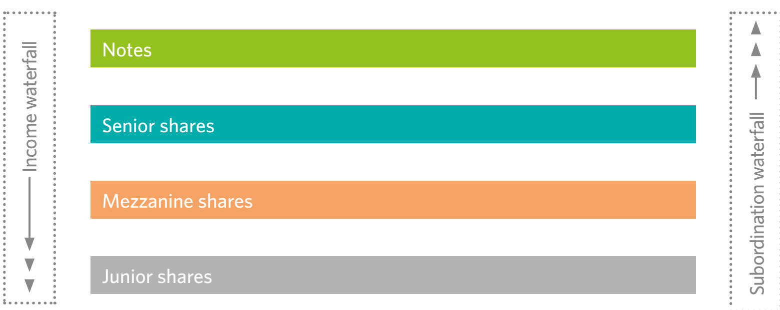
Topping up capital for development impact

The use of public-private partnerships in investment funds provides an efficient mechanism for scaling-up development capital and, at the same, offers private investors a route to make impact investments without high-risk exposure

Existing capital flows available for development fall significantly short of meeting the enormous financial challenges posed by the Sustainable Development Goals (SDGs). Mobilising capital from the private sector is therefore critical. What can be done to attract the impact investor who remains understandably risk averse, especially when it comes to investments made directly into developing countries? Over the past decade, investment funds set up as public-private partnerships (PPPs) have succeeded in addressing this concern and proved their effectiveness by leveraging a capital influx into development finance.

As the SDGs are more ambitious than the previous Millennium Development Goals, additional funding is needed. This is where PPP funds, with their specific

EXAMPLE OF A TRANCHED DEBT FUND



waterfall structures for risk and return, come in. This model – of which, for example, the European Fund for Southeast Europe (EFSE) is a pioneer – uses public funding from donors as a risk cushion in case of any defaults on the investment side.

Only when this so-called first loss tranche is depleted are semi-public investors such as international financial institutions called in, and then – only in a third step – private investors. Private investors who are interested in impact investments can now place their monies with funds that invest in countries or companies that would previously have seemed too risky because they effectively can count on an investment-grade risk cushion.

In the case of the funds advised by Finance in Motion, the PPP model is additionally supported by a very prudent investment and risk management process. In the more than 10 years since its inception, the European Fund for Southeast Europe, for instance, has not had to write off a single investment.

Another crucial element for the sustainable success of Finance in Motion's mandates is the technical assistance (TA) that goes hand in hand with the investment process. TA is not limited to individual support in, for example, optimising processes or developing new products. Its scope encompasses all aspects of the local financial sector, from financial education to supporting local responsible finance practices.

In addition, private investors also benefit from the waterfall structure when it comes to interest rate payments. While public donors in PPPs are usually last to collect interest on their investments, private investors receive a fixed rate yield even when the fund is not making any profit.

The income waterfall structure, together with the revenue waterfall structure, are key to leveraging public seed financing many times over, as many good examples in development finance funds show. In the case of the well-established EFSE, for instance, private funding is double that of public funding. Another example: the eco.business Fund, which was set up with Finance in Motion in December 2014, was able to attract private investments in its first year. In light of this track record, the PPP model is adding and will continue to add significant volume to official development assistance funding, directing flows into much-needed projects for achieving the SDGs in developing countries. ■

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