

Blended Finance

BACKGROUND AND PURPOSE:

The Sustainable Development Goals (SDGs) provide an opportunity for eradicating poverty and improving livelihoods in LDCs by 2030. However, to date the SDGs have been underfinanced, with the annual financing gap currently sitting at US \$2.5 trillion.¹ This underfinancing poses a particular challenge in LDCs, where external finance, particularly official development assistance (ODA), remittances, foreign direct investment and other private investment represent a larger share of GDP than domestic finance.² Compounding this, ODA and Aid for Trade levels are expected to suffer as the COVID-19 crisis sees aid funding re-allocated for humanitarian assistance.³

The Enhanced Integrated Framework's Trade Funding Insights series is highlighting innovative financing opportunities for trade in LDCs, in order to help LDCs to take advantage of these opportunities. In this Insight, we explore how blended finance offers an opportunity to help LDCs recover from COVID-19 and continue their development progress by increasing the total resources available to them.

WHAT IS BLENDED FINANCE?

Blended finance is a strategic way to use public and philanthropic funds to increase private investment in sustainable development in developing countries.⁴

For example, when a government or philanthropic institution makes an initial investment to get a project off the ground, even if that means accepting larger risks or lower returns, this often makes a project more attractive to private investors who seek higher financial returns but require lower risk.

Blended finance can take several forms, and different donors and organisations focus on different aspects. For example, the International Finance Corporation (IFC) and more than 20 other development finance institutions (DFIs) define blended

finance as the combination of concessional finance from development partners (such as institutional donors) or third parties with a DFI's own account finance and/or commercial finance from other investors.⁵

Blended finance allows organisations to invest alongside each other while achieving their own objectives (whether it's financial return, social impact, or a blend of both).⁶ Blended finance can be structured to support companies, projects or portfolios.⁷

HOW CAN BLENDED FINANCE SUPPORT TRADE IN LDCS?

Blended finance supports trade by assisting the development of the private sector, which is ultimately needed for LDCs to increase export competitiveness.

Take IFC's blended concessional finance work – every US\$1 of concessional finance leverages US\$4 of additional finance in LDCs (from DFIs, the sponsor and/or other financiers).²

Because blended finance is strongly connected to sustainable development, any private sector gains must also lead to positive social and environmental impacts.

Blended finance should be seen as an interim solution that provides just enough support for LDCs to kickstart their private sector markets and financing, for example to help with credit risks, project risks, and supporting trade finance flows.

WHAT CHALLENGES CAN BLENDED FINANCE HELP WITH IN LDCS?

A large amount of private sector finance that could be invested in projects of strategic importance and high development impact in LDCs is not flowing. This may be due to:

- A heightened risk perception, which often leads to higher costs, delay, or prevents a transaction from happening.
- Lack of reliable data on financial performance, which prevents LDCs from building a public record of accomplishment to unlock commercial investment.

Blended finance can help overcome these challenges by reducing uncertainty and risk and creating transparency.

Other solutions in LDCs (e.g. technical assistance or policy reforms) can help solve private sector development constraints linked to the lack of an enabling policy environment to support commercial investments at scale.

HOW MUCH BLENDED FINANCE DO LDCS CURRENTLY RECEIVE?

According to a recent report by the OECD and UN Capital Development Fund (UNCDF), between 2012 and 2018, blended finance investments have been increasing, however only 6% of private finance mobilized by development finance interventions (US\$13.4 billion) went to LDCs.²

While 45 of the 47 LDCs have received blended finance, not all LDCs receive equal levels of investment. In 2017-18, sub-Saharan African LDCs received 70% of private finance mobilised by development finance.²

Multilateral institutions - the IFC, the Multilateral Investment Guarantee Agency (MIGA)³ and the International Development Association (IDA) - are the most frequent investors in blended finance deals in LDCs. While bilateral donors tend to invest smaller amounts, they are increasingly engaging in blended finance approaches in LDCs through their development finance institutions. In 2017-18 France mobilized the highest amounts of private finance, followed by the United States, Finland, United Kingdom, Netherlands and Sweden.

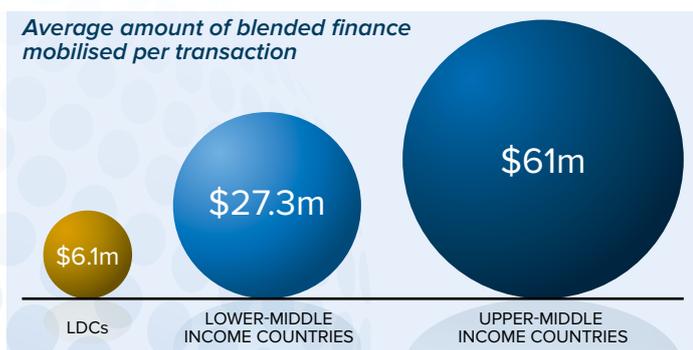
Guarantees mobilised the most (46%) private finance in LDCs in 2017–2018. This is when a guarantor agrees to pay part, or the entire value of a loan, equity, or other instrument in the event of non-payment or loss of value and holds the potential to mitigate the high risk that continues to act as a critical barrier to attracting commercial investment in LDCs.

Energy, banking and financial services and industry, mining and construction sectors account for over 63% of the total volume of blended finance received by LDCs in 2017-18 as it is easier to identify revenue-generating projects in these sectors that would attract private investors.

In a 2019 report, it was found that the average size of a blended finance deal in LDCs is US\$6.1 million, which is significantly less than average deals in lower middle-income countries (\$27 million) and upper middle-income countries (\$60 million).⁹

HOW MIGHT BLENDED FINANCE SUPPORT LDCS TO RECOVER FROM COVID-19?

The OECD Global Outlook on Financing for Sustainable Development has projected a US\$700 billion drop in external finance to developing countries as a result of the COVID-19 crisis¹⁰ This risk is jeopardising the trajectory of finance for LDCs. However, the pandemic also presents opportunities to leverage blended finance initiatives that support economic recovery,



Adapted from: OECD & UNCDF (2019). Blended Finance in the Least Developed Countries <https://bit.ly/2GNbDK2>

allowing the system to build forward better. Fundamentally, it is critical that ODA – the most stable source of external finance to developing countries over the past 60 years, even in the face of economic crises – be protected and leveraged to align more private finance in support of the SDGs in LDCs.

HOW CAN LDCS TAKE BETTER ADVANTAGE OF THE OPPORTUNITIES OFFERED BY BLENDED FINANCE?

In this period of extreme uncertainty, blended finance can help support LDCs’ continued economic activity, ensuring that the progress to date is not erased and that businesses emerge in good standing on the other side of the COVID-19 crisis.

For LDC authorities in charge of/supporting trade efforts¹⁰:

- Create a portfolio of diverse bankable projects by aggregating multiple projects to create a sufficient deal size that will attract large investors. Private investors often look for deals worth at least US\$10-15 million and individual investment opportunities in LDCs are often too small.
- Engage with your national investment promotion agency (IPA) to improve the investment climate and identify investment opportunities. You can find a list of IPAs in LDCs in Annex 1 of a World Bank, OECD and UNCTAD report to the G20 Trade and Investment Working Group.¹¹

For private sector investors:

- When making financial decisions consider the long term economic, social, and environmental gains. This may mean introducing SDG dimensions into your investment decision-making process such as those outlined in the Operating Principles for Impact Management.¹²
- Clearly articulate risks and rewards to invest in impactful projects in LDCs to help identify solutions to clear risks, as some can be solved through reforms and others can be solved through blended finance solutions
- Consider the technical assistance and guarantees provided by the public sector that make investments less risky.
- Seek to partner and engage with domestic financial institutions and other local actors as well as with international actors who have local presence on the ground. This could mean focusing on developing local capital and financial markets, for example with local currency financing solutions.
- Factor in monitoring and evaluation activities from the start. Agree on an M&E plan/system with all other actors involved from the start to ensure impact is assessed and monitored throughout.

For government partners deploying official development assistance, other donors, federal ministries and development finance institutions:

- Maintain and, where possible, increase ODA and Aid for Trade funding to LDCs to enable more private finance to be mobilised.
- Support LDCs to build a pipeline of bankable projects that both accelerate the achievement of the SDGs and can attract investors’ attention while also supporting the LDC’s national development priorities. Agriculture, water and sanitation projects are the least targeted, despite their crucial role in LDCs’ economies.
- Encourage non-traditional partnerships in blended finance such as with impact investors, non-DAC countries, private individuals, philanthropists and foundations.

- Ensure evaluation metrics take into account how well blended finance has contributed to market systems that are more inclusive, sustainable and resilient, and how well it has enabled large-scale and sustainable growth in private investment.
- Encourage rigorous governance and adherence to principles in the use of Blended Finance. Take a look at the OECD's Blended Finance Principles¹³, or the DFI Enhanced Principles on Blended Concessional Finance for Private Sector Projects.¹⁴

READ MORE

1. OECD Development Matters (2020) How Blended Finance can plug the SDG financing gap <https://oecd-development-matters.org/2020/01/22/how-blended-finance-can-plug-the-sdg-financing-gap/>
2. OECD & UNCDF (2020), *Blended Finance in the Least Developed Countries 2020: Supporting a Resilient COVID-19 Recovery* <http://www.oecd.org/dac/blended-finance-in-the-least-developed-countries-57620d04-en.htm>
3. Enhanced Integrated Framework (2021). Funding Insights brief – Official Development Assistance <https://enhancedif.org/en/system/files/uploads/eif-trade-funding-insights-oda-screen.pdf?file=1&type=node&id=6219>
4. Devex (2018) What is Blended Finance? https://www.youtube.com/watch?v=5CewQ4d_zac
5. Blended Finance at IFC <https://bit.ly/3bRGKzy>
6. Convergence (2020) The State of Blended Finance <https://www.convergence.finance/resource/1qEM02yBQxLftPVs4bWmMX/view>
7. Convergence (2020) How To Mobilize Private Investment At Scale In Blended Finance <https://www.convergence.finance/resource/3cpgfoflUn2QY8rFEV2lFt/view>
8. IFC and MIGA's investments in LDCs are also supported through blended concessional finance from the IDA Private Sector Window.
9. OECD & UNCDF (2019). Blended Finance in the Least Developed Countries <https://bit.ly/2GNbDK2>
10. OECD (2021) Global Outlook on Financing for Sustainable Development 2021 https://www.oecd-ilibrary.org/development/global-outlook-on-financing-for-sustainable-development-2021_e3c30a9a-en
11. World Bank, OECD, UNCTAD (2020). FDI Flows and Investment Attraction Frameworks in Developing and Least Developed Countries <https://bit.ly/3pFxDHT>
12. Operating Principles for Impact Management: <https://www.impactprinciples.org/>
13. OECD DAC Blended Finance Principles <https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/guidance-and-principles/>
14. DFI Working Group on Enhanced Blended Concessional Finance for Private Sector Projects: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf/bf-details/bf-dfi

EXAMPLES OF BLENDED FINANCE INITIATIVES SUPPORTING TRADE IN LDCS

Blended finance solutions come in many shapes and sizes, from debt or equity funds, to projects, or companies. These examples illustrate the diversity of blended finance approaches already taking place.

The BUILD Fund

In December 2018, UNCDF partnered with impact investing fund manager Bamboo Capital Partners to launch the BUILD Fund - a blended finance vehicle to connect larger flows of private capital to SDG-positive investment opportunities in LDCs.

The Fund aims to benefit entrepreneurs launching small and medium enterprises in LDCs that cannot access the finance they need to grow their businesses. The Fund is structured as a tiered, permanent capital blended finance vehicle, with three layers of investment at different risk-return levels.

Supporting agriculture in Bhutan

In 2015, the Asian Development Bank (ADB), the Global Agriculture and Food Security Program (GAFSP), and the IFC made an equity investment in Mountain Hazelnuts, a private sector enterprise promoting hazelnut production by contracting smallholders across Bhutan. IFC and ADB each invested US\$3 million of equity, which was matched by a US\$6 million investment by GASFP. The de-risking support from GAFSP has been critical together with IFC and ADB financing given the high-risk profile inherent in the project.

While the overall expected financial return is in the single digits, the project is expected to deliver significant development impact on livelihoods and income of smallholder farmers by linking tens of thousands of farmers to markets, creating jobs and developing skills, increasing women's participation in the job market. In addition, the project is expected to contribute to restoring Bhutan's eroded landscape, mitigating greenhouse gas emissions, preserving forests and reducing rural-urban migration.

Global Trade Finance Program's COVID-19 response

COVID-19 has increased the cost of financial transactions in LDCs, leading to a rapid depletion of foreign reserves and shortage of cash. IFC's Global Trade Finance Program (GTFP) has made it possible for financial institutions to continue providing trade financing to companies that import and export goods. It has done this by offering banks partial or full guarantees to cover payment risk for trade related transactions. In LDCs in particular, GTFP benefits from a blended concessional finance structure: support from the IDA Private Sector Window (PSW) de-risks transactions in eligible countries thus allowing IFC and its partner financial institutions to provide the necessary trade finance to imports and exporters in the riskiest markets.

We can help

The Enhanced Integrated Framework supports LDCs to leverage official development assistance for trade development.

Contact EIFpartnerships@wto.org

EIF's briefs offer an overview of key trade-related issues and up-to-date analysis based on the programme's work with the world's least developed countries, and offer expertise on essential matters related to local, national, regional and global trade.



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Enhanced Integrated Framework

Trade for LDC development

EIF Partner Agencies

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World Bank Group (WB)

World Tourism Organization (UNWTO)

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