Food and Agriculture Organization
of the United Nations

**FAO's
Blue Growth Initiative**

Blue finance guidance notes

Blended finance

Contents

Why blended finance?

The United Nations estimates that USD 4 trillion a year are needed through 2030 to achieve the Sustainable Development Goals (SDGs), compared to around USD 1.5 trillion currently being invested. Public finance does not have sufficient resources to fill this gap, but the private sector – which is responsible for around 90 percent of jobs, 60 percent of investments, most exports, 80 percent of government revenues and a growing share of essential services, inventions and innovations in developing nations (World Bank, 2019) – is not contributing much of the needed investment.

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In the fisheries and aquaculture sector, considerable finance is needed to protect and grow the blue economy and to meet the ocean-related SDGs, particularly SDG 14 (Life Below Water), SDG 12 (Responsible Consumption and Production), SDG 8 (Decent Work and Economic Growth) and SDG 9 (Industry, Innovation and Infrastructure). Many of the countries that depend most on blue economy are developing countries, in particular small island developing States, with limited public finances. Investment in the blue economy – to support existing blue industries such as aquaculture and tourism; protect blue assets such as fish stocks, coral reefs and mangroves; and develop new blue industries such as offshore wind and marine biotechnology – offers benefits for the global community and future generations, but tends not to attract private capital because of the lack of financial returns.

What is blended finance?

Blended finance is the use of public or philanthropic money to catalyse the deployment of private capital, usually in developing countries, to achieve a positive impact. Public finance can also be used to pilot innovative schemes to show their viability, thus attracting subsequent private finance schemes. Small amounts of public finance can open the door to much larger amounts of private finance, thus leveraging public money to maximum effect.

Key actors for blended finance

- **Governments and development finance institutions**, often as project initiators.
- **Private and institutional investors**, such as private equity or pension funds, providing finance at market rates.
- **Non-governmental organizations (NGOs)**, providing advice and technical assistance.
- **Impact investors and philanthropic. foundations or individuals**, providing finance often at below-market rates.
- **Multilateral development banks**, as initiators and facilitators, and designing and managing structures.

Some situations where blended finance can be used effectively

- Where projects are too small for private finance, they can be funded by public money and collected into a portfolio which can then be refinanced with private money, permitting redeployment of public money.
- Where individual projects or companies are too risky for private finance, public finance can reduce risks by creating a diversified portfolio or by offering to bear the first losses, or can improve returns by offering financial incentives such as lower interest rates or performance fees

Case study

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The Meloy Fund for Sustainable Community Fisheries

The Meloy Fund for Sustainable Community Fisheries is an over USD 22 million impact investment fund that incentivizes the development and adoption of sustainable fisheries by making debt and equity investments in fishing-related enterprises that support the recovery of coastal fisheries in Indonesia and the Philippines. Additionally, the fund also provides technical assistance to support business growth, such as financial management, operations and sustainable seafood best practices.

The fund is executed by Rare, a people-centred conservation NGO, and obtains funding from both public and private sectors, such as GEF and Bloomberg. The newest investment comes from FMO with 5million USD, with which the fund has a final close at over USD 22 million.

Together with global conservation organization Rare, The Meloy Fund seeks to invest in fishing and seafood-related enterprises in Indonesia and the Philippines that will lead to better management and protection of historically undervalued community-based coastal fisheries, as well as opportunities to boost the livelihoods of local, small-scale fishers. Together, Rare estimates these two nations represent:

- 4.3 million small-scale fishers;
- 2.7 million tonnes of fish;
- 21 million hectares of critical marine habitat;
- USD 4 billion latent value in smal-scale fisheries.

Which can be unlocked if sustainability can be achieved.

The fund’s first investment was a five-year, USD 1 million financing for Meliomar, a Manila-based fishing, processing and exporting company. The money was used to increase Meliomar’s processing capacity, to improve logistics and to provide working capital. Meliomar promotes sustainably caught tuna from local small-scale fisheries, and with the investment it aims to increase its output of traceable yellowfin tuna by 2020. Working with Rare’s global fisheries recovery programme, Fish Forever, the company has committed to sourcing tuna from a fishery improvement project and from local Filipino communities. It expects to add at least USD 2.5 million in increased annual income for 1 600 local fishermen and to improve the management of 12 000 ha of critically important marine ecosystems by 2021.

- In some cases both government support and private finance are needed, for example to develop infrastructure or to improve regulations to make business more sustainable.
- Where a government or donor wishes to achieve an impact that requires private funding owing to its scale, but that impact cannot be achieved through market-rate returns, public money can be used to create market-rate returns and attract private investment.
- Blended finance can be used to pilot projects that can help to establish a track record and improve credibility. For example, the Global Environment Facility (GEF) and Caribbean countries set up the Caribbean Regional Fund for Wastewater Management to pilot projects for preventing pollution of marine resources by untreated wastewater.

Existing risks and solutions with blended finance

Risks

- Political risks such as political instability, risk of government changing arrangements for access to resources, nationalization of sectors and monetary policies (e.g. related to currency restrictions and taxes).
- Currency risks such as potential currency volatility due to political instability or changes in monetary policies.
- Risk of losses due to corruption and fraud, for example related to the provenance of fish products, which is of critical importance in reaching the lucrative markets of Europe, the United States of America and Japan.
- Lack of track record related to investing in the country, sector or type of project, especially where the key factors for success are not well understood.
- Long time scales for return of investment in fisheries.
- Projects whose financial return is too small to justify the costs of due diligence.
- Private investors' lack of interest in developing countries because of higher risks, less sophisticated financial markets and lack of track record.
- Junk status of many low-income countries, making guarantees or some sort of credit uplift necessary to convince investors to enter the market.

Examples of how blended finance can be used to reduce the risks

- Creating a portfolio of small projects in different countries and sectors diversifies risks.
- Performing due diligence on investments and providing technical assistance, often from local or international non-governmental organizations (NGOs) who have experience in similar projects, can reduce the risk of corruption and fraud
- Creating an investment-grade product, such as a bond, enables private financers to invest at scale.

How does blended finance work?

Tools can be used in blended finance

The following tools are ordered according to the level of risk from the point of view of the public finance component. Lower-risk tools involve limited risk and known expenditure, while higher-risk tools can involve unknown and potentially large losses.

Lower risk

Technical assistance. Public finance can provide funding for technical assistance, often by giving grants to NGOs which can work with partner organizations to help to create and implement projects for maximum environmental benefits. This can also help to provide due diligence for investors by reducing the risks of poor execution or fraud.

Market incentives. Public capital can provide payments based on performance in order to attract private investment. For example, a price premium for sustainably caught fish could encourage small-scale fisheries to invest in the required equipment.

Medium risk

Project amalgamation. Public finance, usually development banks, can help to finance a number of small projects that are not attractive to private capital because of their size and risks. These can be amalgamated into a portfolio which can be refinanced by private capital, as it is at the scale required and can be diversified across different countries and currencies to reduce political and financial risks.

Project co-financing. Public and private finance co-invest in a project, with each side contributing its skill sets and knowledge. Such public-private partnerships are especially useful in constructing infrastructure.

Financial structuring. Public finance can create financial structures that are suitable for private finance. For example, in the case of the amalgamated portfolio above, the bank could create a blue bond – a type of green bond focused on oceans and coastal ecosystems – which is available for purchase by most actors in the private sector. Green bonds are those deployed exclusively for projects designed to help the transition to a low-carbon economy. In contrast, most private actors could not participate as multiple investors in small projects.

Higher risk

Early-stage finance. Public finance can provide early stage capital to support sustainable business models of individuals and private companies in developing countries, often in combination with technical assistance to help them execute their business plans. This capital can range from relatively low-risk tools, such as loans at concessional rates, to higher-risk tools, such as equity investment or funding for pilot projects to establish proof of concept for innovative schemes. As these projects and companies develop a track record and increase in size and profitability, they can attract private finance at scale, thus leveraging public capital effectively.

Credit guarantees. Very few private finance organizations provide capital to small-scale producers in developing countries, because of the high risk. One way of reducing this risk is for a development bank, such as the World Bank, to guarantee some or all loans or to invest in higher-risk equity. The bank may agree to bear the first few losses, or they may underwrite an entire portfolio. It could also provide access to insurance and currency-hedging tools. Such guarantees enable far greater investment of private capital, as the risks are much lower. A Climate Policy Initiative report (Micale, 2018) suggests that guarantees are the most effective way of leveraging private-sector finance. They account for only 5 percent of public-sector commitments but generate around 45 percent of private capital mobilization.

Case study

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Blue Abadi Fund in Indonesia

The Blue Abadi Fund, owed by a trustee as part of the Trust assets of a Singapore “foreign trust”, is a dedicated conservation trust fund designed to protect in perpetuity the Bird’s Head Seascape, a highly diverse marine region in West Papua, Indonesia. The fund was set up by Conservation International, the Walton Family Foundation, GEF (as a component of one child project of the Coastal Fisheries Initiative), The Nature Conservancy and WWF. Its aim is to transition from donor dependence to self-sustaining funding which will empower local communities and agencies to manage the marine ecosystem by procuring local revenue sources and providing complimentary grants.

Management of the seascape by local organizations requires USD 6.7 million annually, of which USD 3.1 million comes from government, USD 0.8 million from local partners and USD 1.4 million from visitor fees. The fund is designed to fill the remaining gap of USD 1.4 million by raising USD 38 million in initial capital from the private sector, public agencies and the philanthropic community, which will then be managed to generate the required annual disbursements while growing sustainably over time. The coalition is also looking at a number of other potential revenue sources, including sale of carbon credits for the carbon stored in mangrove forests and the forest of the Bird’s Head Seascape.

The Meloy Fund versus the Blue Abadi Fund in Indonesia

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Meloy Fund seeks to improve the conservation of coral reef ecosystems by providing financial incentives to fishing communities in the Philippines and Indonesia to adopt sustainable fishing behaviors and rights-based management regimes through capital investments in commercially viable enterprises. The project "impact fund" is designed to play an important role in minimizing risks to historically undervalued and underappreciated coastal fisheries. Although the Meloy Fund and the Blue Abadi Fund support a similar goal of enhanced biodiversity, their approaches are distinct from each other in several ways:

- The Meloy Fund is an investment fund, which makes loans and takes equity positions in enterprises which support improved fisheries management and local communities, enroute to better biodiversity protection. In contrast, the Blue Abadi Fund is a trust fund, which creates an annuity that funds, in perpetuity, marine protected area management.
- The Meloy Fund is funded by investors, has a discreet lifecycle, and is managed by investment professionals. The Blue Abadi Fund, on the other hand, will be governed by a mix of stakeholders that have various roles in the administration and management of marine parks. It's investment portfolio will also be managed by investment professionals.
- Geographically, the Blue Abadi Fund funds activities in the Bird's Head Seascape, and the Meloy Fund will consider investments in any region of Indonesia that meets investment criteria.

Benefits and challenges of blended finance

- Increased scale of impact from leveraging public money to attract private money.
- Creation of new markets for private finance to fund desired impacts, e.g. blue bonds for marine restoration, following proof of concept.
- Access to private-sector knowledge, innovation and efficiencies.
- Achievement of desired impacts which would otherwise not be financed.
- Access to new markets which otherwise would be too high in risk.
- Decreased risk of default as a result of technical assistance funding and due diligence from public finance.
- Access to large-scale, low-risk, long-term projects offering desirable stable returns, not correlated to other asset classes.
- Opportunities to participate in innovative projects and financial structures, to learn and to be seen as thought leaders.
- Opportunities to fund positive social, environmental and financial impacts.

Challenges

Despite the advantages of blended finance, the risks may still be too high for cautious investors, and some blended finance opportunities may be too long term or illiquid for many investors. Even financially successful schemes will not necessarily deliver the required impacts and could have unintended consequences. Some specific challenges, and suggestions for mitigating them, are shown in the Table on the next page.

Some challenges of blended finance

Challenge	How to mitigate the challenge
Imbalance whereby the public sector takes much of the risk and hands the returns to the private sector	A carefully set-up structure
Difficulty of diversifying political risk	Global blended finance structures
Perception of some blended finance as an unnecessary subsidy for private finance	Ensure clarity about the expected impacts and outcomes
Risk of effectively ”overpaying” to attract private capital	
Questions about whether the private sector would have financed the project anyway	
“Crowding out”, whereby private-sector funds effectively compete with public-sector funds in project financing, leading to inefficient use of capital	
Risk of financial losses and poor business models undermining the credibility of both participants and the broader financial instruments being used, especially innovative structures	Technical assistance and effective due diligence
Accusations that with alliances between developing country governments and international private financers, profits are exported from developing to developed countries	Involve local finance market participants who know the country and the market and can contribute local knowledge
Creation of a dependency risk from access to concessionary capital, whereby businesses become reliant on access to cheap capital rather than becoming fully commercial operations	Clearly defined timelines and business plans for the eventual removal of subsidies

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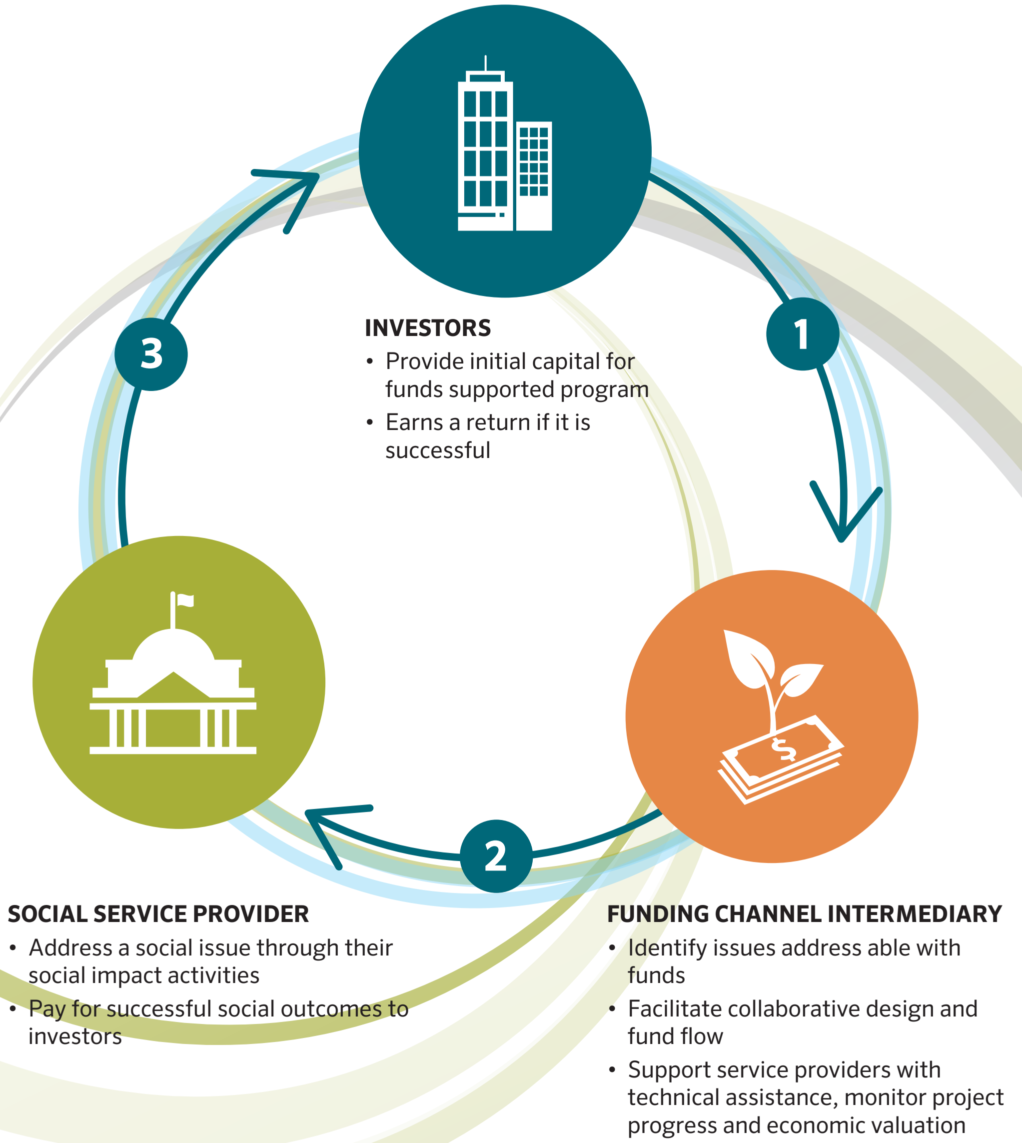
Key actors for impact investment



Financial investment in the fisheries and aquaculture sectors has traditionally been limited. Fisheries and aquaculture sectors' production and profitability have historically been rather unpredictable. Therefore they presented risky business models for the financial sector. However, our understanding of how to manage this unpredictability, through established best practices and ever improving technology, is shifting this paradigm. The financial sector and fisheries and aquaculture sectors can mutually benefit from collaboration given the important scale and economic impact of these sectors, including contributions to employment, value addition and food security. The Blue Finance guidance notes, prepared under FAO's Blue Growth Initiative, include brochures on microfinance and insurance for small-scale fisheries and small-scale aquaculture producers, blue bonds, blended finance and impact investment. The brochures aim to provide governmental, non-governmental, private and public stakeholders with information, resources and concrete pathways for obtaining finance to support blue growth transitions at local, national, regional and global scales.

The Blue Finance Guidance Notes series includes:

- Microfinance for small-scale fisheries
- Blue bonds
- Insurance for small-scale fisheries
- Blended finance
- Aquaculture insurance for small-scale producers
- Impact investment

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