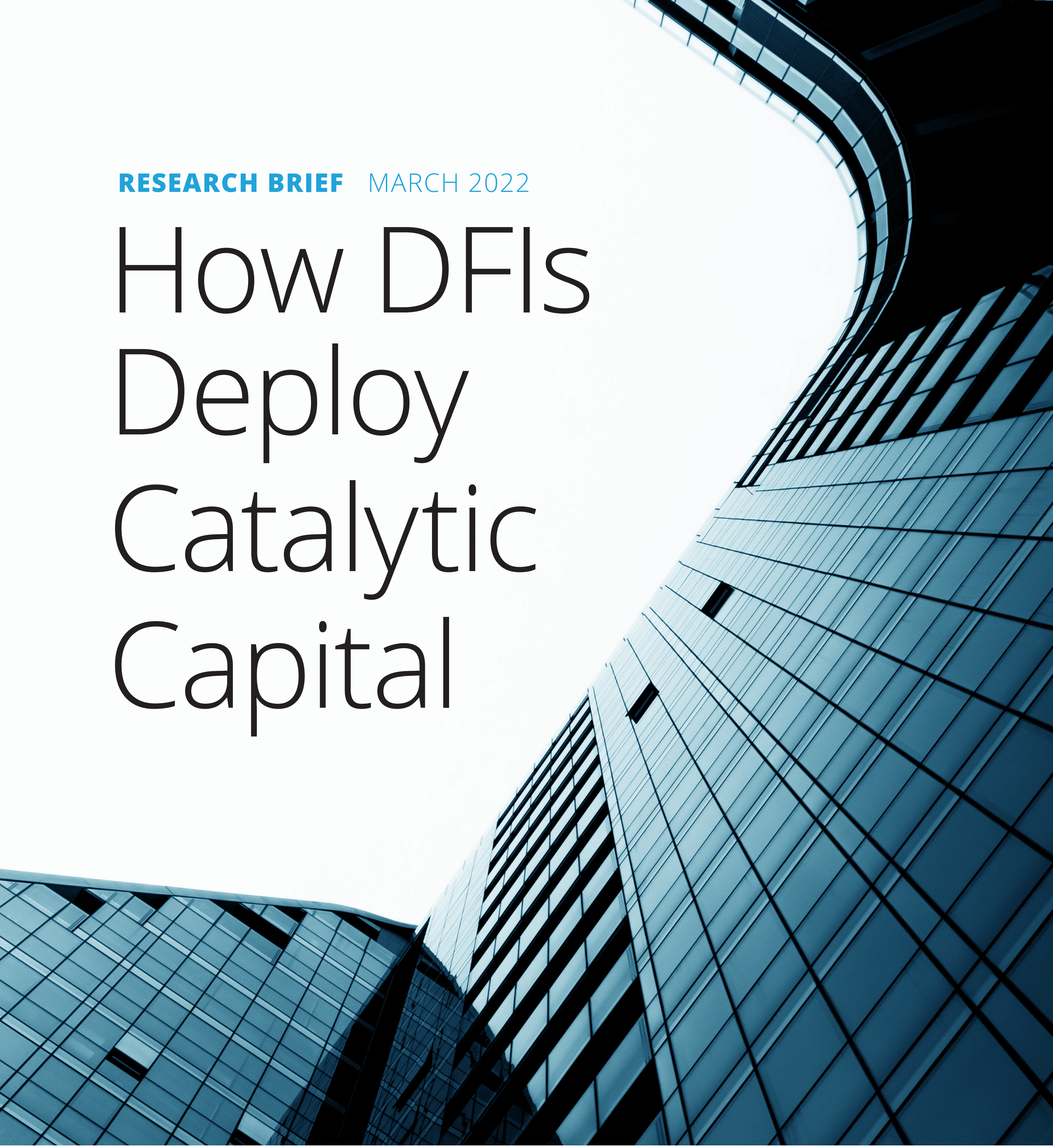
RESEARCH BRIEF MARCH 2022

How DFIs Deploy Catalytic Capital



Catalytic Capital Consortium

CONVERGENCE BLENDING GLOBAL FINANCE

Catalytic Capital Consortium (C3) and Convergence

The Catalytic Capital Consortium (C3) is excited to partner with Convergence on the development of this resource, which we hope will provide valuable information and insights to catalytic capital investors. Creating this research brief is one activity Convergence is undertaking as part of a grant awarded by the C3 Grantmaking Program. C3 is an investment, learning, and market development initiative to promote greater and more effective use of catalytic capital, in recognition of its essential role in realizing the full potential of the impact investing field and achieving the Sustainable Development Goals. Together, the C3 Strategic Partners—the Rockefeller Foundation, the Omidyar Network, and the MacArthur Foundation—are supporting field-building work through the C3 Grantmaking Program, housed at and managed by the New Venture Fund.

C3 Grantmaking works to advance learning and market development related to catalytic capital and helps to answer critical questions about the scope of the need for catalytic capital, when and how catalytic capital can be most effective, and what tools and practices are needed. It does this through activities aimed at strengthening the evidence base, advancing the practice in the field, communicating and facilitating engagement among investors, and fostering solutions and infrastructure. Learn more about the various C3 Grantmaking workstreams here.

In this Research Brief, Convergence aims to shed light on the important role that the development finance community, namely Development Finance Institutes (DFIs), play in deploying catalytic capital. DFIs have a long history making catalytic capital investments, namely through their blended finance activities, to create new commercial markets and leverage additional investors (as well as achieve other goals). Through examining the role of DFIs in blended finance, we hope this Brief offers further insights into the use of catalytic capital by DFIs to date, and opportunities for further catalytic investments.

Catalytic Capital Consortium

This Research Brief was made possible by the support of the Catalytic Capital Consortium.

Executive Summary

- Blended finance and catalytic capital have garnered significant uptake by a wide variety of investors in recent years, as donors and private investors alike look to drive impact, mobilize additional capital, and participate in higher-risk markets.

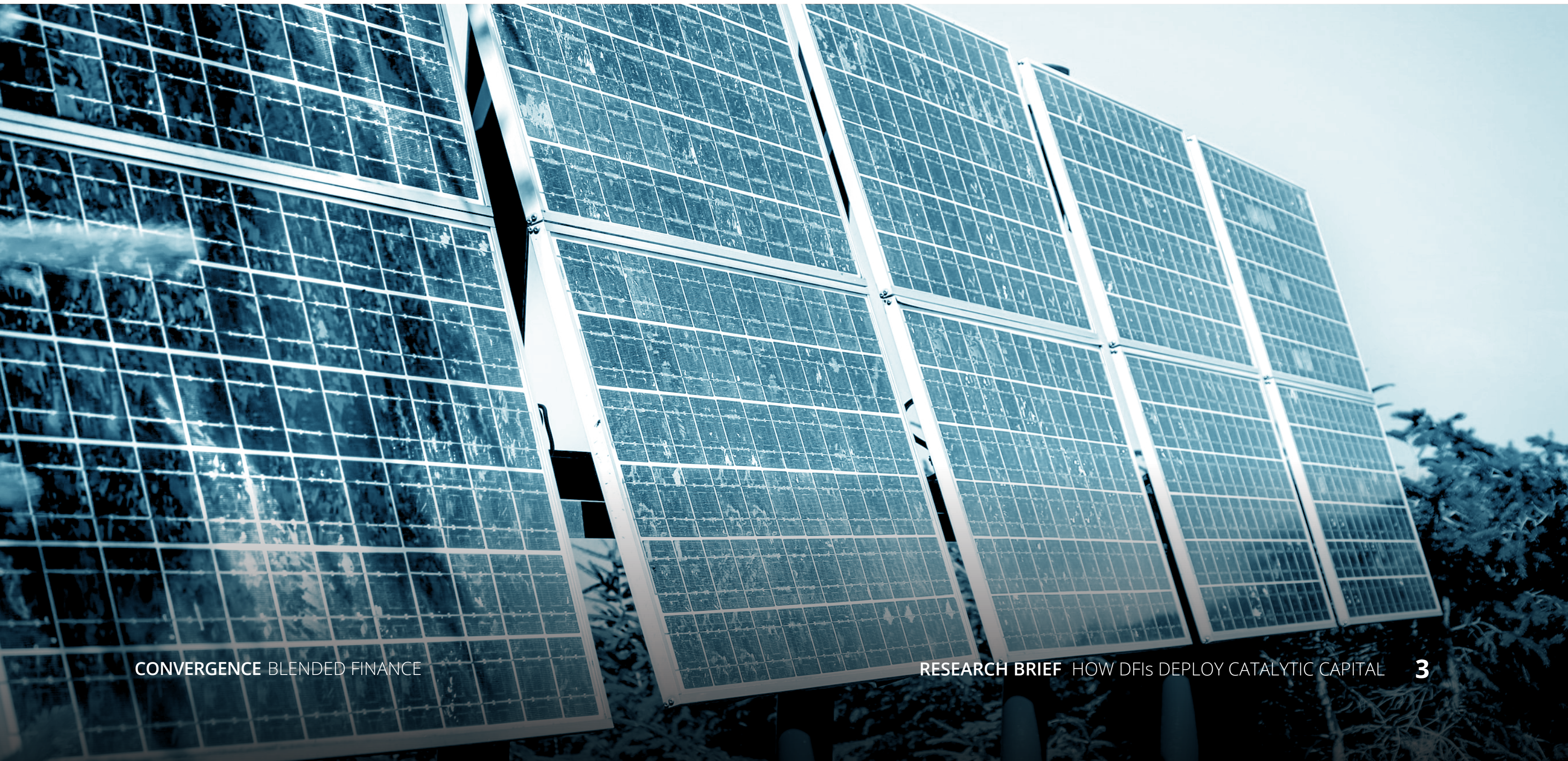
- While blended finance and catalytic capital are not the same, they are closely interlinked. Convergence defines blended finance as the use of catalytic capital to adjust the risk-return profile of investments to an acceptable level for private investors.

- DFIs are one investor group that has consistently incorporated blended finance into their portfolios. DFIs have invested in blended finance transactions both as providers of catalytic (concessionally priced) capital and commercial capital.

- This Brief seeks to understand how DFIs have deployed catalytic capital to date through examining their participation in blended finance transactions. Convergence finds that DFIs have been prominent investors in blended finance, with 75% of blended finance deals including participation from at least one DFI.

- While this Brief finds that DFIs have most commonly invested in blended finance transactions on commercial terms (75%), they nevertheless represent a significant source of catalytic capital, deploying $1.6 billion of concessional financing on average annually since 2015.

- This Brief is divided into five parts:
  - **Part I** will review DFI investment activity in the overall blended finance market.
  - **Part II** provides a deep dive of the deployment of catalytic capital by DFIs, drawing on Tideline's Pathways to Impact framework.
  - **Part III** provides an overview of the co-investors of DFIs in blended finance, including when DFIs are investing concessionally and commercially.
  - **Part IV** outlines the most active DFIs deploying catalytic capital to blended finance transactions and select programs.
  - **Part V** reflects on opportunities for DFIs to deploy greater volumes of catalytic capital going forward.



Introduction & Context

Bolstered by the launch of the global Sustainable Development Goals (SDGs) in 2015, there is growing recognition that new sources of financing will be required to address the world's most pressing social and environmental issues. In tandem, the sustainable investment landscape is growing as private investors increasingly seek investments that meet both financial objectives and non-financial objectives. These investment strategies include sustainable finance, environmental, social, and governance (ESG) investment, responsible investment, impact investment, blended finance, and catalytic capital. While different in mandate and scope, these investment strategies aim to achieve positive social, environmental, or developmental outcomes in addition to financial returns.

Catalytic capital is one approach that has garnered significant traction within the impact investing and philanthropic community over the past few years. Catalytic capital has also been an important instrument deployed by the development finance community, notably through their blended finance activities. Blended finance is defined as the strategic use of catalytic capital – defined here as concessional, risk-tolerant capital that is not otherwise available in the market – provided by development funders and philanthropic sources, to adjust the risk-return profile of investments to an acceptable level for private investors. Public development finance institutions (DFIs), including multilateral and bilateral DFIs are prominent players in the blended finance market; according to Convergence, 75% of blended finance deals include participation from at least one DFI. In an effort to better understand how DFIs engage in catalytic capital (including as investors and benefiters of catalytic capital), this Brief will examine the participation of DFIs in blended finance transactions to date, based on data captured by Convergence's Historical Deals Database (HDD).

Distinguishing Catalytic Capital & Blended Finance

Catalytic capital plays an essential role in blended finance. Private investors faced significant constraints to investing in the SDGs and developing countries, including barriers such as: i) high perceived and actual risk, ii) low returns for the risk, and iii) small investment sizes. Blended finance is a structuring approach which allows parties with different objectives to invest alongside each other. Public and philanthropic parties achieve their impact objectives, while private investors achieve their risk-adjusted return requirements.

Although catalytic capital and blended finance are closely interlinked, they are not the same. While all blended finance approaches use catalytic capital, not all uses of catalytic capital are considered blended finance. Convergence only considers a transaction blended when catalytic capital attracts private financing into the capital stack of the structure. Convergence captures the use of catalytic capital in blended finance based on four common archetypes: 1) concessional debt or equity, ii) concessionally-priced guarantees or risk insurance, iii) technical assistance funds, and iv) design-stage or preparation stage funding. It is important to note that the inclusion of grant capital within Convergence's definition of catalytic capital may differ from other organizations in the market – for example, C3 and Tideline consider only some limited cases of grants in their definition of catalytic capital. For this reason, transactions where the only concessional capital present in the structure is grant-based (i.e., archetypes iii. and iv.) have been excluded for the sake of this analysis. It is important to note that Convergence is only considering the use of catalytic capital when priced explicitly at below-market terms, which represents a subset of the uses of catalytic capital.

Background on DFIs

DFIs are critical sources of financing in developing countries and play an important role in blended finance. As specialized development banks, they are set up to support private sector development in developing countries. They are generally majority owned by one or more national governments and capitalized by national or international development funds. DFIs can therefore include both bilateral institutions (e.g., FMO), which serve to implement their government's foreign development and cooperation policy, and multilateral institutions (e.g., IFC), which are backed by multiple governments.

DFIs have played an increasingly crucial role in leveraging private financing to achieve the SDGs. While DFIs have significant financial resources (in 2017, bilateral DFIs managed over $65 billion in assets) they are also grappling with how to boost the amounts that they invest in low-income countries, and how to effectively mobilize private commercial capital rather than potentially crowd out investors. In this context, DFIs have viewed catalytic capital as a solution to increasing private sector mobilization. While DFIs remain critical development financiers, their focus on commercial lending rates and their relatively conservative risk profiles have served as barriers to their participation in riskier markets and sectors, where there is potential for greater development impact. This includes low-income and least developed countries (LDCs), as well as less commercially oriented sectors such as health and education. DFIs' risk aversion is partly due to the capital adequacy ratios required by their government shareholders, which mandate high amounts of reserved capital. Moreover, DFI risk appetite is constrained by their desire to maintain high credit ratings (many are triple A), which allow them to borrow at low interest rates in the global capital markets.

A note on DFIs & Catalytic Capital

Much of the general business operations of DFIs could be viewed as catalytic. DFI activity is guided by their mandate to be "additional" i.e., to participate in markets not adequately served by the private sector because of high risks or weak institutions. For example, historically most DFI private sector mobilization occurred through their activity in syndicated loan markets. Through their **preferred creditor status**, DFIs are granted preferential access to foreign currency in the event of a country foreign exchange crisis. As the lender of record, DFIs extend this status to their partners, including commercial banks, institutional investors, insurance companies, and other commercial co-lenders. **However, for the purposes of this research brief, we will only consider concessional DFI investments into blended finance transactions to be examples of catalytic capital.**

DFIs generally participate in blended finance in two ways:

1 Catalytic capital providers

Concessional finance deployed by DFIs is generally sourced from specific pools of capital provided by their government shareholders (in the form of Official Development Assistance, commonly abbreviated to ODA), which require less of a return on the market or no return at all. DFIs use these concessional funds to blend with their ordinary capital (together, referred to by DFIs as "blended concessional finance"), to invest on below market terms to reach companies and projects they might otherwise not support given their commercial mandate. In line with their reporting requirements by shareholder governments, DFIs record these blended concessional finance activities annually (see the DFI Working Group on Blended Concessional Finance Joint Report here).

2 Commercial Investors

Most (75%) DFI commitments into blended finance transactions are made on commercial terms. In these cases, the catalytic capital that makes the transaction blended comes directly from other parties, including development agencies or philanthropic foundations, and they are the ones catalyzing DFIs and private investors. While DFIs largely report their blended finance activities only when they are providing the blend, Convergence also captures this second scenario, where the catalytic money comes in independently. Based on Convergence's data, the DFIs' approach to reporting leads to a significant undercount of DFI involvement in blended finance. This is particularly true for the blended finance market in 2018 and 2019; the number of blended transactions in which DFIs are present in all forms is almost double the number of transactions where DFIs provide the blend (see Figure 3 below).

The DFI community has taken steps in elucidating how blended finance fits into their strategy, including the formation of the DFI Working Group on Blended Concessional Finance in 2017. In 2020, the DFIs established the DFI Enhanced Blended Concessional Finance Principles for Private Sector Projects as follows:

Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations

1. **Rationale for Using Blended Concessional Finance:** Blended concessional finance should address market failures and should crowd in the private sector.

2. **Crowding-In and Minimum Concessionality:** DFI support for the private sector should catalyze market development and the mobilization of the private sector, and minimize the use of concessional resources.

3. **Commercial Sustainability:** DFI support should aim to be sustainable, and levels of concessionality should be revisited over time.

4. **Reinforcing Markets:** DFI support for the private sector should be structured to minimize the risk of distorting markets.

5. **Promoting High Standards:** DFI private sector operations should promote high standards, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity, and disclosure.

Methodology

Convergence's database: Convergence maintains the largest and most detailed database of blended finance transactions that have reached financial close. Given the current state of information-sharing, it is not possible for this database to be fully comprehensive. We have made efforts to capture all relevant blended finance transactions; however, there are likely more transactions that have not been captured.

Scope of available data: This Brief is based on 1538 investments provided by DFIs to 467 transactions captured in Convergence's Historical Deals Database (HDD). Data is captured using i) credible public sources like press releases, ii) data sharing agreements, and iii) validation exercises with Convergence members. The majority of transactions (>90%) are captured based on publicly available information.

Key definitions used in this report:

Blended Finance: Convergence defines blended finance as the strategic use of catalytic capital provided by development funders and philanthropic sources, to adjust the risk-return profile of investments to an acceptable level for private investors.

Blended Concessional Finance: The specific definition of blended concessional finance for the private sector operations of DFIs, adopted by the DFI Working Group on Blended Concessional Finance for Private Sector Projects is: "Combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the SDGs, and mobilize private resources".

Catalytic Capital: As defined by Tideline, catalytic capital accepts disproportionate risk and / or concessionary returns to generate positive impact and enable third-party investment that would otherwise not be possible. Using Tideline's "five P's" of catalytic capital, Convergence has mapped concessional capital provided by DFIs to blended finance transactions according to the following forms: i) price, ii) pledge, iii) position, iv) patience, and v) purpose. Additionally, Convergence has also applied Tideline's "uses" of catalytic capital to DFI investment activity in blended finance, including along the following dimensions: i) facilitating innovation, ii) helping build track record, iii) leveraging additional investment, and iv) signaling impact potential. See Part II for further analysis.

Note: Convergence has not included the fifth use described by Tideline, "safeguarding mission", in this analysis as it is more applicable to other forms of catalytic capital separate from blended finance.

Scope of Transactions: Due to the lack of publicly available data on investments into blended finance transactions, Convergence is only considering the use of catalytic capital when priced explicitly at below-market (concessional) terms, which represents a subset of the uses of catalytic capital. This is to ensure a systematic review and is consistent with our inclusion criteria for the HDD. Convergence captures the use of catalytic capital in blended finance structures according to four common uses: i) concessional debt or equity in the capital stack (including first-loss or subordinate debt or equity, without the expectation of commensurate returns), ii) guarantees or risk insurance (e.g., credit-enhancement), iii) technical assistance funds (including for pre- or post-investment support), and iv) early-stage design or preparation grants.

For the purposes of this research brief and to align with the C3 definition of catalytic capital, transactions where the only concessional capital present in the structure is grant-based (archetypes iii. and iv.) have been excluded from this analysis. In addition, Convergence recognizes that DFIs may deploy catalytic capital in ways that extend beyond our explicitly price-based definition of concessional capital, and therefore may be missing from this analysis. Similarly, DFIs can also deploy catalytic capital to transactions that are not blended finance, however this is beyond the scope of this Brief.

Scope of Institutions: This analysis considers both bilateral DFIs (e.g., FMO) and multilateral DFIs (e.g., IFC). In addition, bilateral and multilateral funds that are managed by DFIs for blended finance activities (e.g., Climate Investment Funds) are also included in this analysis.

Part I: DFI Activity in the Overall Blended Finance Market

This Brief seeks to understand how DFIs have participated in catalytic capital, based on their participation in the blended finance market to date. According to Convergence's database, 75% of blended finance deals contain participation from at least one DFI, representing 467 recorded deals in total. DFIs have consistently played a major role in blended finance, participating in more than 70% of deals annually, on average, for the past 5 years. Blended finance deals with participation from DFIs represent approximately $125 billion in total deal flow over that period, accounting for 80% of total financing as captured by Convergence's database.

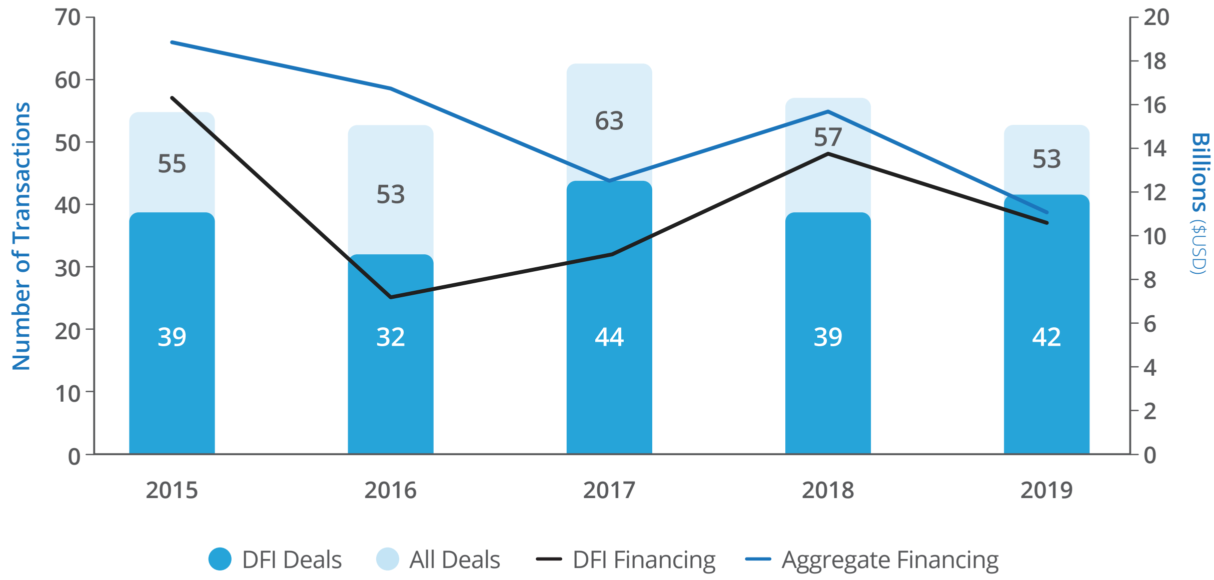
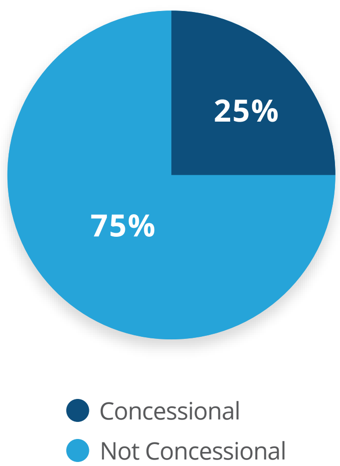


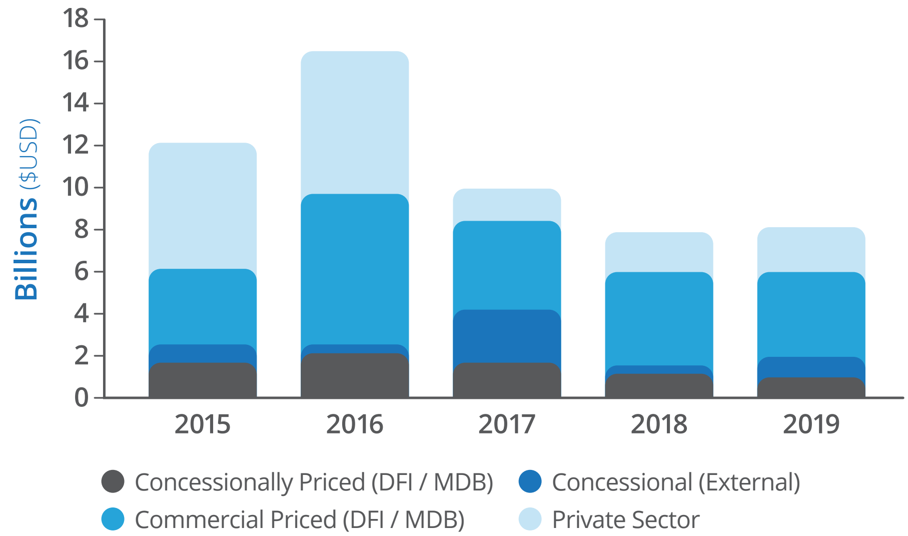
Figure 1: DFI financing in the overall blended finance market

Part II: Revewing Mobilization and Catalytic Commitment Trends

Proportion of Investments on Concessional Terms from DFI / MDBs



Sources of Capital into Blended Finance



Figures 2 and 3: Blended Finance Commitments by Concessionality and Source

One quarter of investments from DFIs in blended finance transactions are using catalytic capital

A quarter (25%) of DFI investments in blended finance deals use catalytic capital; the majority of investments are considered to be provided at near or at market-rate terms. At the same time, given the prominence of DFIs in blended finance, data captured by Convergence demonstrates that concessional capital commitments provided by DFIs to blended finance transactions have constituted a significant amount of financing over the past five years, averaging $1.6 billion per year. Convergence's State of Blended Finance finds that DFIs are consistently the greatest provider of concessional financing to blended finance transactions – between 2018 - 2020, DFIs provided 38% of all concessional commitments to blended finance transactions, representing the greatest source of concessional capital amongst all investors.

In addition to concessional financing, DFIs also routinely invest commercial capital into blended finance transactions; DFIs have provided on average, $4 billion from their own ordinary financing to blended finance transactions annually. However, relative volumes of financing coming from the private sector, including financial institutions, corporates, asset managers, and pension funds, remain small compared to other sources; 25% of aggregate financing was provided on average from the private sector, while commercial financing from DFIs comprised 36% of investments (with the balance provided by other concessional funders). Earlier analysis by Convergence found that in a typical blended finance fund, one dollar of concessional capital leverages four dollars of commercial capital, of which three of those four dollars are invested by DFIs. True private sector financing therefore remains a small overall proportion of commercial financing to blended finance transactions relative to other contributions.

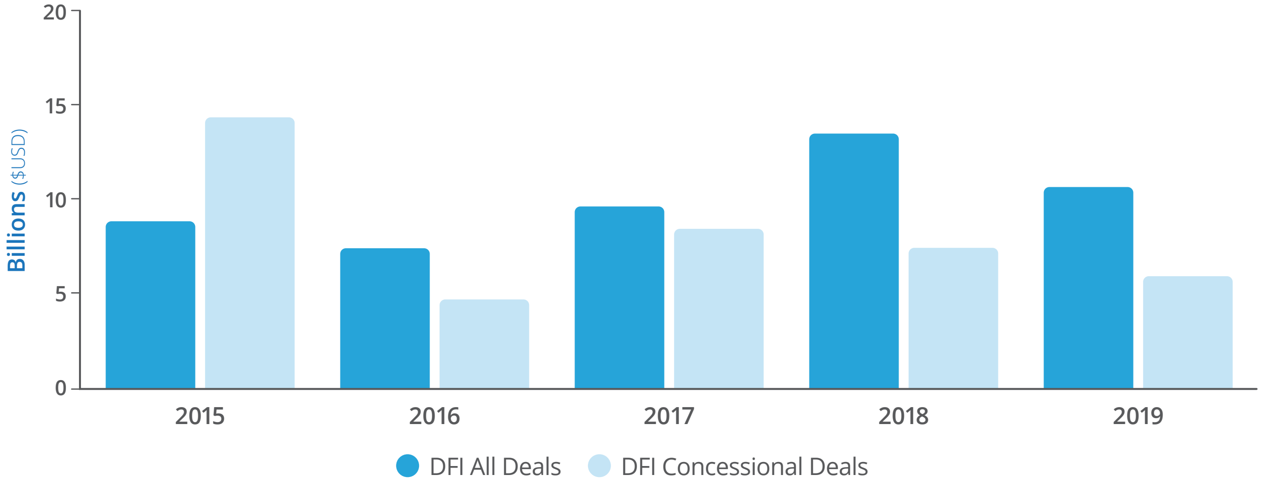


Figure 4: Aggregate Financing Volumes of Blended Finance Transactions with DFI participation

As mentioned previously, Convergence's data departs from other sources (such as the DFI Joint Report) in that it captures the investment activity of DFIs into blended finance transactions both when participating as providers of catalytic capital as well as commercial investors. Based on Convergence's data, DFIs are more active in blended finance than what they disclosed based on their concessional activities. This is particularly true for the blended finance market in 2018 and 2019; the market size (i.e., financing volumes) for blended activities with DFIs is almost double what the size would be if only transactions where DFIs are on concessional terms were considered.

DFIs play an important role in blended finance transactions when investing at terms near-market. This includes: i) investing in new markets, including in new sectors or new regions, ii) originating deal pipeline, iii) acting as the first-in commercial investors, and iii) signalling credibility of deals to other co-investors. As an example of this activity, the box below explores a program run by IFC, which does not always constitute blended concessional finance, but can be understood as catalytic capital according to the Tideline definition due to the assumption of disproportionate risk.

IFC Scaling Solar Programme

Source: Scaling Solar

CHALLENGE: Solar power has huge potential as an energy source in emerging markets. However, many countries have struggled to develop utility scale solar power plants due to challenges including i) limited institutional capacity, ii) lack of scale, iii) lack of competition, iv) high transactions costs, and v) high perceived risks.

SOLUTION: In 2015, IFC launched the Scaling Solar Programme to promote fast transaction development of the solar market in Africa. The Programme is designed to serve as a one stop shop, and includes the provision of capacity building, tendering, financing and insurance, and credit enhancement, with the overall goal of creating a viable market for solar power in each target country. See the 5-step process below.

IMPACT: Since its inception, seven countries in Sub-Saharan Africa and South Asia have signed up for the Programme. It has achieved reductions in the tariffs and timeline of solar projects and mobilized new investors into the African market. Successful programs include the Kael and Kahone solar plants in Senegal, which became operational in May 2021, in partnership with USAID's Power Africa, the Government of the Netherlands, the Rockefeller Foundation, and DevCo. To date, Scaling Solar has enabled Senegal to provide 56.5% of the population with access to electricity.

6 Months	1 Project Preparation	• Technical and economy analysis for optimal size and location of PV plants	• Site Investigation • Legal & Regulatory analysis
	2 Bid Preparation	• Localization of standard tender documents • Localization of standard project documents • Attachment of stapled financing, insurance and credit enhancement	
	3 Tender Process & Award	• Request for qualification • Bidder consultation • Request for proposals	• Proposal review and award • Signing of project documents
6 Months	4 Financial Close	• Finalization of equipment, construction and operation contracts	• Final project approvals • Finalization of loan agreements, insurance and risk management
12 Months	5 Construction & Operation	• Construction • Commissioning • Operation	

How DFIs Deploy Catalytic Capital

Senior debt is the most common catalytic investment instrument for DFIs

DFIs have deployed a diverse range of instruments – including debt, equity, and guarantees – to blended finance transactions. To date, DFIs have most often deployed catalytic capital using senior debt (37% of investments), which follows similar market reports (for example, the 2020 DFI Joint Report states that DFIs most commonly participate in blended concessional finance using senior debt, representing 46% of commitments). The tendency for DFIs to participate in a senior position reflects the relatively conservative risk tolerance of public DFIs compared to other concessional funders. However, senior debt can still be concessional if accepting reduced-market terms. In addition, DFIs have also commonly used equity (26% of investments), and subordinate debt. Only a small proportion of investments provided by DFIs have participated in the most catalytic layer of a blended finance structure, using first-loss debt or equity (under 5% of commitments).

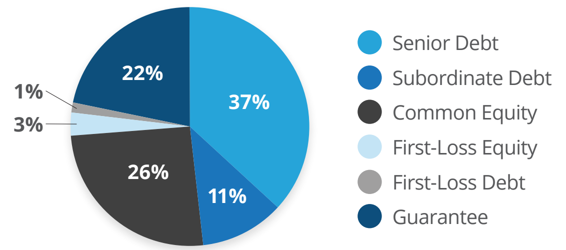


Figure 5: Investment Instruments Used by DFIs

DFIs most frequently participate in catalytic capital by using concessional pricing

According to Tideline, catalytic capital can take the following forms: Price (accepting below-market returns), Pledge (credit-enhancement via a guarantee), Position (investing in the subordinate or first-loss tranche), Patience (accepting longer or uncertain time period), and Purpose (non-traditional terms, smaller investment sizes). Applying this framing to catalytic capital captured by Convergence, our analysis finds that DFIs are most likely to deploy catalytic capital using concessional pricing (43% of transactions). It is important to note that catalytic capital may take on multiple forms at once (e.g., catalytic capital could be both in a junior position and accept below-market returns). In addition, 22% of catalytic capital deployed by DFIs sit in a junior position (e.g., subordinate or first-loss tranche), while 19% of catalytic capital investments are in the form of guarantees. In select cases, DFIs may also make other concessions, including extending capital at longer tenors (6% of cases), or participate in smaller deals (5% of investments have been into deals <$20 million) where transaction costs are higher, in order to support ice-breaker transactions or innovative financial models[1].

[1] Note, we have included the use of design-stage grants when considering the "innovation" category in Figure 7, given the nature of transactions supported.

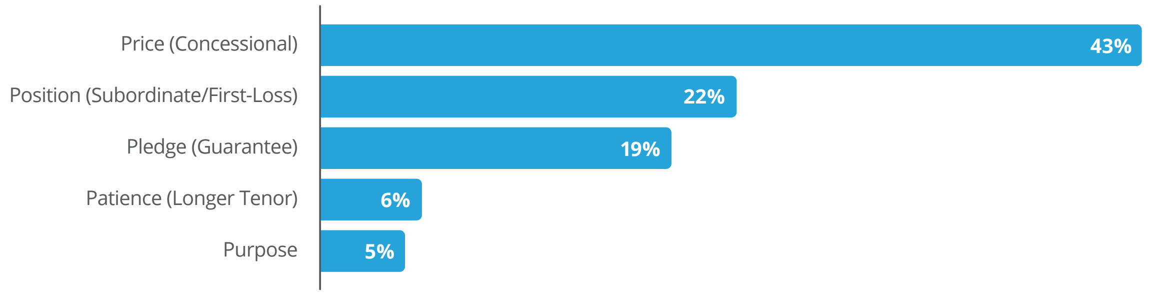


Figure 6: Proportion of catalytic capital provided by DFIs according to Tideline's "five P's"

DFIs use catalytic capital for two main uses: build a track record and leverage additional investments

Tideline also categorizes catalytic capital for the following uses: i) facilitating innovation (e.g., experimentation of new solutions), ii) helping build a track record (establish proof of concept, developing new markets), iii) leveraging additional investment (by reducing risk for other investors), and iv) signaling impact potential (e.g., by serving as a first-in anchor investor). Applying these categories to data captured by Convergence, DFIs have most commonly used catalytic capital to build a track record and build markets (46% of investments), which follows closely with their mandate – as outlined by the enhanced blended concessional finance principles – to "reinforce markets". DFIs have also frequently participated in a deal in order to leverage additional investors, which also aligns with the purpose of blended concessional finance to "crowd in" additional investments. DFIs have less frequently participated as anchor funders in transactions (8% of investments), and rarely have provided catalytic capital to promote innovation (5% of investments). Given the significant cost and time associated with launching truly innovative financial structures, DFIs tend to deploy capital mainly to vehicles which can promote scale and replication. As a result, acceleration programs that foster innovation for new business models have traditionally been funded by philanthropic organizations (e.g., Rockefeller's Zero Gap Portfolio), or development agencies (e.g., USAID's Development Innovation Ventures).

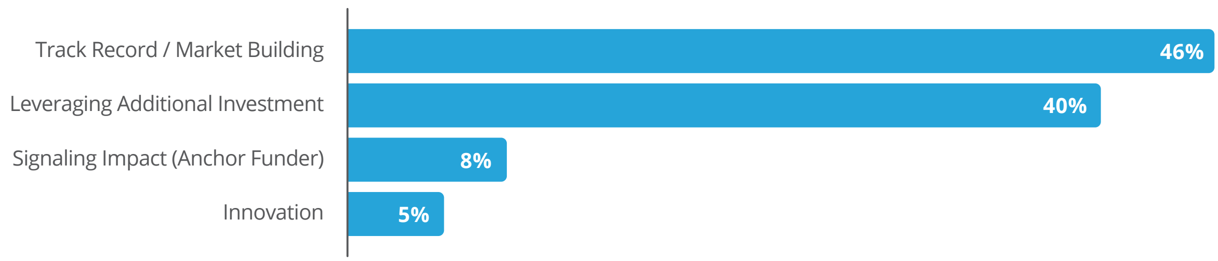


Figure 7: Proportion of catalytic capital provided by DFIs according to Tideline's defined uses

DFIs are more likely to deploy capital on concessional terms to low-income countries

According to Convergence's data, the largest concentration (56%) of DFI capital has been deployed towards blended finance transactions targeting lower-middle income countries, in line with overarching trends for the blended finance market. While DFIs have also funded transactions in low-income countries and fragile states (28% of transactions), traditional forms of aid (i.e., ODA) and philanthropy have been the dominant forms of financial support in these countries. This trend is also reflected in aggregate financing volumes in deals with participation from DFIs; $56 billion has been provided in aggregate financing to middle-income countries, compared to $22 billion towards lower-income countries. Encouragingly, DFIs have been most likely to provide catalytic capital when funding transactions in lower-income countries; 73% of transactions targeting lower-income countries, including low-income and lower-middle income countries, include a DFI participating on concessional terms. In contrast, 60% of upper-middle income countries have included participation from DFIs on concessional terms.

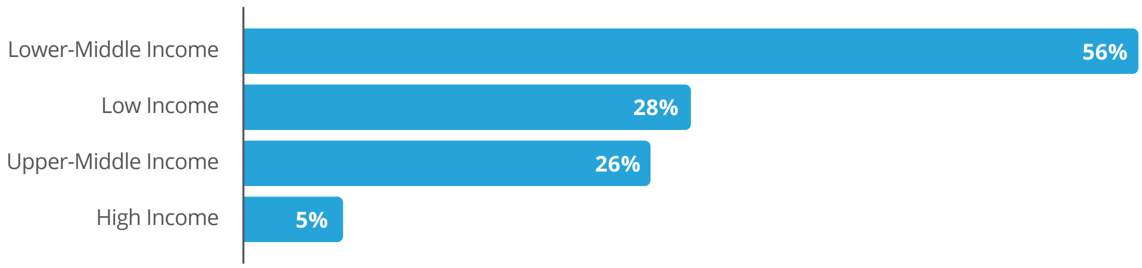


Figure 8: Proportion of blended finance transactions with participation from DFIs, according to country income-levels

Nevertheless, the imperative to support poor and fragile country contexts has led DFIs to develop more targeted strategies to create impact. This includes the development of specific programs to promote private sector growth in fragile contexts. Examples include the International Development Association (IDA) Private Sector Window, which focuses on supporting private sector development in the world's poorest countries through four facilities: the Blended Finance Facility, the Local Currency Facility, the Risk-Mitigation Facility, and the MIGA Guarantee Facility. IFC has established a target to increase its annual share of commitments in IDA countries—largely low- and lower middle-income countries—from about 25% today to 40% by 2030, and increase its share in low-income and fragile countries from about 10% to 15 to 20% over the same period. Other examples include the FMO MASSIF facility, which focuses on the unbanked in least financially penetrated and fragile countries, and the IFC Global Agriculture Food Security Program (GAFSP) Private Sector Window, which uses blended finance to improve the livelihoods of smallholder farmers living in the world's poorest countries.

Case Study on Global Agriculture and Food Security Program Private Sector Window Project: Helping Afghanistan Regain its World-Class Raisin Export Industry

Source: Adapted from GAFSP Project Description, accessible here.

CHALLENGE: For many decades, Afghanistan claimed about 20% of the global market for raisins. But years of conflict and political instability contributed to a decline in production volumes and quality, and today less than 40% of Afghan raisins are exported. These are traded at deep discounts compared with those from neighboring countries because they fall short of international quality and food safety standards.

SOLUTION: The Rikweda Fruit Processing Company aims to help Afghanistan reclaim its status as a world-class raisin producer and exporter. With support from GAFSP and IFC, Rikweda has built a greenfield raisin processing plant with a production capacity of 15,000 tons per annum. IFC will invest $3 million in financing to support the project, while GAFSP has provided a first-loss guarantee of up to $1.25 million. The project will create a market for high-quality, locally processed Afghan raisins and is expected to double Afghanistan's raisin processing capacity as well as link the country's raisin supply chain to global markets.

RESULTS: The project has the potential to improve livelihoods for approximately 3,000 smallholder farmers in remote rural areas by strengthening their access to the market. The new raisin processing plant will create a total of 50 full time jobs, of which 35 will likely be held by women.

DFIs deploy catalytic capital to support economic growth and climate finance

Convergence captures blended finance transactions based on their alignment to the SDGs. DFIs have most frequently invested catalytic capital in blended finance transactions supporting economic growth; nearly 78% of investments are aligned with Goal 8: Decent Work and Economic Growth, followed by 75% of investments aligned with Goal 9: Industry, Innovation, & Infrastructure. This is reflected in the large number of transactions in the financial services and infrastructure sectors. In addition, DFIs have also concentrated much of their catalytic capital on climate finance, particularly renewable energy; this includes SDGs aligned with Goal 7 (Affordable & Clean Energy), Goal 11 (Sustainable Cities), and Goal 13 (Climate Action). These results reflect findings from the 2020 DFI Joint Blended Finance Report, which purports that DFIs channeled the most amount of blended concessional finance into climate finance, including climate related infrastructure projects as well as climate banking and finance. Indeed, a large number of catalytic programs housed by DFIs target climate finance including: the IFC-Canada Climate Change Program (IFC-CCP), IDB Canadian Climate Fund (C2F), and the multi-donor Climate Investment Funds. In addition, 26% of catalytic capital used by DFIs has targeted SDG 5 (Gender Equality). Specific catalytic programs leveraged by DFIs to boost gender equality include the IFC Women Entrepreneurs Finance Initiative (We-Fi). Here, IFC uses We-Fi funds, including concessional loans, risk-sharing facilities and guarantees, and performance incentives, to support financial intermediaries invest in more women entrepreneurs and grow their women-led small and medium enterprises (WSME) lending portfolios.

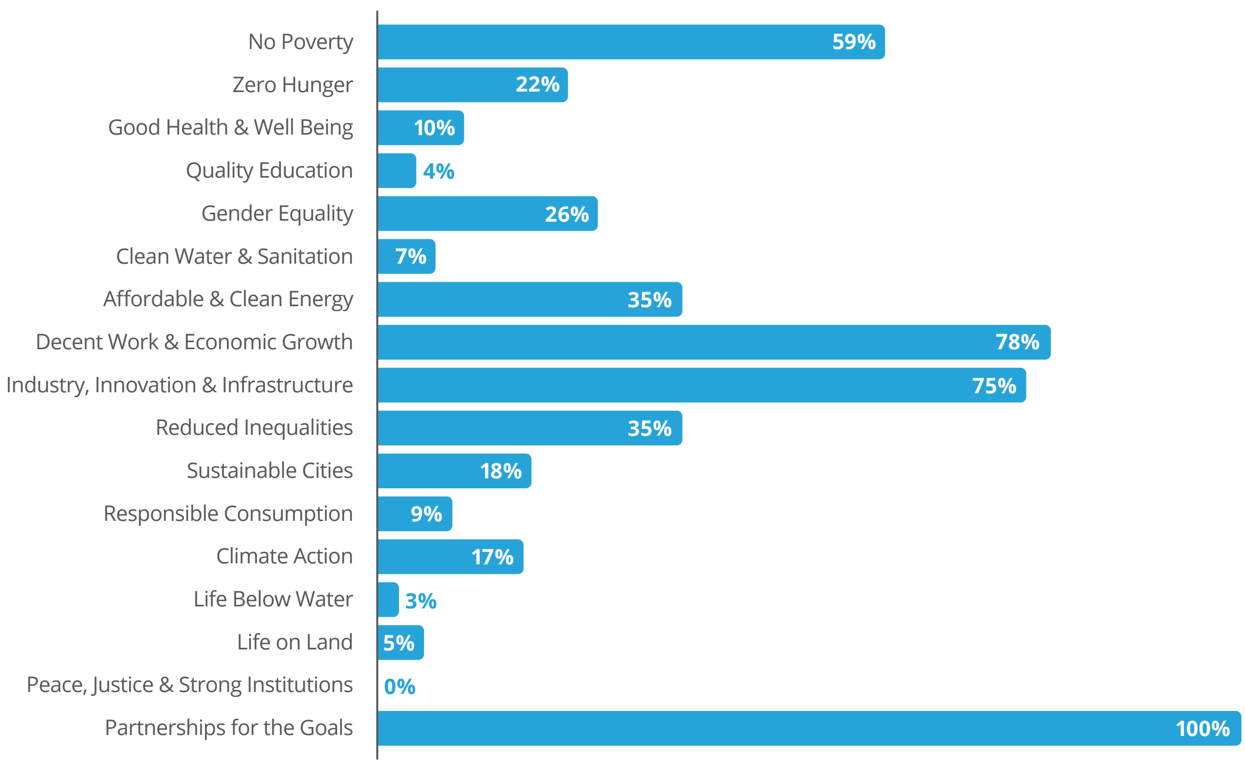


Figure 9: Proportion of blended finance transactions with participation by DFIs aligned with each SDG

Part III: Co-Funders of DFIs in Blended Finance

DFIs catalyze private investors and other DFIs

As stated earlier, approximately a quarter of commitments from DFIs use catalytic capital. Unsurprisingly, the majority (51%) of catalyzed investors in these transactions are private investors, including both traditional commercial investors (e.g., commercial banks), as well as impact investors (e.g., investors seeking both impact and financial returns). This makes sense, given that DFIs use blended concessional finance in part as a strategy to mobilize additional private investors, in addition to reducing their own risk. It is important to note that DFIs often work alongside other catalytic capital providers to mobilize investors; 40% of transactions include DFIs providing catalytic capital alongside development agencies, and 20% of cases include DFIs alongside foundations. As an example of these types of partnerships, IFC and the Rockefeller Foundation recently announced a catalytic partnership to increase renewable energy solutions in emerging markets using blended finance. The Rockefeller Foundation will deploy up to $150 million in catalytic capital to mobilize $2 billion in private sector finance, with both institutions initially contributing $30 million to initial projects identified by IFC.

Our analysis shows that DFIs also catalyze other DFIs (43% of catalyzed investors). How this is determined and the true additionality of this is beyond the scope of our analysis.

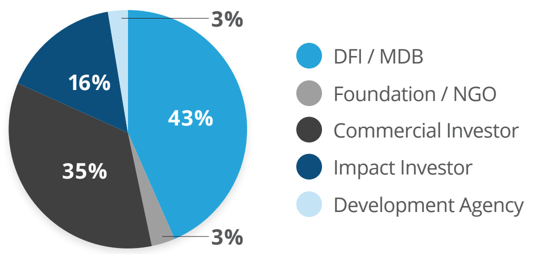


Figure 10: Catalyzed investors of DFIs

Development agencies and philanthropic organizations catalyze DFIs

When participating as commercial co-investors, DFIs benefit from concessional capital provided by two sources: development agencies (providing 52% of catalytic investments in deals where DFIs are commercial) and philanthropic foundations (providing 38% of catalytic investments). Donor agencies and foundations have a long history of supporting development efforts, including through government (ODA) and philanthropic grants. In recent years, we have seen both types of institutions expand their activities to support blended finance in the form of catalytic investment capital. In 2017, the Organisation for Economic Development and Coordination's (OECD) Development Assistance Committee (DAC) members adopted the OECD Blended Finance Principles, a tool for providers of development funding to increase financing for development. Blended finance also builds on the 'leave no one behind' agenda and principles on aid effectiveness. Meanwhile, foundations are uniquely positioned to participate in blended finance because of their i) aptitude for flexible financing, ii) long-term vision for achieving impact, and iii) focus on using endowed resources to generate big change. Indeed, both donor governments and foundations have tended to participate in blended finance transactions using risk-taking capital. Consider the following: 24% of investments by development agencies are in the form of first-loss capital, while 20% are taking a subordinate position, with the balance of investments comprised primarily of grant capital. Similarly, foundations have increasingly deployed investment capital such as concessional debt (28% of transactions) or concessional equity (35% of investments).

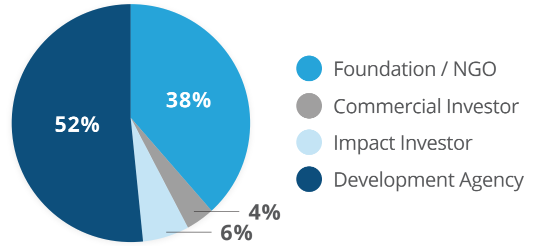


Figure 11: Catalyzers of DFIs

Part IV: Top DFIs and Examples of Catalytic Capital Programs

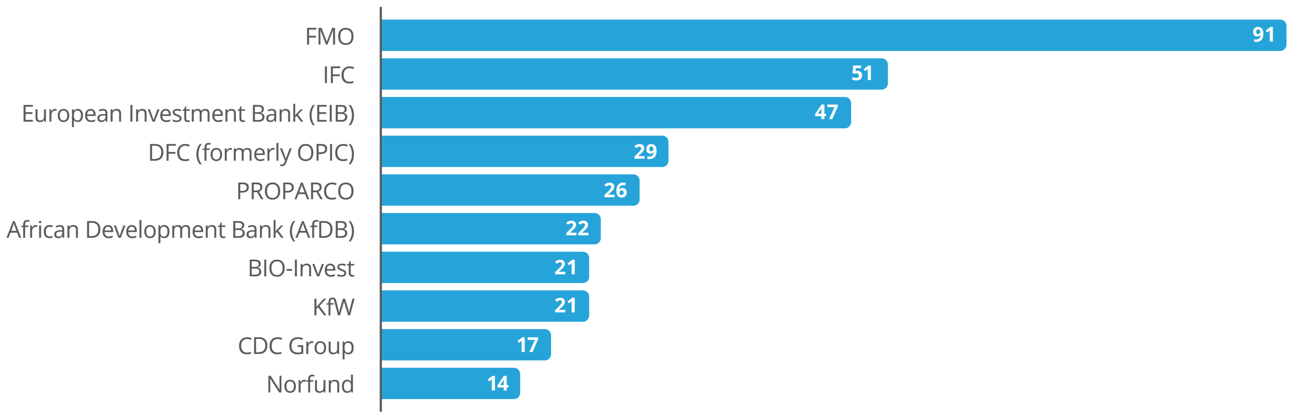


Figure 12: Most active DFIs in blended finance according to their catalytic capital commitments

IFC and FMO are the most active DFIs in blended finance

Here, Convergence captures the most active DFIs based on the number of their catalytic capital commitments to blended finance transactions. To date, FMO and IFC have led the field; collectively, these two DFIs have placed catalytic capital into blended finance transactions almost as frequently as the following eight most active DFIs combined. Other active DFIs in the blended finance market include the European Investment Bank (EIB), the US International Development Finance Corporation (DFC), PROPARCO, African Development Bank (AfDB), KfW, CDC Group, Asian Development Bank (ABD), and IDB Invest. The section below outlines the specific catalytic capital programs leveraged by DFIs.

DFIs frequently deploy catalytic capital using concessional contributions from their shareholders (donor governments). These programs are diverse in mandate and thematic scope; some are focused on specific sectors (e.g., climate finance), while others might focus on certain geographies (e.g., fragile and conflict-affected states) or types of businesses (e.g., SME finance). The above figure looks at the most common concessional capital programs through which DFIs deploy catalytic capital to blended finance transactions. These programs include both bilateral (e.g., MASSIF) and multilateral funds (e.g., Climate Investment Funds), and extend support through a broad array of instruments including grants, debt, equity, and performance incentives. The most frequent programs include: FMO's MASSIF Fund, the IDA Private Sector Window and the IDB's Canadian Climate Fund for the Americas Program. The next section will provide greater details on each program.

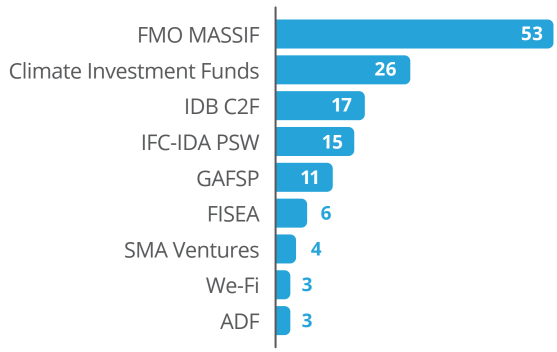


Figure 13: Most common sources of concessional capital used by DFIs in blended finance

Breakdown of Select DFI Catalytic Capital Programs

DFI: INTERNATIONAL FINANCE CORPORATION

INSTRUMENTS: Blended finance solutions at IFC can be structured as debt, equity, risk-sharing, or guarantee products with different rates, tenor, security, or rank. Under select facilities, they can also be performance-based incentive structures. Concessional funds are structured as co-investments, with an expectation of reflows for future investments or other uses.

EXAMPLE OF CATALYTIC PROGRAMS:

IDA PSW (18 AND 19): A $2.5 billion facility established to catalyze private sector investments in IDA-only countries, with a focus on fragile and conflict-afflicted states. IDA PSW consists of three IFC-managed facilities- the Blended Finance Facility, the Local Currency Facility, and the Risk-Mitigation Facility – as well as the MIGA Guarantee Facility (MGF).

IFC-CANADA CLIMATE CHANGE PROGRAM: IFC-CCP was established as a partnership between the Government of Canada and IFC to promote private sector financing for clean energy and climate adaptation projects to catalyze investments in low-carbon technologies. The investment period for the IFC-Canada Climate Change Program ended in 2018, and has since grown to include two newer programs: the Canada-IFC Blended Climate Finance Program, and the Canada-IFC Renewable Energy Program for Africa.

IFC SME VENTURES PROGRAM: SME Ventures provides risk capital, including equity, loans, and quasi-loans, with some technical assistance, to entrepreneurs and fund managers in the world's most challenging markets.

THE GLOBAL AGRICULTURE AND FOOD SECURITY PROGRAM (GASFP): targets agricultural projects in low-income countries.

WOMEN ENTREPRENEURS FINANCE FACILITY (WE-FI): a multi-donor collaborative partnership that aims to unlock financing for women and women-led businesses, including in fragile and low-income markets. IFC uses We-Fi funds, including concessional loans, risk-sharing facilities and guarantees, and performance incentives, to support financial intermediaries develop solutions tailored to women entrepreneurs and grow their WSME lending portfolios.

IFC-ROCKEFELLER BLENDED FINANCE PARTNERSHIP FOR RENEWABLE ENERGY: In June 2021, IFC and the Rockefeller Foundation jointly announced a catalytic partnership to increase renewable energy solutions in emerging markets using blended finance. The Rockefeller Foundation will deploy up to $150 million in catalytic capital to mobilize $2 billion in private sector finance, with both institutions initially contributing $30 million to initial projects identified by IFC.

DFI: IDB INVEST

INSTRUMENTS: Debt, Equity, Guarantees

EXAMPLE OF CONCESSIONAL PROGRAM: IDB CANADIAN CLIMATE FUND (C2F)

C2F seeks to catalyze greater investment in climate change mitigation and adaptation projects in Latin America and the Caribbean by providing concessional financing to projects in the poorest and most vulnerable countries. The total funding for C2F I and C2F II are CAD$250 and CAD$223.5 million, respectively, both funded by the Government of Canada. In its second phase (C2F II), the fund seeks to invest in projects that enable environmentally sustainable technologies and practices in all sectors, with a special focus on empowerment of women and vulnerable groups.

DFI: FMO

INSTRUMENTS: MASSIF can invest using a wide range of products, including, but not limited to, direct equity, private equity fund investments, guarantees, mezzanine products, loans, convertible loans, and convertible grants. In addition, funding for capacity development is available to MASSIF clients, to increase clients' non-financial additionality.

EXAMPLE OF CONCESSIONAL PROGRAM: MASSIF

Managed by FMO on behalf of the Dutch government, the MASSIF Fund was created as a revolving fund to strengthen financial sectors and promote micro, small and medium sized enterprises (MSMEs) in developing countries.
Since 2017, MASSIF investments fall along four themes: i) the unbanked, including MSMEs in fragile countries, ii) agriculture and rural livelihoods, iii) WSMEs (women-owned businesses and youth entrepreneurs),
iv) and innovations in inclusive business.

DFI: AFRICAN DEVELOPMENT BANK (AFDB)

INSTRUMENTS: Debt, Technical Assistance, Credit-Enhancement

EXAMPLE OF CONCESSIONAL PROGRAM: AFRICAN DEVELOPMENT FUND (ADF)

The African Development Fund (ADF) is the concessional window of the African Development Bank (AfDB) Group. The ADF contributes to poverty reduction and economic and social development in the least developed African countries by providing concessional funding for projects and programs, as well as technical assistance for studies and capacity-building activities. The Fund has cumulatively invested UA 29.4 billion (USD 45 billion) over its 44 years of operationalization on the African continent.

DFI: PROPARCO

INSTRUMENTS: Equity (including pre-seed or seed capital), technical assistance

EXAMPLE OF CONCESSIONAL PROGRAM: INVESTMENT AND SUPPORT FUND FOR BUSINESSES IN AFRICA (FISEA) AND FISEA+

FISEA was set up by AFD (Agence Francaise de Developpement) in 2009 and advised by PROPARCO to promote economic growth and support start-ups and MSMEs on the Africa continent. The initial capacity (EUR 250M) of FISEA was deployed in 2019. Since then, the agency has set up a new facility, FISEA+, in 2021 under the Choose Africa initiative. FISEA+ has a capacity of EUR 210M and a technical assistance budget of EUR 21M. FISEA+ may invest a limited amount of funds with longer lifespans (15 years) or venture capital funds positioned on pre-seed or seed-capital.

Part V: Concluding Remarks

DFIs have a long history of deploying catalytic capital; this includes, but extends beyond, blended finance activities.

DFIs are significant financiers of blended finance, including both as catalytic capital providers and commercial funders; more than 75% of blended finance transactions contain participation from a DFI. Indeed, DFIs are increasingly adopting blended finance as a strategy to drive further impact and crowd-in private investors, as evidenced by the progress made by the DFI Joint Report on Blended Finance. Catalytic capital programs housed by DFIs have enabled these institutions to better address goals such as climate finance, gender equality, and access to finance.

At the same time, we know that DFI's have deployed catalytic capital beyond blended finance transactions. For example, DFIs are significantly catalytic in developing new viable markets. A good example of this is the aforementioned IFC Scaling Solar Programme which creates new regional markets for solar energy. Another example comes from the UK DFI CDC Group, through its MedAccess strategy, which is deploying innovative fee-based volume guarantees to make essential medicines more accessible in poorer countries. Its first deal has enabled challenger medical manufacturer Hologic to scale up volumes for viral-load diagnostic testing systems, a technology critical to the lives of people living with HIV, resulting in up to 50% lower prices in up to 48 of the world's poorest countries, and savings of over $50 million to those healthcare systems in the next four years alone. However, these types of catalytic capital can be harder to capture and systematically track. More information sharing is therefore needed to better capture and categorize the kinds of non-price-based or non-blended catalytic capital deployment. Without this, it is possible that DFIs are underreporting their current levels of catalytic capital deployment, while also missing further opportunities to deploy catalytic capital. This subject deserves further interrogation to bring lessons to the field and encourage replication.

Partnerships provide an untapped opportunity to bolster the catalytic capital potential of DFIs

DFIs work closely alongside a range of co-investors in blended finance. In addition to crowding in commercial investors, DFIs frequently participate alongside other catalytic capital providers such as development agencies and foundations to further their catalytic potential. However, while this co-investment activity is common, it is often done sporadically and on a transaction-by-transaction basis. This is partly because the governance structure of DFIs do not incentivize a systematic approach to catalytic capital. This is reinforced by an emphasis on counting ODA-eligible dollars, in line with the requirements of DFI shareholder governments, which draws attention away from catalytic capital that falls outside that definition.

We believe an untapped opportunity exists here for more strategic, long-lasting, and fruitful partnerships between different catalytic capital providers. On the one hand, development agencies and foundations are well positioned to be catalytic, given their flexible capital arrangements and impact mandate. Meanwhile, DFIs possess deep capabilities when it comes to originating, conducting due-diligence, and investing debt and equity in emerging markets. More formalized partnerships provide an opportunity to extend catalytic investments beyond individual transactions, towards more strategic programming. The recently launched IFC-Rockefeller Foundation partnership to advance distributed renewable energy is a prime example of how partnerships can play an impactful role, and can provide a model for how future programmes may function.

CONVERGENCE
BLENDING GLOBAL FINANCE

CONVERGENCE is the global network for blended finance. We generate blended finance data, intelligence, and deal flow to increase private sector investment in developing countries.

BLENDED FINANCE uses catalytic capital from public or philanthropic sources to scale up private sector investment in emerging markets to realize the SDGs.

Our **GLOBAL MEMBERSHIP** includes public, private, and philanthropic investors as well as sponsors of transactions and funds. We offer this community a curated, online platform to connect with each other on blended finance transactions in progress, as well as exclusive access to original market intelligence and knowledge products such as case studies, reports, trainings, and webinars. To accelerate advances in the field, Convergence also provides grants for the design of vehicles that could attract private capital to global development at scale.