

CONVERGENCE BLENDED FINANCE



Ladé Araba
Managing Director, Africa

Convergence Blended Finance (Convergence) is the global network for blended finance. Convergence generates blended finance data, intelligence, and deal flow to increase private sector investment in developing countries to close the US\$2.5trn annual funding gap threatening the success of the Sustainable Development Goals.

To accelerate advancement in the blended finance field, Convergence also runs a Design Funding Program to provide early-stage grant funding to support the design and launch of blended finance solutions in frontier markets and nascent sectors with high investible potential to attract private capital to achieve global development at scale. Our growing global membership includes 200+ public, private, and philanthropic investors, as well as sponsors, of transactions and funds.

AVCA speaks with Ladé Araba, Managing Director for Africa at Convergence to learn more about the history of the network, how blended finance can be applied, and its role in achieving Africa's development goals.

Q: How was Convergence created? What does the network do?

Convergence was born out of the Addis Ababa Action Agenda in 2015, where world leaders gathered to transition from the Millennium Development Goals to the Sustainable Development Goals (SDGs). There was a realisation that funding SDG-related projects would require around US\$4-6trn, annually. Today, despite significant donor and philanthropic funding, there remains an estimated annual funding gap of around US\$2.5trn. Global capital markets represent a tremendous opportunity to finance the SDGs; securing just 1.5% of the estimated US\$200trn pool of global capital available would help close this gap and ensure a more sustainable future.

Convergence was formally launched in 2016 as the global network for blended finance. We were originally funded by the Canadian government with design and incubation undertaken by Dalberg and the Global Development Incubator (GDI) respectively. We are a network comprising a diverse membership, encompassing public institutions including donor agencies, multilateral development banks (MDBs) and development finance institutions (DFIs), while our private sector members include commercial banks, private equity firms, and institutional investors.

Convergence promotes blended finance and facilitates investible opportunities for private investors, by connecting them with other types of capital providers to co-invest in emerging and frontier markets. We also provide data and market intelligence, serving both the buy- and sell-sides of deals, as well as benchmarks and good practices, in areas such as deal structuring and risk mitigation, to make deals more attractive to commercial

NAME OF FIRM

Convergence Blended Finance

FIRM TYPE

Foundation

investors. Lastly, Convergence provides design funding to strengthen pipelines and accelerate regional markets for blended finance, given the dearth of bankable projects in emerging and frontier markets. To this end, we've awarded over US\$6mn in the last 4 years to 18 blended finance vehicles (including funds, facilities, impact bonds and projects in the energy, agriculture, health and financial services sectors). Over the last few months, we've also opened two new windows in the APAC and South East Asia regions, the [Indo-Pacific Design Funding Window](#) and the [Asia Natural Capital Design Funding Window](#), respectively funded by the Australian government and a Hong Kong-based family office.

Q: How has the global blended finance landscape changed over time?

Blended finance is sometimes perceived as a relatively recent development but has in fact existed since the late 1970s. The use of blended finance picked up in 2008 and 2009 with the Global Financial Crisis, and again from 2015 onwards in the context of the SDGs. Discussions around co-investment opportunities between public and private sector players had been taking place on an ad hoc basis prior to the establishment of Convergence. We saw this trend accelerate over the last decade, even as DFIs and MDBs sought to leverage their balance sheets to

attract private capital to impactful projects. The launch of Convergence has helped to formalise these relationships, provide authoritative data, and share key lessons and capacity building, to strengthen market activity and bring more clarity and transparency to blended finance.

Lastly, it's key to remember that blended finance covers a wide range of financial products and asset classes, ranging from private equity to project or structured finance or fixed income securities such as Kenya's first green bond issued in 2019.

Q: What key trends have you identified in blended finance in Africa?

Firstly, it's important to note that many investors on the continent are involved in blended finance without necessarily knowing it. In effect, they are blending out of necessity – without the participation of catalytic or concessional capital, their projects or investments would struggle to get off the ground. Overall, we've seen close to US\$50bn in blended finance deals across Sub-Saharan Africa, targeting 237 deals. In line with global trends, we continue to see the majority of activity in the energy and financial services sectors. Most transactions are through generalist funds but there has been an uptick in the number of deals in non-energy infrastructure sub-sectors, agriculture and healthcare, over the last few years.

Sub-Saharan Africa accounts for over 40% of over 3,800 financial commitments made by more than 1,170 investors in blended finance transactions identified by Convergence, with East Africa being the most frequently targeted destination. Compared with other regions, Africa's transactions are typically smaller in size; which is a key barrier to attracting institutional capital given that institutional investors are often reluctant to take full exposure to single and small-scale transactions. The relatively small ticket size of deals in Africa means that institutional investors prefer to spread their exposure across multiple deals by investing in larger sized funds or facilities, in order to reduce additional efforts and costs, particularly in terms of due diligence. There is a need to create larger, commercially viable opportunities that can absorb direct investment from these players.

Q: What are the biggest challenges to financing Africa's SDG agenda? How can blended finance help close the gap?

For one, there is a significant gap between perceived and actual risk in Africa. There are countless stories of successful local and foreign investors on the continent, but all too often the prevailing narrative focuses on the challenges rather than the opportunities. Africa faces similar challenges found in other emerging and frontier markets. These include limited levels of liquidity, political risk, foreign currency exposure, as well as market failures that can have a direct impact on transactions and deal sizes. Financing the SDGs is a big challenge for these reasons, but we've found that deal structuring can be

improved in many cases by applying diverse blended finance approaches.

Secondly, having a strong pipeline of investible opportunities is a challenge, particularly when it comes to identifying deals that meet the right risk/return appetites. Blended finance addresses these issues by providing a wide range of approaches and instruments to help de-risk transactions. This might include the participation of concessional capital providers who provide credit enhancement and risk insurance against specific factors, or concessional capital that is deployed strategically to cover first-loss. Likewise, technical assistance or early stage grants that help build a pipeline of projects are other levers that can reduce risk and create investible opportunities. Ultimately, blended finance provides either downside protection or creates an even more attractive upside for investors, resulting in a win-win situation for all.

Q: Is one approach predominant over the other?

Most deals have focused on downside protection because donors tend to worry about subsidising the private sector. As a result, there's been a historical tension between buying impact and the perception of subsidising private investors. Moving forward, we see the latter approach is likely to play an increasingly important role in creating an even more attractive upside to get certain types of investors to participate. Public, development-oriented players and commercial capital providers can achieve their mandates through both approaches. As an industry network, Convergence has a focus to help create awareness about the long-term impact such transactions can generate.

Q: What impact has the COVID-19 pandemic had on blended finance?

It's clear that the demand for concessional capital has significantly increased, with many portfolio companies and projects at a standstill, seeking to secure liquidity to ensure their survival. We expect this to continue for the next year—at a minimum—as companies try to weather the storm. Over the last few months, we've also received a lot more requests for membership and to facilitate introductions through our network.

Q: What sectors do you think will benefit from using the blended finance model post-COVID19?

- **Healthcare:** The pandemic has shone a spotlight on healthcare and the sector is set to see a significant uptick in transactions. It's clear that health cannot be a public project in Africa given the limited manoeuvring space of many governments. Accordingly, the private sector alongside sources of development finance will prove to be instrumental in expanding access to, and the quality of, healthcare.
- **Financial services:** This is the second-most active

sector in blended finance after energy, and will continue to be one of the top sectors, especially with regards to mobilising private capital to improve access to finance for Small and Medium-Sized Enterprises (SMEs), the lifeblood of many African economies in terms of creating jobs and stimulating local economic activity.

- **Agriculture:** We are starting to see a shift in how agriculture finance is being deployed. Historically, it was focused on smaller-scale and subsistence farmers, which, in the long run, will not deliver the kind of risk-adjusted returns attractive to investors, nor the economic empowerment opportunities that the bottom billion require to transform their lives. Increasingly, investments are being focused on agro-processing and commercial agriculture at scale to move African countries up the value chain. Foreign currency earning and export-oriented agriculture are also a key focus.
- **Energy:** Energy will remain a key sector for investment because of its development impact, and the fact that it's relatively easy to commercialise. Blended finance will increasingly play a role in financing utility-scale projects, while making off-grid projects such as mini-grids or solar home systems more attractive to commercial investors.

Q: Can you please share an example of how blended finance has been used in investments within Africa?

Climate Investor One is a blended finance facility that was posted on the Convergence deal sourcing platform in October 2017. Convergence played a role in helping facilitate this transaction through its platform, but by no means facilitated the deal in its entirety. Climate Investor One combines three investment funds into one facility to finance renewable energy projects at every stage of the project lifecycle. The facility reached final close at US\$850mn in June 2019 and expects to invest up to 40% of this in Africa.

The first fund addresses the absence of a pipeline of robust projects by providing development loans and technical assistance at the pre-investment stage; which is important since private investors tend not to fund such studies as they are costly, and do not always lead to an investible opportunity. The second fund focuses on construction financing through an all-equity approach, while the third fund provides debt refinancing once projects are operational so that they can be cash-flow positive and secure commercial loans.

The three funds are backed by different types of investors. While the first fund is entirely donor-funded, the second fund is backed by MDBs, donors and impact investors. The third fund is entirely capitalised by institutional investors with purely commercial mandates. This innovative, whole-of-life financing approach ultimately relies on the presence of concessional capital in the early stages to allow private investors to enter in

the latter stages.

Q: Where do you see Convergence and the blended finance approach in the next five years?

We would like to see blended finance become mainstream in the next 5 years, with upwards of US\$100bn of private investment targeting SDG-related transactions each year. These are ambitious but reachable goals if we leverage our platform and multiply our partnerships to scale our impact. We need to accelerate the uptake of blended finance. We have only 10 years left to realize the SDGs. The global annual market for blended finance is only about US\$15bn, which is substantially short of the US\$2+trn annual funding gap. Lastly, I think we need to see concessional capital providers use their resources more strategically; for instance, taking on more early-stage risk or thinking beyond downside protection to improve upside prospects for private capital.

There are already encouraging signs, such as Allianz's US\$115mn commitment to the Emerging Africa Infrastructure Fund. This investment is by one of the world's largest institutional investors and is a testament to the power of blended finance, and indicative of the opportunities that can be found in Africa. We remain committed to helping catalyse domestic and foreign flows of institutional capital to the African continent.

Q: How have you benefited from the AVCA membership?

The AVCA network has been tremendously beneficial and has helped us connect with other members, network and identify new opportunities. Some of the transactions and members on our platform were introduced by AVCA. The Association has also given us visibility and a platform to dispel some of the myths or misconceptions around blended finance.

Want to learn more about Convergence Blended Finance? [Click here](#) to explore AVCA's 2020 Member Directory.

CONTACT AVCA

37 North Row
3rd Floor
London W1K 6DH

E avca@avca-africa.org
W www.avca-africa.org
T +44 (0)20 3874 7008

 African Private Equity and
Venture Capital Association