



# MARKETLINKS

**USAID's Use of Blended Finance to  
Grow Investment in Developing and  
Frontier Markets**

March 26, 2020



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### Facilitator

**Sashi Jayatileke, USAID**

### Speakers

Maria Hilda Rivera, USAID

Robin Young, INVEST

Paul Ouma, CrossBoundary

Reza Fazel, Open Capital Advisors

# Sashi Jayatileke



Sashi Jayatileke is the Team Lead of the Development Finance, Impact Investing, and Entrepreneurship team in USAID'S Private Sector Engagement (PSE) Team. She manages the team that provides technical and strategic advice on finance, including the PACE program, INVEST, Catalyze, and the blended finance learning agenda. She previously worked with USAID's Asia Bureau supporting economic growth priorities. Sashi holds an MSc from the London School of Economics and a BA from Vanderbilt University.

# María Hilda Rivera



María Hilda Rivera is an Energy Advisor for Power Africa. She joined Power Africa in 2014 to launch its distributed energy initiative. At Power Africa she covers country portfolios in East Africa, and leads efforts in financing for distributed energy. María Hilda has worked in renewable and distributed energy with a focus on private sector development. Her graduate studies were in Biological and Agricultural Engineering and in International Development- Agricultural Economics-at the University of California, Davis. She studied Bio-Resource Engineering at Rutgers University.

# Robin Young



Robin Young is a Strategic Investment Advisor with USAID INVEST. In 2017, on behalf of DAI she led development of the INVEST project with USAID and investment partners to create the platform for mobilizing investment for development impact. As a Strategic Investment Advisor on INVEST, she works with USAID Missions and with network partners to mobilize private capital for health, clean energy, sustainable landscapes, agriculture, and small and growing businesses in Asia, Africa, Latin America, and the Caribbean. Robin has an M.B.A. from the Georgetown University McDonough School of Business and a B.A. in Economics from Tufts University.

# Paul Ouma



Paul Ouma leads CrossBoundary's East Africa investment advisory team and is based out of the Nairobi office. Prior to joining CrossBoundary, Paul worked with a sub-Saharan Africa focused private equity firm in Mauritius. He has also worked for the International Finance Corporation (IFC) executing debt and equity transactions across Sub-Saharan Africa in the manufacturing and services sectors. Paul holds a Bachelor in Finance with a minor in Accounting from DePaul University in Chicago.

# Reza Fazel



Reza Fazel joined Open Capital in 2015, and has developed core expertise in the off-grid energy sector. Reza's energy access experience encompasses support at strategic, capital raising, operational, and ecosystem levels, having acted as Country Manager for a pay-as-you-go solar home systems business in Rwanda, engaged deeply at a sectoral level in Uganda where he leads the Uganda Off-Grid Energy Market Accelerator (UOMA), and provided strategic and capital raise support to several off-grid operators across the region. Reza holds a degree in Economics from the University of Warwick.

# Key Topics of Discussion

- What is **blended finance** and why are development agencies using it?
- How would we **replicate** some of the approaches discussed today?
- What is the importance of and approach to **market development** in the **off-grid energy sector**?
- How can development agencies utilize **pay-for-results** contracts for investment facilitation activities?
- What is the role of **transaction advisors** in raising capital in developing markets?



Photo by Azuri Technologies

# Blended Finance 101

(Contents drawn from resources produced by Convergence)



MARKETLINKS

# What is Blended Finance?

- The strategic use of donor funds to mobilize private capital for sustainable development results.
- Structuring approach that allows organizations with different goals to invest alongside each other to create financial returns and positive development outcomes.
- Reduces investment barriers and aligns private capital flows with development needs by creating investable opportunities in developing countries.
- Often measured by leverage ratio (the amount of commercial financing mobilized by development capital using blended finance) or development impact.

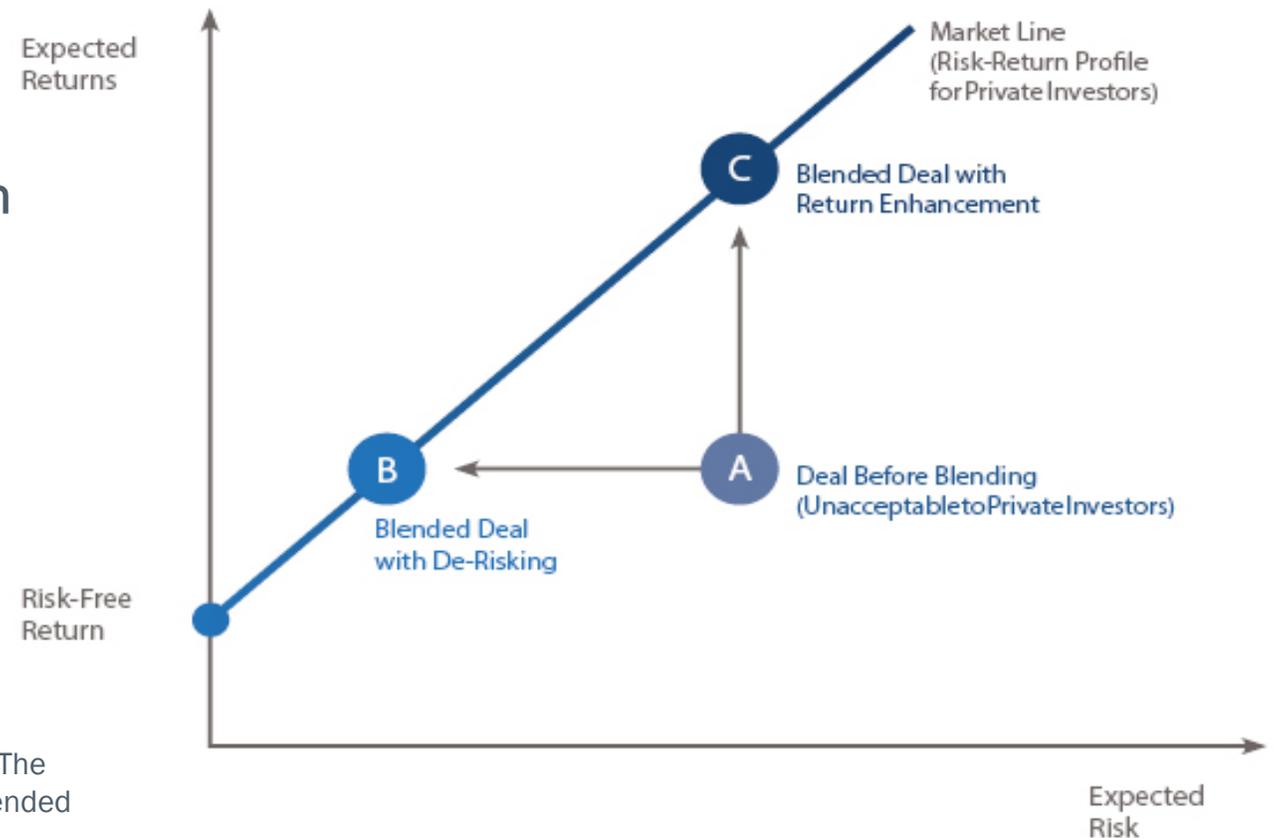
# The Importance of Blended Finance for Development

- Can be used to close the \$2.5 trillion annual financing gap
- Market characteristics and barriers to entry in developing countries – increase real and perceived investment risk and discourage private capital flows
- Leverages limited donor funding to mobilize private investment to support sustainable and inclusive development
- Crowds in additional private sector funds to emerging and frontier markets and, in the longer-term, build local financial ecosystems and improve access to financial services

# How Does Blended Finance Work?

1. **Reduces barriers** to private investment in emerging and frontier markets.
2. **Enhances an investment's expected return relative to its expected risk factor** – or the investment's risk-adjusted return - thereby making the investment more attractive to investors.
3. **Creates a demonstration effect** in the market.

## DEPLOYING BLENDED FINANCE TO ACHIEVE COMMERCIALY ACCEPTABLE RISK-RETURN PROFILE

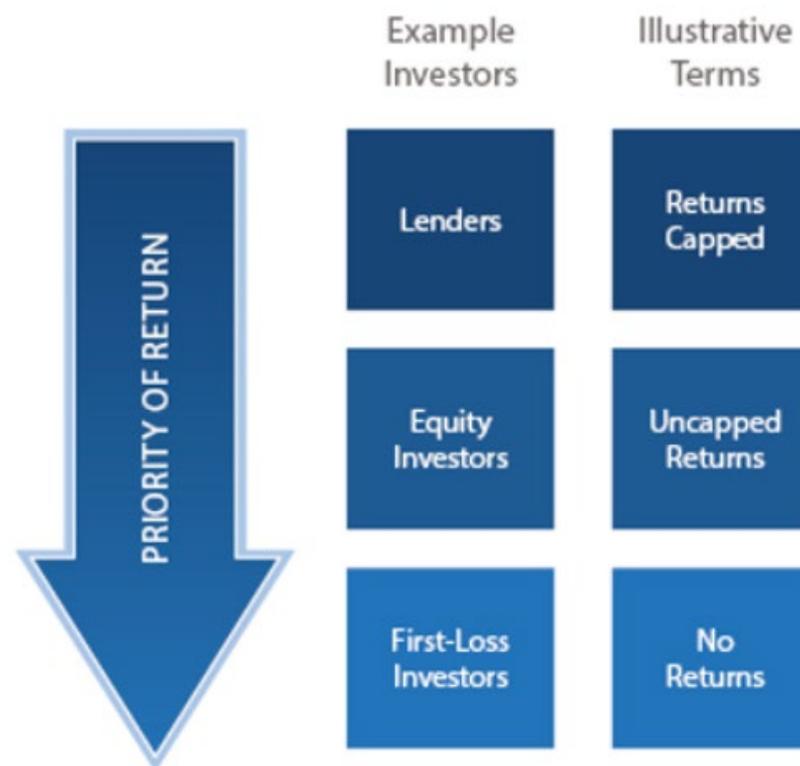


# How Does Blended Finance Work?

## Blended finance is a structuring approach

- **Structuring:** Combining different types of capital, risk mitigation, and incentives to attract investors and appropriately fund an investment.
- **Debt:** By taking on debt, the borrower pays interest to borrow money from a lender and has a defined repayment schedule. Lenders who issue debt are paid back before equity investors gain profits.
- **Equity:** By taking an equity investment, the investee is allowing an outside party to take partial ownership of the company. Equity investors often expect a higher rate of return and more control over the investment.

## ILLUSTRATIVE BLENDED FINANCE STRUCTURE (SIMPLIFIED)



# Key Players in Blended Finance Deals



- Development agencies
- Philanthropic organizations
- Private investors



- Institutional investors
  - Pension funds, insurance companies, sovereign wealth funds, commercial banks, investment banks, private equity firms, etc.



- Development Finance Institutions (DFIs)
- Multilateral development banks



- Intermediaries
  - Transaction advisory firms, fund managers, NGOs, etc.

The contents of this slide are drawn from Convergence's *Who Is the Private Sector*, The Blended Finance Taskforce's *Better Financing, Better World*, and Convergence's Blended Finance Training for USAID's PIVOT Program

# Development Agency Approaches to Blended Finance

- **Contributing catalytic capital** that helps de-risk investments and create the appropriate risk/returns required to crowd in private investment.
- **Providing guarantees** to lenders that in cases of losses or default, donor will cover a portion of the borrower's payments. This reduces the risk for the lender.
- **Purchasing insurance** against certain risks to expected returns. This protects investors should certain risks arise and cause a loss.
- **Assisting project design and development** so that its fruition appeals to private sector actors and simultaneously has social and economic development benefit.
- **Facilitating technical assistance** sidecar facilities and transaction advisory services.

# What is Considered a Successful Blended Finance Approach?

## Characteristics demonstrating alignment of private and development interests

- **Additionality** offers evidence that the blended finance development initiative generated meaningful private sector participation that wouldn't have happened otherwise, although it can be hard to prove.
- **Impact** illustrates the ways in which the investee or investable project contributes to sustainable development in a developing country.
- **Returns** demonstrate that the deal is expected to generate a profit (size depends on investor's preference for profit or impact).

# Development Agency Approaches to Blended Finance

## Technical Assistance:

- **Transaction advisory services:** By covering the fees of transaction advisors, development agencies can incentivize them to work on deals in emerging markets that would otherwise be viewed as too risky and less profitable.
- **Technical assistance sidecar facilities:** Supports fund managers to provide portfolio companies with business advisory services, thereby decreasing the *risk* associated with investing in these companies.



Photo by Azuri Technologies

Power Africa and USAID INVEST: Insights and Lessons from East Africa



# Power Africa

## Leveraging partnerships to increase access to power in sub-Saharan Africa

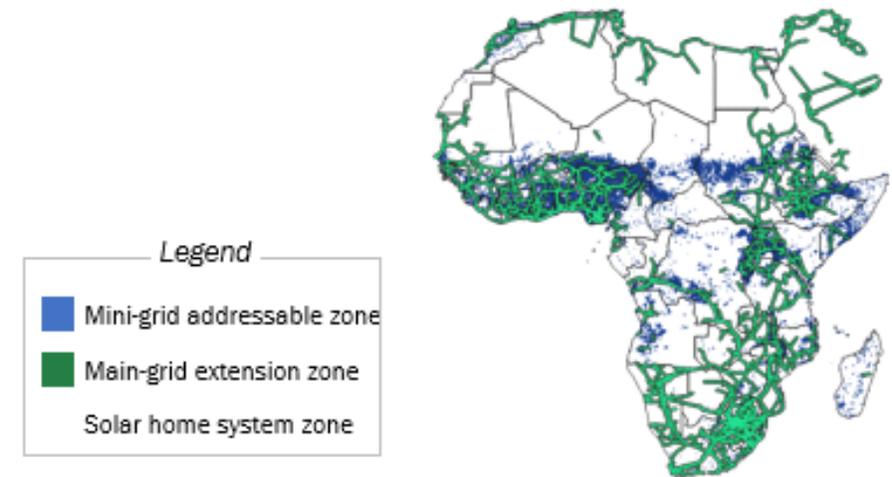
- **Problem:** Two out of three people, approximately 600 million, in sub-Saharan Africa are without electricity. While many of these people will be connected to the electricity grid in the future, some live in remote areas that will never be connected.
- **Goal: Double access to electricity** by adding more than 30,000 megawatts (MW) of cleaner, more efficient electricity generation capacity and 60 million new home and business connections.
- **Approach:** Bring together resources of over 170 **public and private sector partners**. Power Africa uses a **transaction-focused model** adapted to local market conditions to galvanize collaboration, engage in critical actions to accelerate transactions, and drive systemic reforms to facilitate future investment.



# Power Africa Beyond the Grid

- **Goal: Accelerating off-grid electricity access** to add 25-30 million new connections by 2030 with a focus on household solar and micro-grids.
- **Approach:**
  - **Scaling up** household solar energy market by increasing access to finance and providing technical assistance.
  - Striving to **identify scalable micro-grids** that offer opportunities for powering rural communities and industry.
- Globally the off-grid solar industry has grown to a **\$1.75 billion** annual market.

Geospatial analysis demonstrates off-grid potential



308mm best served by SHS

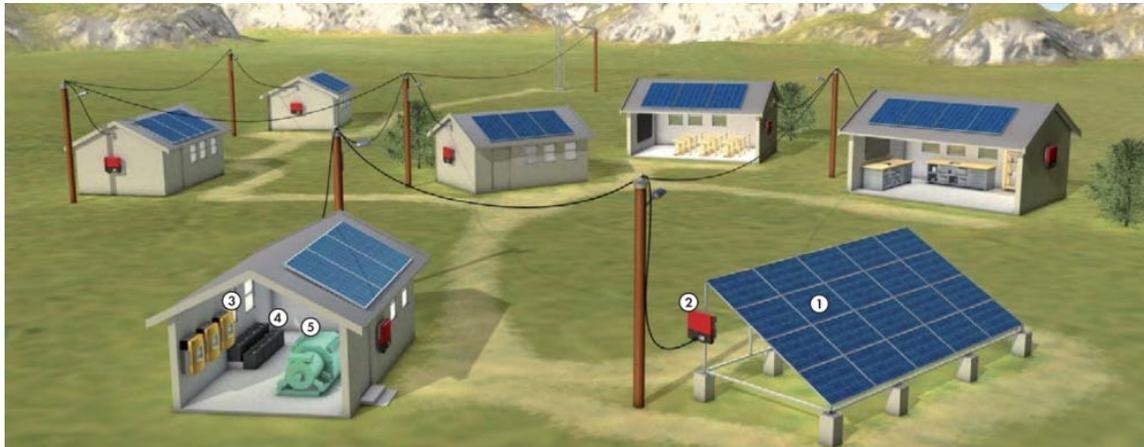
100mm best served by mini-grids

210mm best served by grid extension

# Beyond the Grid

## Mini-grid (MG)

- Small-scale electricity generation system
- Support loads for productive use
- Typical generation per household is 100W-500W



1. Solar panel, 2. battery inverter, 3. solar inverter, 4. batteries, 5. Generator

## Solar Home System (SHS)

- Stand-alone systems offer cost-effective mode of supplying power
- Mainly used for lighting but can also support appliances
- Typical size is 6W- 80W



# Power Africa and USAID INVEST

Power Africa has partnered with INVEST on two initiatives to mobilize private capital for off-grid energy in East Africa.

- **INVEST Power Africa Kenya:** Focused on providing transaction advisory services to identify and close deals in the increasingly complex financial and business reality of the growing off-grid sector.
- **Uganda Off-grid Energy Market Accelerator (UOMA):** Employs a market development approach in partnership with other donors and the private sector to build the demand, supply, and an improved enabling environment for off-grid energy.

# Insights and Lessons from Kenya



Photo by Azuri Technologies

# INVEST Power Africa Kenya

## Transaction advisory to support off-grid energy markets

- INVEST ran a **competitive procurement** and selected CrossBoundary and Open Capital Advisors to identify four promising off-grid energy businesses and one DFI for transaction advisory services.
- **Transaction advisors** helped conduct market assessments, prepare financial documentation, and engage with investors to raise growth capital.
- This was INVEST's first subcontract with a built-in **performance success fee**. Over half of the contract's value depends on the subcontractors advancing on the capital raises and closing transactions.
- Efforts have **unlocked over \$63.25 million** from three transactions across the energy access sector, enabling these companies to provide a projected 390,000 new connections and 6,000 upgraded connections,

# INVEST Power Africa Kenya

## Transaction advisory engagement and selection process



Scorecard covered several key **factors important for engagement selection**, such as:

- Capital need amount, type, raised to date
- Total connections to date & expected KE connections over next 3 years
- Overall summary justification capturing any uniqueness /possible innovative structuring

Together with additional input provided by USAID/Power Africa, the Consortium aligned on a **shortlist of 14 organizations to consider for outreach**, these included:

- 1 Development Finance Institution (“DFI”)
- 6 Solar Home System (“SHS”) operators
- 2 Mini-grid (“MG”) operators
- 6 local Financial Institutions (“FIs”)

Agreed to segment outreach to **first speak with operators + DFI** as many of these already speak with local banks. Held consultations with nine organizations.

Following consultations, the Consortium filtered the engagements based on key criteria to select underlying priority engagements

1. Azuri
2. GreenLight Planet
3. PowerGen
4. M-KOPA
5. DFI

# INVEST Power Africa Kenya

## Five transactions across Kenya's energy sector

|                                 |  |  |  | DFI <sup>1</sup>                    |  |
|---------------------------------|---|--|---|-------------------------------------|---|
| <b>Transaction Size (USD)</b>   | \$26M<br>(7.8m ~ KE)  | \$70M<br>(35m ~ KE)  | Undisclosed   | Undisclosed                         | Undisclosed   |
| <b>Status</b>                   | Closed<br>\$26M   | Closed<br>\$37.25M, First round  | Closed,<br>First round  | On hold                             | Closed,<br>First round  |
| <b>Potential KE connections</b> | 190,000   | 200,000  | 6,000   | 20,000                              | 30,000  |
| <b>Type of engagement</b>       | Equity Transaction  | Debt Transaction   | Equity Transaction  | Debt Facility,<br>Multiple Currency | Debt Transaction  |

<sup>1</sup> Development Finance Institution requested anonymity for commercial reasons

# 1 Azuri Technologies

|                                   | Activities   | Investment goals  | Next steps   |
|-----------------------------------|--|---|--|
| Develop energy access capital map | <ul style="list-style-type: none"><li>• Screened 215 investors for ticket size and financial instrument</li><li>• Identified 46 candidates, contacted 28 of them, 12 of them went through initial DD process</li></ul>   | <ul style="list-style-type: none"><li>• <b>\$26 million<sup>1</sup> equity</b> round closed in June 2019</li><li>• \$20 million from Marubeni Corporation (Japan) - first off-grid investment</li><li>• <b>190,000 KE connections</b></li><li>• <b>Azuri has sold 25,000 units</b> since receiving the investment – 90% in Kenya to more than 80% new customers</li></ul> | <ul style="list-style-type: none"><li>• Looking to raise additional financing for the Azuri FinCo Mezzanine Debt</li><li>• Launching solar irrigation pilots in Uganda</li></ul> |
| Revised investor facing materials | <ul style="list-style-type: none"><li>• Drafted additional documents to highlight: impact metrics, geospatial electrification analysis, add-on service roadmap, product differentiation, and value chain focus</li></ul> |   |  |

<sup>1</sup> 30% or \$7.8 million expected for Kenya market



## 2 Greenlight Planet

|  | Activities   | Investment goals   | Next steps   |
|--|--|--|--|
| Aligning existing unsecured lender covenants | <ul style="list-style-type: none"><li>Analyzed several covenant materials to propose recommendations aligned across existing lenders</li></ul>                                 | <ul style="list-style-type: none"><li>\$70 million<sup>1</sup> debt syndicate; <b>\$37 million first round closed</b> (investors include GP, Symbiotics, responsAbility)</li></ul> | <ul style="list-style-type: none"><li>Coordinate due diligence process and final credit approvals for second close</li></ul> |
| Updating investor materials                  | <ul style="list-style-type: none"><li>Built out revised investor-facing model, focus on PAYG growth</li><li>Updated IM with latest developments</li></ul>                      | <ul style="list-style-type: none"><li><b>200,000 KE connections</b> (first close enables ~80,000 KE connections)</li></ul>   |  |
| Providing transaction facilitation           | <ul style="list-style-type: none"><li>Conducting investor outreach, aligning investors on terms, preparing marked-up loan documentation for discussion and iteration</li></ul> |  |  |

<sup>1</sup>\$35 million or ~50% expected for Kenya connections

# Insights and Lessons from Kenya

## Off-grid Sector

- Off-grid companies and their investors are **shifting their focus from growth at all costs to demonstrating a clear path to profitability, including product diversification to move with customers up the income ladder.**
- The **portfolio health of established companies has deteriorated slightly** driven by tight macroeconomic conditions.



# Insights and Lessons from Kenya

## Investor Landscape

- **Big ticket deals** are picking up but **remain concentrated among already scaled players**. Top 10 SHS providers have raised over \$1.1 billion since 2010 - representing two-thirds of total investment in the energy access sector.
- Historically, SHS companies borrowing in hard currency have done so inconsistently resulting in overall market inefficiency. As the market matures, companies are now **moving towards more structure syndicated issues to address some of the challenges that result from having different terms from multiple investors**.



# Insights and Lessons from Uganda

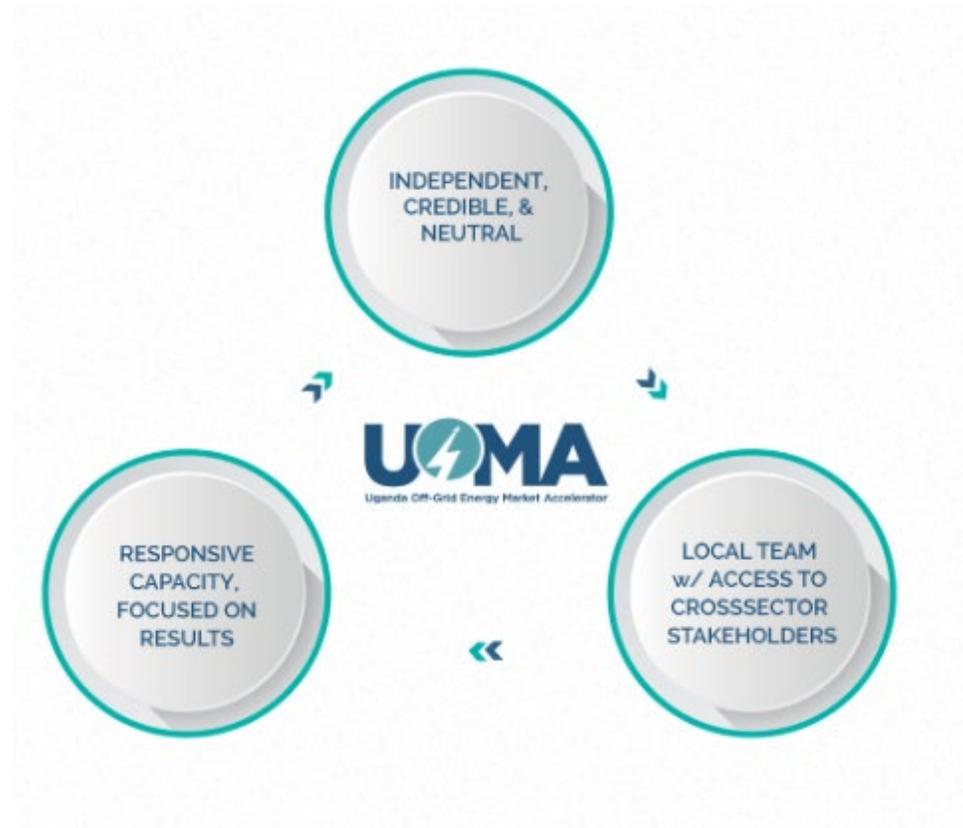


Photo by Azuri Technologies

# Uganda Off-grid Energy Market Accelerator

Reducing barriers to scale to accelerate off-grid energy access in Uganda through:

- **Research & Insight:** Providing data, analysis, and insight to businesses, investors, development partners, and policy-makers.
- **Coordination:** Coordinating industry actors and resources to increase efficiency.
- **Direct Interventions:** Catalyzing interventions where necessary to reduce barriers to off-grid energy access.



# Uganda Off-grid Energy Market Accelerator

UOMA initiatives for deeper engagement and impact:

- **Access to finance:** Increase access to local currency debt finance for private sector actors in off-grid energy, bridging a critical working capital shortfall and currency mismatch and enabling operators to increase affordability of units.
- **Unserved populations:** Reduce barriers to better target unserved populations in Uganda, improving access for some of the hardest-to-reach and most in need communities.
- **Productive use technology:** Support industry to test & validate productive-use technologies that can achieve economic benefits for off-grid Ugandans while growing energy demand.
- **Government policy and targets:** Support the public sector to create effective policies and an effective enabling environment to increase off-grid energy uptake in Uganda.
- **Communication and coordination:** Enable more effective communication and coordination in the off-grid energy sector in Uganda, resulting in better resource allocation and accelerated progress in achieving universal access.

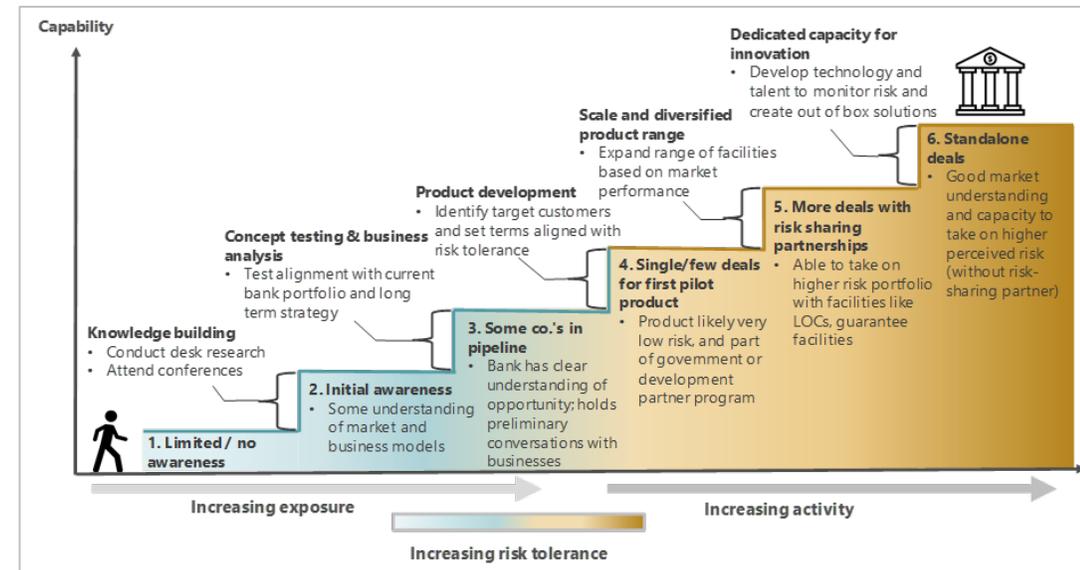
# INVEST and UOMA

## Market development support to scale off-grid energy

- **Improved access to finance** among private sector
  - Refined strategies to improve investment readiness and facilitated matchmaking events with lenders
- **Improved capacity of banks** to understand off-grid lending
  - Provided off-grid sector investment opportunity training to management, credit, and product teams
  - Improved due diligence process with proprietary tools
  - Identified potential pipeline of off-grid borrowers to test new due diligence tools
  - Identified synergies between bank portfolios, long-term bank strategies, and off-grid energy borrowers
- **Evaluated ability** for off-grid productive use (pilots in irrigation, refrigeration, and coffee processing underway)
- **Supported off-grid sector communication and engagement** as well as strengthened **policy and advocacy**

# Insights and Lessons from Uganda

- TA focused on **local banks**. Long-term sector sustainability requires local lenders to play a core role in providing local debt.
- **Banks have different levels of familiarity with off-grid market**. INVEST support allowed for a tiered approach with tailored, deal-oriented transaction advisory.
- Current risk sharing mechanisms are largely **insufficient for banks' risk appetites**.
- Banks are heavily bureaucratic; it is **critical to identify bank stakeholders who have influence and expressed interest**.
- A **local banking expert** was instrumental to “open doors,” increasing advocacy through deep understanding of inner workings of banks and advising on how to frame key messages.
- Transaction advisory services resulted in two pioneering deals with locally owned and operated firms and a local bank. **Deals were catalyzed by existing, although previously underutilized, donor/DFI-provided blended finance facilities**.





## USAID's Use of Blended Finance to Grow Investment in Developing and Frontier Markets

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# MARKETLINKS

# Q&A

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