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Platform for
Rural Development

WEBINAR:
DECODING THE FUNDAMENTALS OF DEVELOPMENT FINANCE

Financial Instruments

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The building blocks of a capital structure

TYPICAL CAPITAL STRUCTURE

Debt

Mezzanine

Equity

The building blocks of a capital structure

TYPICAL CAPITAL STRUCTURE

- Ownership
- Takes the most risk
- First in, last out
- Different types have different rights
- Defines credit worthiness, buffer against losses, basis for raising debt

Equity

The building blocks of a capital structure

TYPICAL CAPITAL STRUCTURE

- A financial obligation
- Characteristics: principal, tenor/maturity, interest, repayment terms, covenants, collateral
- Used to finance growth
- First in the capital stack
- Different types: loans, bonds, commercial paper

Debt

The building blocks of a capital structure

TYPICAL CAPITAL STRUCTURE

- Subordinate to debt but senior to equity
- Combines elements of debt and equity
  e.g. Convertible debt: has an interest rate but also the option to convert under certain conditions

Mezzanine

Development add-ons: Grants

Debt

Mezzanine

Equity

Grants: seed capital

Provides initial capital e.g. for start ups or new projects to reduce risks support innovation etc.

Can be **returnable** or **convertible**

Grants: Technical Assistance

Sits outside the capital structure.

Supports impact that would otherwise not happen eg:

- Feasibility and design
- Upstream policy and regulatory work
- supporting access, inclusivity etc

Development add-ons: Guarantees

Debt Guarantees

A promise to step in and replay the debt under certain conditions.

Supports access to finance:

- Reduces risk and sometimes the price
- Enhances credit worthiness
- Attracts private investment

Debt

Mezzanine

Equity

Equity Guarantees

Mitigates risk and encourages investment in certain types of harder to invest places/sectors.

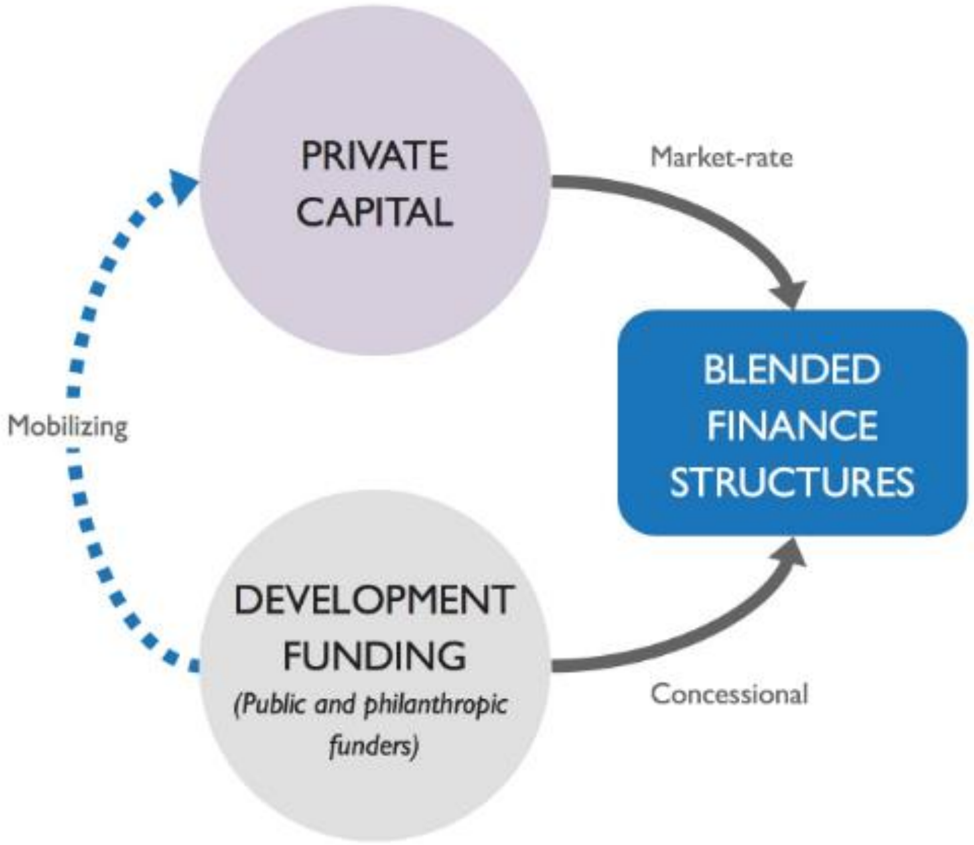
Examples include:

- First loss guarantee
- Min Return guarantees
- Capital protection
- PRI

What is blended finance?

Blended finance is a developmental finance tool for mobilization and impact

- Blended finance is the **strategic use of development finance** for the **mobilization of additional commercial finance** towards **sustainable development** in developing countries
- It attracts **commercial capital** towards projects that contribute to sustainable development, while providing financial returns to investors



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Why blend?

- This approach helps **enlarge the total** amount of resources available to developing countries and seeks to **address market constraints** e.g. high perceived risks

- Blended finance **reduces investment barriers**:
  i. high perceived and real risk and
  ii. poor returns for the risk relative to comparable investments
- **Blended finance is a structuring approach** that allows organizations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both)

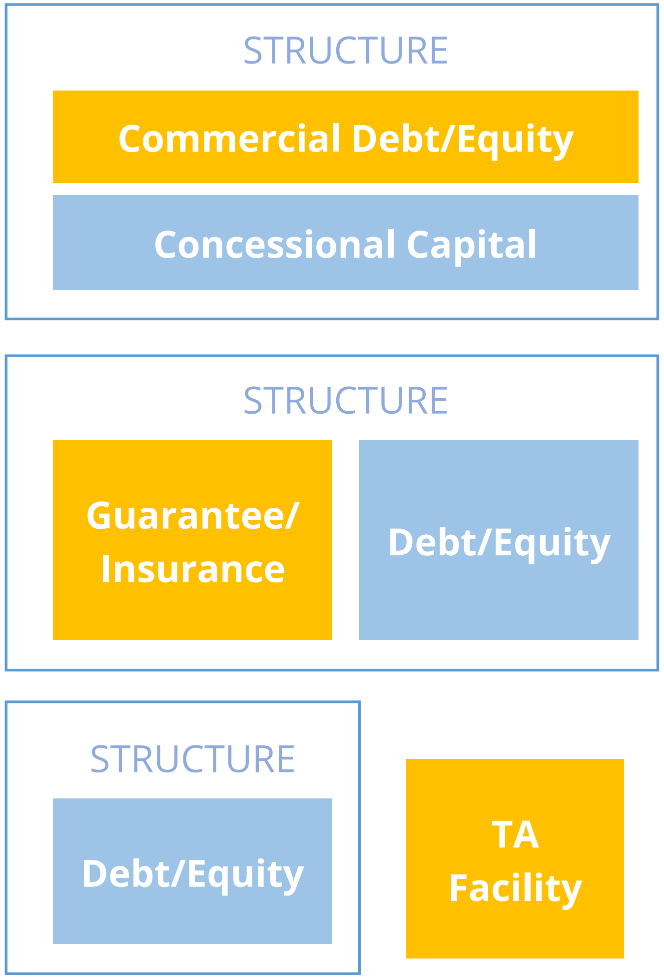
Blended finance structures

Development funding to a blended finance transaction can be **structured** as:

i. **Concessionary capital**: capital provided on below-market terms within the capital structure to lower overall cost or provide a layer of protection e.g. subordinated, first loss, lower return seeking etc.

ii. **Guarantee/risk insurance**: credit enhancement on below-market terms including political risk insurance and results-based financing

iii. **Grants**: design funding and technical assistance to strengthen commercial viability and development impact



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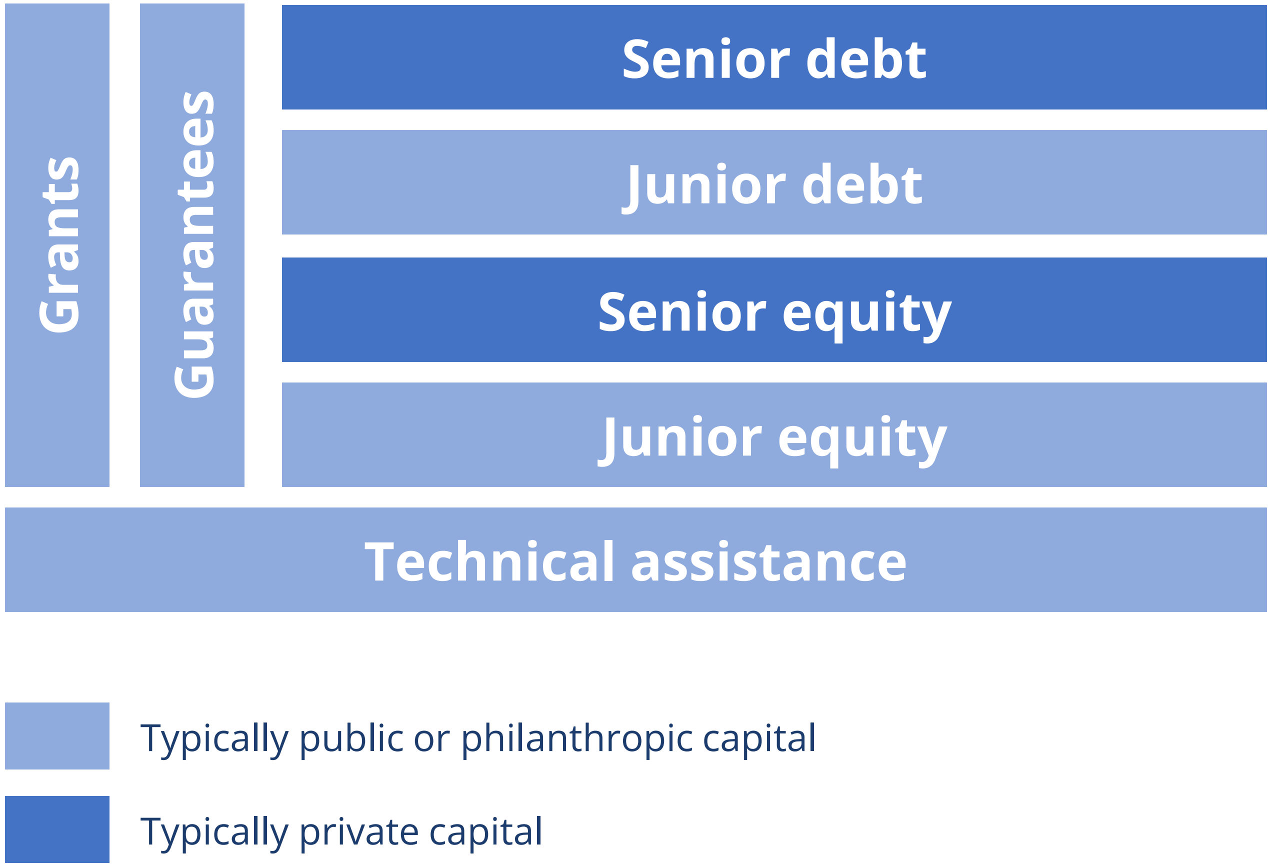
Blended finance structures

Optimum structure depends on many factors such as:

- type of entity
- industry
- stage of growth
- use of proceeds
- wider market conditions



Blended finance trends

- At 72% **Concessionary capital is the most popular** type of blended finance tool, including first loss debt or equity, investment-stage grants, debt or equity with below-market return expectations
- In recent years there has been an **increase in the use of guarantees, risk insurance and technical assistance**.
- Deal sizes range from $110k to $8bn, but the **median deal size is $64m**. Funds account for the largest share of blended finance transactions.
- Generalist structures (sector agnostic) have been common in the past, but with **a growing focus on Climate and Food Security**, Energy, Financial Services and Agriculture make up over 70% of the transactions

Characteristics of blended finance

Blended finance transactions should have three signature characteristics:

1 The transaction contributes towards achieving the SDGs

- However, not every participant needs to have that development objective
- Private investors in a blended finance structure may simply be seeking a market-rate financial return

2 Overall, the transaction expects to yield a positive financial return

- Different investors in a blended finance structure will have different return expectations, ranging from concessional to market-rate

3 The public and/or philanthropic parties are catalytic

- The participation from these parties improves the risk/return profile of the transaction in order to attract participation from the private sector

Principles for use of blended finance

1 **Maximizing impact** – commercial finance mobilized and development impact created

2 **Financial additionality** – transaction would not happen without the concessionary funds

3 **Minimum concessionality** – minimum ticket sizes, capital provided close to market terms, cognizant of perverse incentives

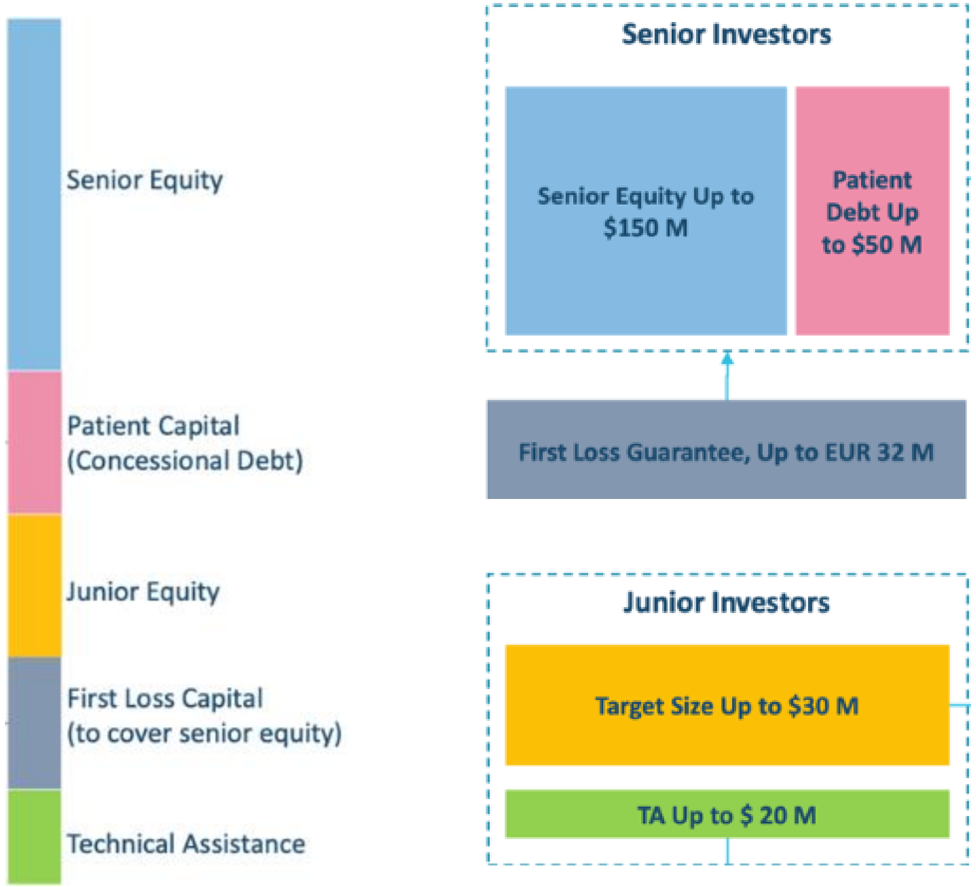
4 **Time bound** – used to address specific constraints rather than prop or create markets dependent on concessionality

5 **Catalytic, reinforcing markets and promoting high standards**

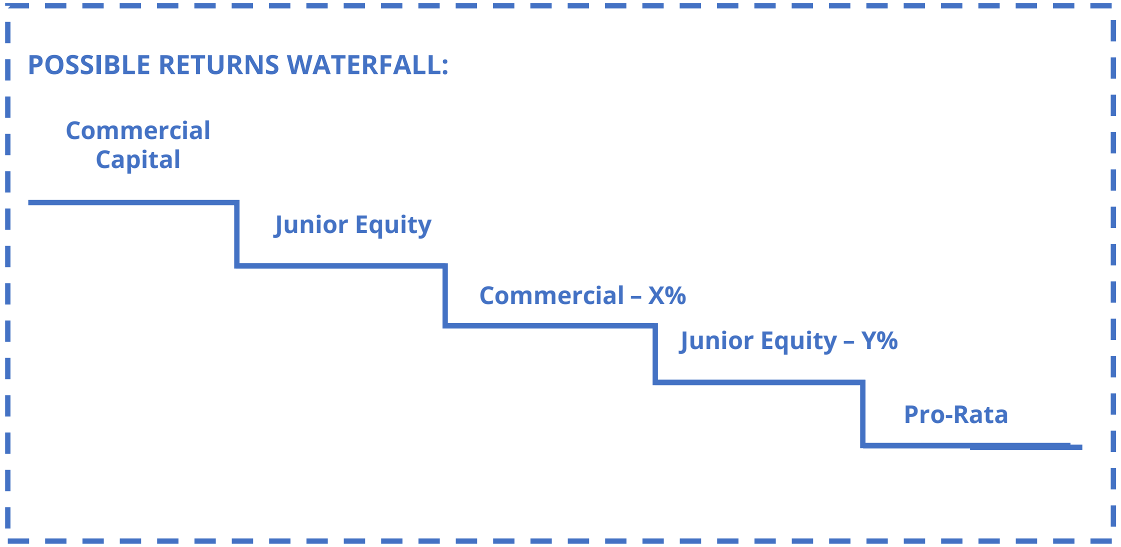
Illustrative example

Risk sharing

(for illustration only)



Capital	Terms
Grant	▪ No returns expectation
Guarantee	▪ First loss ▪ Fees
Junior Equity	▪ Subordinate to commercial, delayed returns until commercial gets x%, or ▪ Do not benefit from first loss
Commercial	▪ Capital protected by first loss ▪ Priority to concessionary for x% returns



Blended finance trends in agriculture

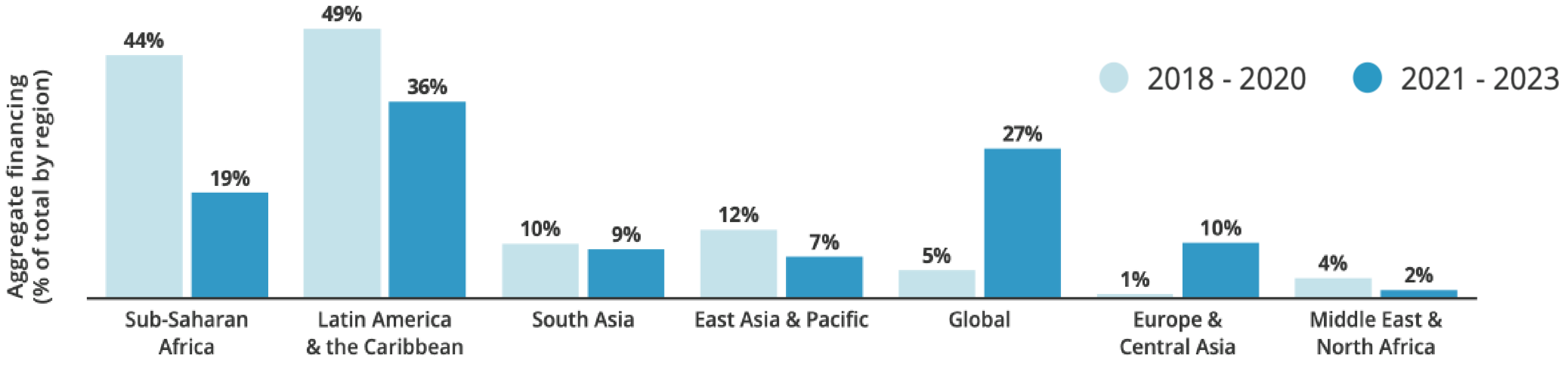
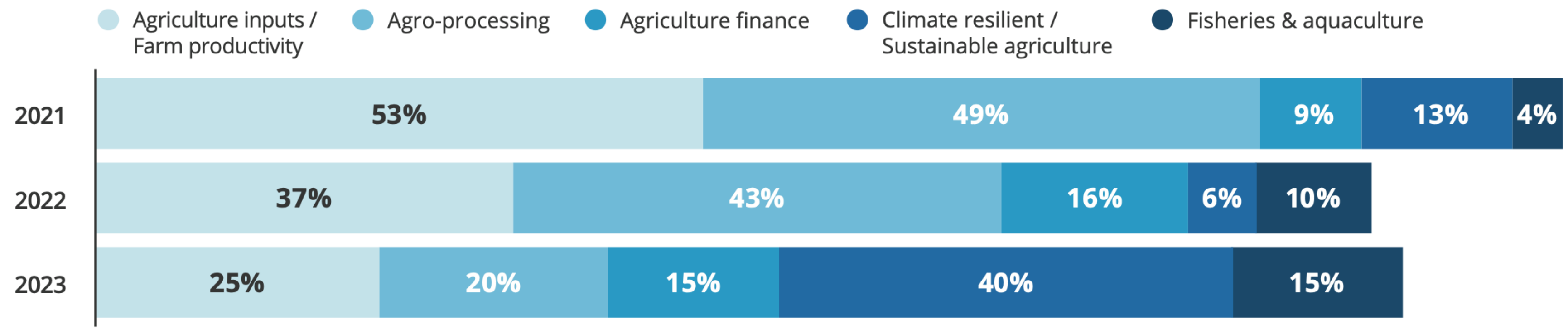


Figure 14: Breakdown of agriculture deals by sub-sector, 2021-2023



Blended finance trends in agriculture

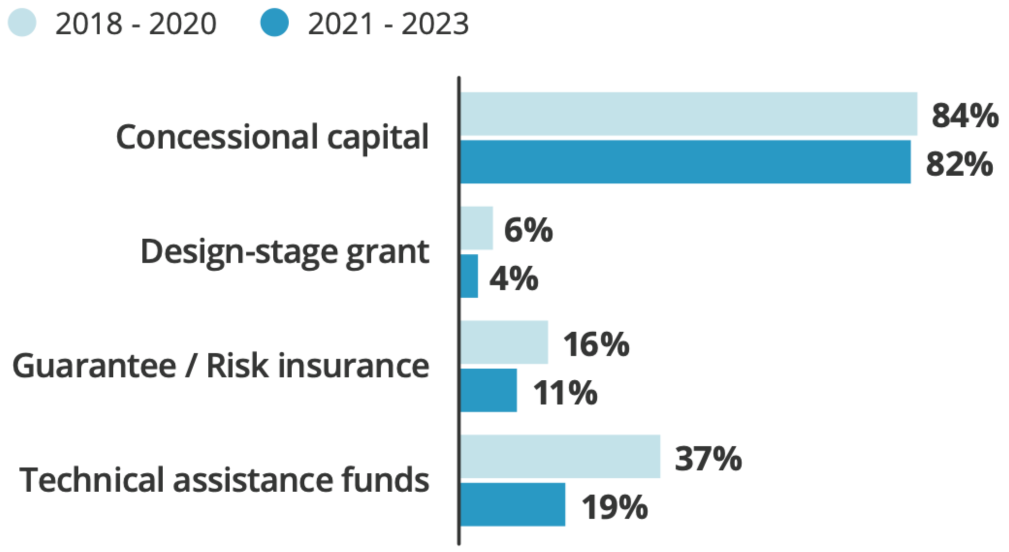
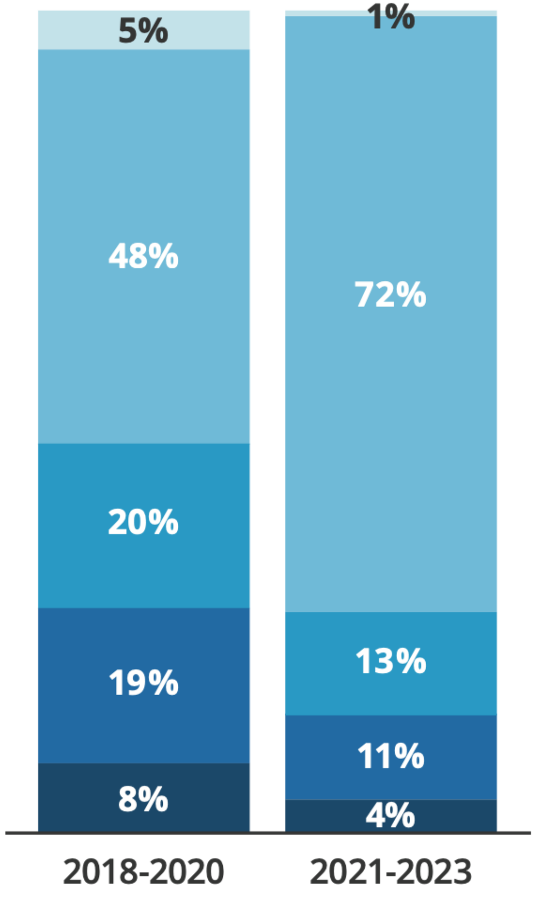


Figure 19: Proportion of concessional financial commitments to agriculture blended finance deals by investor sub-sector, 2018-2023

- Commercial investor
- Development agency
- DFI / MDB
- Foundation / NGO
- Impact investor



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Thank you

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GDPRD Food Systems Recommendations Database

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