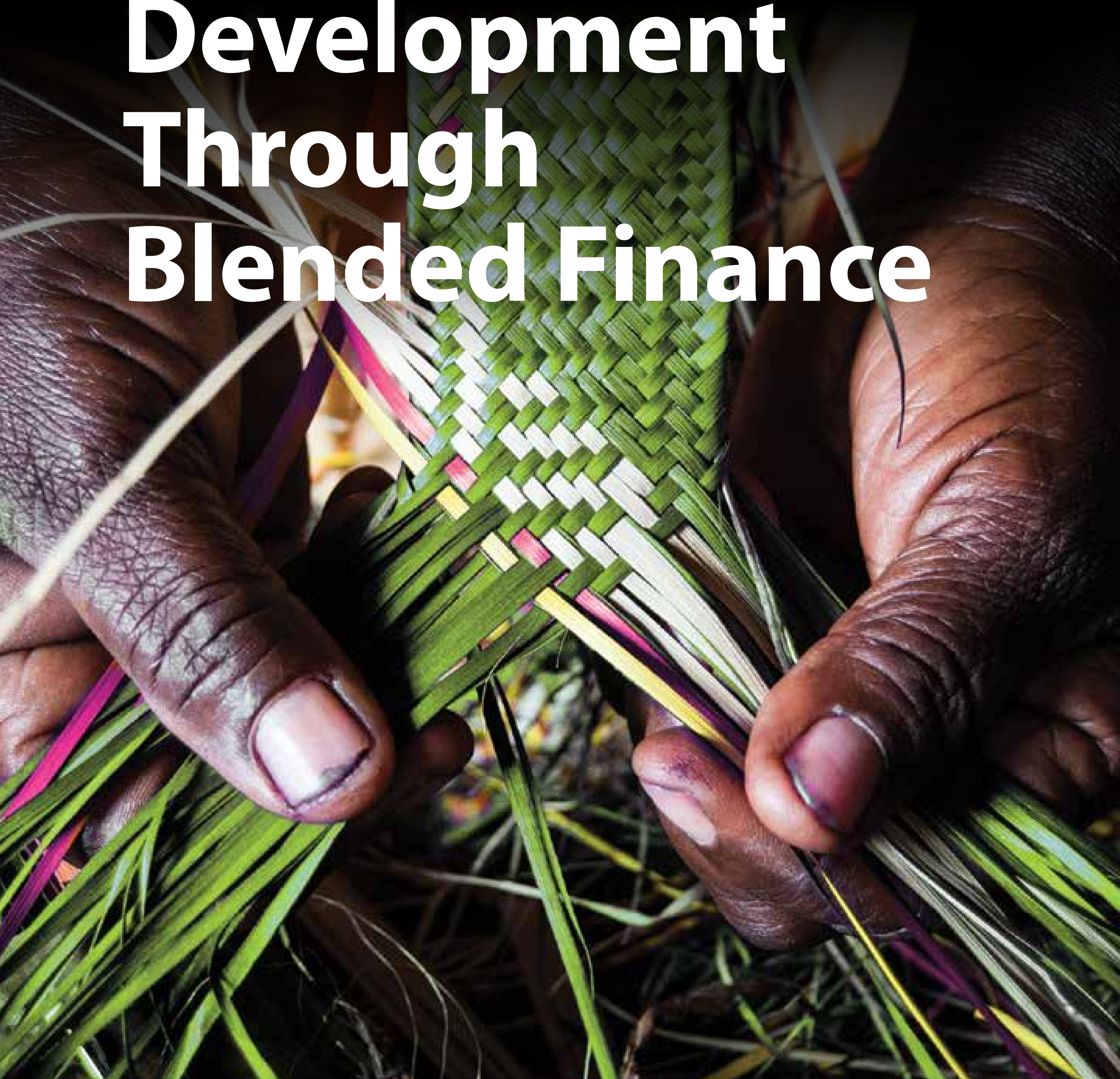
financeinmotion

Advancing Development Through Blended Finance



Content

Introduction

Today, the term "blended finance" is everywhere in the development finance and impact investing spheres. But what exactly does it mean? And why is blended finance such a popular proposition?

This paper provides an overview of the background, concept, and practice of blended finance – and how this model of fund structuring offers a win-win scenario for private investors, public financiers, and the pursuit of the Sustainable Development Goals.

What is Blended Finance?

What is **Blended Finance?**

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Blended finance is the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets.

World Economic Forum and OECD

Taking **Shape**

These days, many discussions of development finance or impact investing involve the phrase "blended finance." But while popular use of the term is relatively new, the concept behind it is not.

The term was already around in the early 2000s, when it was associated within the development finance space with subsidies, and later with the co-financing of large infrastructure projects. Applied in the form of a public-private partnership, "blended finance" was – and still is – commonly used in the project finance world to describe blending different funding sources as well as interests.

Blended finance as a defined, internationally acknowledged investment approach truly arose within in the years leading up to 2015. That was when, in a paper entitled "From Billions to Trillions: Transforming Development Finance," multilateral development banks introduced blending as a method to crowd in private funding for development purposes.[1] After all, it was clear even then that financing needs are far higher than can be shouldered by the public sector alone; an efficient means to amplify the impact of public monies is therefore to use them as catalytic capital. This increases the effectiveness of investments on a global scale.

The World Economic Forum and the OECD were also working on concepts to expand private investing in low and middle-income countries. The result was a primer on blended finance, introducing a definition still widely used today: **"The strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets."** [2]

Blended finance even became part of the UN General Assembly's resolution in 2015, which recognized the impact potential of new investment vehicles by "combining public finance with private finance but also expertise from the public and private sector."[3] While development or philanthropic finance is mostly provided on concessional terms, private sector funding is mostly non-concessional. Notably, the UN resolution referred to blended finance as a key attribute of these new investment vehicles, clarifying that blended finance is strongly linked to structuring or packaging finance. But it is not limited to one investment theme, topic or asset class: blended finance is, as a concept, sector and asset-class agnostic.

Once coined, the term spread quickly throughout both the development finance and impact investing spheres.

[1] World Bank/International Monetary Fund (2015), *"From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance",* http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002(E)FinancingforDevelopment.pdf (accessed on 3 February 2020).

[2] OECD/World Economic Forum (2015), *"Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders",* http://www3.weforum.org/docs/WEF_Blended_Finance_A_Primer_Development_Finance_Philanthropic_Funders.pdf (accessed on 3 February 2020).

[3] United Nations (2015), Resolution 70/1 *"Transforming our world: the 2030 Agenda for Sustainable Development"*, https://www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_RES_70_1_E.pdf (accessed on 19 March 2020)

Blended finance, development finance, impact investing: breaking down the difference

While there is certainly some overlap, blended finance is not interchangeable with development finance or impact investing.

DF

Development finance describes the provision of capital for economic development on a semi-commercial basis; it feeds undersupplied markets whose access to commercial lenders can otherwise be inhibited by high commercial or political risks. Development finance is often associated with the provision of capital by public donors, but also semi-public entities such as international financial institutions.

II

Impact investing is an investing approach that aims to generate positive, measurable social and environmental impact alongside a financial return. Impact investments can be made in a wide variety of topics, across all asset classes and geographies.

BF

Blended finance, used as a structuring approach, leverages catalytic capital, often from public sources, to mobilize private capital for development objectives. Blended finance often refers to public-private partnership. Particularly in the impact investing world, however, a philanthropic-private partnership is also common. An additional, although less common, combination is of all three Ps: public, philanthropic, and private.

In some cases, such public-private partnerships take the form of defined, durable structures – such as in the form of development funds. There are also public-private partnerships that involve one-off public support given to a venture or project, for example, in the form of a limited guarantee pool or a budget for preparatory consulting work.

Blended Finance
and the SDGs

It is likely no coincidence that 2015 was the year blended finance became internationally recognized as a powerful tool for raising resources for social and environmental purposes. A worldwide movement toward collaboration for sustainable development was in full swing: The Paris Agreement was drafted at that time, marking a global effort to cap carbon emissions. And it was in that year that the world agreed on the United Nations' 2030 Agenda for Sustainable Development and the 17 Sustainable Development Goals (SDGs).

The SDGs spell out important focus areas for international cooperation, from improving health and education, reducing poverty and inequality, and spurring economic growth to tackling climate change and preserving natural resources.

It was also widely understood, as underscored by SDG 17, that achieving the goals will only work in partnership – not only between countries of differing economic levels, but also between public organizations, the private sector, and other civil society stakeholders. Pursuing goals means the allocation of resources. And that often involves money.

The call for the private sector to help finance SDG-related activities in low and middle-income countries propelled interest in blended finance structures. Meanwhile, private investors themselves were increasingly keen on taking a more active role in solving problems (as witnessed, for instance, in the parallel rise of social entrepreneurship). As a result today, a large number of blended finance funds and facilities anchor their investment strategies to one or more of the UN SDGs.[4]

Finance in Motion contributes to the following SDGs

[4] Basile, I. et al. (2020), *"Blended Finance Funds and Facilities – 2018 Survey Results Part II: Development Performance"*, https://doi.org/10.1787/7c194ce5-en (accessed on 3 February 2020).

What is Blended Finance?

A Win-Win Proposition
for Different Investors

In the context of development finance and impact investing, blended finance often begins with the public side providing a financial investment (debt or equity) in the form of first-loss funding into a facility, signing the junior/subordinated capital of a fund, or providing some other sort of catalytic risk-absorbing capital.[5] Private investors, investing commercial funding, then take a more senior piece.

The beauty of this model is that blending offers an attractive proposition to both public financiers and private investors.

For the public investor, the business case is straightforward: Blended finance responds to the desire to increase funding for the SDGs, to leverage scarce public funding, and deploy it efficiently and effectively. It allows public funders to play a catalytic role and to multiply their impact manifold.

Commercially oriented private investors, for their part, appreciate the opportunity to support the SDGs but are usually only drawn to impact investing if the investment can also deliver risk-adjusted returns. The capital provided by public financiers allows for exactly that: It provides a risk cushion, thereby creating a favorable risk-return proposition for the private investor as compared to a stand-alone private investment into the same company, project, or fund. In an ideal scenario, and particularly across a range of blended finance vehicles, private investors will have various risk-return profiles to choose from to satisfy their individual risk-return appetite.

An increasing number of private investors are no longer entirely driven by the expectation of financial return. Many also have an impact agenda. Investing in blended finance structures allows these investors to pursue their impact objectives without being fully exposed to the risks traditionally associated with frontier markets or topics. And many of the SDGs tackle just such: themes that do not easily attract financing, as they either expose the investor to an untested region, a young industry, an underregulated market, or other information asymmetries.

Enabling private investors to enter such new territories with the protection of a blended finance vehicle can be a first step toward opening new business opportunities (such as in the field of climate change mitigation or adaptation) or providing first access to growing markets (i.e., emerging markets).

Finally, blended finance structures provide an additional benefit: They combine different skill sets, knowledge, and resources. Bringing together development finance professionals and commercial investors, each with their own expertise, broadens the scope, range, and effectiveness of many investments. In addition, the participation of public representatives in the governance of such vehicles assures private investors of a strong impetus to achieve, monitor, and report on impact.

[5] Blended finance instruments can also include: guarantees, insurance, hedging, securitization, results-based incentives, grants (for technical assistance).

Blending at different levels of an investment

Option 1: At fund level
Funding from different sources – that is, public, semi-public, philanthropic and private capital – can all be pooled within a fund (including funds-of-funds), with the fund subsequently acting as investor.

In this case, the investee benefits indirectly from the blending approach: As more purpose-driven capital is made available for impact investing, the more an investee's chance of accessing funding increases.

Option 2: At project level
The pooling can also take place at an individual project level. In such a case, the investee is an integral part of the process and might even be actively involved in individual negotiations with different investors.

When dealing with smaller, less experienced investees, blending at the fund level is often the more efficient and effective solution. Blended investment vehicles allow transaction sizes for private investors to be larger. They improve the liquidity profile, diversify risks, facilitate access to bankable assets, and enable different capital tranches that appeal to different types of private investors.

Blended Finance **in Practice**

Blending does not necessarily require a complex structure. It can, for example, be embedded in a simple flat fund with investors investing pari-passu; that gives private investors the comfort of investing alongside development banks with decades of experience in emerging markets.

Yet structured models also have their advantages. Finance in Motion has set up, and is actively advising and managing, a number of emerging market impact funds that take advantage of a layered concept of blended finance. The structured model of these funds enables them to offer different tranches, providing investors with a variety of investment options with different risk-return profiles tailored to their needs. Most of these funds are evergreen and pursue a private debt approach when investing.

Since the first such fund was initiated in 2005[6], funds have accounted for the largest share of blended finance transactions, representing around 43% among all vehicle types[7]. These funds (including equity funds, debt funds, and funds-of-funds) have emerged with the same goal: to crowd in private capital for impact purposes. It is thus worth taking a closer look at the concept.

The various share classes of the structured debt funds can be broadly categorized into three types of investment instruments: junior shares, senior shares, and notes.

Junior shares are usually subscribed by public donor organizations such as the European Union or the German Ministry for Economic Cooperation and Development. These junior shares serve as a first-loss piece, or risk buffer, for the senior shareholders and note investors.

Senior shares, the mezzanine piece of the fund, are typically offered to (multilateral) development banks or international financial institutions such as the German development bank KfW, the IFC, EBRD, EIB, or FMO, to name a few. These institutions are clearly impact driven and their key motivation is to catalyze additional capital, but they also have a higher risk appetite and often a longer-term investment horizon than private investors. Therefore, they often act as initiators of such funds.

Blending – also works for equity funds

Though blending is most common in either individual transactions or debt funds, it has also been applied in private equity funds. One example are the equity sub-funds of the SANAD Fund for MSME, which promotes financial inclusion in the Middle East and North Africa. When conceptualizing this private equity fund, the concept of having separate tranches with different risk absorption capacities – which had worked beautifully for the debt fund – was taken on board.

Here is how it works: A junior tranche is held by public institutions, including the German government and the European Commission, while the senior tranche was signed by semi-institutional investors such as family offices and foundations. When it comes time for payout, senior investors are the first to recuperate their capital, followed by the junior shareholders. Then, returns made on the investment again go first to the senior shareholders, followed by their junior-ranked partners. Finally, any additional gains are distributed among the various stakeholders – which include shareholders but also, for example, the fund's Technical Assistance Facility.

In a region with increased country risk and the need to greenfield microfinance institutions, such a concept was instrumental to improving the fund's risk profile and making it more attractive to the private sector. By thus adjusting the risk-return proposition, SANAD is able to go deeper and broader with regard to its impact intentionality. The ultimate goal of blending is achieved: mobilizing capital and scaling impact.

[6] European Fund for Southeast Europe (EFSE)

[7] Convergence (2019), *"The State of Blended Finance 2019"*, https://assets.ctfassets.net/4cgqlwde6qy0/58T9bhxExlNh2RilxWxSNe/ba56fa36c81349640179779ddd68cc99/Convergence_-_The_State_of_Blended_Finance_2019.pdf (accessed on 3 February 2020).

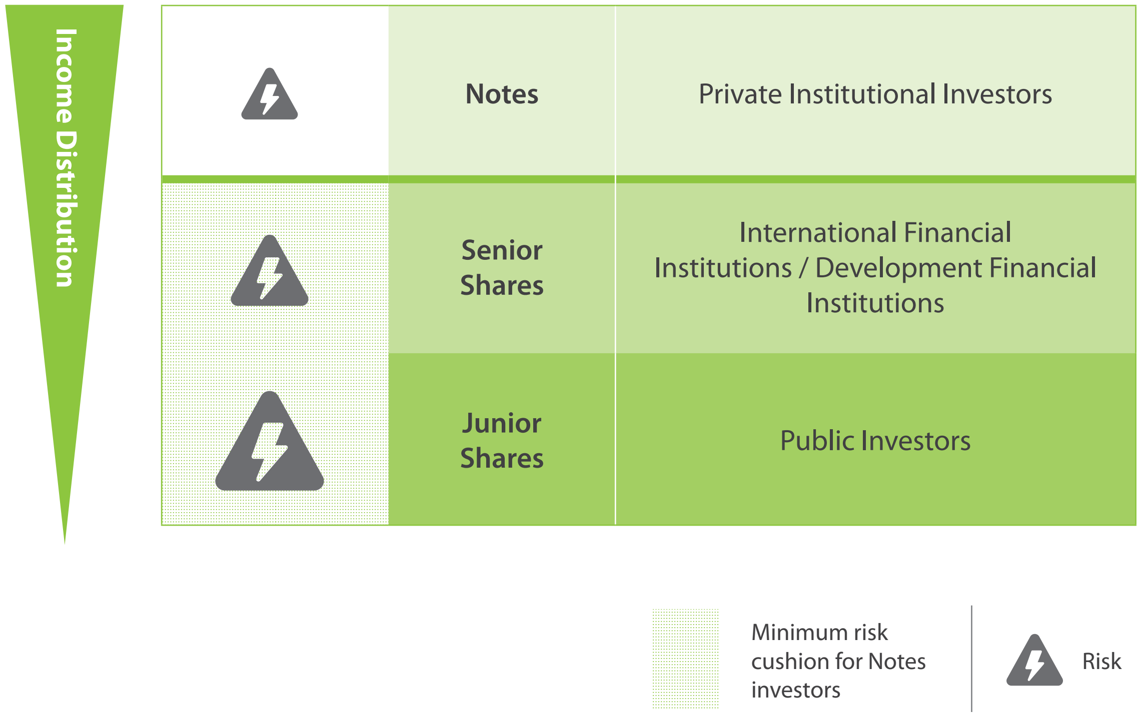
What is Blended Finance?

The most senior tranche of a typical structured blended finance fund is held by private institutional investors. Due to their evergreen structure, the funds regularly issue notes, allowing for continuous onboarding of new investors into already existing, sustainable vehicles, managed by specialized fund managers and advisors.

While risks are primarily absorbed by the junior shareholders, note holders (and after them, senior shareholders) are the first to receive their returns. Such unique risk-income distribution allows the funds to offer fixed-income instruments to private institutional investors with a very low default risk, not only in terms of repayment of principal but also of interest payments.

The open-ended structure also enables the funds to apply a cautious approach in expanding into new territories – be these countries, regions, or topics. With experience and size comes excellence and diversification, as well as the possibility to reflect on lessons learned in the continuous refinement of the fund's structure and strategy.

Figure 1:
Example structure of a blended finance fund



Local currency for local impact

Blended finance is the strategic use of concessional capital. "Strategic" can refer to mobilizing capital for underserved regions or topics. It can also refer to pushing innovation. For funds that reach out to entrepreneurs and small enterprises in developing countries, one such innovation proved to be the introduction of a specific share class to push local currency lending and shield vulnerable groups from foreign currency risk they are not equipped to manage.

Lending to microfinance institutions in foreign currency, for instance, forces them to on-lend in foreign currency to their clients – or, alternatively, to on-lend in local currency by taking on the currency risk themselves, as most microfinance institutions have no access to hedging. As a responsible asset manager, Finance in Motion developed a solution that starts even earlier in the funding chain: granting local currency loans to the microfinance institutions themselves, thereby keeping the currency risk within the fund and not passing it on to the borrower.

To enable such an impact proposition to work and not put the private investors at risk, a new share class was introduced and funded by the European Union and the German government (BMZ), dedicated to bearing the risk of unhedged local currency investments. For the funds advised by Finance in Motion, this share class – referred to as "L-shares" – has unleashed their capacity to offer local currency financing to their partners without exposing investors to any additional risk.

Thanks to this concessional capital provided by public investors, the fund's private capital mobilization is not impacted by an increasing risk profile; instead, the impact agenda is further strengthened as vulnerable groups can be successfully shielded from currency risks.

EFSE

The first of its kind

The story of the European Fund for Southeast Europe (EFSE) begins with an idea: to support the post-conflict reconstruction of regions in Southeast Europe by bringing together public donors and private investors.

Starting in the late 1990s, KfW Entwicklungsbank was coordinating and consolidating international donor efforts to provide long-term funds and technical assistance to financial intermediaries for onward lending to micro and small enterprises (MSEs) and households. As these credit lines approached the end of their lifetime, KfW began proposing plans to donors to launch an evergreen development finance vehicle that would provide a sustainable source of financing for MSE lenders in Southeast Europe and the Eastern Neighbourhood Region. The successful merger of several refinancing programs into a single new fund, EFSE, in 2005 was a major milestone.

EFSE is, in fact, where Finance in Motion itself has its roots; the founders of the impact asset manager were closely involved in setting up EFSE's public-private partnership structure, and eventually established Finance in Motion a few short years later largely to continue advising the fund on an operational level while replicating its successful blended finance model for new impact funds.

Drawing on seed capital from the existing donor programs to provide a risk cushion to leverage additional funding, EFSE today has over EUR 1 billion in total funding, 22% of which is private capital. The fund has invested nearly EUR 3 billion across the 16 countries of its operations since inception. Due to the revolving nature of the funding, these investments have unleashed over EUR 7.3 billion in loans to restore local housing and foster employment.

GREEN FOR GROWTH FUND

Unleashing innovation for impact

Blended finance structures can also allow an existing fund to innovate, expand, or broaden its investment activities.

The Green for Growth Fund (GGF) is a structured debt fund investing in measures to reduce energy consumption, resource use, and CO_2 emissions. To date, the fund has provided EUR 1 billion in green finance to more than 35,000 households, businesses, and projects across 19 target markets.

The GGF has seen remarkable expansion in both geography and focus in the ten years since its founding. When it was created, the fund's mandate was to invest in renewable energy and energy efficiency in the Western Balkans. Much has been added in the intervening years: expanding from Southeast Europe into the Eastern Neighbourhood Region, followed by the Middle East and North Africa; pushing deeper into the real economy to stimulate new investments on the ground; broadening the definition of green finance to include the important nexus of interdependence between energy and improvements in water, waste and material management.

This ability to expand into new regions, reach out to more beneficiaries, and target a broader set of technologies and sectors has been thanks in large part to the fund's blended finance structure. The risk capital made available by the combination of public and private funding has given the GGF the necessary flexibility to innovate and take on new challenges. This has, in turn, allowed the fund to employ a more holistic approach to tackling climate change, build a more substantial understanding of green finance in target markets, deliver a broad palette of impact benefits, and broaden its impact beyond energy and CO_2 savings.

Reduced Risk, **High Impact**

Private institutional investors are a key target investor group for structured funds, as such funds typically involve sophisticated structures reserved for non-retail investors. Private institutional investors include pension funds, insurance companies, sovereign wealth funds, and commercial banks, as well as foundations, family offices, and ultra high net worth individuals. Such investors are interested in generating impact, yet are also bound by internally or externally imposed risk limits.

What concerns do investors traditionally associate with frontier markets?

Risks – real or perceived – can range from macro risk, such as political and currency risks, to liquidity risk and deal-specific risks such as credit/counterparty risk or operational risk. At the same time, the financial returns generated by impact investments are sometimes not considered adequate for such risk, especially in comparison to traditional emerging market opportunities. If returns cannot compete, the risk profile must to be adapted for the investment to remain an attractive proposition.

One mitigating factor is certainly to choose a diversified fund over a direct investment. A fund is managed and advised by a specialized fund manager that has expertise in the respective market and with the respective asset class. However, emerging market risk or risks inherent to new businesses are more difficult to buffer. This is where the first-loss tranche provided by a public investor can play a crucial role: Should any of the fund's assets lose value, this layer absorbs the first hit. First-loss tranches in the early stages of a fund's growth can amount to over 50% – a comfortable risk cushion for private investors, even when investing in relatively challenging geographies such as the Middle East, North Africa, or sub-Saharan Africa.[8]

The first-loss portion provided by public investors also contributes to buffering other risks. Liquidity risk, for instance, is indirectly reduced as public investors usually provide patient capital with very long tenors, while private investors subscribe senior tranches with much shorter maturities.

In some cases, the risk profile can also be positively impacted through technical assistance to the fund's investees. Providing investees with capacity building, in addition to strengthening the overall ecosystem in which they operate, both increases impact and helps strengthen the fund's commercial performance.

Lower risk justifies an adjusted return. Blended finance contributes to paying out risk-adjusted, market-based returns, which is a key principle for making impact finance attractive to private investors.

However, the risk-return profile is not the only concern of either the fund or the investor. Impact investing is marked by the explicit intention to generate a social or environmental impact alongside a financial return. Blended finance vehicles have proven to have an excellent track record in scaling impact: not only through their amplified ability to mobilize the necessary capital, but also through the combined participation of impact-minded stakeholders, as well as the ability to create economies of scale that allow for sophisticated impact management.

[8] A recent study of the OECD confirmed that while the composition of capital is quite diverse among funds, the average composition is the following: 42% concessional development finance, 32% non-concessional development finance, and 26% commercial/private finance.

Basile, I. et al. (2020), *"Blended Finance Funds and Facilities – 2018 Survey Results Part II: Development Performance"*, https://doi.org/10.1787/7c194ce5-en (accessed on 3 February 2020).

Interview

Interview with **Calvert Impact Capital**

How does Calvert Impact Capital pursue its impact goals?

We take a systems approach to addressing our world's greatest challenges and believe that we have the greatest power to affect change by leveraging and adapting the existing financial infrastructure to value social and environmental impact. We reject the common bifurcated mindset that requires a choice between financial results and positive impact. In emerging markets like the ones that Finance in Motion works in, we support local financial market creation to ensure an efficient flow of capital from private international markets to fragmented local markets. To do so, we capitalize specialist intermediaries that can complete the job in a more efficient and scalable manner.

We have spent decades bringing capital markets and underserved communities closer together. Over the past 25 years, we've worked with nearly 20,000 investors – retail, accredited, institutional – to raise more than USD 2 billion while maintaining a 100% repayment rate to all investors.

How do blended finance vehicles help Calvert accomplish this?

Blended finance funds like those that Finance in Motion advises are essential to creating the efficient flow of capital in local emerging markets that is so important to us. Calvert Impact Capital is a global lender, but we operate from a single office just outside of Washington, D.C. Finance in Motion vehicles provide a critical access point for us to invest – at scale – in regions that are typically challenging to reach.

Why invest in a blended finance fund rather than directly in – or in addition to – impact projects?

It's not possible to achieve the systemic and market-building impact that we seek or the scale that we require through direct deal-by-deal investing. One of the key bottlenecks for moving capital at scale efficiently is the lack of intermediation capacity across the financing value chain. By investing in funds employing blended finance techniques, we are helping to distinguish between the perceived risk versus the real risk of doing business in emerging sectors and markets. We firmly believe that with a deep track record of success, what was once unfamiliar or perceived as "too risky" to traditional capital markets starts to become more understood and recognizable.

How important is private investment in achieving the SDGs?

There's no way to achieve SDGS without private capital; it simply cannot be done. But we need all types of capital – private, public, philanthropic – and it's important that we use each type strategically.

It's also important to realize that private capital isn't the answer to every problem. In some sectors, private capital can't be leveraged until an enabling environment is created, and that often requires policy solutions and grant or catalytic capital.

Where do you see further potential for blended finance?

Catalytic capital, a key element of blended finance structures, is paramount for building and growing the track record of emerging sectors and markets. However, we as an impact focused investment community fall prey at times of looking for new ideas and initiatives and claiming "victory" too early on the track record of existing initiatives.

We need to focus on continuing to build the track record of blended finance approaches that are proving successful in de-risking markets. Private investors require three things: data, de-risking mechanisms, and scale. We need to grow the amount of performance data and the pool of risk-absorbing catalytic capital to establish a track record that continues crowding in additional investors.

Blended finance funds like those that Finance in Motion advises are essential to creating the efficient flow of capital in local emerging markets that is so important to us

Najada Kumbuli
Director of Investments, Calvert Impact Capital

Scaling Impact Through Blended Finance Funds

Scaling Impact Through Blended Finance Funds

The impact generated by blended finance takes place at two levels: **that of the fund and of the investee.**

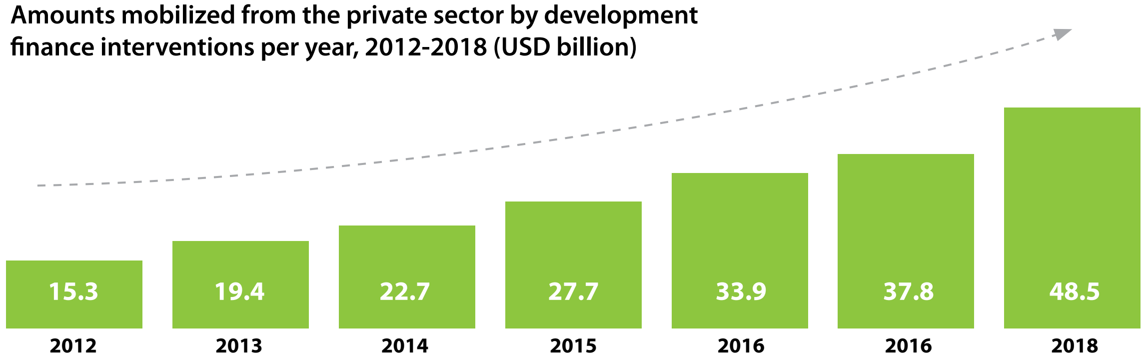
Impact **at the Fund Level**

The capital mobilized from private sources increases continuously as a fund matures. Once raised, such private sector funding can be channeled to hard-to-reach areas (geographies, topics, and themes), thus providing access to capital for development activities that may otherwise have difficulty receiving funding.

Research by the OECD shows that from 2012 to 2018, development finance interventions were able to mobilize USD 205.2 billion from the private sector for investing towards the SDGs[9]. Convergence estimates that, to date, blended finance has attracted approximately USD 140 billion in private capital towards sustainable development in low and middle-income countries, and emphasizes that the private sector is providing an increasing share of commitments to blended finance transactions[10]. A considerable part of this capital was invested in (structured) funds, allowing investors to combine impact and financial return aspirations.

Impact is further scaled by creating vehicles of a certain size, as well as by focus on a specific topic. Compared to an individual investment, pooling resources into a structured vehicle creates economies of scale – not only operationally but also in terms of impact. Thematic investing can be fine-tuned, hypotheses can be tested and honed, and impact management principles can be applied vis-à-vis a number of similar investees. Generally, larger vehicles that also have the ability to combine investing with technical assistance and capacity building facilitate the creation of systemic changes in the markets where they invest. All of this, combined with the benefit of public representatives playing a governance role, helps ensure that scaling occurs responsibly and with maximum impact.

Amounts mobilized from the private sector by development finance interventions per year, 2012-2018 (USD billion)



[9] OECD (2020), *"Amounts mobilised from the private sector for development"*, https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/mobilisation.htm (accessed on 3 February 2020).

[10] Convergence (2019), *"The State of Blended Finance 2019"*, https://assets.ctfassets.net/4cgqlwde6qy0/58T9bhxExlNh2RilxWxSNe/ba56fa36c81349640179779ddd68cc99/Convergence_-_The_State_of_Blended_Finance_2019.pdf (accessed on 3 February 2020).

Impact **at the Investee Level**

The second level at which blended finance has an impact consists of the development activities as such: the impact projects, investees, and funding recipients on the ground.

Let us recall that blended finance is often referred to as "the strategic use of development finance for the mobilization of additional finance towards sustainable *development in emerging and frontier countries*." As such, blended finance has an inherent impact intentionality. Blended finance funds are therefore held accountable to clear development or impact objectives and outcome targets.

The funds advised by Finance in Motion often deploy their funding in partnership with local financial institutions, such as banks or microfinance institutions. In terms of risk, this is an additional diversification element. In terms of impact, it is a strong driver for enhancing the systemic impact of the fund. By working through and with local financial institutions with on-the-ground market knowledge, funding can be channeled to the final borrower in an efficient and appropriate manner. In addition, these players are an integral part of the local ecosystem, and hence positioned to provide sustainable financing beyond the lifetime of a fund. Very often, they also channel additional commercial funding to the ultimate recipient, thereby increasing the leverage effect.

In this context, technical assistance plays a crucial role and becomes part of the blended finance equation. This supplementary, non-financial support is provided to institutions, and sometimes even individuals, with an aim to enhance the conditions surrounding the investment that anchor and sustain impact: for example, training local bank employees on environmental risk management, or providing financial education to smallholder farmers in need of loans. Such measures address the environment in which monetary investments are made, thus conveying long-term, systemic benefits.

Technical assistance facilities (sometimes also called development facilities) are separate endowments established in combination with each fund. They receive donations from most of the fund's public sponsors or philanthropic donors, which are then used to cover the cost of non-financial activities aimed to enhance the impact of the fund's investments. Structured as independent vehicles operating alongside the funds, the provision of such services does not impact financial return for the private institutional investors.

This technical support can have a deep impact. For instance, a local commercial bank that receives support in building its capacity to provide small enterprises with better access to finance will develop new products and processes for this purpose. These not only channel the dedicated investor funding to the final target group – the entrepreneurs – but also additional money from their own funding sources. Moreover, experience shows that a positive intervention in one local financial institution triggers competition and thereby an increase in quality, better pricing, and transparency by all players. These are just some of the ways that the catalytic effect of public development finance goes beyond the mobilization of private funding: If applied correctly, blended finance stimulates positive change at the level of the ecosystem and local players.

Finally, in contrast to investors acting individually, a fund – particularly when combining forces of the public and private sector – can also play a stronger role in influencing sector standards or regulatory frameworks.

Impact management framework

The eco.business Fund aims to promote business and consumption practices that contribute to biodiversity conservation and the sustainable use of natural resources as well as to mitigating climate change and adapting to its impacts. The fund focuses on Latin America, the Caribbean, and sub-Saharan Africa. To achieve its aim, the fund provides dedicated financing and technical assistance to local financial institutions and businesses who are committed to implementing sustainable practices.

Impact management is integrated into every step of the investment and technical assistance cycle. As such, all recipients of funding must meet at least one of the following criteria: hold an eligible sustainability standard, such as Rainforest Alliance, FSC or Fairtrade, or implement one of the sustainable production practices from the fund's "Green List", such as water-saving irrigation systems or cultivation of shade-grown coffee.

Once invested, the eco.business Fund continuously monitors and assesses its impact based on key performance indicators that reflect the fund's impact pathway. To track progress against these indicators, the fund combines first-hand data from investees with technical parameters from scientific literature and reports from international organizations, as well as case studies conducted by the fund and on-site visits to investees.

Ultimately, this practice provides insights and learnings that feed back into the fund's strategy, enabling it to continuously fine-tune its activities to enhance the reach and depth of impact.

Equipping entrepreneurs with the tools to succeed

Financial inclusion refers to providing access to financial services for underserved target groups, whether individuals or enterprises. It is one of the prime topics for blended finance actors. Public-private partnership funds have proven, for example, to be successful in channeling funding to what is known as the "missing middle": entrepreneurs who lack much-needed capital for business expansion and job creation, because their financing needs occupy an underserved "middle" category between microfinance and large commercial loans. Yet capital alone will not be a panacea for boosting sustainable entrepreneurship.

Funds like the European Fund for Southeast Europe (EFSE) and the SANAD Fund for MSME have set up structures to provide complementary, non-financial support to the entrepreneurship sector in the funds' target countries. The funding for these technical assistance programs is either provided by public donors or by the fund itself to scale the intended impact.

For example, both funds have established special "Entrepreneurship Academies" to deliver support services straight to small business owners. A recent project of SANAD's Entrepreneurship Academy was to develop a curriculum for free online courses in business management in the Middle East and North Africa. Especially targeted toward micro and small enterprises, this training aims to increase financial literacy and skills among the region's entrepreneurs – thus supporting the business success that drives economic growth and job creation.

Meanwhile, EFSE's Entrepreneurship Academy has launched a "TechBoost" program in the Western Balkans to accelerate tech startups with an impactful business model. EFSE is working together with local incubation and acceleration organizations to provide preparation courses, mentoring, boot camps, and more in four countries. In the end, the startups with the most promising results will have the chance to pitch their ideas to investors and prepare market-ready products.

Such technical support is an example of how a blended finance model is not restricted to tranches within an investment vehicle. Blended finance can also allow for delivering non-financial support to different stakeholders in the fund-relevant ecosystem. Private investors who join a public-private partnership therefore benefit not only from the first-loss risk cushion, but also from the impact boost provided by enhanced non-financial support.

Conclusion and Outlook

Blended finance has come a long way. Once a subsidy component, it has become a powerful strategy for creating investment opportunities for private sector impact investors and scaling impact for development.

After years of successfully deploying blended finance, it is clear that social and environmental impact does not need to come at the detriment of financial returns. The risk cushion provided by public investors functions as a credit enhancement; combined with the skills of an expert investment manager knowledgeable in emerging markets, blended finance can offer even investment-grade products to private investors. This in turn channels much-needed funding to areas that may otherwise find difficulty accessing resources for sustainable development.

Blended finance can now draw on a wealth of experience. A robust industry has developed of fund managers and service providers. Blended finance has proven successful across geographies and topics. These are very valuable developments, as the need to mobilize private capital for impact is unlikely to abate: not only because we are still far from mobilizing the necessary amounts of capital to achieve the SDGs across all countries, but also because new impact topics are emerging continuously.

Partnership is essential to advancing impact investment and scaling the market. At Finance in Motion, our track record and success would not have been possible without the initiators of our funds, most importantly KfW and EIB, as well as the partners and stakeholders who have been instrumental in structuring and managing them.

There is still progress to be made in the industry. As in any relatively new field, best practice guidelines are needed to combat "impact washing" and avoid mission drift. Regulators must acknowledge a first-loss piece as a risk mitigation tool. Investors must be incentivized to move their capital toward impact investing. We need to develop more liquid investment opportunities, as the challenge of liquidity is currently hindering scalability. Regulators, public investors, and private investors need to work hand in hand to tackle these challenges.

Fortunately, overall momentum is positive. Now more than ever, organizations and individuals are increasingly aware of the urgency for concrete action to protect the environment and address social issues. More and more, private investors want to make their money make a difference.

At Finance in Motion, we are proud to have been at the forefront of blended finance for more than a decade.

Conclusion and Outlook

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Florian Meister

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TEXTS
Milena Bertram

EDITOR
Nicole Eggers

DESIGN
Sarika Alt

PRINTING
Druckerei Wagner & Söhne

IMAGES
SANAD, GGF, EFSE

PUBLISHER
Finance in Motion GmbH
Carl-von-Noorden-Platz 5
60596 Frankfurt am Main
Phone +49 (0) 69 271 035-0
info@finance-in-motion.com

Visit us at:
finance-in-motion.com

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