



October 2020

# The power of blended finance to build back stronger

Report on Virtual Webinar Series #One



## **The Power of Blended Finance to Build Back Stronger**

### Report on Virtual Webinar Series #One

#### **Introduction**

The broader theme in having this virtual seminar series is about igniting thought leadership, collaboration and action around the adoption of innovative financing models that will help Kenya, and by extension East Africa, **Build Back Stronger** post COVID, while also achieving the UN Sustainable Development Goals (SDGs).

Africa faces a \$500b - \$1.2trillion annual SDG financing gap between now and 2030. Traditional development aid from public and philanthropic sources is just not enough to meet this deficit because the funding landscape has changed from aid to trade, or in some instances to very little or no aid. In addition, COVID-19 has highlighted the need for: (1) more collaboration between diverse development players/social investors and (2) new models of financing that can help drive scale.

The organizers of this virtual seminar series, believe that Blended Finance can disrupt traditional development finance as we know it, by leveraging and deploying grant funds as catalytic risk capital in order to attract and crowd-in private sector capital for development initiatives. To help promote the concept of Blended Finance, relevant and timely knowledge on the subject of innovative financing is critical. This virtual seminar series is one way of building and capturing that knowledge.

#### **Series #One Key Points**

- There is need to not only unlock private capital but also deploy it in previously ignored and marginalized rural areas (where communities live below the poverty line).

- We need to unpack the SDGs and identify those that offer a commercial opportunity (or borrow from the rest of the world to identify those opportunities).
- Blended Finance needs to be transformational to go beyond the pockets of success.
- Deals are dependent on the ability of the market to utilize the capital.
- There is a need to rewire our market structures to allow traditional commercial entities, such as banks, to work in areas that they were previously unable to venture into.
- We need to ensure efficient allocation of capital and proper packaging of incentives and impact.
- The policy framework in Africa needs to be developed further to encourage participation of the private sector in Blended Finance opportunities.
- There is need for more rigorous oversight of public spending if private capital providers are to get involved in Blended Finance projects.

**Case Study: Presented by Dr. Myriam Sidibe – Founder and Chair of the National Business Compact on Coronavirus**

Three major principles were employed by Kenyan soap manufacturers to address COVID-19.

**1. Collaboration**

Bringing together the major players to help focus efforts towards reducing the spread of COVID-19 and mitigating negative impacts.

**2. Communication**

Using a variety of avenues both informal and formal, such as online platforms and the transport sector to reach the intended audience. Creating a catchy slogan like “Komesha Corona” to gain the attention of millions. This campaign has reached over 45% of households in Kenya.

**3. Last mile distribution**

Partnering with NGOs and e-commerce companies to reach the grassroots in the distribution and deliver of much needed supplies.



## Key Highlights From Guest Panelists

### Mr. Arif Neky – Senior Advisor, United Nations Strategic Partnerships and SDG Partnership Platform

There is renewed focus on private sector capital and expertise that can be used strategically to address the SDG financing gap. There are some key things that need to happen: (1) we need to find more creative ways of unlocking private capital that can complement the constraints of public capital and (2) we need to converge for impact, not work in silos, (3) we need to create wealth and impact simultaneously, especially in marginalized areas so that no one is left behind, (4) we need to improve our legal, fiscal and regulatory policies to make Kenya a stronger destination for private capital and (5) we need to move beyond short-term fiscal and political cycles so that investments are more predictable and sustainable. Blended finance is one tool to use - it is not the silver bullet.

Incentives are important. Right now in Kenya, we don't have social enterprises set up in our legislation, and that means in terms of tax incentives such establishments are treated the same as traditional for-profit companies (irrespective of the impact they make on society). We are drafting a social enterprise bill to address this gap. The groundwork is being laid to create a clear definition of what social enterprises look like and what incentives they can receive through legislation. This needs to be pushed with more urgency in order to fast-track the introduction of capital. In addition, there is an effort to write a foundations law to ensure we have enabling legislation that can support and incentivize such entities.

No single financing instrument can provide a viable, long-term solution by itself. Although the volume of Blended Financing is increasing, there is need to highlight the fact that it is ideally used in certain contexts. Financing on commercial terms should still remain the default approach so as not to create dependency on private sector subsidies or distort long-term markets. Blended Finance can be catalytic but it's not the model to use when it comes to long-term structural issues where permanent subsidies



are required. Blended Finance is better matched to projects where there is a greater public benefit that exceeds returns to private investors. Blended Financing should be used primarily for transitory challenges in the market place and some level of initial de-risking to crowd-in more scaled-up commercial financing. It's critical that the specific instrument being used for Blended Financing (such as debt, equity, a guarantee product or performance based incentive structure) must be clearly designed to meet the development challenge at hand, so that markets can eventually get to commercial sustainability.

**Dr. Mercy Mwangangi – CAS, Kenya Government Ministry of Health**

A Blended Finance instrument can be used to meet the merits of the three normative pillars of financing a health system i.e. resource generation, pooling and strategic purchasing. We currently have about KES400bill circulating each year in the health sector. This figure begs the question: Is this money leading to desirable, aspirational health outcomes? The short answer is Kenya is facing a huge gap of another KES1bill to achieve the health care outcomes we desire.

Health for all is the ministry's goal. To this end the Ministry of Health is working on a Health Financing Framework Policy Document that will provide better clarity and rationality regarding where and how we are deploying resources. The ministry is keen to harness the agility presented by the private sector and use the augmented role of philanthropy to help achieve primary healthcare outcomes. The ministry is also looking at how to finance public health security issues and asking hard questions, such as: Are the Kenyan laws and frameworks flexible and accountable enough to provide quick service/response when required?

Blended Finance can be a powerful tool for various development initiatives, but some have argued that there is need for caution especially if such models bring about market distortion when there is too much private sector engagement, especially in a sector like healthcare. Development players also have to be very keen to avoid fungibility because every time a sector, like health, experiences increased funding



there is risk of disinvestment by government. Which means any innovative financing instrument has to be used as a catalyst, not a deterrent or crowding out of government resources.

### **Mr. Peter Wamicwe – Convergence Finance**

We first need to understand what blended finance is. Blending is not an asset class or investment thesis like impact investment. Blending is basically a structuring approach used to de-risk a transaction in order to attract private sector investment. There are three key things that make blended finance transactions viable and/or successful:

1. Capital leveraging: the de-risking ability has to attract private capital
2. Bankability: capital providers want to invest in going concerns
3. Solid business plan: blended finance will not solve a flawed business plan

Kenya's investment climate has continued to provide a conducive space for private investors and financiers, hence Kenya has been able to lead in the number of blended finance transactions. Since the first blended transaction in Kenya, back in 1981, there have been 92 such transactions with a bankable value of approximately US\$13bill and catalytic capital providers account for 31% of this amount (from foundations, NGOs and donor agencies).

The reason why Kenya ranks #1 in Africa when it comes to the *number* of Blended Financing transactions, is due to:

1. A favourable investment climate that provides comfort for private sector investors and soft capital providers
2. A good number of bankable investment opportunities because entrepreneurs are skilled enough to identify key target areas/pain points for would-be customers
3. Reduced time between deal origination and conclusion as a result of better preparation when it comes to making sure all stakeholders know exactly what the counter party wants/needs



4. Improved technical assistance, which accounts for about 30% of the four blended financing archetypes (concessional capital, guarantee/risk insurance, technical assistance funds and design-stage grants)

But Kenya ranks among the top seven when it comes to the average *deal size* of Blended Finance transactions.

**Ms. Nuru Mugambi – Director of Public Affairs and Sustainable Finance, Kenya Bankers Association**

During this pandemic central bank has been working closely with the banking industry to open up liquidity while mitigating risk to ensure the economy is still moving despite reduced productive activity. Private banks are working hand-in-hand with their customers to reprice and lower the debt burden. In Kenya, banks have already repriced in excess of KES800bill worth of household and commercial debt.

Blended Finance (BF) is not new. This financing model has been primarily advanced by develop finance institutions (DFIs) that get their capital from multiple sources—sovereign money, grants, philanthropists, and foundations. But now, as a response to the coronavirus pandemic, we are seeing new players such as insurance companies, fintechs and banks collaborating with NGOs and foundations to advance Blended Finance and mitigate the challenges we are facing. Risk mitigation is probably the biggest issue that is slowing down the flow of capita but, at the same time, the financial sector is now more willing to partner, collaborate and have conversations about increasing the flow of capital while mitigating risk.

The Acorn transaction, finalized in October 2019, was the first certified Green Bond initiative in east and central Africa. It was listed on the London Stock Exchange in January 2020 and it demonstrated the importance for collaboration. The Green Bond programme provided the policy framework that introduced a withholding tax incentive.

The government has a critical role to play in incentivizing activity around blended finance, particularly when it comes to signalling. The use and dissemination of data and announcement of new strategic



directions (for example our Government's interest in green building initiatives) helps send the right signal to the market place and helps attract free or patient capital.

East Africa and Kenya in particular is receiving a lot of investment around fintech start-ups that target the informal sector. A large number of co-operatives operate in the quasi informal sector (even though co-operatives are formal structures). The risk within this sector has to do with pricing; some fintechs charge as high as 5% per month for credit (60% annually). There is a cost associated with operating/investing in the informal sector but that does not mean that there are no opportunity, especially if investors strategically leverage on mobile telephony, peer networks and peer accountability frameworks. It's important to address the inherent risks within our informal economy market structure in order to incentivize investors.

Government is doing a good job in terms of introducing the Movable Assets Registry that helps diversify the types of collateral that institutions can use to access capital. In fact, SACCOS and co-operatives are now beginning to look at this registry as a way of derisking their capital.

**Mr. William Asiko – Managing Director Africa Regional Office, The Rockefeller Foundation**

There are pockets of success where Blended Finance models have been impactful, but we have to figure out why they have not been transformative at a national, regional or even international level. We should start viewing blended finance opportunities as deals that have to be led by professional deal facilitators or brokers. We also need to focus on developing the market to a level that can easily absorb large amounts of capital. Another area that needs to be addressed is the highly regulated sectors, such as banking, that are often unable to engage in Blended Finance opportunities simply because of the legal and regulatory frameworks they are forced to operate in. We also need to unpack the SDGs and list those that are commercially viable with a view to understanding/addressing the risk factors. Foundations can often help de-risk such opportunities.





The challenge is not that the majority of informal entrepreneurs are unbanked or that co-operatives are not receiving the finances they need. The real challenge is our enabling and regulatory environment that doesn't facilitate the efficient allocation of resources to these groups.

Yes, social enterprises need to grow and therefore they may require distinctive laws to support their growth. But it's a double-edged sword, because at some point they should be treated exactly the same as private companies because they have to adopt robust governing structures to attract private sector investment.

Some of the things we need to address from an ecosystem perspective include, but are not limited to, creating an enabling environment, creating regulations around how to allocate resources and making sure that governance structures are appropriate, not only for social enterprises, but even for the informal sector that continuously struggles with attracting capital.

#### **Highlights From Two Seminar Attendees:**

##### **Dr. Manu Chandaria**

"Demonstrable accountability measures by Government especially in response to COVID19 Emergency response is key in giving confidence to private capital and donations."

##### **Dr. Richard Munang – United Nations Environment Programme**

"There lies opportunities in the youth, the informal sector and mobile money platforms in contributing to financing social investments towards the achievement of the SDGs"

----- 0 -----

Africa's social challenges cannot be achieved without a paradigm shift and innovative financing approaches.

To **#buildbackstronger** we need to scale interventions with urgency.