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
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

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 e.g.:  
  - 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

**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.
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
Development add-ons: **Grants**

- **Debt**
- **Mezzanine**
- **Equity**

**Grants: seed capital**

- Provides initial capital e.g. for startups 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
### Blended finance structures

Optimum structure depends on many factors such as:

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

#### Senior\ debt

#### Junior\ debt

#### Senior\ equity

#### Junior\ equity

#### Technical\ assistance

**Grants**

**Guarantees**

- Typically public or philanthropic capital
- Typically private capital
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

<table>
<thead>
<tr>
<th>Terms</th>
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<tbody>
<tr>
<td>Grant</td>
</tr>
<tr>
<td>▪ No returns expectation</td>
</tr>
<tr>
<td>Guarantee</td>
</tr>
<tr>
<td>▪ First loss</td>
</tr>
<tr>
<td>▪ Fees</td>
</tr>
<tr>
<td>Junior Equity</td>
</tr>
<tr>
<td>▪ Subordinate to commercial, delayed returns until commercial gets x%, or</td>
</tr>
<tr>
<td>▪ Do not benefit from first loss</td>
</tr>
<tr>
<td>Commercial</td>
</tr>
<tr>
<td>▪ Capital protected by first loss</td>
</tr>
<tr>
<td>▪ Priority to concessionary for x% returns</td>
</tr>
</tbody>
</table>

POSSIBLE RETURNS WATERFALL:

- Commercial Capital
- Junior Equity
- Commercial - X%
- Junior Equity - Y%
- Pro-Rata
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

<table>
<thead>
<tr>
<th>Type</th>
<th>2018 - 2020</th>
<th>2021 - 2023</th>
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<tbody>
<tr>
<td>Concessional capital</td>
<td>6%</td>
<td>16%</td>
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<tr>
<td>Design-stage grant</td>
<td>4%</td>
<td>11%</td>
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<tr>
<td>Guarantee / Risk insurance</td>
<td>19%</td>
<td>37%</td>
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<tr>
<td>Technical assistance funds</td>
<td>19%</td>
<td>84%</td>
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<tr>
<td>Total</td>
<td>48%</td>
<td>72%</td>
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Thank you

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GDPRD Food Systems Recommendations Database
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