

THE ALCHEMY OF BLENDED FINANCE: OPPORTUNITIES AND CHALLENGES

By Patrick Brean, Managing Director, Crystalus Inc.

A few months ago in Addis Ababa, at the UN's Third Conference on Financing for Development, the world came together to chart the course of development finance for a generation. Nations agreed on a set of 17 Sustainable Development Goals to eradicate extreme poverty and address social inequalities by 2030.

The Addis conference sharpened global focus not only on the highest-priority development needs, but also on the challenging new funding targets to meet these needs, thought to be some \$4 trillion **annually** across sectors such as infrastructure, climate, food, education, and health.

Closing this enormous funding gap will take a host of measures, not least of which is an emerging funding trend called "blended finance" – essentially a combination of public, private and not-for-profit funds for development. And while blended finance promises to deliver far-reaching benefits for sustainable development, the path forward for stakeholders – public and private – is anything but clear.



Consider some hard numbers. Official development assistance hovers around \$130 billion annually; add another \$100 billion from multilateral development banks, \$45 billion from not-for-profits and similar sources, and a further \$1.1 trillion from private flows and you reach nearly \$1.5 in annual funding for development.

As substantial as these numbers are, they still fall short by \$2.5 trillion annually.

And while blended finance is not a panacea – local measures like improved tax collection and reduced subsidies must be pursued – it holds tremendous promise to significantly close this funding gap. Put simply, public funds must be deployed more creatively, so that substantially more private funds can be mobilized – a veritable alchemy of development finance.

The question is, how?

Development Finance's Philosopher Stone

Medieval alchemists pursued the mythical philosopher's stone as a catalyst to transform lead into gold. Today's practitioners of blended finance

seek catalytic approaches – admixtures of public and private funding – seemingly as elusive and daunting.

The challenge lies in the diverse natures of key market players, and the complex financial structuring often required. Development agencies bring their strong culture of poverty alleviation and impact measurement, not-for-profits deliver creative approaches and on-the-ground networks, and private funders bring deep pockets and risk appetite.

All players are skilled, in their own way, at deploying funds to produce results; however, each comes from a different angle and with their own language and motivations. The notion of a “closed end master fund” might seem foreign to a development agency officer, while the criteria for deeming government funding as “official development assistance” could be inscrutable to a private fund manager.

As a result, many blended finance initiatives start with the right players and the best intentions, but stumble and fail shortly thereafter. Despite everyone bringing a crucial piece of the puzzle to the table, they can’t make the pieces fit into an overall picture. Important opportunities are lost, and valuable relationships break down.

So how best to pursue opportunities and overcome challenges? Although the blended finance space is still in its infancy, some keys to success are quickly emerging. Understanding and capitalizing on these keys will separate the winners from the losers.

Adept and Adapt

At Crystalus, we have worked tirelessly with blended finance practitioners over the past decade, long before the term was coined. We have advised on over \$4 billion in multilateral and public-private development finance initiatives around the world. And we have worked with all key players – government agencies, multilateral institutions, not-for-profits, and private fund managers. We understand how each side thinks and what unlocks their participation.

And while myriad blended finance ideas abound, success rests, in our view, on two key principles – *adept* and *adapt*.

Why adept? Since governments have finite resources to catalyze as much private engagement as possible, they want to find the most skilled and proficient private and not-for-profit partners to work with and fund. More than just being able to raise and deploy capital, potential partners must demonstrate development credentials, international networks, and local-market capacity.

Why adapt? Like any early-stage market – think dot-com in the late 1990s – blended finance initiatives have been lumpy, with different approaches leading to various degrees of success or failure. Like today’s Google or Amazon, successful blended finance players won’t be built easily or quickly; rather, they will need a combination of patience, vision, nimbleness, and non-linear thinking. Those with a longer-term end game, and an ability to roll with the punches, will excel.

Importantly, there is a need for the various parties to be on the same page, often involving facilitated discussions, as well as integrating traditional development funding techniques with complex structured finance in a sound and effective manner.

And just like the early alchemists were the pioneers for modern-day chemistry and medicine, the

current pioneers of blended finance will usher in an exciting new era of development, with the power to transform millions of lives.

How can Crystalus help you?

We deliver unparalleled expertise in blended finance mechanisms by helping clients seamlessly integrate development finance and structured finance approaches involving debt, equity and all approaches in between. We have advised on over \$4 billion in multilateral and public-private development finance initiatives around the world. And we have worked with all key players – government agencies, multilateral institutions, not-for-profits, and private fund managers – to advance development finance initiatives and ensure appropriate internal capacity and expertise.

- Seamless integration of complexities between development finance and structured finance
- Opportunity identification and assessment
- Strategic positioning and messaging
- Due diligence and risk analysis
- Identifying and working with funders (public, not-for-profit and private)
- Knowledge transfer, tailored training, mentoring

Patrick Brean is Managing Director of Crystalus, Inc., an international advisory firm specializing in development finance, risk management and corporate strategy. He can be reached at pbrean@crystalus.ca.

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CRYSTALUS RECENT MANDATES

Governments & Multilaterals

CLIENT	LOCATION	ACHIEVEMENT
Government Agency	International	<i>Due diligence and risk advisory for a major multi-donor climate fund</i>
Government Agency	International	<i>Structuring and risk advisory for three emerging-market investment funds totaling \$500 million</i>
Government Agency	International	<i>Risk management and assessment tools & training</i>
Government Agency	Asia	<i>Export credit agency business strategy and financial modeling</i>
Multilateral Institution	Middle East	<i>Structuring and advisory for trust funds totalling \$1 billion</i>
Municipal Loan Fund	North America	<i>Outsourced credit due diligence</i>
Clean-Tech Fund	North America	<i>Risk management, credit risk advisory and training</i>
Export Finance Institution	Europe	<i>Outsourced credit due diligence</i>
Export Finance Institution	International	<i>Training courses in due diligence and credit analysis</i>
Export Credit Agency	North America	<i>Carbon finance products and risk assessment</i>
Government Agency	North America	<i>Restructuring of asset-backed securities investment portfolio</i>
Government Agency	North America	<i>Program risk analysis and governance structure assessment</i>
Multilateral Institution	Middle East	<i>Performance evaluation and restructuring plan</i>
Multilateral Institution	Middle East	<i>Risk management framework for private sector financing operations</i>

Private Sector

CLIENT SECTOR	LOCATION	ACHIEVEMENT
Foundation	International	<i>Donor engagement advisory for \$2.5 billion loan fund</i>
Investment Fund	International	<i>Fund structuring and capital raising</i>
Nanotechnology	North America	<i>Strategic & financial planning, capital raising</i>
Investment Fund	North America	<i>Investor engagement and business planning</i>
Foundation	Latin America	<i>Business plan, capital structure, financial modeling</i>
Waste Recovery	North America	<i>Business plan, financial modeling and funding strategy</i>
Renewable Energy (Solar)	North America	<i>Financial modeling and capital structure</i>
Major Banking Group	Asia	<i>Business plan and funding strategy for special-purpose subsidiary</i>
Emerging Market Fund	International	<i>Investor memorandum</i>
Renewable Energy (Biotech)	Caribbean & Latin America	<i>Business plan, financial modeling, capital raising</i>
Mobile Voice & Data	Africa	<i>Business plan, funding strategy</i>
Biomass Conversion	North America	<i>Business planning and strategy, financial modeling, capital raising</i>