Glossary of Blended Finance Terms

ADDITIONALITY: Additionality describes the role concessional capital plays in bringing a deal to financial close. A deal is additional if concessional capital was the determining factor in bringing private capital into the transaction; i.e. the private capital would not have come in otherwise and is therefore considered "additional".

BLENDED FINANCE: The use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries to realize the Sustainable Development Goals (SDGs). Blended finance is a structuring approach, not an investment approach.

BOND: A bond is a fixed-income instrument that represents a loan made by an investor to a borrower (including privately placed securities and public issuances). Bond details include the end date when the principal of the loan is due to be paid to the bond owner and usually include the terms for variable (or fixed) interest payments made by the borrower. Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations. Owners of bonds are debtholders, or creditors, of the issuer.

CATALYTIC CAPITAL/FUNDING: Financial instruments allocated to transactions with the intent to mobilize private sector investment. The definition of catalytic capital can vary widely. At Convergence, catalytic capital only refers to financial instruments priced below-market (concessional), with evidence of the intent to mitigate investment risks and / or enhance the expected returns for private sector investors and deployed through one of Convergence's four blending archetypes:

- i concessional debt / equity,
- ii concessionally priced guarantees / insurance,
- iii project preparation or design-stage grant funding, and
- iv technical assistance grant funding.

CONCESSIONAL CAPITAL: Funds provided on below-market terms within the capital structure of a financial transaction to reduce the overall cost-of capital for the borrower and / or provide additional downside protection to more senior investors (if in a first-loss position). Concessional capital can be provided through a diversity of financial instruments, including debt, equity, grant funding, and mezzanine capital.

DEBT: An amount borrowed that must be repaid. The borrower usually repays the principal, i.e. the amount borrowed, over time, and, on top of that, also has to pay interest (i.e. an annual percentage of the loan outstanding).

DEVELOPMENT IMPACT BOND (DIB): A pay-for-success model where an investor pays up front for an intervention's costs (e.g. providing access to education to kids in rural India), the results of the intervention are then measured by clear, predetermined metrics (e.g. results of literacy tests in the intervention area). Then an outcome funder (usually a development agency or philanthropic organization) repays the investor, and provides a return on the investment, if the intervention achieves pre-agreed outcomes. A DIB is not equal to a fixed income security, i.e. from a 'real' bond.

EQUITY: A share of ownership of an entity. Equity can be found on a company's balance sheet and is one of the most common pieces of data employed by analysts to assess a company's financial health. A shareholders' equity (or owners' equity for privately held companies) represents the value that would be returned to a company's shareholders if all of the assets were liquidated and all of the company's debts were paid off.

FACILITY: Convergence defines a blended facility as an earmarked allocation of public development resources with private capital at the vehicle level, for deployment towards a specific recipient or intervention. This also includes risk-sharing facilities, or bilateral transactions, typically between donor or public entities and financial intermediaries, where the concessional capital helps mitigate potential losses on underlying loans originated by the financial institution. Another type of facility mentioned in this course is a Technical Assistance facility, which pools grant funding from donors to provide training and capacity building support to beneficiaries, such as entrepreneurs or financial institutions.

FUND: A fund is a pool of money that is allocated for a specific purpose. In the context of blended finance, examples include limited partnership debt and private equity funds, as well as funds-of-funds. These investment funds are entities created to pool the money of various investors with the goal of investing that money into various assets in order to generate a return on the invested capital. The pool of money in a fund is often invested and managed by a professional fund manager.

FUND MANAGER: A professional fund manager is responsible for implementing a fund's investing strategy and managing its portfolio. A fund manager can structure a fund in various ways and for different purposes. The manager oversees both the long-term and day-to-day fund operations, including marketing. Fund managers are paid a fee for their work, which is often a percentage of the fund's average assets under management (AUM).

GRANT: A grant is an amount of money that a government or philanthropic foundation gives to an organization or an individual for a particular purpose such as education or health. This money does not need to be repaid.

GUARANTEE: In this instrument, the guarantor agrees to pay part of the entire value of the loan to the lender as a risk-mitigation measure in the event of non-payment or loss of value. This instrument aids in shifting the risk-return profile of the investment and reduces the cost of capital, making the investments commercially viable. A partial credit guarantee can attract private investors by improving an investment's creditworthiness by limiting the downside losses and reducing the required return for that level of risk for other investors.

IMPACT INVESTING: An investment philosophy that seeks to generate both financial returns and development impact. Not to be confused with blended finance, which is an approach to structuring transactions that brings together multiple types of investors (e.g. public, private and philanthropic). Impact investors often take part in blended finance transactions.

INSTITUTIONAL INVESTORS: Large entities that invest on other people's behalf, such as pension funds, insurance companies, sovereign wealth funds, commercial banks, private equity firms, and asset/wealth managers. In blended finance, institutional investors are usually the providers of commercial capital.

INTERMEDIARY: Intermediaries can be advisory firms or even NGOs that facilitate deal sourcing between investors and investees. In blended finance deals that bring together public, philanthropic, and private investors, intermediaries are often the glue that makes these very hard transactions actually happen.

LEVERAGE RATIO: The amount of commercial capital mobilized by each dollar of concessional capital, where commercial capital includes capital deployed by private, public (e.g., Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs)), and philanthropic investors at market rates.

LIQUIDITY: Liquidity refers to a market's ability to allow assets to be bought and sold easily and quickly. In various emerging and frontier markets, market liquidity is often weak or nonexistent, which prevents an investor from getting their money out when they need it.

NOTE: A note is a debt security obligating repayment of a loan, at a predetermined interest rate, within a defined time frame. Notes are similar to bonds but typically have an earlier maturity date than other debt securities, such as bonds. For example, a note might pay an interest rate of 2% per year and mature in one year or less.

RISK-ADJUSTED RETURN: Risk-adjusted return defines an investment's return by measuring how much risk is involved in producing that return.

SUBORDINATED DEBT: Subordinated debt is an unsecured loan or bond that ranks below other, more senior loans or securities with respect to claims on assets or earnings. In the case of borrower default, creditors who own subordinated debt will not be paid out until after senior debt/bondholders are paid in full. Therefore, subordinated debt is riskier than unsubordinated (and senior) debt.

TECHNICAL ASSISTANCE: Technical assistance is funding (usually in the form of grants) provided by donor agencies and foundations to pay for information, expertise, instruction, skills training, transmission of working knowledge, and consulting services. Technical assistance is not part of the financial structure of a deal. The aim of technical assistance is to maximise the quality of project implementation and impact. The idea being that a stronger project will lead to private capital being drawn into the transaction.

WEIGHTED AVERAGE COST OF CAPITAL (WACC): WACC represents a firm's cost of capital where each category of capital is proportionately weighted. It is calculated by multiplying the cost of each capital source (debt and equity) by its relevant weight by market value, then adding the products together to determine the total. WACC is commonly used as a hurdle rate against which companies and investors can gauge the desirability of a given project or acquisition.