

Just For a Change Podcast_S2 Ep9_Blended Finance - when to use what instrument when? _Transcript

[00:00:00] **Barry Panulo:** Welcome to Season 2 of the Just for a change podcast with me, Barry Panulo, your guest host for today's episode. A bit about me and how I fit into the picture: I am a Senior Project Manager in the Bertha Centre's innovative finance team and I am passionate about innovative finance research and product development - especially where they create spaces for exciting collaborations in impact investing and financing for sustainable development.

[00:00:26] What blended finance comes down to, is finding the best financial approach to an existing challenge or problem - be that in the education, health, or any other sector in society. This is, once again, what the Bertha Centre is all about - finding innovative solutions to address systemic problems. So, what does this mean in reality?

[00:00:47] Well, perhaps an example from education will give this some context. Knowledge is power, they say... So if we want to empower the next generation, we need to make sure they continue to get the necessary education. Across the board, the demand for education is increasing, particularly in African and other global south countries.

[00:01:08] Though this is a reality, the public education sector faces some challenges, despite considerable resources and energy being deployed in this space. In terms of equitable access to quality education, we still aren't where we hoped to be in 2022. In addition, education organisations used to be able to rely on grants, but unfortunately that's not always a given.

[00:01:32] It's clear that innovative approaches are needed, and one such approach is blended finance. Perhaps a new term for some of our listeners, Blended Finance can be defined as 'the strategic use of development finance and philanthropic funds to mobilise private capital flows to emerging and frontier markets'.

[00:01:52] But for a bit more context, let's quickly rewind to 2014. Blended Finance emerged following the work of the ReDesigning Development Finance Initiative which was established by the Organisation for Economic Co-operation Development and the World Economic Forum. Their goal? To explore options for expanding private investment in developing countries, through risk mitigation and concessional finance.

[00:02:18] In the past, there used to be a lot of aid for development, and finance was more input or activity based. Recently, however, there has been a shift towards more outcome-based financing where people want to fund 'success' or 'outcomes'. This gave a push into more interesting and innovative financing instruments such as impact bonds,

[00:02:38] For example.... Now we're entering a phase where we're looking into activity-based as well as results-based financing. As blended finance moves more into the spotlight, there has been a rapid growth in diverse, innovative tools and practices. As approaches have diversified, guidance on which instrument to use and when, has not followed at the same pace.

[00:02:59] That's why the Bertha Centre recently partnered with the Centre for Sustainable Finance & Private Wealth (CSP) at the University of Zurich as well as Roots of Impact on the project, Blended Finance: When to use which instrument. This was made possible by funding from the UBS Optimus Foundation. On this episode, we have some amazing guests that we'll be hearing more from on the topic of blended finance.

[00:03:21] And the various instruments. And on that note, let me introduce them to you. Hann Verheijen is the managing director at Cordaid Investment Management. Cordaid has been investing in positive social impact for the last 25 years with a focus on fragile markets. Mandy Jayakody, is a project manager on the Green Outcomes Fund, where she coordinates the knowledge management function of the fund.

[00:03:45] And lastly, we have Taeun Kwon, research lead of Blended Finance at the Centre for Sustainable Finance & Private

Wealth at the University of Zurich. Taeun is a 'Pracademic' with a focus on catalytic capital. Welcome everyone. Great to have you on the [00:04:00] show. Hang, let's start with you. We touched a bit on the definition of blended finance, but why is this something that interests private investors?

[00:04:07] **Hann Verheijen:** Yeah. Thanks Barry. Well in traditional markets, risk and return go hand in hand. So the higher the risk, the higher the financial return, but in development finance. So in emerging markets and in fragile context, that is definitely not the case, the higher, the risk, the lower, the return, and that is simply driven by the high country risk because there's war, uh, there's poverty, uh, there is scarcity and, um, blended finance helps to overcome that, uh, risk return issue.

[00:04:45] So it enables investors to, despite of the high risk to create a decent return next to a beautiful impact and that can be access to finance, access to energy, job creation whatsoever.

[00:04:58] **Barry Panulo:** Thank you Hann. So [00:05:00] it's lowering the level of, of risk, but then also bringing in this impact angle. So with that in mind Taeun, why is blended finance beneficial in the development sector?

[00:05:12] **Taeun Kwon:** Blended finance is particularly important in the development sector because we have to speak financing gap between what we want to achieve in terms of sustainable development goals and how much money we need to finance all of that. And we don't have enough currently. So that's been identified by the UN.

[00:05:32] Which means that development capital and philanthropic capital, needs to be either bigger or smarter and, um, to be bigger, or you need to find new sources of capital, uh, to be smarter you need to be more efficient in saying paying less for more impact. And this can all happen through either blending within a transaction or blending over time using your development capital.

[00:06:00] **Barry Panulo:** Thank you Taeun. And that's, and that's something that we've been, um, looking at in a recent white paper that we wrote together. Can you tell us a little bit more about that white paper and the research process? Um, that it went through?

[00:06:13] **Taeun Kwon:** blended finance is generally a super hot topic among development actors, and there is always this call.

[00:06:20] Ah, we need more research and we need more frameworks that guide our decisions, and we've done an extensive research. Whether something like this already exists. And the thing we've noticed most is that first of all, a lot of frameworks stop at being frameworks and are not very usable for, for practitioners.

[00:06:37] So we deliberately wanted to bring in more of a practitioner lens and be very, uh, close to practice. Second point that we saw missing was that it had a tendency to focus on large scale infrastructure projects, um, as opposed to financing entrepreneurial solutions. So we wanted to also get [00:07:00] really close to the entrepreneur who was being financed at the end of the chain.

[00:07:04] And so these two element - being close to practice and being close to entrepreneurs are the two different focus areas with our research project, which brought us all together - University of Zurich, more from academia, let's say, and Birta Centre that has extensive knowledge of being practice-oriented and being close to the entrepreneurs and actually having roots of impact, uh, who was a practice organization and the three of us all being in a happy marriage.

[00:07:36] **Barry Panulo:** And then just focusing on the blended finance approaches identified through the course of the research. What were they? Can you give us a bit of an overview?

[00:07:46] **Taeun Kwon:** Sure. I think if I would list all instruments, it would take us way too long, but just to give a few examples, right? I mentioned before that you needed to crowd in certain, um, private capital.

[00:07:58] And usually [00:08:00] instruments such as first loss, capital or guarantee or some blended finance approaches that are quite popular, that would do these things. On the other hand, there are also other, um, more, let's say innovative approaches such as impact bonds or social impact incentives that would incentivize certain impacts and pay.

[00:08:20] So to speak for that impact that would lock in the mission and make it more efficient. Um, so you'd get more bang for the buck in a way, because you would deploy a certain amount of capital and get outsized impact due to that. So we looked into both sides of blending.

[00:08:40] **Barry Panulo:** Thank you Taeun. And we'll circle back on that a little bit.

[00:08:43] Uh, but back back to Mandy and Hann, can you tell us a little bit about your funds and the, and the sustainable development goals they align with? Uh, Mandy let's please start with you.

[00:08:56] **Mandy Jayakody:** Thank you, Barry. Um, the Green Outcomes Fund is a free [00:09:00] pilot, which was started in 2020, probably not the best time for a fund to start.

[00:09:04] Nevertheless. It aims to incentivize intermediaries or, uh, local fund managers in the Green Outcome Fund, we refer to them as catalytic finance partners, and we aim to develop new approaches and financing models targeted at high potential smaller micro and medium enterprises operating in South Africa's green economy.

[00:09:27] Um, the funding potential could align with, with all of the sustainable development goals, depending on the small micro medium enterprise supported through the intermediaries. Currently majority of the projects funded through the facility aligned to, um, goal six, which is clean water and sanitation goal seven, which is affordable and clean energy goal eight, which is decent work and economic growth.

[00:09:51] Any goal 12, which is responsible, consumption and production.

[00:09:56] **Hann Verheijen:** Yeah, we, uh, we just launched the west Africa Bright Future Funds, [00:10:00] and that focuses on four of the most fragile countries in west Africa. So Guinea Bissau, Sierra Leone, Mali, and Guinea. And just to give you a picture, three out of four countries have a coup d'etat [00:10:11] this very moment and people are really poor and unemployed, but we have found out that there are many, uh, relatively small organizations that do create decent jobs. And by creating these in jobs, they build sustainable livelihoods. And that's actually what we're aiming for with the west Africa, bright future funds.

[00:10:30] So supporting local enterprises, helping them scale and helping them create decent jobs. That was ultimately the aim of the, uh, of the fund. And we focus specifically on youth and women, uh, because they need really some extra help in that, uh, region.

[00:10:49] **Barry Panulo:** All right. Thank you, Hann. Mandy, how do you apply blended finance in the context of the Green Outcomes Fund.

[00:10:56] **Mandy Jayakody:** Um, so it's interesting looking at the research done [00:11:00] by the BIRTHA center and the university of Zurich, uh, in my mind, if it straddles two clusters and it's the first cluster, which is your, uh, your, uh, technical assistance and your grant, as well as your outcomes based funding, uh, what the green outcome fund does, is it blends concessional funding with private capital and this enables participants to establish opportunities for the SMMEs, uh, funding [00:11:24] through the, uh, the CFP, which is the catalytic finance partners.

[00:11:28] **Barry Panulo:** And coming back to you, Hann. So you, so you mentioned that your key beneficiaries include women and youth. Can you give us a picture of the impact that you're attempting to create for them? So when we think about this on a regional level, almost what is the impact that Cordaid investment managers is trying to drive in the areas that it was.

[00:11:52] **Hann Verheijen:** Yeah. Ultimately, we try to, uh, contribute to creating decent jobs. So that is what drives us and then specifically for women [00:12:00] and youth, but there are many side effects. For example, we invest in, uh, uh, companies that are active in clean energy. Uh, and next to creating decent jobs for these target groups, who also provide access to a, to energy, and that is particularly in rural areas, really an important thing for, uh, for these, uh, livelihoods.

[00:12:23] **Barry Panulo:** Thank you. And Taeun, back to you. Based on the research, what are some of the key things to keep in mind when choosing the most suitable?

[00:12:32] **Taeun Kwon:** So in our first report, we laid out 12 key questions that you could, that anyone can use and go through to identify or clear their thoughts sort of before deciding on a certain approach.

[00:12:45] Um, what I found interesting in general is that it seemed to be very, or people who are setting up a transaction were perhaps not as clear about their primary motivation. So some people would say, Hey, we [00:13:00] want to crowd and more capital, but would then use instruments or approaches that were not very effective in crowding and capital or investing in very early stage companies, for instance, with first-class capital, um, in the hopes of drawing in commercial capital. But commercial capital, usually doesn't have much interest, even if it's de-risked, um, to invest in super early stage companies because they don't have a financial track record.

[00:13:25] So it's still too risky for them, things like that. So being very clear about your primary motivation for me, um, seemed like a really good way to start. And then, and then we have a upcoming reports or upcoming tool that we want to set up that provides a more granular and detailed guideline or step-by-step guideline that would help you.

[00:13:51] Okay. Once you have your primary motivation and your, um, Theory of change or your investment thesis in place. [00:14:00] What else can you add? What else should you think about? And

there were two things that were really missing for me of that we heard from practitioners and, you know, Hann your organization being an exception because he thought it was a really good example that does it well, was actually think about the enterprise.

[00:14:20] Um, and what they need in terms of capital and not what do we, as an investor want to deploy? And then the second part was, okay, what is the end beneficiary or the end impact going to look like and how can we then cater this back into the design of the transaction to make sure that this impact happens? Was actually not considered a lot because probably a lot of these capital providers sits very high level in, in Bern, in, um, Salaam, um, into hag.

[00:14:58] They are a bit too [00:15:00] removed to think until the very end or how the impact is going to look like in a very specific way.

[00:15:06] **Barry Panulo:** A very interesting take there too. Yes. Um, Hann and Mandy, what are your thoughts on that? Can you link that to the rationale used to choose approaches on your fund? Um, Hann, let's start with you.

[00:15:20] **Hann Verheijen:** Yeah, I think Taeun is really making an important point, uh, So it starts, it really understanding the market in which we invest and quite a lot of impact investors work from the United States or from Europe, but in order to be successful and to really support local economies, you need to have feet on the ground.

[00:15:41] So, for example, in west Africa, we do have local investment managers in, in Freetown, in Bamako, in Wagga dugu, uh, that on a monthly base visits, the enterprises that we support and, and consequently, they know the local context and they know the needs of the enterprise and, [00:16:00] and can truly support that. So that is one of the lessons that we have learned. Proximity. Have your feet on the ground in order to support those enterprises.

[00:16:07] **Barry Panulo:** Thank you. Mandy, what do you think?

[00:16:10] **Mandy Jayakody:** I agree with Hann and, and Taeun. I think, um, through your research and report that you guys presented, uh, Uh, what came out quite critical was when choosing the instruments, that key considerations are that was quite well outlined in the report. And some of that was, uh, conservations are, you know, understanding the organization and investee context, uh, the purpose of the transaction and the resources available.

[00:16:36] These are all key in, um, developing a solid model and understanding that, you know, there are going to be tweaks that would happen to the model and, um, you should be open to that.

[00:16:48] **Barry Panulo:** Thank you Mandy. And I think that's a good Segway to you Taeun, and to you and the 12 questions that you identified that can help practitioners as they select financing approaches.

[00:16:58] Could you give us [00:17:00] an overview of those?

[00:17:02] **Taeun Kwon:** Yeah so, the 12 questions we identified, we bundled them up into five themes. One is the organizational context and second, purpose of the transaction, third investee context four, costs and resources, five, risk and return. Um, one element that was oftentimes, I mean, there are frameworks out there that help you guide your decision-making and choosing certain approaches.

[00:17:27] So we're not the first one doing this, but what I find unique about our approach is that it's quite holistic and human-centric in a way. So it does have a certain logic related to cost and resources, risk and return and so on so forth. But we added the layer of the human part, which organization is it that is trying to deploy this capital because this actually at the end of the day matters a lot, realistically speaking.

[00:17:56] And, um, for instance, as a foundation, [00:18:00] perhaps in certain jurisdictions, you'd find it difficult to deploy equity, even if equity is really what is necessary on the ground, things like that. And these things matter, um, that go beyond just the logical

framework. So I think that one that's one, um, the organizational context is one big sector that we have identified as relevant that is included in the framework that we haven't seen in any other framework.

[00:18:27] **Barry Panulo:** I'd like to kind of move over to Hann and Hann has obviously launched our relatively new fund pretty recently. Um, so with the west Africa, bright future Fund achieving first close last year on. So I'd, I'd love to hear your thoughts on, on what Taeun just outlined in terms of the process and if you think that that mirrors your experience or approach in setting up a new fund of the nature of the west Africa, bright Future.

[00:18:58] **Hann Verheijen:** Allow me Barry to [00:19:00] first sketch, zoom out and sketch a bit the historical landscape because in the, in the past two decades, micro finance came up and in the meantime it has become a mature business and, uh, even a sustainable business. So you can make good money in micro finance and in the fragile contexts in which we are investing also.

[00:19:22] Big corporates to do have access to finance, but there's a gap which we call the missing middle. Uh, these are typically growing enterprises, which we call small and medium sized enterprises (SME's), and they don't have access to finance. Uh, there is hardly local markets. If you want to have a loan as an entrepreneur in these, uh, contexts, uh, then, uh, the interest rates are really high on the credentials that are needed are immense.

[00:19:51] But they do contribute to economic development. So it's important to show that's a serving these enterprises, serving the missing [00:20:00] middle is a sustainable business model. And that's actually what we have been doing in the past decades in the past 25 years and we are trying to prove with the west Africa bright future fund, that it's a sustainable business.

[00:20:13] Um, uh, and for that reason, we crowd in external investors that get a decent return next to a beautiful impact, uh, economic development in that, uh, in that area. Ultimately, we want to prove that, uh, serving enterprises in these markets, pro-

viding them access to finance is a sustainable business model. And, uh, we get a lot of support from our, um, our partners.

[00:20:43] So we have a first loss investors on board from a us aid. There's a credit guarantee from the development finance corporation in the United States and based on their support, we are able to attract external investors. That do get some return next to that, that [00:21:00] beautiful impact.

[00:21:01] **Barry Panulo:** Thank you, Hann. And Taeun has kind of mentioned the influence of context on the choice of instrument in a sense.

[00:21:08] I think that our listeners would be quite interested to hear. What is, what is the unique point, um, that you're addressing in west Africa? So in other words, is that a unique approach that, that is required in that geography versus others that you've seen?

[00:21:26] **Hann Verheijen:** Yeah. In west Africa, there are hardly there's hardly any international lender, simply because the risk is too high.

[00:21:33] Um, and with that structure of the first loss and the credit guarantee, we are able to invest and scale our operations over there. Um, and maybe we're simply doers. So we like doing things and, uh, set things in motion. And what I like about the research project is that, uh, there's also a scientific approach and we can learn from that, [00:22:00] um, and bringing these worlds together.

[00:22:01] So, uh, uh, trial and error versus Uh, science, I think that can have an immense effect on the industry in total.

[00:22:10] **Barry Panulo:** Thank you so much Hann. And I'd like to kind of conclude by just getting a sense of the projects or enterprises that, that your respective funds have worked with. So how has blending, uh, helped them along their journey and how do you think they might describe the value of your fund to others?

[00:22:31] So I'll start with Mandy and then circle back to you, Hann.

[00:22:34] **Mandy Jayakody:** Thanks Barry. Um, I think there's two types of beneficiaries for the green outcomes fund. The primary beneficiary would be the intermediaries who are critical because they form the nexus between the supply and demand. Uh, and they are, uh, you know, developed the ecosystem in which they, we operate, you know, in a large way.

[00:22:57] Um, and what the fund aimed to do [00:23:00] was, um, to try to incentivize movement in a specific direction. And this was basically to invest more into SME's, the uptake of it in South Africa, green economy, um, it also encouraged the uptake of verifiable green, uh, metrics across the local investing, um, industry.

[00:23:21] It also developed capacity among the CFPs, because what we found is that, you know, with, um, the green economy, there's certain nuances that come in that normal funds probably don't know how to handle and one such nuance is the rigorous reporting requirement, which we, we do have on the green outcomes fund and how to handle this.

[00:23:45] And is it worthwhile kind of, um, spending that money on these? So what happened was with the blended finance approach we used, um, the jobs fund came in as well as, uh, the Rand Merchant Bank, [00:24:00] which formed the catalytic part of financing. And they finance that kind of, uh, area of the fund. I think also, uh, what it does and what we found that it supports price discovery on the delivery of green outcomes, which is very important because currently the fund, uh, in this pilot phase is looking at jobs because jobs fund is financing it and.

[00:24:25] It is one of those areas that is easy to kind of, um, understand what the pricing of jobs is. So what we're looking forward to doing in the next iteration is trying to understand the pricing of outcomes and how that works within our model. Um, the second beneficiaries are the SMMEs who the activities wouldn't be feasible without the support of through the intermediaries.

[00:24:49] So, um, I think there is definitely value. What we're trying to understand is how we, um, figure out the ecosystem and support the ecosystem, um, in [00:25:00] understanding what's hap-

pening and moving forward in a positive and a way that everybody is moving the right direction.

[00:25:07] **Barry Panulo:** Thank you, Mandy, just, just to double tap on that.

[00:25:09] So could you give us an example of that type of SMME that might get funded through the green outcomes fund? What, what are they doing? Where are they working etcetera.

[00:25:20] **Mandy Jayakody:** Um, so there's different incentives and obviously we're looking at jobs, but one would, and I won't give you the name. Uh, but one of the SMEs would look at, um, for instance, solar power in rural areas or a water purification, um, in areas where, um, there's not, uh, a lot of water that is, is clean.

[00:25:42] Um, so those are the kinds of angles we look at and some SMEs are easier to support because their models make sense. Um, and I think this all comes through, um, As you go through the project.

[00:25:57] **Barry Panulo:** Alright, thank you, Mandy, [00:26:00] uh, Hann over to you,

[00:26:01] **Hann Verheijen:** and maybe it's good to understand. So we invest in these four very fragile countries in west Africa, and we focus on three sectors.

[00:26:12] Agriculture, waste managements and clean energy. And we have selected these three sectors, uh, because next to job creation, they create a lot of jobs and are quite labor intense. It has many positive side effects. For example, uh, there was hardly any waste collection in a country like Mali. So it has also a social function next to job creation to collect waste.

[00:26:36] It keeps the cities cleaner basically. One of my favorite investees is, uh, is Easy Solar. We, uh, supported them with a first loan some five or six years ago. And that was really a starting company at that time with the idea to provide, provide solar home systems in rural areas in Sierra Leone. And basically every-

one is off the grid and doesn't [00:27:00] have any access to electricity over there.

[00:27:03] We supported them with some technical assistance, provided the second loan and a third loan. Uh, so actually we grew with them. And they create a lot of positive impact. So, uh, job creation, uh, access to energy, it has positive health effects and also positive. Uh, let's say social effects because you don't need to spend so much time in collecting, uh, woods to have a fire. It's only possible to serve these kinds of companies [00:27:35] if you can somehow mitigate the risk because the risk is pretty high over there the blended model come in. So there are a few instruments that we're using it's technical assistance, supporting them with, uh, for example, uh, uh, structuring their organization, the governance of the organizations with, uh, supporting them with marketing, but also the first loss investments and the [00:28:00] credit [00:28:00] guarantee that we got from USA ID and the DFC enables us to make a decent return and to also welcome third-parties and to scale up in the region. So I think from their perspective, we have supported them for a long time in our true partner. And we have enabled them to bring in external capital. And that is basically a model that we're aiming for.

[00:28:23] So we want to be the first international lender to most of our investees and once they have matured a bit, then we try to bring in external investors as well to enable them to further grow and create more jobs, even.

[00:28:37] **Barry Panulo:** Thank you so much Taeun, Hann and Mandy for your fascinating insights on blended finance.

[00:28:43] I'm looking forward to seeing all the amazing things that your respective projects do, um, in the coming year.

[00:28:51] **Mandy Jayakody:** Thank you, Barry.

[00:28:53] **Hann Verheijen:** Yeah. Thanks, Barry. Thanks Taeun and Mandy. I really hope that, uh, the, the green outcomes fund and the [00:29:00] research, uh, can be a source of inspiration for, for many impact investors.

[00:29:05] **Taeun Kwon:** Thank you. Thank you, Barry. Thank you guys. So it was really lovely chatting.

[00:29:09] **Barry Panulo:** It's exciting to witness the impact benefits of an innovative finance solution, such as blended finance, in the development sector. But at the same time it's crucial to know when to use which blended finance tool for maximum impact and successful development outcomes.

[00:29:26] If you want to find out more about blended finance, and this white paper on selecting the best blended finance tool, be sure to have a look at the show notes. Our hope is that our research will guide and streamline the decision making process for practitioners. Thank you for tuning in to season 2 of the Just for a Change Podcast, powered by the Bertha Centre for Social Innovation and Entrepreneurship.

[00:29:47] If you're curious about what innovation is happening in Africa and the Global South and who the movers and shakers behind these initiatives are, then make sure you subscribe so that you don't miss any of our upcoming episodes! [00:30:00]