**Blended Finance: Bringing New Opportunities to the Development Sector**

Meeting the National Development Plan's (NDP) targets, including the eradication of poverty by 2030, will depend on the amount of resources available. A large part of these resources consist of government transfers. However, with a slowing economy, declining tax revenue and a looming downgrade, it is expected that government will have no choice but to reduce its budget for social spending in the near future. The above also holds for philanthropic funders such as foundations and other social investment vehicles, given increased economic pressure. (No quantifiable numbers are available for the South African context, but the United Nations Conference on Trade and Development has estimated the annual investment gap to fund the sustainable development goals in developing countries is around US$2.5 trillion annually.)

Such an environment calls for development funders to start exploring innovative funding models, especially ones that unlock new forms of capital that go beyond traditional grantmaking. One such source of financing includes traditional private sector capital invested in pension funds and insurers, which represent a significant supply of capital that could fund sustainable development. The levels of such private sector investment flowing to development-related social enterprises and projects remains relatively low in both South Africa and emerging markets. Translating these assets into development-compatible investment will be important in future, with the potential being greater in sectors such as education, health, climate resilience, water, sanitation and social housing.

A mechanism available to development funders that crowds-in private capital into development is Blended Finance. This concept has gained much traction internationally in recent years and refers to the strategic use of development and philanthropic funds to mobilise private capital for high-impact initiatives. Through this financing mechanism, development funders can expand the impact of their limited resources by leveraging billions of rands in capital sitting with private investors, and thus closing the substantial (local and global) development funding gap.

According to the World Economic Forum (WEF), Blended Finance consists of three main characteristics: **Leverage**- the use of grant funding to attract private financing into deals; **Impact**-investments that drive social, environmental and economic progress; and **Returns-** financial returns for private investors in line with real and perceived risk.

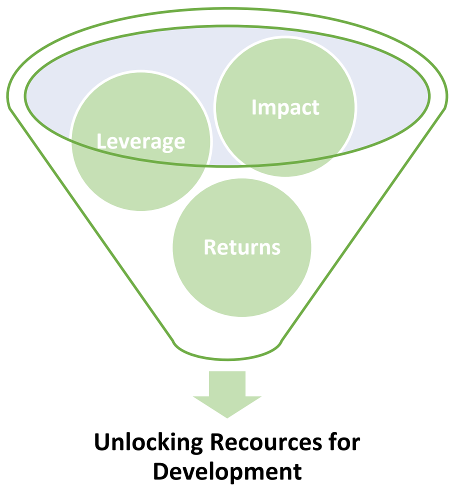
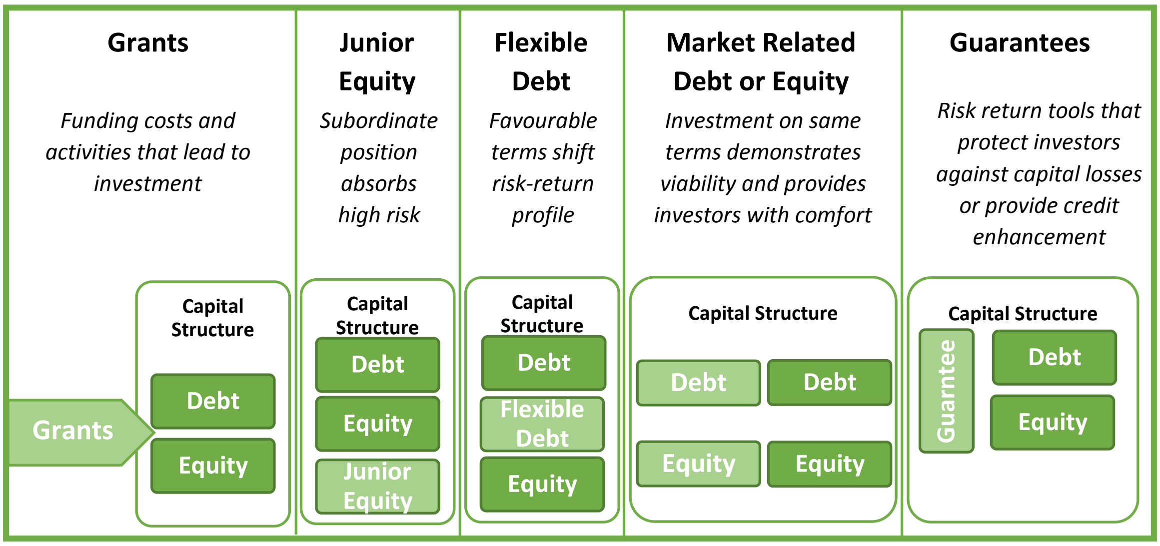



**Figure 1 Pillars of Blended Finance**

Within Blended Finance, a number of financial tools are available to development funders, which include (but are not limited to) grants, debt, equity and guarantees. Blended finance deals comprise of three distinct features as identified by Joan Larrea of Convergence:

1. The transaction – whether a project, company, fund, or structured offering – **is intended to yield a financial return.**
2. The venture or activity **contributes toward meeting development objectives**.
3. **The public and/or philanthropic parties at the table are catalytic,** making a deal happen that would otherwise attract little or no interest from the private sector.




*Source: World Economic Forum, "A How-To Guide for Blended Finance" (2015)*
**Figure 2 Tools Available in Blended Finance Transactions**

A recent example of a local Blended Finance transaction is the Inclusive Youth Employment Pay-for-Performance (PfP) pilot being structured by one of Tshikululu's partners, and to which we have brought two of our clients to the table. The investor side of the Inclusive Youth Employment PfP pilot includes three organisations:

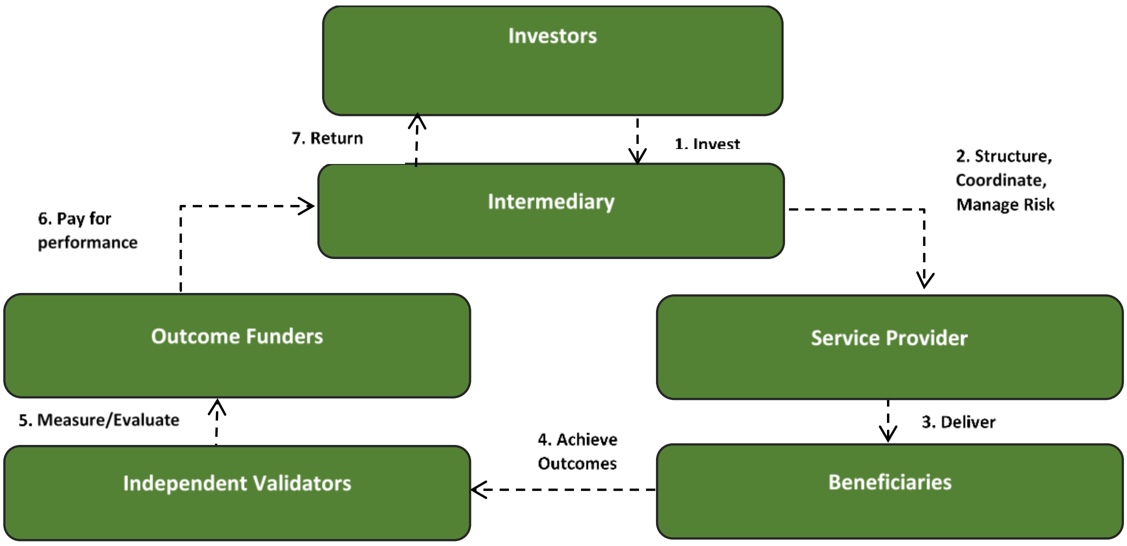
- ***a large South African Insurer*** which has invested using its balance sheet and is looking for market related returns;
- ***an impact investor*** which is looking to preserve its capital; and
- ***a large corporate foundation*** which has taken on a first loss position.

This subordinated position taken by the corporate foundation has resulted in the strengthening of the project's creditworthiness by cushioning the downside losses for investors and thus shifting the risk-return profile to one that is attractive to private capital. The involvement of a corporate foundation (and in particular its ability to absorb the highest risk), has seen philanthropic funding play a catalytic role in unlocking three times the amount it would have been able to contribute on its own.

**Box 1: What is a Pay-for-Performance model?**

A pay-for-performance platform is a type of social impact bond, where initial private investors provide funding for the delivery of social programmes. This funding is used by "operators" to deliver the social programmes, with the goal of reaching pre-determined outcomes. If these outcomes are achieved (and verified by an external party), an "outcomes funder" pays the initial investors back. If the outcomes are not achieved, no outcomes funding is paid. In other words, the initial investors expect both a social and financial return on their investment, but take the risk that a return (of either kind) is not guaranteed. Figure 1 below provides a high-level structure of a Pay-for-Performance platform. This is a relatively new financing model in South Africa; other than the Inclusive Youth Employment PfP, there are currently two other bonds that exist in the country operating in the Health and Early Childhood Development sectors (both of which are funded by Tshikululu managed funds working in these sectors).

**Figure 3 Pay-for Performance Model**




In addition to providing direct funding to projects, development funders are in a unique position to provide resources towards supporting mechanisms which are traditionally tools not available to mainstream private investors. Through the funding of mechanisms like Technical Assistance, development funders can carry costs such as those related to advisory or preparatory services and thus help lower up-front costs associated with high-impact development transactions. For the PfP pilot, the Anglo American Chairman's Fund (managed by Tshikululu) recently approved a grant aimed at covering some of the costs associated with the critical intermediary function (which include structuring the transaction, legal fees and on-going monitoring and evaluation), which is essential to the success of the pilot.

With both public resources and philanthropic funding coming under pressure, development funders will need to be innovative in the way they deploy their capital. Although Blended Finance is still a relatively new concept in South Africa, it is proving to be one model that provides development funders with new opportunities to enhance development impact and contribute in new ways towards achieving the country's 2030 agenda.