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Development Return Versus Investment Return:

Two Solitudes or Two Sides of the Same Coin?

The Urban Dictionary describes a war of attrition as a situation where *"forces do not confront each other in direct combat…, but instead aim to wear each other down over a period of time".*

In many ways, the development finance space has devolved into such a conflict – not physical, not financial, but motivational. As a result, innovative finance for development – including concepts like blended finance – has largely failed to live up to its promise, and Sustainable Development Goals (SGDs) seem as unattainable as ever.

Is there a better way? Quite possibly, but it requires different thinking about how development capital can be deployed.

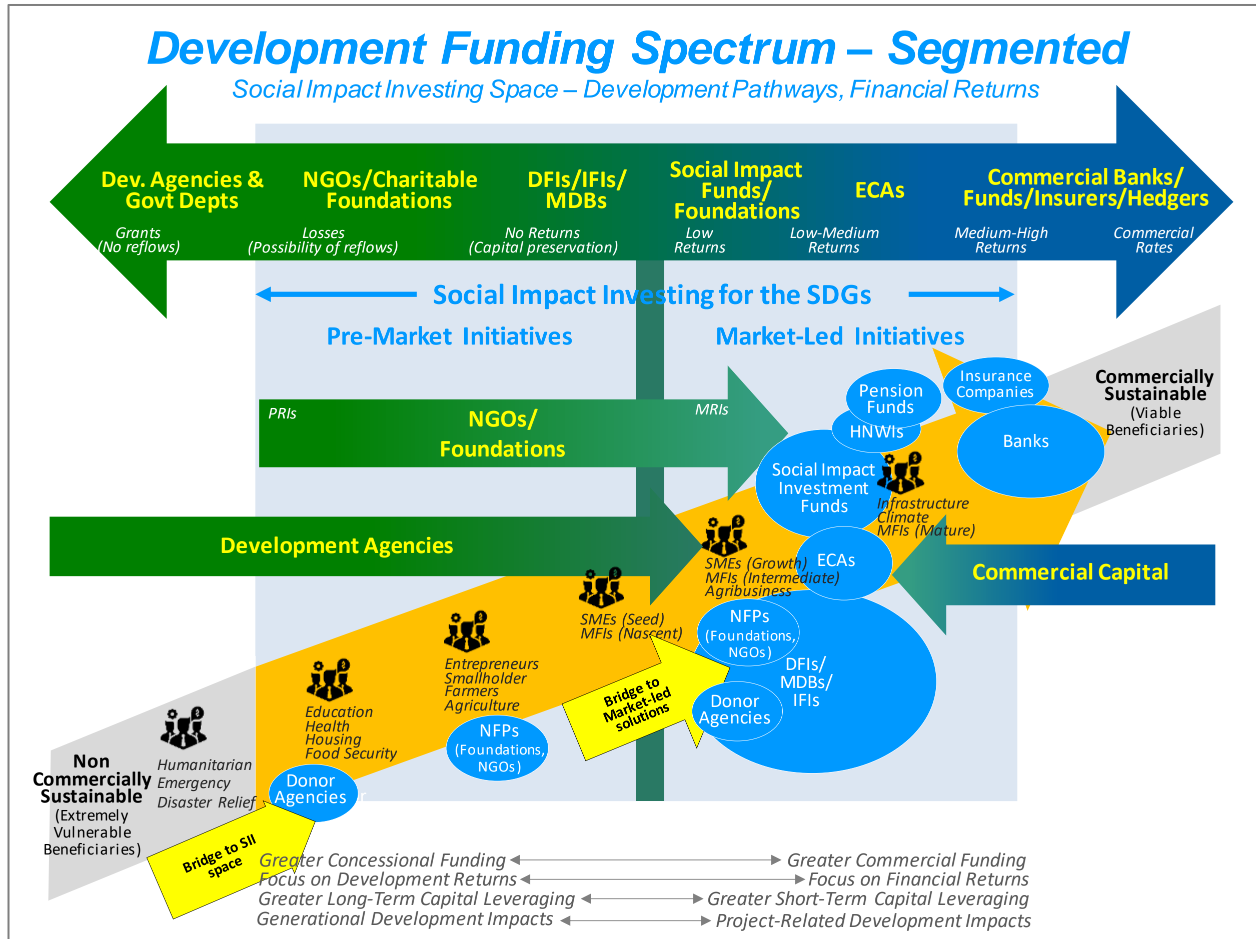
At the risk of stating the obvious, different development finance players have different motivations when they spend a dollar.

More concessional funders – donor agencies like SIDA and USAID – prioritize a development return on the capital they deploy. Meanwhile, more commercial funders – such as social impact investors – prioritize a financial return on the capital they deploy. Of course, donor agencies are happy to receive some financial reflows for their efforts, and impact investors are pleased when their investments improve lives.

In recent years, the sustainable development community has endeavored to compel concessional and commercial funders to collaborate under various "blended finance" schemes, with varying degrees of success. An inherent challenge with these approaches is that a substantial – and often uncomfortable – shift is required one way or the other. Either concessional donors are pulled into the commercial world of impact investors, or impact investors are pulled into the development world of donors. As one might expect, this results in much figurative kicking, screaming and dragging of heels.

Much of the problem stems from a fundamental misunderstanding of the development finance landscape. Most current approaches presuppose that a given development opportunity is bankable or not bankable – in other words, a given development intervention either can produce a financial return sufficient to attract impact investors, or it cannot. This kind of binary approach is both simplistic and, often, wrong.

The innovative development finance landscape is a dynamic, interconnected fabric, a mosaic comprising myriad players, products, needs and outcomes. There is a natural flow, a progression over time that benefits from an abiding patience and persistence.



Source: Crystalus Inc.

Consider, for example, microfinance. Several decades ago, microfinance was a development oddity funded almost exclusively by donor agencies and philanthropic institutions. Today, it's a multi-billion global dollar industry funded (many would say over-funded) by mostly commercial investors.

It's an example of how pre-bankable can become bankable over time. Bridges can be built to reach market-led solutions. Pre-market initiatives can graduate to become market-led initiatives over time.

How?

Consider a typical social impact fund. The fund has a manager, and the manager has an investment committee. The investment committee assesses potential investments against a host of criteria. Investments are made if they are expected to meet or exceed pre-agreed targets, primarily financial return, and secondarily social impact. Moreover, nearly all such funds operate firmly on the right side of the above spectrum.

Is this the only way? is it even the best way? Perhaps not.

What if we developed an approach more aligned with the dynamic, fluid nature of the development funding continuum? How would this look?

It would probably look more like a platform than a fund – an evergreen, sustainable funding entity with patient capital to encourage development progression over a generation or more.

Most important, it would have a different kind of investment committee – or rather, funding committee.

The funding committee would span both sides of the spectrum, pre-bankable and bankable. Pre-bankable opportunities would favor development return on capital, while bankable opportunities would favor financial return on capital. In most cases, a given funding opportunity would progress over time from pre-bankable to bankable.

A platform like this would require support from both concessional and commercial funders, but not in any traditional blended sense. Rather, a new kind of mutual engagement is envisioned, quite different from existing models and approaches. Not least, it would require a robust model for assessing development return on capital.

Is such an approach feasible? It's certainly worth a try.