided to be in the fund corporate governance – MIFA Supervisory Board – is very unique. Could you explain why UMR made this decision?

*“Participating in the corporate governance of the Fund was important and essential as this was our first investment in this asset class and we did not have internal expertise or previous experience to rely on. Be at the heart of the core fund decisions, analyze closely the compliance with the investment guidelines, the assessment of country risk in frontier markets, and the risk management including portfolio valuation was crucial for making us comfortable. We also realized that engaging in the corporate governance of the Fund would allow us to benefit from the extensive experience of other investors, in particular of KFW and IFC. BlueOrchard also organized field trips to see its investment team at work and to meet MFIs and entrepreneurs financed. This provided us with a comprehensive view of the investment process.”*

### UMR has supported MIFA when the fund was still in the ramp-up phase. What has been important for your investment decision? Was it the credit enhancement provided by the junior 1<sup>st</sup> loss, the active involvement of leading DFIs, or the target coupon? Would UMR consider investing in similar blended finance mandates in the future?

*“In reality, our investment decision was a mix of the above factors. Several aspects were important to us: the very solid protection provided by the mezzanine and junior share classes, the protection of the currency risk since we are Euro investors, the expertise of the fund sponsors, and also the demonstrated resilience and decorrelation of this asset class versus other asset classes in our portfolio of investments. And yes, we would consider again investing in blended finance mandates as long as our requirements are met.”*

## VII. BlueOrchard's Vision of Blended Finance 2.0

The blended finance market is still dominated by public sector actors and financing. While this makes sense in some frontier markets that are perceived as high risk, in innovative sectors, and probably in some “public good” markets (e.g. climate finance), there seems to be a number of sectors where public funding could be reduced and play a more pivotal role to catalyze private capital.

*Catalyzing and upscaling this private capital is crucial for achieving the SDGs and facilitating sustainable and ecological growth and development beyond 2030. We believe that it is about time for a shift in the equilibrium between public and private sector actors in blended finance structures.*

We are convinced that the first step on the road to a “Blended Finance 2.0,” a blended finance that attracts private capital at scale, is a cultural shift that changes the dynamic of the interactions and collaboration between public and private stakeholders. The change should effectively be reflected in a larger weight of commercial capital (see Figure 20). A recent survey by the OECD suggests that we are well on the way to achieving this goal: this survey states that 68% of blended finance funds are managed by private fund managers.<sup>22</sup>

*As impact investment managers play a significant role in intermediation and in blending public and private capital, these actors could become the game changers by designing blended finance products that meet private sector investors' requirements.*

Furthermore, public stakeholders and policy makers, as per the testimonials collected in this paper, also call for a bigger involvement of the private sector and state their readiness to engage in more private-sector friendly structures. The effective use of ODA resources, for example, is an important building block for mobilizing commercial capital from both, so-called “impact investors” and mainstream private investors.

We have compiled the *decisive ingredients for Blended Finance 2.0* by leveraging our extensive experience with blended finance based on the numerous mandates we have managed

since 2001, and building on the findings of our private investors' survey. These components are as follows:

**Commercial investors' contribution:** Private investors not only have funding to contribute, but also relevant sectoral and technical expertise. In addition, private investors might also have their own footprint in emerging markets and provide a large distribution network and Research and Development (R&D) capacity. Local investors should also be given a chance to participate in blended finance schemes as they have, in addition to market intelligence, valuable local currency resources.

**Time of investment:** While it is true that commercial investors generally want to invest after the proof of concept, it is important to ensure that the design of blended finance instruments meets their requirements in terms of financial return, impact objectives and measurement, as well as their regulatory obligations. Many blended finance funds are marketed too late to investors and do not present the flexibility required to on-board them. To increase private sectors' ownership in blended finance mandates it is important to involve investors in the early stage of project design and seek their contribution to the mandate's objectives and corporate governance. This has allowed in our experience both the improvement of the structure of the vehicle and its resilience to market changes. Contributions in the corporate governance by commercial investors have also resulted in streamlined processes, operational efficiency, and cost savings.

**Time-bound investments:** The concept of public sector and DFI funding being available forever is not the reality anymore. This means that public funding needs to be used strategically for innovative sectors, for the riskiest or more exotic markets, and also for a defined time horizon. An example here could be funds in financial inclusion where commercial investors have slowly been comfortable in investing in mezzanine tranches (i.e. taking more risk) and have also participated in fully commercial funds (e.g. BlueOrchard Microfinance Fund). The expectation here is that the public sector makes time-bound investments and phases out its participation as commercial capital is deployed.

<sup>22</sup> Cf. OECD. *Making Blended Finance Work for the Sustainable Development Goals*. Pg 29.

**Simplification of blended finance mandates:** To date, blended finance mandates have often reflected the priorities of public investors in terms of financial and social returns as well as structuring features. This means that some of the concepts used require simplification to be valued by private investors. Examples could be the provision of earmarked junior tranches (e.g. for a region or even a country), multi-layered structure that includes as many as 4 different tranches, and laborious set of impact objectives.

**Accessibility of blended finance opportunities:** Blended finance funds are still regarded as an offering for a selective group of commercial investors. Many institutional investors are simply not aware of the successful track-record of blended finance schemes in some asset classes. Retail investors directly, or via banks, are even further away from this investment reality, and the same is the case for foundations, family offices and endowments. Recently, a number of platforms like the Convergence and the Sustainable Development Investment Partnership (SDIP) have created opportunities to connect demand and supply in blended finance. Still, when looking at their memberships and outreach, it is clear that more efforts are required to have a larger private sector repre-

sentation and a real match-making market for blended finance vehicles and transactions. Mobilization of the members of sustainable associations (e.g. Swiss Sustainable Finance) could ensure the inclusiveness and outreach of blended finance initiatives to a broader group of potential investors.

**Standardization of blended finance offering:** When we market blended finance funds, tranches, and projects to commercial investors we are often confronted with requests of ratings, be it at the vehicle or tranche level. The development of a rating practice for blended finance funds would allow quantifying the credit enchantment provided by junior first loss capital, for instance, and make these mandates more comparable with other offerings in the market. Recent transactions have also shown that the structuring of the deal itself (via country risk cover, guarantees, and collateral) could indeed result in better ratings for the issuer/vehicle.

**Common system of impact measurement:** The standardization of the development impact of blended finance mandates is important to ensure more efficient communication with commercial investors. The SDGs have created a unified platform to lead the effectiveness of impact measurement and the



development of best practice tools and simplified impact measurement processes. A common system and language are crucial to scale-up blended finance activities with private capital.

**Opening up to retail investors:** The introduction of notes and debt instruments in many blended finance funds has allowed commercial banks and their retail clients to participate in these structures. A fundraising approach based on attracting a larger group of retail investors could benefit from wider distribution platforms and even more short-term liquidity features.

**Changing the incentive structure:** The current incentive structure to accelerate private capital mobilization is often weak across the value chain of public donors, DFIs, and fund managers. More explicit targets and incentives could help mobilize commercial investments. As one DFI representative recently stated at a blended finance conference “each dollar mobilized is like a dollar invested in our Group.” This should be the guiding principle of Blended Finance 2.0.

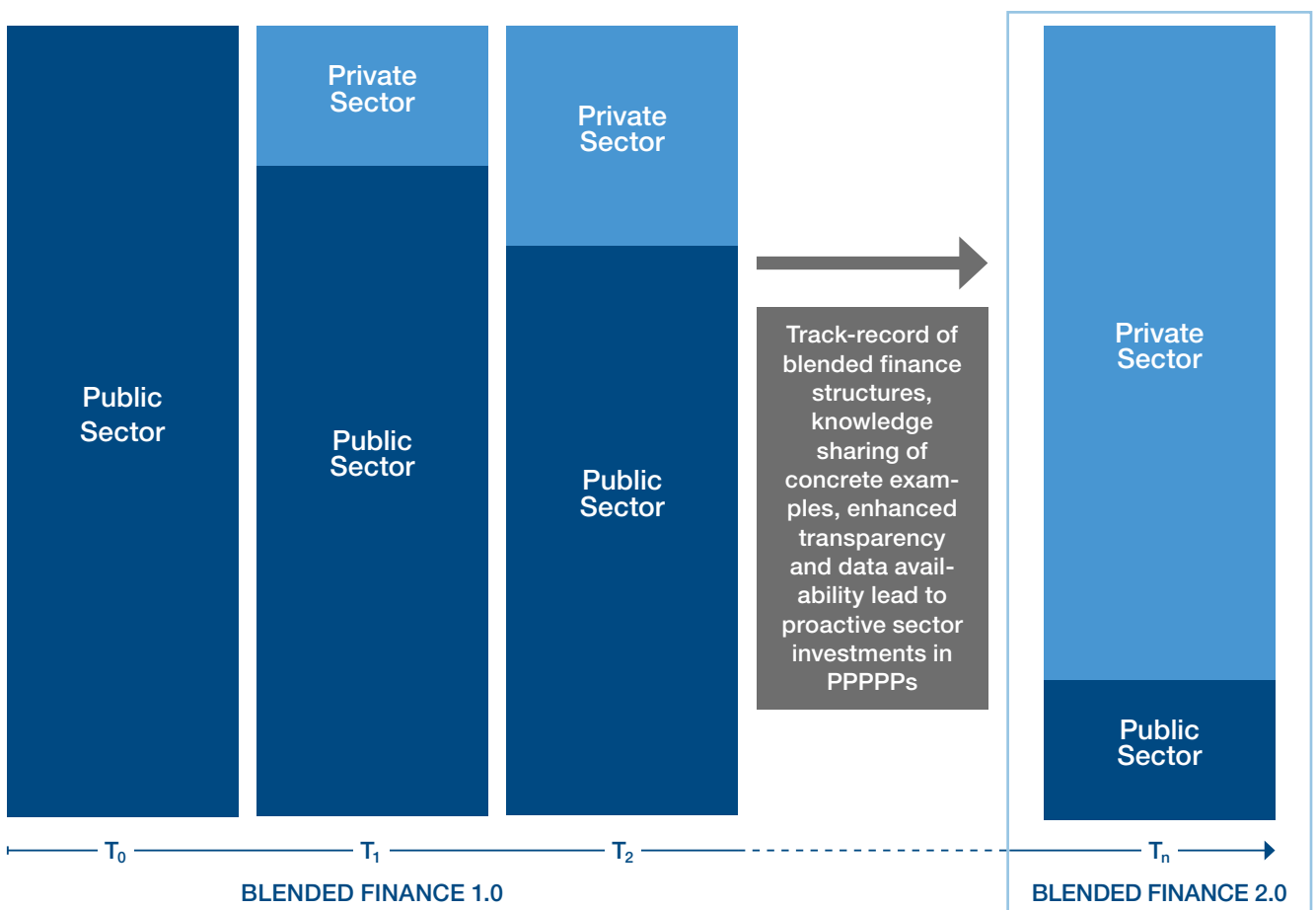
**Increase transparency:** Private investors seek transparent structures with clear delegation of authority that empowers fund managers to take decisions free from the disproportionate influence of any shareholder.

**Capacity building:** Pre-investment and post-investment capacity building at the investee level is valued by private sector investors as this is perceived as quasi-equity, mitigates investment risks, and/or is preparatory to future investments (e.g. make pipeline projects investment ready).

**Risk-returns expectations:** While de-risking financing instruments is important for private investors, private investors should be able to achieve market returns in order for blended finance to succeed.

The implementation of Blended Finance 2.0 will demonstrate which of the above ingredients will be more successful in mobilizing capital for the SDGs.

**Figure 20: Blended Finance 2.0**



## VIII. Conclusion

“Blended finance 1.0” has tested the appetite of mainstream commercial investors for blended finance mandates. Public sector investors and private investors alike have learnt that they can both gain from partnering together. They have demonstrated the success of a number of blended finance structures when there is an alignment of financial and social interests to fast-track the achievement of the SDGs. In BlueOrchard’s experience, areas of impact have been financial inclusion, micro-finance and SME finance, education finance, women’s empowerment, and climate finance.

However, as demonstrated by the results of the BlueOrchard private sector survey, this is only the tip of the iceberg if the objective is to mobilize private capital at scale. The private sector has many needs, and the bridge between concessional funders, DFIs, and private sector investors should be strengthened and shortened if all stakeholders want to participate in filling the massive financing gap linked to the SDGs.

The BlueOrchard survey is an attempt to listen to commercial investors and see how best to engage with them in ensuring that blended finance mandates become part of their investment universe, and not only an anecdotal investment opportu-

nity. We discussed in this paper how blended finance could be further improved to ensure inclusiveness of all investors, consolidation of existing blended finance opportunities when possible, as well as replicability and standardization of best practices. A part of BlueOrchard’s vision of Blended Finance 2.0 is to achieve these objectives.

*In our view, a key priority in Blended Finance 2.0 should be to give voice to the private sector and ensure that commercial investors take the lead in structuring, sponsoring, and seeding blended finance funds together with public investors and DFIs. The private sector cannot sit back, and needs to actively participate and be listened to in the blended finance industry.*

BlueOrchard is committed to being a game changer and driving Blended Finance 2.0 forward by developing decisive structures to unlock private capital at scale, ensuring the contribution of different investor groups, and catering for their specific needs via a broad product offering.

*In short, we are only at the beginning of the blended finance industry and Blended Finance 2.0 is expected to be a revolution where commercial capital leads the way.*

# About the Authors



## Maria Teresa Zappia, Chief Investment Officer

Maria Teresa has been working in the emerging markets finance sector for over 20 years. She has worked for several development banks and financial institutions like the European Bank for Reconstruction and Development (EBRD), Asian Development Bank (ADB), Overseas Development Institute (ODI), and OECD Development Centre based both in the field (Africa, South East Asia, and Central Asia) and in the headquarters. Maria Teresa contributed to the development of dedicated financing instruments for local commercial banks entering the SME sector and for microfinance institutions. She also managed technical assistance programs to accompany credit line financing with capacity building. Maria Teresa joined BlueOrchard in 2008 to manage the investment team. As of 2012 Maria Teresa was appointed Chief Investment Officer and was responsible for the top-down part of the investment process at BlueOrchard together with the Portfolio Management Team. She now leads the Blended Finance Impact Management team and is responsible for the PPP funds under BlueOrchard's management. She holds a Master of Philosophy in Development Studies from the University of Sussex (Distinction), and a Degree in Economics (1<sup>st</sup> Class Honors) from the University of Florence (Italy).



## Nadina Stodiek, Fund Manager PPP Mandates and Impact Manager

Nadina has been working in the impact investing industry for four years in both asset management and private banking. Throughout her various roles in portfolio management, investor relations and fund management, Nadina has gathered significant experience across different asset classes and impact themes with a focus on financial inclusion in emerging markets. Today, as part of the Blended Finance and Impact Management team, she actively contributes to the management and further development of BlueOrchard blended finance mandates. Nadina also leads BlueOrchard's social performance practice and impact management activities and proprietary tools. Prior to BlueOrchard Nadina has worked as a Financial Analyst at responsAbility Investments AG. Nadina started her career in the impact investing team of a large Swiss private bank, Lombard Odier. She holds a Master's degree in Economics and Strategy for Business from Imperial College Business School in London and a Bachelor's degree in Business Administration from the University of Geneva.

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# Acknowledgements

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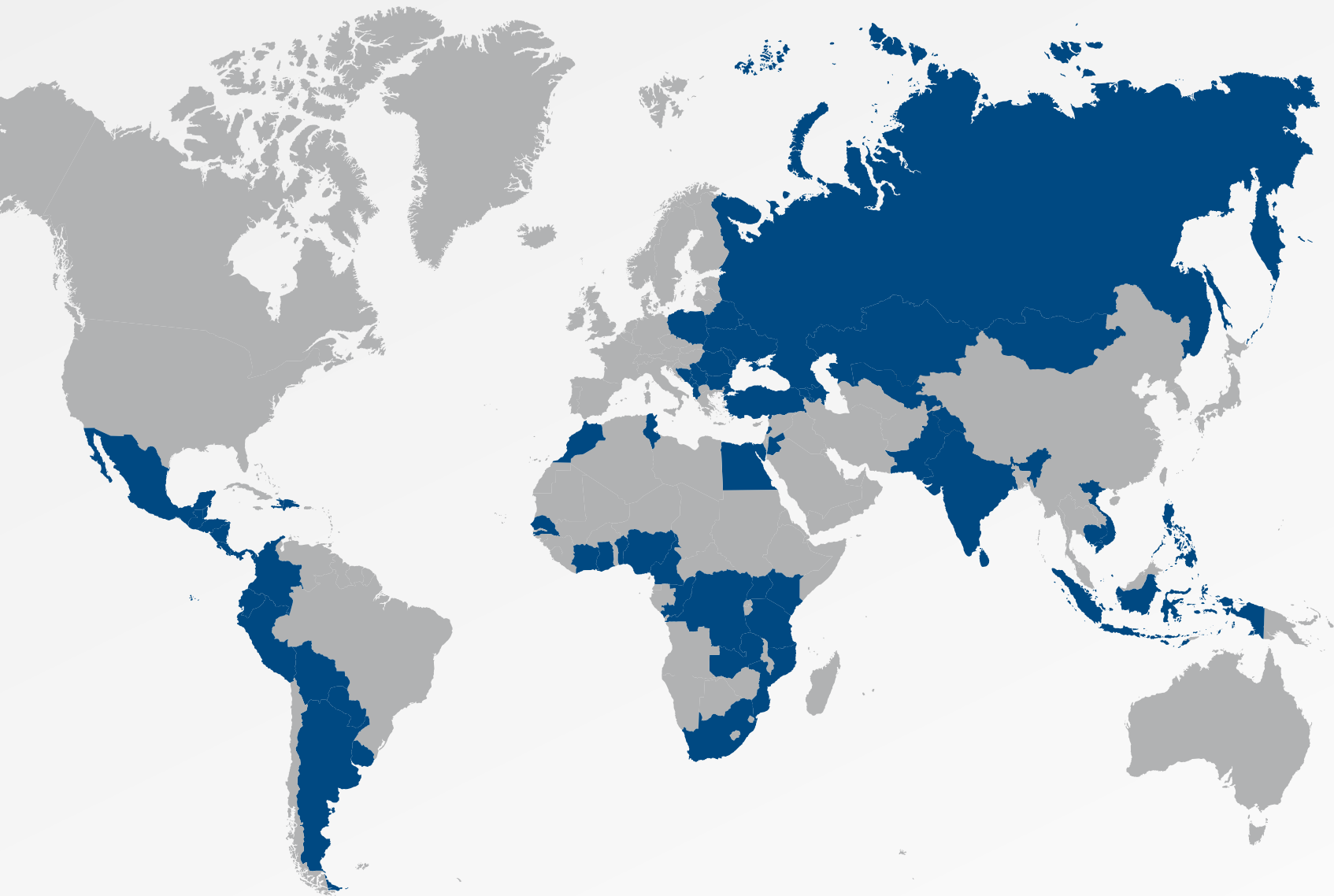
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