Blended Finance in the Least Developed Countries 2019

OECD

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Unlocking Public and Private Finance for the Poor

Blended Finance in the Least Developed Countries 2019

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Foreword

The Sustainable Development Goals (SDGs) are all about transformation – transformation driven by partnerships, risk-taking and innovation. Getting the finance piece of the SDGs right is essential. There is a lot of exciting progress being made, with new tools and instruments helping to mobilise resources for sustainable development. But we are still not moving fast enough if we are to get more finance aligned with our collective aspiration to leave no one behind.

Too little private finance gets invested in least developed countries (LDCs). As this report suggests, only 6% of private finance mobilised by official development finance benefits LDCs. With the recent downturn in official development assistance to LDCs, too little international public finance is being invested there as well. If current trends persist, development finance will entrench exclusions and inequalities between and within countries, rather than help overcome and transcend them.

That is why we need new ways of channelling more and better-quality public and private, domestic and international financial flows to the world's most vulnerable countries, underserved communities, and projects in the "missing middle". An underlying question of this report is therefore not whether we should pursue blended finance approaches, but how and when we can make them work better for LDCs and for those furthest behind.

Indeed, as this report highlights through a mixture of hard data and curated guest pieces, where they are appropriate and carefully deployed, blended finance approaches can be an important part of the financing solution for LDCs. They can help to catalyse much-needed additional resources for SDG-aligned projects that private investors would otherwise overlook.

But getting blended finance to work for LDCs requires important step changes. It requires that the development community is willing to experiment more and take more risks to work in challenging environments. It requires ensuring that blended transactions align with national priorities and respect national ownership, and form part of broader SDG financing strategies. It means we need to ensure that a growing use of blended finance does not lead to a decline in the overall share of development finance received by LDCs, where blending has proved to be more difficult. We also need to improve how we measure and report on the SDG impacts of blended operations, and we need more sharing of knowledge.

The research in this report can also help to build bridges between the development and private finance communities. Identifying how best we can achieve our shared objectives, including through blended transactions, is an essential prerequisite for achieving the vision enshrined in the 2030 Agenda.

The stakes are high. The time for action is now. We need to use all options at our disposal to close SDG financing gaps. Our hope is that this report, the second such instalment looking at blended finance in LDCs, prompts a lively debate on what more could or should be done when it comes to applying blended finance effectively and efficiently in a broader range of countries.

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Table of contents

Foreword 3

Acknowledgements 5

Abbreviations and acronyms 9

Executive summary 10

1 What are the latest trends in blended finance for least developed countries? 15

1.1 Introduction 16
1.2 Methodology 18
1.3 The proportion of private finance going to LDCs remains relatively small, but stable 19
1.4 Blended finance approaches have expanded to additional least developed countries 22
1.5 Deals vary across countries by number and size 25
1.6 Blended finance and ODA seem linked, but ODA plays a unique role 26
1.7 Guarantees are the most powerful leveraging mechanisms, but simple co-financing agreements are the most used 27
1.8 Energy, banking and financial services mobilise the most private finance 29
1.9 Bilateral providers are becoming more prominent in the LDC blended finance market 33
1.10 In LDCs, investors from high-income countries are being more mobilised than domestic ones 35
References 37
Notes 38

2 Views from the field: Guest contributions 41

2.1. Mobilising private finance for agricultural investments in developing countries 42
2.2. Ensuring blended finance respects national ownership 44
2.3. The potential of blended finance for global health 45
2.4. Blended finance in Nepal's cities: challenges and prospects 47
2.5. Blended finance - Uniting the yin and the yang 49
2.6. Investing to overcome fragility 51
2.7. Bringing private investment to challenging environments: lessons from the World Bank Group's Private Sector Window 53
References 56
Notes 57

3 Key questions and next steps for how blended finance can best support least developed countries 59
3.1. Making blended finance work for LDCs 60
3.2. Principles and a roadmap to guide blended finance in the least developed countries 61
3.3. How do the OECD Principles and Tri Hita Karana Roadmap apply to the least developed countries? 62
3.4. What's next for UNCDF's action agenda on blended finance for least developed countries? 63
3.5. Questions to shape the next steps 65
References 66
Notes 67

FIGURES

Figure 1.1 Private investment inflows in developing countries (2000-2016) 16
Figure 1.2. Private capital mobilised by official development finance (2012-2017) 19
Figure 1.3. Private finance mobilised in LDCs (2012-2017) 20
Figure 1.4. Cumulative blended finance targeting least developed countries (Convergence) 21
Figure 1.5. Top 10 least developed country recipients of private finance mobilised (2012-2017) 22
Figure 1.6. Average annual amount of private finance mobilised per least developed country (2012-2017) 23
Figure 1.7. Top least developed countries benefiting from concessional blended finance transactions (Convergence) 24
Figure 1.8. Total amounts mobilised and number of deals by LDC (2012-2017) 25
Figure 1.9. The type and size of concessional blended finance deals in least developed countries (Convergence) 27
Figure 1.10. Leverage mechanisms in least developed countries (2012–2017) 28
Figure 1.11. Private finance mobilised by sector in least developed countries (2012-2017) 30
Figure 1.12. Private finance mobilised by sector in least developed countries and other developing countries (2012-2017) 30
Figure 1.13. Private finance mobilised in LDCs by deal and sector (2012-2017) 31
Figure 1.14. Average amounts mobilised in least developed countries per deal by sector (2012-2017) 32
Figure 1.15. Average annual amount mobilised in least developed countries per provider (2012-2017) 33
Figure 1.16. Bilateral and multilateral channels for blending in least developed countries (2012-2017) 34
Figure 1.17. Sources of private finance mobilised in least developed countries (2012-2017) 35
Figure 1.18. Trend in sources of private finance mobilised in least developed countries (2012-2017) 36
Figure 3.1. The OECD Development Assistance Committee Blended Finance Principles 62
Figure 3.2. The Tri Hita Karana Roadmap for blended finance: Action areas and working groups 63

INFOGRAPHICS

Infographic 1. How is blended finance benefitting least developed countries? 13
Infographic 2. What's next for blended finance in least developed countries? 14

TABLES

Table 1.1. Private finance mobilised in LDCs and other developing countries 20
Table 1.2. Number of deals and average mobilisation by country income group (2012-2017) 25
Table 1.3. Annual private finance mobilised per deal by leverage mechanism (2012-2017) 29

Abbreviations and acronyms

AAAA	Addis Ababa Action Agenda
CIV	Collective investment vehicle
DAC	Development Assistance Committee
DFI	Development finance institution
ESG	Environmental, social and governance
EUR	Euro
FDI	Foreign direct investment
GDP	Gross domestic product
IDA	International Development Association
IFC	International Finance Corporation
IFI	International financial institution
LDC	Least developed country
MDB	Multilateral development bank
MIGA	Multilateral Investment Guarantee Agency
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PPP	Public-private partnership
SDG	Sustainable development goal
SME	Small and medium-sized enterprise
SPV	Special purpose vehicles
UNCDF	United Nations Capital Development Fund
USD	United States dollar

Executive summary

The challenge

While turning the "billions into trillions" is essential to bridge the Sustainable Development Goals (SDGs) financing gaps, there is a need also to focus on the quality of resources mobilised and how they reach those being left behind. While international and domestic public finance remains essential to meet the SDGs, public resources alone will not be enough. The challenge is particularly acute in the least developed countries (LDCs), which have experienced a recent decline in official development assistance (ODA). LDCs also often find it difficult to attract private investment, including foreign direct investment. Increased public and private financial flows must therefore be made to work for the world's most vulnerable countries, for underserved markets, and for smaller projects in the so-called "missing middle" – those small and medium-sized enterprises that are too big to access microfinance but too small or seen as being too risky to access commercial loans offered by mainstream financial institutions.

In these settings, blended finance offers potential opportunities to increase the resources available to LDCs and the missing middle. But such approaches are not without limitations or risks, and need to be deployed carefully. To improve how blended finance strategies can best work for LDCs, it is essential to understand not only the quantities of finance they mobilise and the regions and sectors they are benefitting, but also how these strategies are being applied, and, more broadly, how the financing for development architecture is evolving and supporting LDCs to meet the SDGs and ensure no one is left behind.

This report, the second in a collaboration between the United Nations Capital Development Fund (UNCDF) and the Organisation for Economic Co-operation and Development (OECD), outlines the latest trends in blended finance approaches in LDCs. It updates the previous 2018 report with the latest available data from the OECD, which now cover the six years from 2012 through 2017. It also features seven guest pieces by practitioners and experts working in the blended finance space, which showcase the opportunities and challenges of applying blended finance solutions in LDCs. The report concludes with a review of the next steps for the blended finance and development communities, and flags some emerging issues revealed in the report.

Recent trends

LDCs receive a small piece of the blended finance pie. Of all the private finance mobilised by official development finance interventions between 2012 and 2017, approximately USD 9.3 billion, or 6%, went to LDCs, whereas over 70% went to middle-income countries. Gaps in the data mean it is unclear whether this represents a fall relative to the 7% of private finance mobilised for LDCs observed for 2012-2015.

On average, blended finance deals in LDCs mobilise less private finance than those in other developing countries. Over 2012-2017, the average amount of private finance mobilised in LDCs was USD 6.1 million per deal, compared to USD 27 million in lower middle-income countries and over USD 60 million in upper middle-income countries.

Some LDCs benefit more than others. The top five recipients - Angola, Senegal, Myanmar, Bangladesh, and Zambia - together received approximately 44% of the total volume of private finance mobilised and almost 22.5% of all deals in the LDCs in 2012-2017.

Some LDCs receive no blended finance, but do receive official development assistance (ODA). There is a weak but positive relationship between ODA received and private finance mobilised.

Credit and risk guarantees continue to mobilise the most private finance in absolute terms, at 63% of the total volume reported in 2012-2017. The average volume of private finance mobilised in LDCs is consistently lower for all leveraging mechanisms. Simple co-financing agreements are instead the most frequent leveraging mechanism, as they represent 56% by number of deals overall.

Energy, banking and financial services are the largest, and growing, sectors, representing 23% (USD 2.16 billion) and 19% (USD 1.8 billion) respectively over the six years analysed. Data for 2016-2017 indicate this share is growing. Education and healthcare are scarcely addressed.

Multilateral donors mobilised the largest amounts of private finance in LDCs: USD 5.2 billion or 56% of all private finance over 2012-2017. Yet, bilateral donors are increasingly important blended finance players in LDCs.

Most mobilised private capital reaching LDCs comes from high-income countries. While LDCs themselves remain a significant source of additional capital, their importance has diminished from 42% of finance mobilised in 2012 to 14% in 2017. However, the average volume of private finance mobilised from domestic investors in LDCs increased from USD 4.5 million in 2012 to USD 5.8 million in 2017.

The number and variety of players entering the blended finance space is increasing. While some donors are taking steps to increase their engagement in LDCs, the data suggest that many providers still tend to overlook these markets when it comes to blending. This in turn implies there is a need for further risk-taking and experimentation at both the balance sheet and project level to get more private finance invested in LDCs when appropriate. Blended transactions typically also require greater levels of concessional support in LDCs than in other developing countries.

Making blended finance work for least developed countries

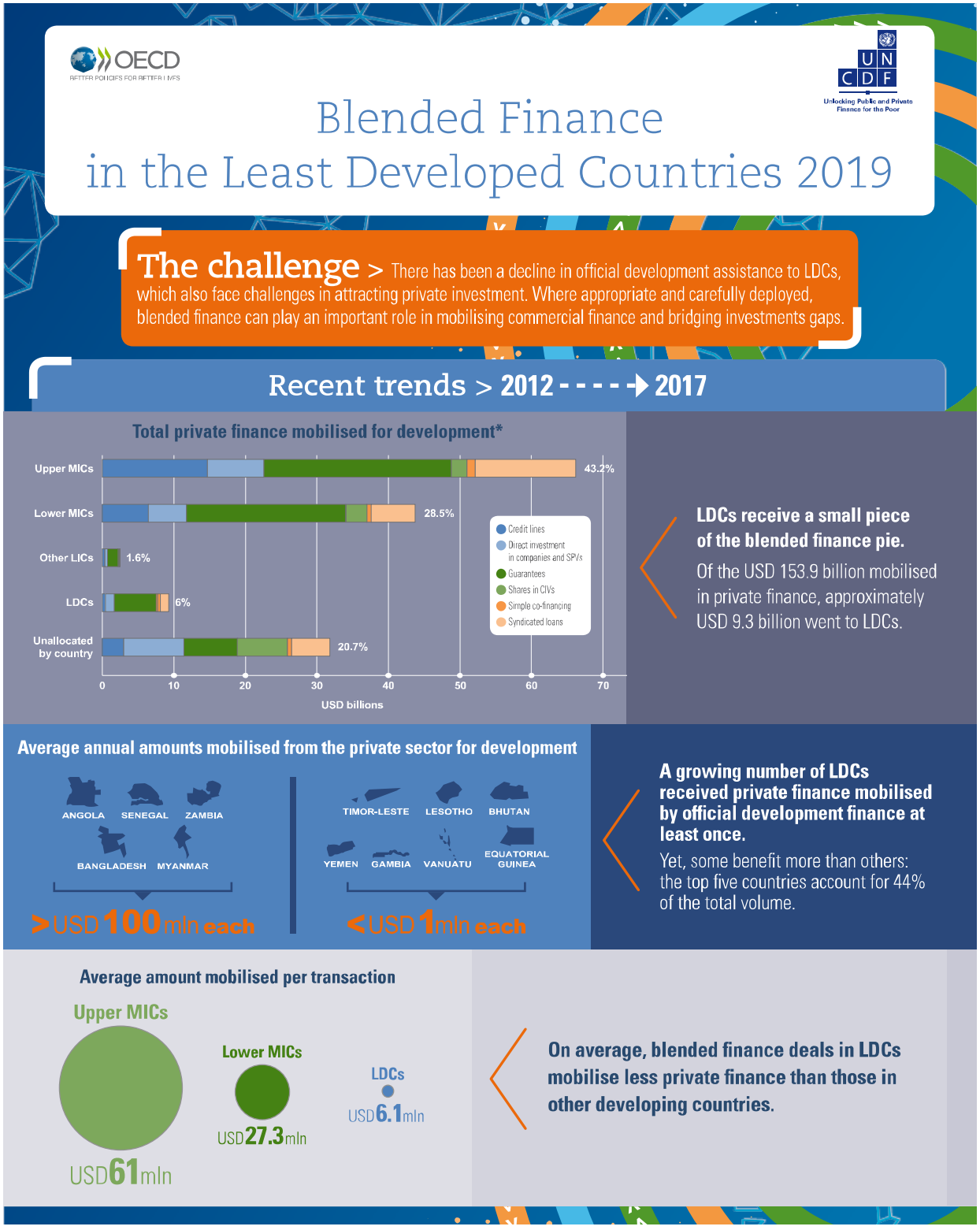
Blended approaches can help mobilise much-needed additional resources for the LDCs and they can create demonstration effects that narrow the gap between actual and perceived risks of investing in these markets. But such approaches need to be considered and deployed carefully. In signing the Addis Ababa Action Agenda, Member States have agreed on a set of overarching principles for blended finance and public-private partnerships (PPPs). The OECD principles on blended finance provide a policy framework to ensure the sustainability of blended finance, while initiatives such as the multi-stakeholder Tri Hita Karana Roadmap and the UNCDF action agenda on LDCs are also focused on improving the effectiveness and efficiency of blended operations. Specific lessons from this report include:

- Blended finance solutions should respect national ownership, be aligned with national priorities and applied as part of a broader national SDG financing strategy that takes into account domestic and international, public and private sources of finance.
- In crisis-affected contexts, where ODA plays an essential role, blended approaches must be particularly transparent and accountable, and avoid doing harm by widening disparities.
- Technical assistance plays an important role in blended finance transactions in LDCs, including by helping to put in place the right capacities and institutions to identify, analyse and structure blended operations; and to strengthen investees' operational efficiency and environmental, social and governance (ESG) compliance.

- A local presence, be it an investor or a fund manager, can help build local capacity and understand risks and opportunities attached to each investment.
- There is a need for further research and efforts to strengthen SDG impact monitoring and measurement.

If blended finance continues to become an increasingly important modality of development co-operation, then development partners will need to ensure that this does not come at the expense of support for LDCs and other vulnerable countries – those where blending has been more challenging. It may be that there is a need to accept that the mobilisation agenda in LDCs will be different – but that those blended finance deals, where they are appropriate, are pursued because of their sustainable development additionality. Ultimately, different financing models - public, private or blended - will be best suited for different SDG investments in different contexts and governments should be in the driver's seat in determining which approach works best where.

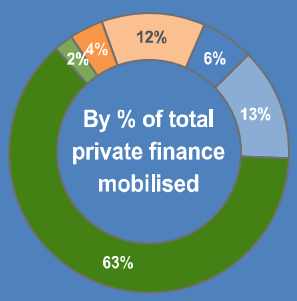
Infographic 1. How is blended finance benefitting least developed countries?



Note: All data are from OECD statistics on amounts mobilised from the private sector by official development finance interventions as of 1 April 2019

Infographic 2. What's next for blended finance in least developed countries?

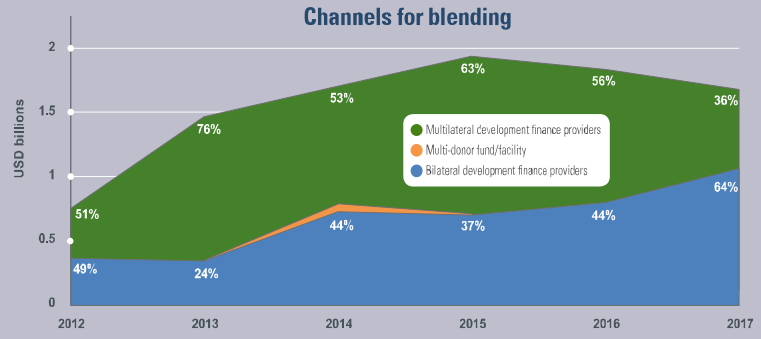
Guarantees are the most powerful leveraging mechanisms, but simple co-financing agreements are the most frequently used.



Leveraging mechanisms used in LDCs

- Credit lines
- Direct investment in companies and SPVs
- Guarantees
- Shares in CIVs
- Simple co-financing
- Syndicated loans

Channels for blending

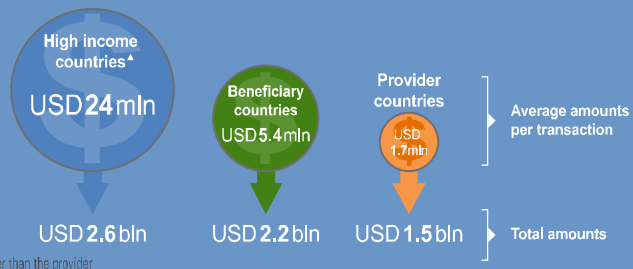


Note: % refer to the proportion of private finance mobilised reported by each type of provider over the total amounts reported as mobilised in LDCs.

Multilateral donors mobilised the largest amounts of private finance. Yet, bilateral donors are increasingly important blended finance players in LDCs.

Most mobilised private capital reaching LDCs comes from high-income countries.

Top sources of private finance mobilised



▲ Other than the provider

What's next?

- Blended approaches can potentially help mobilize much-needed additional resources that help LDCs bridge SDG financing gaps – but this is not happening at scale. More needs to be done to build the evidence base, improve SDG impact measurement and transparency, and share lessons on the role of blended finance in LDCs.
- Blended finance solutions should be aligned with national priorities and applied as part of a broader national SDG financing strategy.
- In the Addis Ababa Action Agenda, Member States agreed on a set of overarching principles for blended finance and public–private partnerships. The OECD DAC Blended Finance Principles, the UNCDF Action Agenda and the Tri Hita Karana Roadmap represent further efforts to improve the effectiveness and efficiency of blended operations.

Note: All data are from OECD statistics on amounts mobilised from the private sector by official development finance interventions as of 1 April 2019

1 What are the latest trends in blended finance for least developed countries?

Between 2012 and 2015, of the USD 81 billion in private finance mobilised for development, some 7% benefited the least developed countries (LDCs). This chapter looks at the latest situation, extending the analysis to include OECD data covering 2016 and 2017, as well as data on new leverage mechanisms, to explore trends over a six-year timeframe. It describes who the main mobilisers of private finance in LDCs are; the top sources of private finance mobilised; how blended finance is deployed across sectors; and how LDCs fare in comparison to other developing countries.

1.1 Introduction

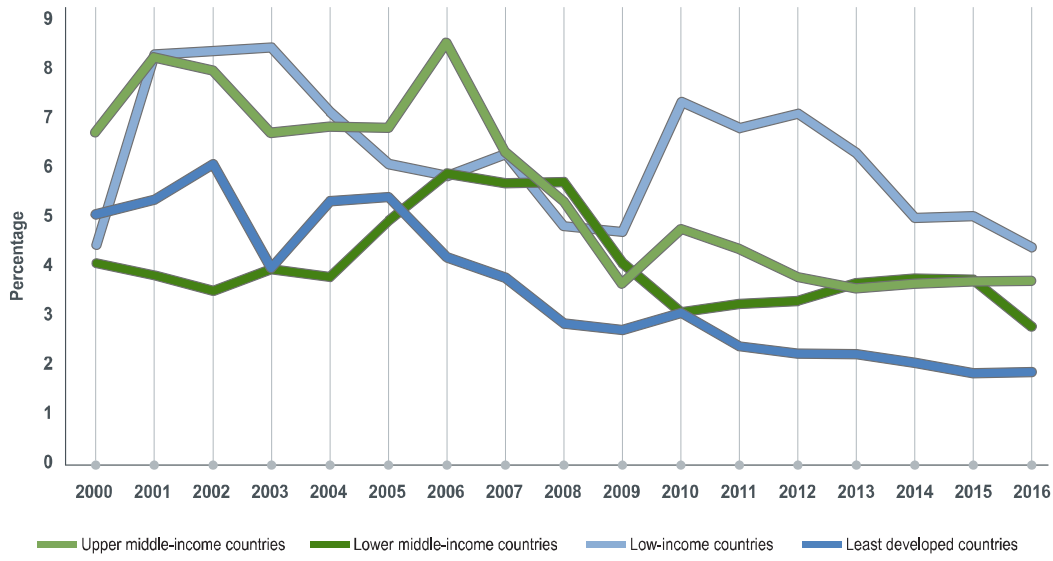
The outlook for development finance is troubling, especially for least developed countries. Foreign direct investment (FDI) to LDCs fell by 17% over the two years of 2016-17 to USD 750 billion, while official development assistance (ODA) remains the largest source of external financing (UNCTAD, 2018[1]).

As Figure 1.1 shows, the importance of private investment flows[1] has declined across all income groups (OECD, 2018[2]). At their peak in the early 2000s, private investment inflows represented approximately 6% of LDCs' gross domestic product. Despite yearly fluctuations, the share of private investment in GDP steadily declined throughout the ensuing decade. This is particularly true for LDCs, where private investment inflows have been below 3% of GDP since 2010, falling each year to reach approximately 2% in 2016.

Moreover, preliminary data show that, in 2018, less ODA went to least developed and African countries. The new cash-flow basis methodology[2] suggests that bilateral ODA to the least developed countries fell by 3% in real terms from 2017, aid to Africa fell by 4%, and humanitarian aid fell by 8%. This is of particular concern given ODA's important role in helping LDCs meet their development goals.

Figure 1.1 Private investment inflows in developing countries (2000-2016)

Private investment as a % of GDP



Source: (OECD, 2018[2]), *Global Outlook on Financing for Sustainable Development 2019*, https://doi.org/10.1787/9789264307995-en

Overall, the financing for development architecture is not channelling resources to LDCs effectively or at the scale and speed needed to leave no one behind. This is why there is increasing focus on how limited public resources can be used to put in place the right incentives and regulations to mobilise private finance for the SDGs.

In this context, blended finance (Box 1.1) is receiving increasing attention for its potential to maximise the catalytic impact of development finance by sharing risks or lowering costs to adjust risk-return profiles for private investors. Blended approaches can help mobilise much-needed additional capital for least developed countries. But they need to be considered carefully and should be applied as part of a broader SDG financing strategy.

Box 1.1. What is blended finance?

There are different definitions of blended finance. The Addis Ababa Action Agenda refers to blended finance as combining concessional public finance with non-concessional private finance. The OECD employs a broader definition that extends beyond concessional finance, as follows: "The strategic use of development finance for the mobilization of additional finance towards the SDGs in developing countries", where "additional finance" refers primarily to commercial finance that does not have an explicit development purpose. "Development finance" is taken to include both concessional and non-concessional resources. The data presented in this report are consistent with the OECD's definition. The OECD data on private finance mobilised by official development finance is, today, the best proxy available to understand how the blended finance market is evolving and where it still needs to go.

Note: For more background, see (OECD, 2018[3]), "Blended finance Definitions and concepts", in *Making Blended Finance Work for the Sustainable Development Goals*, https://doi.org/10.1787/9789264288768-7-en
Source: (UNCDF, 2018[4]), *Blended Finance in Least Developed Countries,* https://www.uncdf.org/bfldcs/home

This report, the second in a series, reviews the emerging trends and issues in blending finance in the LDCs. It begins in Chapter 1 by reviewing the latest statistics: how much private sector finance is being mobilised for LDCs; is it increasing; where is it going – geographically and by sector; how is it being mobilised, etc.? Chapter 2 then brings in the voices of practitioners and experts at the blended finance coal face, who highlight important issues in the field. Chapter 3 concludes by summarising the emerging risks and opportunities, outlining key principles for all blended finance operations in LDCs, and raising some important questions to guide the next steps in this novel area. Many blended finance projects tend to fall into two categories: infrastructure projects and corporate investments. This report has maintained a particular focus on the "missing middle" segment of the corporate sector (Box 1.2).

Box 1.2. Minding the missing middle

There is a huge financing gap in the so-called missing middle. Smaller-sized projects can transform local communities but need much more technical assistance as well as financing to fulfil their potential.

Supporting missing-middle projects in LDCs requires patience and can be costly. In UNCDF's experience, small and medium-sized enterprises (SMEs) in these geographies typically need financial support ranging from USD 50 000 to 1 million. This means they are too large for microfinance organisations, but too small or risky to access affordable or appropriate growth capital from conventional debt and equity investors.

While bank loans represent the main source of finance for SMEs, commercial banks have traditionally found lending to some SMEs challenging because of information asymmetries, lack of collateral, and the higher cost of serving smaller transactions and finding entrepreneurs with a solid business plan. Many international financial institutions (IFIs) or development finance institutions (DFIs) also do not routinely directly support smaller projects in LDCs, often because of the risks or transaction costs involved, although they do work through intermediaries or use instruments such as portfolio guarantees to encourage increased lending to SMEs.

But finance is only part of the issue. Many SMEs also need technical and advisory support – from helping them strengthen their financial practices to adhering to high environmental, social or governance standards. Ultimately, the lack of assistance for the transaction sizes required in LDCs means that SMEs are unable to grow and create jobs.

In this context, UNCDF supports smaller-sized projects with strong SDG impact throughout their lifecycle by bundling and combining capital investments with technical assistance. In addition to helping projects become bankable, often through a combination of grants and business advisory support, UNCDF also offers, through its recently established LDC Investment Platform, loans and guarantees which are intended as stepping stones for SMEs to access more commercial follow-on finance. In the case of its blended transactions, UNCDF's support aims at mobilising private resources, notably from domestic banks, for projects they otherwise would not consider.

While each project has been assessed for its development and financial additionality, UNCDF is also intent on using its transactions to create powerful demonstration effects, narrow the gap between the perceived and actual risks of supporting the missing middle and with a view to opening up new markets for private investors.

1.2 Methodology

The OECD-DAC has been reporting on the amounts mobilised from the private sector by official development finance[3] since 2017. Until 2018, the OECD-DAC collected this data through ad-hoc surveys which examined five instruments: guarantees, syndicated loans, shares in collective investment vehicles (CIVs; see Box 1.6), direct investment in companies, and credit lines.[4] The data covered 2012-2015 and was collected retrospectively.

In 2018, the OECD-DAC agreed on a methodology to measure two additional leverage mechanisms:

1. Project finance: special purpose vehicles (SPVs) are included as part of a new category "direct investment in companies and SPVs".
2. Simple co-financing, such as public-private partnerships (PPPs).

These data have also been retroactively incorporated in an analysis covering 2012-2017, thereby expanding and updating the dataset since the publication of the *2018 Blended Finance in Least Developed Countries report* (UNCDF, 2018[4]). This methodological improvement and integrations to the historical dataset explain the differences in the figures presented in this report and the 2018 report. The private finance mobilised dataset is continuously being updated due to staggered reporting by development finance providers.[5] This chapter presents the latest data as of 1 April 2019, but further revisions are possible.

The analysis is based on the United Nations' classification of least developed countries (UN, 2018[5]) as applicable in 2017, the last year of reporting covered in the dataset. The group thus comprises 48 LDCs, and includes Equatorial Guinea, even though it graduated in 2018.

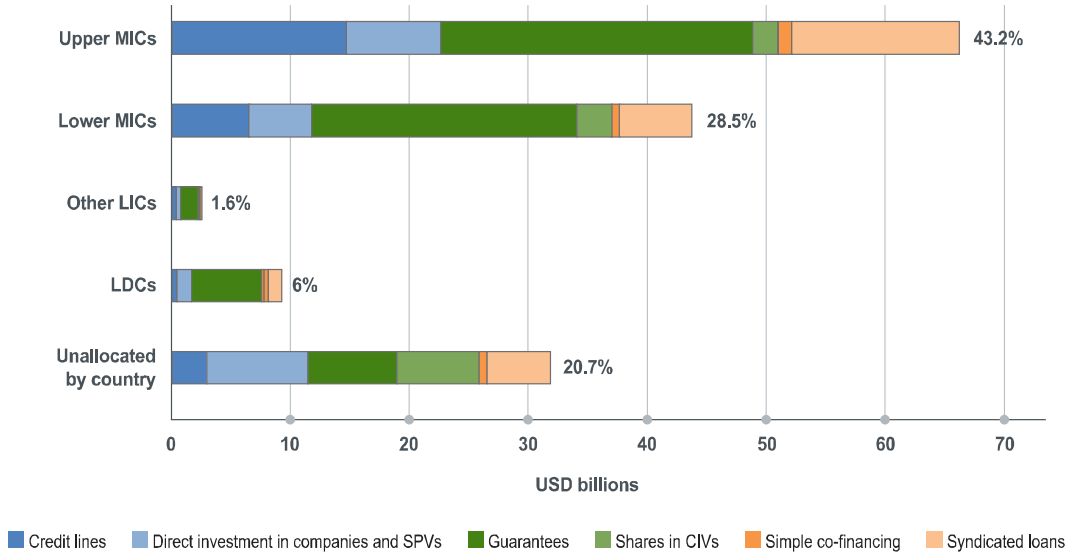
Finally, the report also presents quantitative analysis contributed by Convergence,[6] providing an additional perspective on blended finance in LDCs. Whereas the OECD information draws from the annual reporting exercise undertaken as part of the Development Assistance Committee (DAC) statistics, Convergence collects information from other credible public sources (e.g. press releases, case studies, news articles), as well as through data-sharing agreements and validation exercises with its members. In order to be included in Convergence's database, the transaction must use concessional capital (public or philanthropic), whereas the OECD's scope extends to all development finance, independent of the terms of its deployment. In fact, the six leveraging mechanisms are mostly market-oriented instruments. Another important difference is that Convergence captures the total deal size (including the development finance deployed) while the OECD only accounts for the amount of private finance mobilised in each operation.

The Convergence and OECD databases contain many of the same transactions. Given the current state of information sharing, it is not possible for either of them to be fully comprehensive. While some deals may be captured in both sources, the information collected is complementary. At times, the datasets may convey similar or different trends given their respective focuses, but together they help paint a fuller picture of what is happening when it comes to blended finance in LDCs.

1.3 The proportion of private finance going to LDCs remains relatively small, but stable

Of all private finance reported to the OECD as having been mobilised by official development finance interventions between 2012 and 2017, approximately USD 9.3 billion or 6% went to LDCs, whereas over 70% went to middle-income countries (Figure 1.2). Of the total USD 9.3 billion benefiting LDCs, USD 1.676 billion was mobilised in 2017.

Figure 1.2. Private capital mobilised by official development finance (2012-2017)



Note: LIC: low-income country; LMIC: lower middle-income country; UMIC: upper middle-income country; LDC: least developed country. The upper middle-income countries group includes Chile, Uruguay and the Seychelles, though they have since graduated from the DAC list of ODA recipients.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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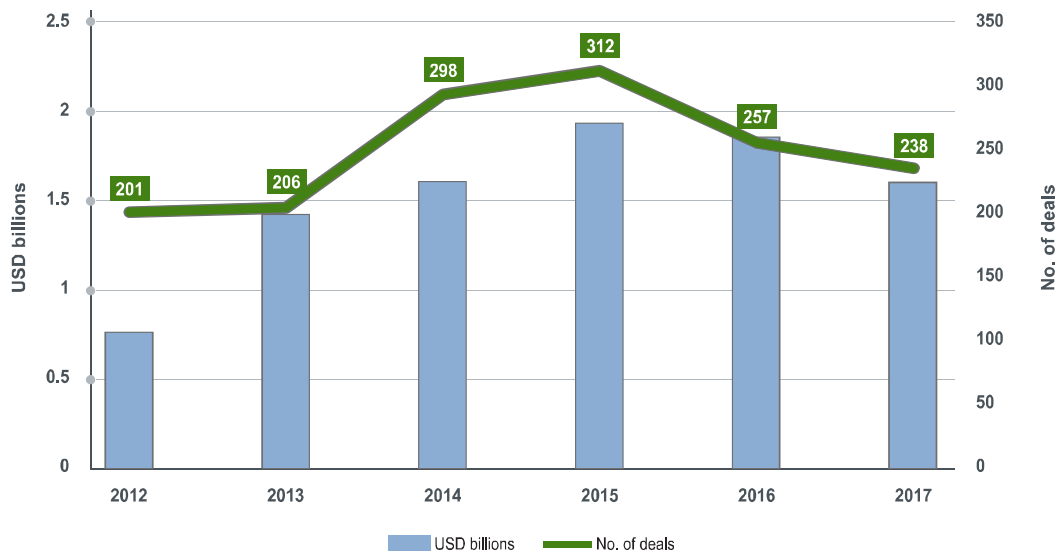
Data gaps mean it is unclear whether this 6% is actually lower than the 7% of private finance mobilised for LDCs observed for 2012-2015. The data on the amounts mobilised by the International Finance Corporation (IFC) in 2016-2017 (USD10.3 billion) were not broken down by country for confidentiality reasons. In practice, all the amounts reported by IFC over the last two years are thus unallocated by income group.

Figure 1.3 shows the six-year trend for private capital mobilisation in LDCs. As the IFC did not report country-level data for 2016-2017, it is still unclear whether the amount of private finance mobilised in LDCs is decreasing overall. Had IFC reporting been included, it is likely the aggregate trend would have been stable throughout the whole period.[7] Box 1.3 presents trend data from the Convergence database which, as per the methodological note above, provide further useful insights into how blended finance transactions are touching down in LDCs.

Figure 1.3. Private finance mobilised in LDCs (2012-2017)



Note: As data from the new leverage mechanisms have been retroactively included in this analysis, the data for 2012-2015 differ from Figure 4 in (UNCDF, 2018[4]).
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933965858

Table 1.1 indicates the percentage of private finance mobilised in LDCs for each year, though the caveat on data availability for 2016-2017 makes it somewhat difficult to confirm any trends for these years.

Table 1.1. Private finance mobilised in LDCs and other developing countries

Year	Private finance mobilised in LDCs USD billions	Total private finance mobilised in all developing countries USD billions	Private finance mobilised in LDCs as % of total
2012	USD 0.752	USD 15.274	4.9%
2013	USD 1.448	USD 19.363	7.5%
2014	USD 1.677	USD 22.653	7.4%
2015	USD 1.911	USD 27.674	6.9%
2016	USD 1.803	USD 34.272	5.3%
2017	USD 1.676	USD 34.685	4.8%

Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933966105

The Convergence database of concessional blended finance transactions (see Section 1.2) paints a somewhat different picture, whereby operations targeting one or more LDCs, either exclusively or in part, have accounted for 12% of the aggregate volume since 2005 (Box 1.3).[8]

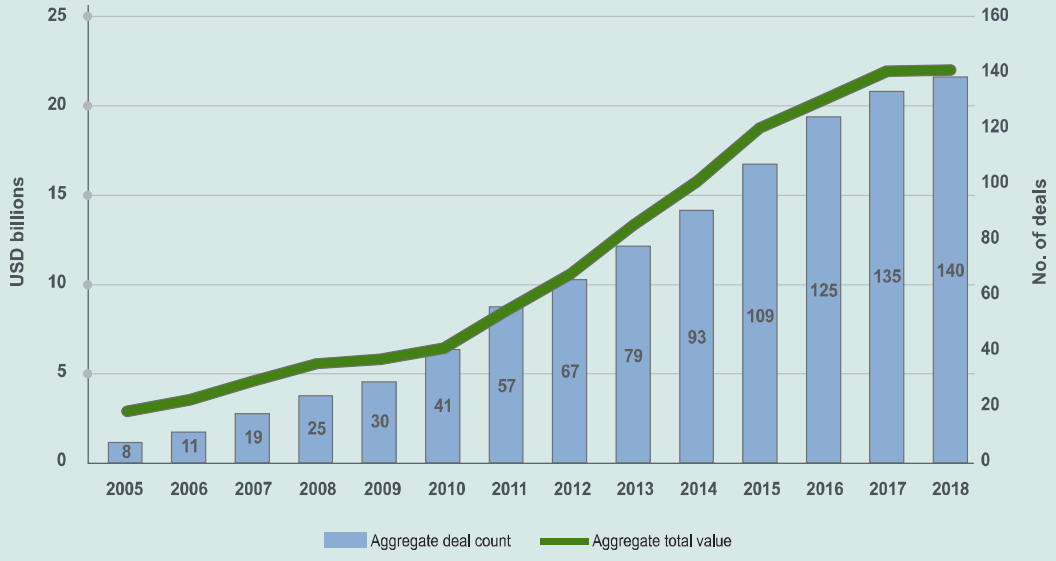
Box 1.3. The importance of concessionality for blending in least developed countries

As of May 2019, the Convergence database captures 440 blended finance transactions that include the use of either public or philanthropic concessional funding to catalyse private sector investment in SDG-related investments in developing countries (see Section 1.2). According to this source, one in three concessional blended finance transactions, i.e. 140, targeted one or more least developed countries (LDCs). The majority of them (40%) exclusively focused on LDCs, with another 25% having a primary focus on LDCs.

Overall, Convergence estimates that, since 2005, up to USD 15.5 billion in capital has been earmarked for LDCs through blended finance. Blended finance transactions targeting one or more LDCs, either exclusively or in part, have accounted for only 12% of the aggregate volume to date, in part because these transactions have been smaller, on average, than all blended finance deals (USD 164 million versus USD 301 million across the entire database). Figure 1.4 illustrates that there has been accelerating growth in the cumulative number and aggregate value of blended finance transactions targeting one or more LDCs since 2010.

Blended finance solutions come in many shapes and sizes. The majority of these blended finance transactions targeting LDCs in part or full were funds (e.g. debt or equity funds, at 45%), followed by projects (e.g. infrastructure projects or health programmes, at 27%), and companies (e.g. social enterprises or alternative finance companies, at 18%).

Figure 1.4. Cumulative blended finance targeting least developed countries (Convergence)



Note: Convergence tracks country data by stated countries of focus at the time of financial close, not actual investment flows. Often, countries of eligibility are broader than those explicitly stated.
Source: (Convergence, 2019[7]), www.convergence.finance

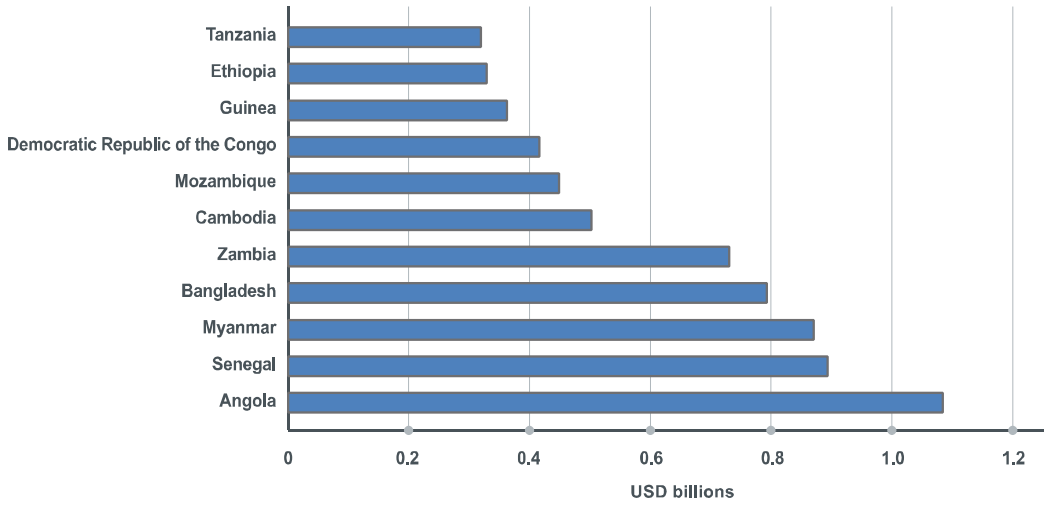
1.4 Blended finance approaches have expanded to additional least developed countries

Of the 48 countries categorised as LDCs, 43 benefited from private finance mobilised by official development finance at least once over 2012-2017 (Figure 1.6). Compared to the previous report, private finance mobilised was also reported in Equatorial Guinea, Vanuatu and Somalia during the last two years.[9]

The regional volumes of private capital mobilised continue to reflect the number of LDCs located within the region. The LDCs in the sub-Saharan Africa region collectively received the biggest share of private finance mobilised, at approximately 70% in 2012-2017. However, in 2016-2017, LDCs in sub-Saharan Africa received a lower share of private finance (58%), while Asian LDCs (predominantly South and Central Asia) represented 41%. Central America received under 1% of private finance mobilised, reflecting the fact that only one LDC (Haiti) is located in this region.

Figure 1.5 shows the top recipient countries for the time period 2012-2017. Angola remains the largest recipient of private finance mobilised for 2012-2017, mostly due to a few large transactions, and so this may not be a predictor of future trends (UNCDF, 2018[4]). Senegal, Bangladesh, Zambia, Cambodia and the Democratic Republic of the Congo – in descending order of volumes mobilised – also figure among the top 10 recipients for the whole time series. Myanmar more recently appeared as an important recipient of private finance mobilised, with two large deals in the telecommunications industry during the last two years. Overall, LDCs benefiting from the most private finance mobilised tend to be those with larger economies[10] and/or those with large natural resource endowments.

Figure 1.5. Top 10 least developed country recipients of private finance mobilised (2012-2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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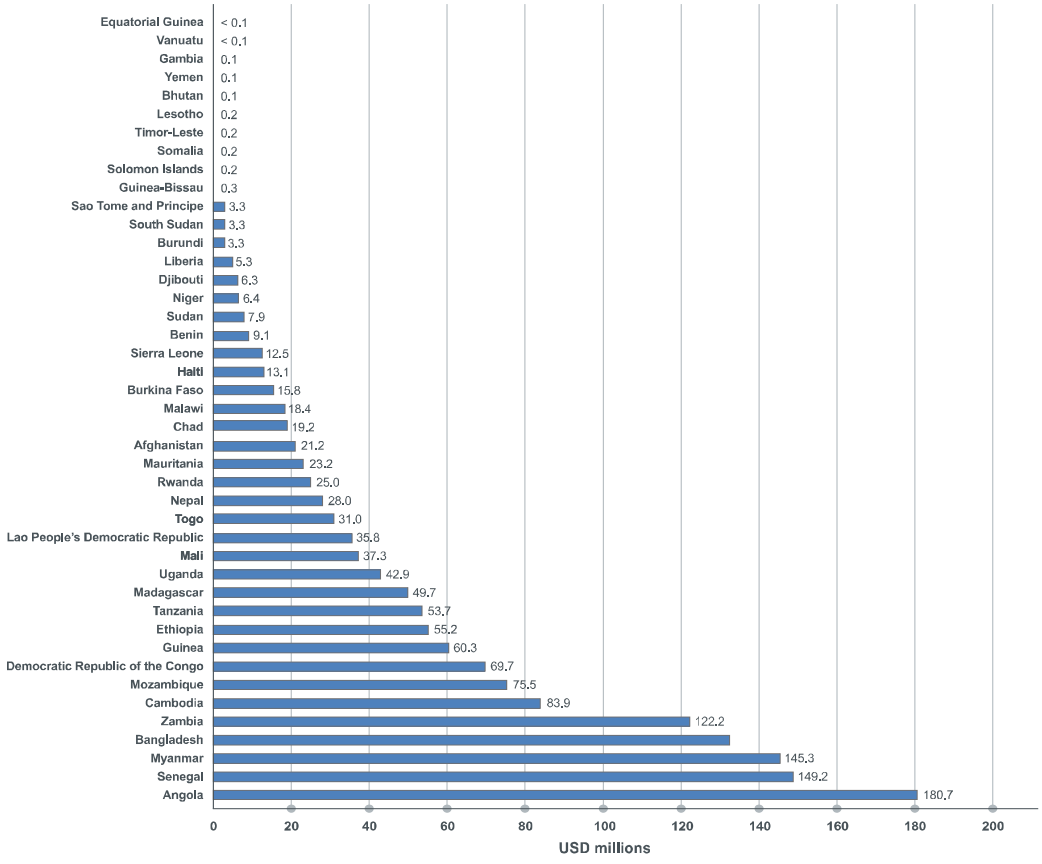
In 2012-2015, the eight LDCs with no private capital mobilised were mostly small islands and conflict-afflicted states. In 2016-2017, of the nine LDCs with no private capital,[11] five were fragile contexts according to the OECD multidimensional fragility framework (OECD, 2018[8]): Central African Republic, Eritrea, South Sudan and Yemen, and Comoros was scored as severely fragile for its economic environment and security. Five countries received no private finance mobilised throughout the six-year

period: Central African Republic, Comoros, Eritrea, Kiribati and Tuvalu. For further insights into making blended finance work in fragile contexts, see Guest Piece 2.6 by Izabella Toth (Cordaid) and Romy Miyashiro (Cordaid Investment Management BV).

Figure 1.6 shows an overview of the average annual amounts mobilised in each LDC for the full period 2012-2017 (see also Box 1.4 on average deal size).

Figure 1.6. Average annual amount of private finance mobilised per least developed country (2012-2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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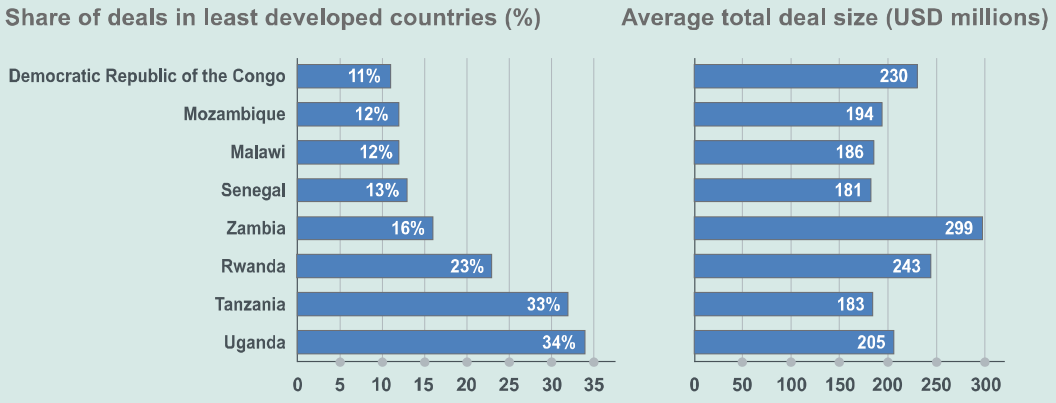
Further analysis indicates that Angola, Mauritania and Guinea achieved the highest volumes of private finance mobilised on average per deal over the six years. Despite the limited number of transactions, Angola ranks first with USD 51.6 million mobilised on average per deal in 2012-2017. This was driven by two large operations in river basin development and public sector policy and administrative management. There were only four deals in Mauritania, which shows the second largest average amount of private finance mobilised per deal, USD 34.9 million. Guinea comes in third, with 24 deals, mobilising on average USD 15 million per deal.

Box 1.4. Historical blended finance transactions targeting least developed countries are even more concentrated on sub-Saharan Africa

Blended finance transactions vary significantly in geographical scope, from a single-country infrastructure project to a global equity fund. According to Convergence data, the vast majority (88%) of blended finance transactions targeting one or more LDCs since 2005 focus on the sub-Saharan Africa region.

Within sub-Saharan Africa, the most frequently targeted LDCs have been Uganda, Tanzania, Rwanda, Zambia, Senegal, Malawi, Mozambique, and the Democratic Republic of the Congo (Figure 1.7). The first two – Uganda and Tanzania – are also among the top five developing countries globally most frequently targeted by blended finance deals.

Figure 1.7. Top least developed countries benefiting from concessional blended finance transactions (Convergence)



Note: Convergence tracks country data by stated countries of focus at the time of financial close, not actual investment flows. Often, countries of eligibility are broader than those explicitly stated. Totals in the "proportion of deals in LDCs" are more than 100% as deals can take place in more than one country.
Source: (Convergence, 2019[7]), www.convergence.finance

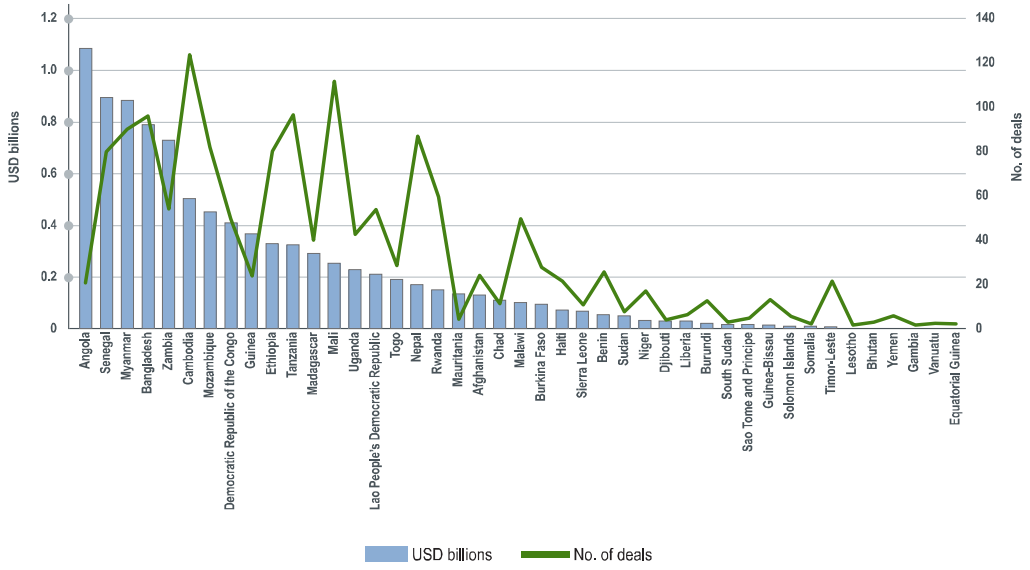
While the top recipients in Figure 1.6 and Figure 1.7 are not identical, the two sources agree that Zambia, Senegal, Mozambique and the Democratic Republic of the Congo are among the top LDCs for blended finance. The differences in country ranking may be attributable to methodological differences, but also to the fact that Convergence data cover a longer timeframe, dating back to 2005.

The OECD database also shows that the amount of private finance mobilised and number of deals varies significantly among LDCs (Figure 1.8). The top five recipients (Angola, Senegal, Myanmar, Bangladesh, and Zambia) in 2012-2017 together received approximately 44% of the total volume of private finance mobilised and almost 22.5% of all deals in the LDCs. Overall, the top 10 deals represented over 25% of all private finance mobilised in LDCs.

While the number of deals in Guinea was limited, two of them were big ticket items: a guarantee of USD 100 million for fossil fuel electric power plants with carbon capture storage and a USD 150 million guarantee for a nonferrous metals project. In addition, one deal in Myanmar (a guarantee valued at USD 450 million for telecommunications) represents over 12% of all private finance mobilised in LDCs. This suggests that blended finance transactions tend to be geographically concentrated and that some countries are able to attract larger investments than others.

Figure 1.8. Total amounts mobilised and number of deals by LDC (2012-2017)

Size of private finance mobilised (USD, left-hand axis) and number of deals (right-hand axis)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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1.5 Deals vary across countries by number and size

The six-year dataset further suggests that larger volumes of mobilisation may be harder to achieve in LDCs than in middle-income countries, possibly due to the smaller size of private-sector transactions and/or the higher use of concessional finance per transaction. Over 2012-2017, the average amount of private finance mobilised per deal in LDCs was USD 6.1 million, compared to USD 27 million in lower middle-income countries and over USD 60 million in upper middle-income countries (Table 1.2).

Table 1.2. Number of deals and average mobilisation by country income group (2012-2017)

	Unallocated	LDCs	Other LICs	LMICs	UMICs
No. of deals	565	1 513	179	1 608	1 087
Average amount of private finance mobilised per deal (USD millions)	56.5	6.1	13.9	27.3	61
Total private finance mobilised (USD billions)	31.9	9.3	2.5	43.9	66.4

Note: LIC: low-income countries; LMIC: lower middle-income countries; UMIC: upper middle-income countries; LDC: least developed countries
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933966124

1.6 Blended finance and ODA seem linked, but ODA plays a unique role

The geographic breakdown of ODA recipients is broadly similar to that of private finance mobilisation, with sub-Saharan Africa and Asia (mostly South and Central) receiving 62% and 31% respectively of all ODA in 2012-2017. The highest ODA recipients partially overlap with those who receive the highest amount of mobilised private finance: 5 countries (namely Ethiopia, Bangladesh, Myanmar, Mozambique and the Democratic Republic of the Congo) feature in the top 10 of both ODA and private finance mobilised over 2012-2017.

In examining the relationship between ODA and private finance mobilised, the OECD found a weak but positive relationship. This relationship might be a result of an increased focus on the use of ODA to mobilise private finance for sustainable development. ODA is also going to those five LDCs where no private finance has been mobilised. This confirms the continuing and essential role of ODA for delivering on the promise of leaving no one behind. It also highlights the concern that, if blended finance becomes an increasingly important development co-operation approach, development partners will need to ensure this is not at the expense of support for LDCs and other vulnerable contexts, where blending is more challenging.

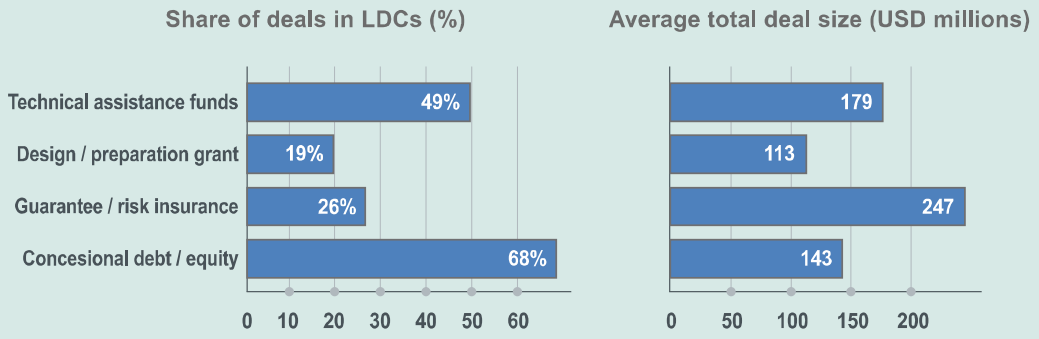
While the OECD definition - and hence also its data - extends blending to all development finance, independent of the terms of its deployment, the 2018 report highlighted the importance of concessional finance in making blended transactions work in LDCs. Convergence identifies four ways in which concessional capital can be deployed by public and/or philanthropic actors to mobilise additional financing for the SDGs in developing countries (i.e. through concessional debt or equity, guarantees or risk insurance, design/preparation grants, and technical assistance funds). Box 1.5 shows that technical assistance is more likely to be deployed and that concessional resources represent a larger share of the total transaction in LDCs compared to other developing countries.

Box 1.5. The use of concessional resources for blended finance transactions in LDCs

According to Convergence, nearly 70% of blended finance transactions targeting one or more LDCs have benefited from concessional debt or equity (e.g. investment-stage grant, first-loss capital) since 2005. Compared to blended finance transactions in other developing countries, transactions targeting one or more LDCs are more likely to deploy technical assistance alongside investment capital (49% versus 38% of all transactions). In LDCs as in other developing countries, guarantees are associated with larger average deal sizes.

Blended finance transactions targeting one or more LDCs have seen a larger share of concessional resources as a proportion of the total transaction size. Convergence reviewed the leverage ratio (i.e. total non-concessional capital mobilised divided by total concessional capital provided) for a sample of blended finance operations targeting one or more LDCs. Based on this estimate, transactions focused on LDCs show a lower average leverage ratio: for every one dollar of concessional financing only USD 2.80 of non-concessional capital was mobilised, compared to the average of USD 4.00 across all operations included in Convergence's 2018 Brief (Convergence, 2019[9]).

Figure 1.9. The type and size of concessional blended finance deals in least developed countries (Convergence)



Note: Convergence tracks country data by stated countries of focus at the time of financial close, not actual investment flows. Often, countries of eligibility are broader than those explicitly stated. Totals in the "proportion of deals in LDCs" are more than 100% as deals can take place in more than one country. Percentages based on all deals in the Convergence database targeting one or more LDC.
Source: (Convergence, 2019[9]), "Leverage of concessional capital", https://www.convergence.finance/knowledge/35t8IVft5uYMOGOaQ42qgS/view

The findings from Box 1.5 are broadly consistent with those presented in Section 1.5 above and Table 1.3 below. They further suggest that guarantees have been associated with greater mobilisation and that it has been more difficult to mobilise private finance for LDCs, compared to middle income countries, through blended finance.

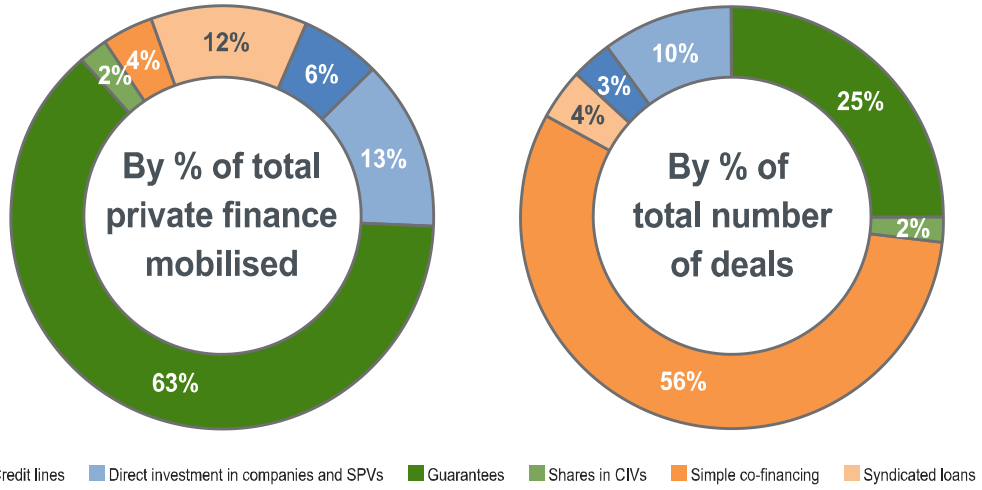
The identification of and support for bankable projects in LDCs can be challenging and time-consuming, but this work is essential to generate investable opportunities. The Guest Piece by Bettina Prato (Smallholder and Agri-SME Finance and Investment Network, IFAD) and Dagmawi Habte Selassie (IFAD) in Section 2.1 highlights the importance of technical assistance, including for strengthening investees' capacity in areas like environmental, social and governance (ESG) compliance and improved operational efficiency.

1.7 Guarantees are the most powerful leveraging mechanisms, but simple co-financing agreements are the most used

Credit and risk guarantees continue to be the instruments that have mobilised the most private finance in absolute terms, at 63% of the total volume reported in 2012-2017 (Figure 1.10). Guarantees represent over 55% of all private finance mobilised in every year excluding 2017, when guarantees fell to 44% of private finance mobilised. This could point to an increased diversification of the blended finance mechanisms used in LDCs. Total amounts reported as mobilised from direct investments in companies registered a slight increase over the full time period, from representing 18% of private finance mobilised in 2012, to over 21% in 2017. The number of operations based on guarantees also decreased, representing 35% of deals in 2012 but only 15% in 2017, in favour of direct investment in companies and SPVs and simple co-financing. Guarantees were used in 35 LDCs to mobilise private finance. However, 5 countries - Angola, Bangladesh, Myanmar, Senegal and Zambia - received over half of all private finance mobilised through guarantees.

Simple co-financing arrangements represent the largest number of deals overall, but mobilised a relatively small share of private capital, i.e. 4% over 2012-2017. Acquiring shares in collective investment vehicles (CIVs) remains a minor leveraging mechanism in LDCs: it represents the fewest deals and the smallest volume of mobilised private capital over the whole time series. The use of CIVs is further explored by complementary OECD research, as described in Box 1.6.

Figure 1.10. Leverage mechanisms in least developed countries (2012–2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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Box 1.6. Insights from the OECD 2018 Blended Finance Funds and Facilities survey

Blended finance funds and facilities, also referred to as collective investment vehicles (CIVs), are an important channel for blending as well as a primary driver of innovation. The OECD distinguished between two different models of CIVs:

- A fund is a pool of commercial, or both development and commercial, capital to collectively supply financial resources to projects or companies. Funds can be structured in two ways, either in a flat structure where risks and returns are allocated equally to all investors, or in a layered structure where risks and returns are allocated differently across investors. This category includes private equity funds, fixed income funds, some special purpose vehicles, and other fund-like structures.
- A facility is an earmarked allocation of public development resources (sometimes including support from philanthropies), which can invest in development projects through a range of instruments, including by purchasing shares in collective vehicles such as funds.

While the OECD data on private finance mobilised aims to capture information on leverage at the operations level, the OECD work on blended finance funds and facilities provides complementary information by examining the composition of such vehicles at the capital level.

Based on the latest survey, blended finance vehicles invested USD 7.6 billion in LDCs in 2017, out of a total of USD 41 billion, where information by country was available. This amount comprises both development finance (concessional or not) and commercial capital – the latter amounting to USD 340 million. This amount corresponds to roughly 7.5% of the total USD 4.5 billion in commercial capital mobilised by flat and structured funds across all developing countries in 2017. This share is roughly consistent with that observed in the OECD private finance mobilised dataset over 2012-2017.

The 180 blended finance vehicles surveyed invest in a total of 25 LDCs, with Uganda, Zambia, Tanzania, Ethiopia and Cambodia capturing most of the investment volume. No investments were reported in Kiribati or Lesotho by the blended finance CIVs or by official donors as private finance mobilised. According to both sources, Bhutan, South Sudan and Comoros received very limited amounts.

Source: (Basile and Dutra, forthcoming[10]), OECD Blended Finance Funds and Facilities 2018 Survey results.

As mentioned earlier, the amount mobilised by each instrument over six years is significantly lower in LDCs than in upper and lower middle-income countries. Table 1.3 compares the average amount mobilised per instrument per deal in LDCs from 2012-2017 with all other developing countries. **The average volume mobilised in LDCs is consistently lower for all leveraging mechanisms. Interestingly, in LDCs syndicated loans mobilised more private finance per deal on average than guarantees.** This reflects the large variation in the amounts mobilised by guarantees, with 81 out of 380 deals mobilising under USD 1 million and the top 10 deals representing approximately 39% of all private finance mobilised by guarantees.

Table 1.3. Annual private finance mobilised per deal by leverage mechanism (2012-2017)

	LDCs (USD millions)	Other developing countries (USD millions)
Credit lines	10.3	92.9
Direct investment in companies and SPVs	8.3	39.6
Guarantees	15.4	73.6
Shares in CIVs	7.2	28.9
Simple co-financing	0.4	2.5
Syndicated loans	17.7	63.3

Note: CIVs: collective investment vehicles; SPVs: special purpose vehicles.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933966143

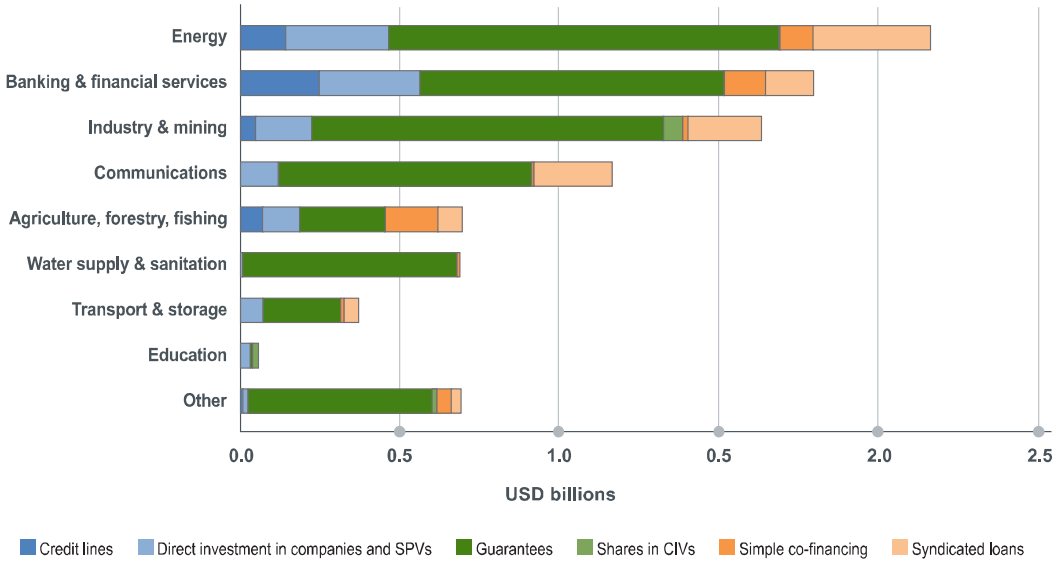
1.8 Energy, banking and financial services mobilise the most private finance

Over 2012-2017, the energy and banking and financial services sectors in LDCs are confirmed as the largest recipient sectors, representing 23% (USD 2.16 billion) and 19% (USD 1.8 billion) of all private finance mobilised respectively. In the last two years, these sectors received even greater focus, with energy representing 30% of the USD 3.48 billion in private finance mobilised in LDCs and banking and financial services sector 24%.

Industry and mining was the third largest sector over 2012-2017, representing 17.6% or USD 1.6 billion of all private finance mobilised in LDCs. Communications followed as the fourth largest sector, representing 12.6% or USD 1.16 billion of private finance mobilised.

As illustrated in Figure 1.11, trends over the six-year period show that **guarantees are a prominent leveraging mechanism in almost every sector** (excluding education), whereas direct investments and syndicated loans mobilise larger amounts in areas with clear revenue streams.

Figure 1.11. Private finance mobilised by sector in least developed countries (2012-2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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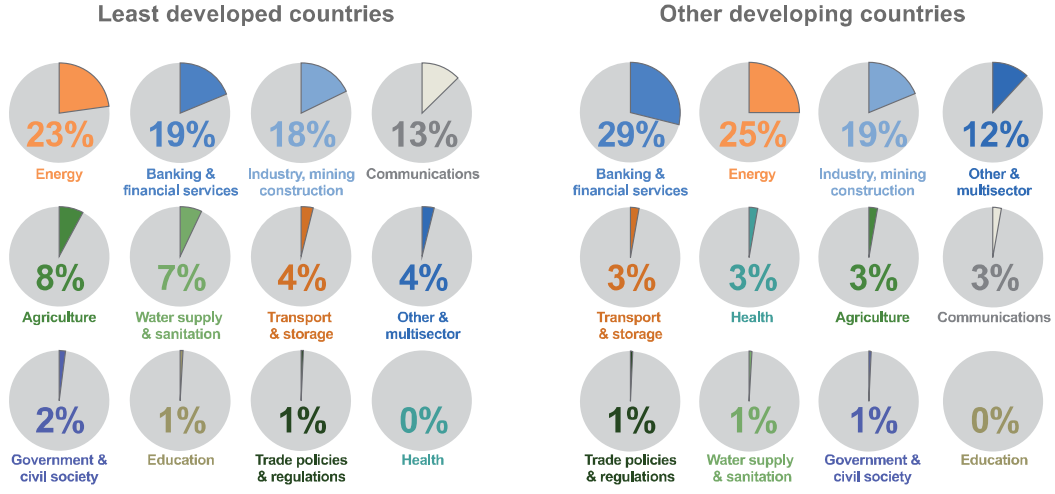
Figure 1.12 confirms the findings from the 2018 report that energy, banking and financial services are also the largest sectors for private finance mobilised in both LDCs and other developing countries (UNCDF, 2018[4]). Indeed, energy, banking and financial services are consistently amongst the top sectors of private finance mobilised for both groups of countries almost every year.[12]

Figure 1.12. Private finance mobilised by sector in least developed countries and other developing countries (2012-2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933965972

In terms of the energy sector breakdown, between 2012 and 2017, over 40% of private finance mobilised went to natural gas and oil-fired electric power plants. Another 10% went to fossil fuel electric power plants with carbon capture storage and other non-renewable sources. Renewable energy (hydroelectric power, solar, wind, geothermal, and multiple technologies) was more prominent in other developing countries than in LDCs (57% of private finance mobilised in energy compared to 42% in LDCs).

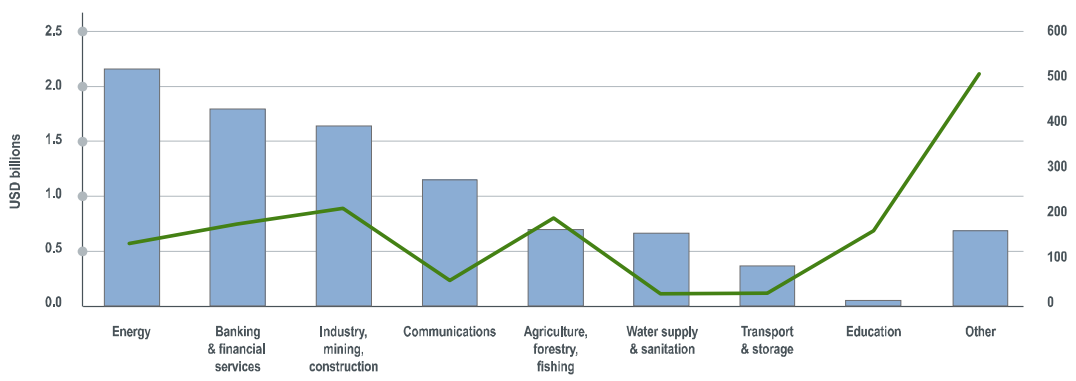
In the banking and financial services sector, 92% of private finance was mobilised for financial intermediaries in LDCs and 7% for financial policy and administrative assistance. SME development was the largest subsector and received 34% of all private finance mobilised to industry, mining and construction, followed by oil and gas (16%) and nonferrous metals (14%). Over 99% of the private finance mobilised in the communications sector over 2012-2017 was mobilised in the telecommunications industry, which includes telephone networks, telecommunication satellites, and earth stations.

From 2012-2017, the majority of the USD 58.79 million private finance mobilised in the education sector went to building education facilities and training (52%), followed by vocational training (19%) and education policy and administrative management (13%). Very little private finance was mobilised in the health sector, which represents under 0.5% of private finance mobilised in LDCs from 2012-2017 (categorised as other in Figure 1.11). For further insights into the potential of blended finance in the health sector, see the Guest Piece in Section 2.3 by Priya Sharma.

In terms of number of deals, industry, mining and construction received the most deals over the six-year period, but with a fairly low mobilisation (USD 7.6 million per deal on average). Water supply and sanitation reported the highest mobilisation per deal, USD 26.2 million, driven by the large transaction on river basin development in Angola.

Figure 1.13 breaks down the amounts mobilised by sector and number of deals for 2012-2017. The graph indicates that whilst communications, water supply and sanitation benefited from the fewest number of deals, they achieved higher levels of mobilisation on average than other sectors. The largest average amounts of private finance mobilised per transaction were in the communications sector at USD 36 million – again skewed by two large transactions – and transport at USD 25 million. In the energy sector the average amounts of private finance mobilised was USD 15.6 million, USD 11 million in the banking and financial services sector and USD 9.6 million in industry, mining and construction.

Figure 1.13. Private finance mobilised in LDCs by deal and sector (2012-2017)



Note: *the category "Other" combines amounts reported under multisector, business & other services, general environment protection and disaster prevention, population, other social infrastructure, government, health, water and sanitation, tourism and unallocated.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

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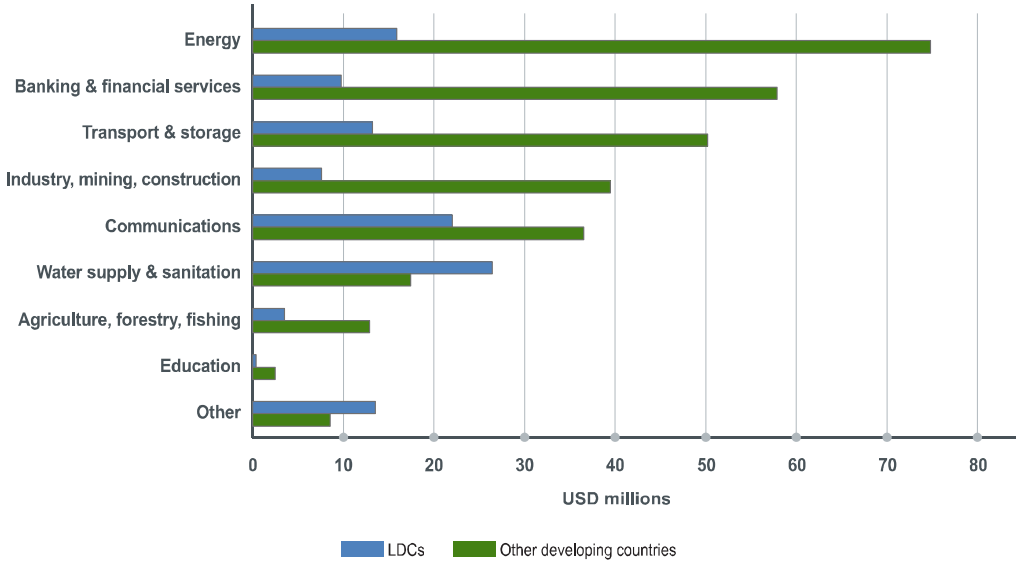
Compared to other developing countries, the amount of private finance mobilised per deal is substantially smaller across all sectors in LDCs, except water supply and sanitation (Figure 1.14). For example, during 2012-2017, the average energy deal mobilised over four times as much private finance (USD 70 million) in other developing countries and nearly six times in banking and financial services (USD 57 million) compared to LDCs. The average deal size in LDCs for water and sanitation is skewed by one large transaction in Angola which represents over 98% of private finance mobilised in the sector and over 7% of all private finance mobilised in LDCs for the full time period.

Figure 1.14. Average amounts mobilised in least developed countries per deal by sector (2012-2017)



Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

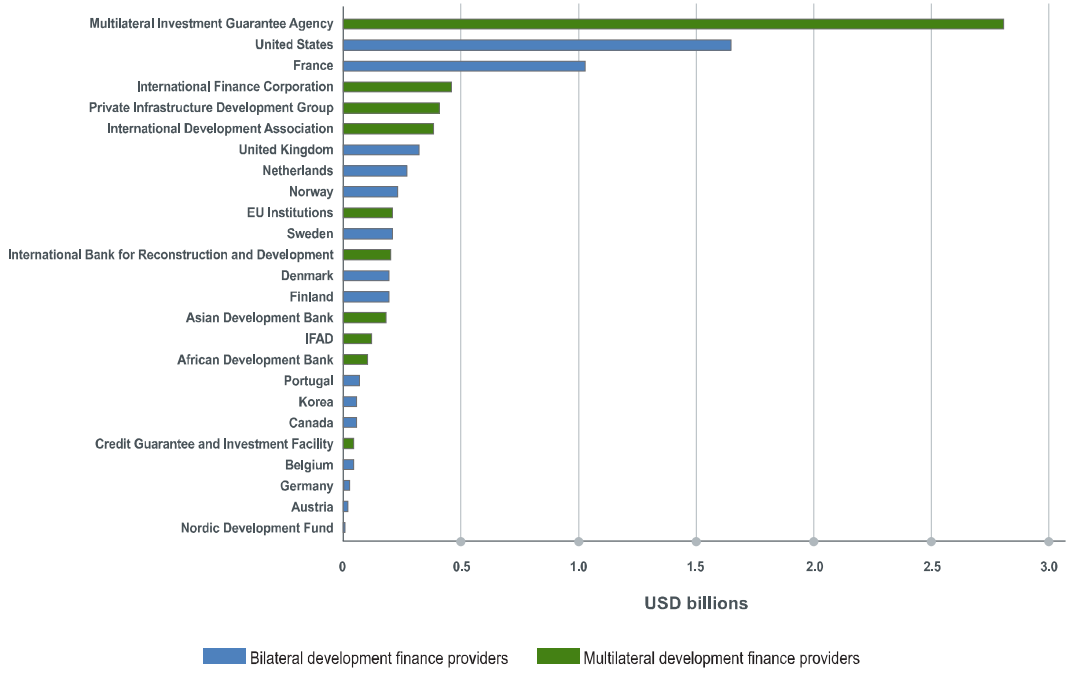
StatLink https://doi.org/10.1787/888933966010

As important as it is to understand which sectors are being targeted by blended finance operations, it is also essential to understand the impact these deals are having on achieving the SDGs. Ensuring development additionality has been one of the main points of concern in blended projects. See the Guest Piece in Section 2.5 by Jean-Philippe de Schrevel (Bamboo Capital Partners) for a discussion of how important it is to improve impact measurement.

1.9 Bilateral providers are becoming more prominent in the LDC blended finance market

Once again, the largest amounts of private finance mobilised in LDCs were reported by multilateral donors (Figure 1.15). They mobilised USD 5.2 billion or 56% of all private finance from 2012-2017, compared to USD 4 billion or 43% mobilised by bilateral donors. However, bilateral channels are playing an important role in mobilising private capital in LDCs.

Figure 1.15. Average annual amount mobilised in least developed countries per provider (2012-2017)



Note: Ireland, Luxembourg, Czech Republic, Switzerland, Slovak Republic, Australia reported less than USD 5 million in private finance mobilised. Other DAC members, not listed in the above, did not report on amounts mobilised from the private sector.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

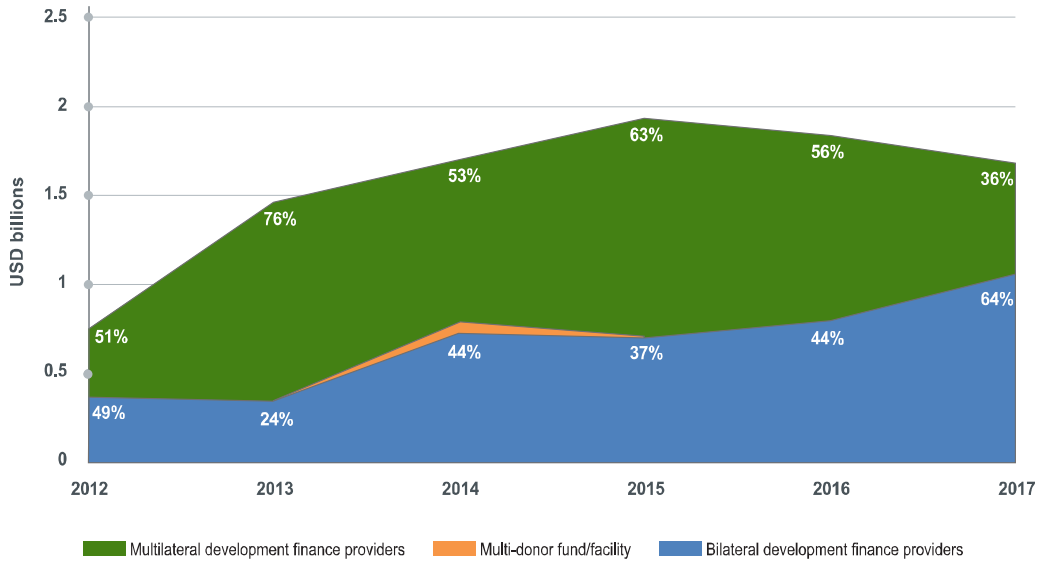
StatLink https://doi.org/10.1787/888933966029

The Multilateral Investment Guarantee Agency (MIGA) is the largest mobiliser of private finance for LDCs over the six-year period. The IFC also plays a prominent role, ranking 4th overall for the full 2012-2017 period, despite claiming no mobilisation in LDCs for the first two years and despite the unavailability of country-level data for the last two years. For further insights into how the World Bank Group is working to catalyse private sector investment in the world's poorest countries, see the Guest Piece in Section 2.7 by Federica Dal Bono and Barbara Lee.

The US and France are among the largest players for blending in LDCs. The UK, Finland, Denmark and the Netherlands mobilised significantly more private capital in LDCs in 2017 than in 2012. In addition, data from 2016-2017 indicate that Canada and Korea are emerging as new players in the field.

Figure 1.16 reveals the **growing prominence of bilateral donors in mobilising private capital in LDCs**. The annual average amount of private finance mobilised in LDCs but the United States, France, United Kingdom, Finland, Denmark, Netherlands and Sweden has increased between 2012 and 2017. The reduction in prominence of multilaterals could be because of IFC's reporting gaps, however.

Figure 1.16. Bilateral and multilateral channels for blending in least developed countries (2012-2017)



Note: Percentages refer to the proportion of private finance mobilised reported by each type of development finance provider over the total amounts reported as mobilised in LDCs.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933966048

In terms of geographical concentration, 16 of the 48 LDCs[13] each attracted blending operations by 10 or more donors in 2012-2017. As a consequence, these countries dominate the top ranking of recipients of private finance mobilised for LDCs. Five LDCs[14] only benefited from deals from one donor, and this is reflected in the small amounts mobilised in those countries.

Looking at how much each donor succeeded in mobilising in LDCs compared to other developing countries may reveal the priority of LDCs in their blending strategies. From 2012-2017 Portugal was the country that saw the highest percentage of all the private finance it mobilised benefitting LDCs, at 76% (USD 72 million) of all mobilisation reported by Portugal across all developing countries. This was followed by IFAD at 59% (USD 118 million). Over half of the private finance mobilised by both Korea and Finland was in LDCs.

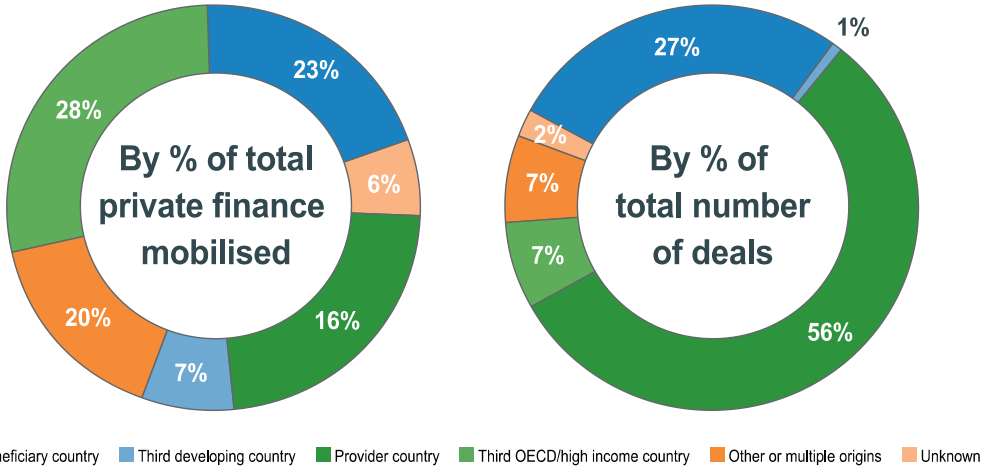
MIGA mobilised over USD 2.8 billion for LDCs in 2012-2017 (Figure 1.15), representing 14% of all the private finance it mobilised. The United States mobilised approximately USD 1.6 billion for LDCs over 2012-2017 (mostly focused on Guinea, Zambia, Cambodia and Senegal). This was the largest amount of all bilateral donors, and represented 6% of the private finance mobilised by the US overall. Almost half of the USD 1 billion mobilised bilaterally by France in 2012-2017 was for Madagascar, Senegal and Mali. The USD 324 million mobilised by the UK was mostly invested in Zambia, Bangladesh and Uganda. The Netherlands, Norway, Sweden all mobilised over USD 200 million for LDCs from 2012-2017. All the other bilateral development finance providers each mobilised less than USD 200 million of private finance in LDCs during the six years.

1.10 In LDCs, investors from high-income countries are being more mobilised than domestic ones

Over the six-year period, **most blended finance operations reported in LDCs mobilised private capital from high-income countries**. Yet, private finance mobilised domestically, i.e. within beneficiary LDCs, has decreased. The involvement of the domestic private sector can be especially important in deepening financial markets and supporting country ownership. For further insights into the question of ownership, see the Guest Piece in Section 2.2 by Andrea Ordóñez (Southern Voice).

While beneficiary countries remain a significant source of additional capital, both in volume and number of transactions, their importance has diminished from 42% of finance mobilised in 2012 to 14% in 2017. Private financing sourced from third developing countries also remains low (Figure 1.17 and Figure 1.18).

Figure 1.17. Sources of private finance mobilised in least developed countries (2012-2017)



Note: The definition of the origins of the funds follows the Balance of Payments' residence principle. Residence is not based on nationality or legal criteria, but on the transactor's centre of economic interest: an institutional unit has a centre of economic interest and is a resident unit of a country when, from some location (dwelling, place of production, or other premises) within the economic territory of the country, the unit engages and intends to continue engaging (indefinitely or for a finite period) in economic activities and transactions on a significant scale.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

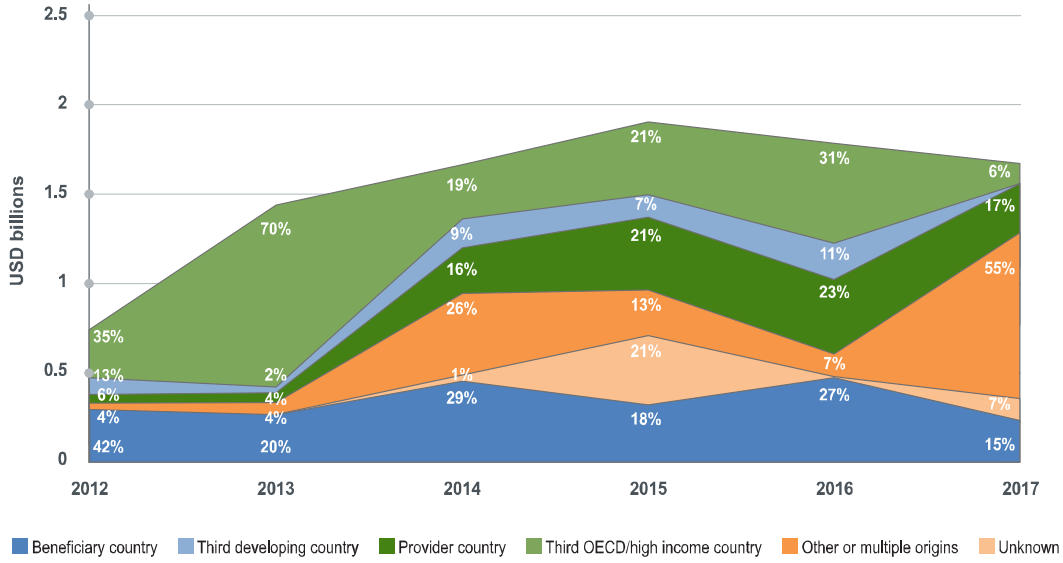
StatLink https://doi.org/10.1787/888933966067

The LDCs most successful in mobilising domestic private investors were Senegal, Zambia, Madagascar, Mozambique and the United Republic of Tanzania ("Tanzania"), representing over 41% of the USD 2.16 billion in local capital mobilised by LDCs over the six years. However, the average mobilisation per deal from beneficiary countries appears to have increased. In fact, the average amount mobilised per transaction from domestic investors in LDCs increased from USD 4.5 million in 2012 to USD 5.8 million in 2017. France was the largest domestic finance mobiliser, representing 42% of all domestic finance mobilised from 2012-2017, followed by the United States (19%) and the EU (10%).

Over USD 4.1 billion or 44.5% of all private finance mobilised in LDCs from 2012-2017 originated from the provider or another high-income country. Because the OECD data do not include any information on the conditions that lead to the selection of the private partner, it is impossible to determine if these volumes are ascribable to tied aid.[15]

Figure 1.18 displays the trends for origin of finance mobilised over the six-year period. The figure indicates that finance from beneficiary and third high-income countries has fallen in recent years.

Figure 1.18. Trend in sources of private finance mobilised in least developed countries (2012-2017)



Note: Percentages refer to the proportion mobilised from each source of private finance over the total amounts reported as mobilised in LDCs.
Source: (OECD, n.d.[6]), Statistics on amounts mobilised from the private sector by official development finance interventions as of 1st April 2019, http://www.oecd.org/development/stats/mobilisation.htm

StatLink https://doi.org/10.1787/888933966086

Regional analysis of the sources of private finance mobilised in LDCs indicates that 57% of private finance mobilised from third high-income countries over six years went to sub-Saharan Africa and the remaining went to Asia. Sub-Saharan Africa benefited from 83% of the amounts mobilised from beneficiary countries themselves. Moreover, provider countries represented a slightly higher source of private finance mobilised in LDCs (16%) than other developing countries (14%). Similarly, third high-income countries played a more important role in LDCs (providing 28% of total private finance mobilised in 2012-2017) than in other developing countries (at 18% of the total).

Seventy-five percent of foreign sources of finance mobilised (other or multiple origins, third developing country, provider country and third high-income country) benefited four sectors: energy (26.5%), industry, mining and construction (17%), communications (16.6%) and banking and financial services (14.5%).

Guarantees played a key role in mobilising private finance from every source over 2012-2017. Direct investments in companies and SPVs are also quite versatile, playing a significant role in mobilising private finance from provider countries and from the other or multiple origins category. Credit lines are typically extended to local financial institutions with the aim of improving access to finance, and hence directly target domestic private actors in beneficiary countries. Syndicated loans and shares in CIV are the most-widely deployed tool to mobilise finance from other or multiple origins, reflecting how these mechanisms are structured to pull in varied sources of capital and investor profiles.

Some sectors are more appealing to domestic investors in LDCs. **Blending in agriculture, forestry and fishing mostly relied on private capital mobilised from the recipient country**, while receiving very little investment from the provider country. This is systematically observed over the entire six-year period. Domestic investors are also active in the education sector, where the presence of capital from high-income

countries remains strong. The majority of finance mobilised in the communications sector, instead, stemmed from third OECD/high-income countries, in LDCs and beyond.

Many LDCs have national development banks or other domestic financial institutions that are set up to help fund national development plans and could potentially play a much greater role in crowding in private investors. By blending concessional resources with their own, more expensive sources of finance from capital markets, national DFIs can potentially reduce the cost of capital for projects. For further insights into this topic, see the Guest Piece in Section 2.4 by Maniram Singh Mahat (Town Development Fund).

While opportunities for leveraging domestic investors may be limited in nascent financial markets with fewer local investors and intermediaries, their involvement can foster local development and ownership, a grounding principle of development effectiveness. This also raises the broader question of whether ODA would be more effectively used in supporting the development of an improved business climate or the local private sector in LDCs rather than (or in addition to) being used to directly mobilise private investments. Certainly, while some barriers to an enabling environment for private sector investment can only be fixed through public intervention, demonstration effects from blended projects (especially when they are of national importance) could inform government-led policy reforms. Supporting both project financing and country-led reforms at the same time should be possible and could potentially create virtuous circles. This further underlines the need for co-ordination among blended finance and other interventions aimed at supporting long-term private sector development.

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Notes

[1] Private investment flows include FDI, portfolio investment and long-term debt. FDI makes up the largest share of private investment flows.

[2] The 2018 ODA release marks the adoption of the "grant-equivalent" methodology, which the Development Assistance Committee (DAC) agreed in 2014 would provide a more realistic comparison between grants and loans (OECD, 2019[12]).

[3] Official development finance includes: 1) bilateral official development assistance (ODA); 2) grants and concessional and non-concessional development lending by multilateral financial institutions; and 3) other official flows for development purposes (including refinancing loans) which have too low a grant element to qualify as ODA.

[4] More information about that survey and its original findings can be found in (Benn, Sangaré and Hos, 2017[11]).

[5] The official providers who report private finance mobilised to the OECD are: African Development Bank, Asian Development Bank, Australia, Austria, Belgium, Canada, Caribbean Development Bank, Council of Europe Development Bank, Credit Guarantee and Investment Facility, Czech Republic, Denmark, Development Bank of Latin America, EU Institutions, European Bank for Reconstruction and Development, Finland, France, Germany, Global Energy Efficiency and Renewable Energy Fund, IDB Invest, IFAD, Inter-American Development Bank, International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Ireland, Korea, Luxembourg, Multilateral Investment Guarantee Agency, Netherlands, Nordic Development Fund, Norway, Portugal, Private Infrastructure Development Group, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom, United States.

[6] Convergence is the global network for blended finance. It generates blended finance data, intelligence, and deal flows to increase private sector investment in developing countries and sustainable development. Convergence works to make the SDGs investable through transaction and market-building activities.

[7] Analysis of the 2012-2015 IFC data indicates that 4.6% or just under USD 460 million of the USD 9.89 billion in private finance mobilised by the IFC was in LDCs. For the period 2016-2017 the IFC reported USD 10.3 billion of private finance mobilised. Assuming the same percentage allocation to LDCs, that would mean approximately USD 480 million was mobilised in LDCs for 2016-2017. These amounts added to the total mobilised in LDCs would in fact indicate a continued increase in private finance mobilised in LDCs to over USD 2 billion in 2016. However, they would still indicate a decrease in 2017, at USD 1.94 billion mobilised. However, the estimates based on historical IFC amounts mobilised may not be accurate for the actual amounts mobilised in LDCs.

[8] Besides the different time frames, the higher proportion (12% versus 6%) exhibited by Convergence with respect to the OECD data can be explained by a number of factors: 1) Convergence only tracks operations that include a concessional element (of public or philanthropic origin), which is often essential to mobilise private investors in markets perceived as more risky; 2) the amounts tracked by Convergence may cover LDCs either exclusively or in part, whereas the OECD methodology would only account for the part of finance destined to LDCs; and 3) the information is captured by Convergence at announcement of the deal closure and hence refers to expected investment targets, while the OECD requires annual reporting on the actual invested flows deployed.

[9] More precisely, the most recent OECD data reveal that 40 LDCs had private finance mobilised during 2012-2015 compared to 39 LDCs during 2016-2017. Bhutan, Lesotho, South Sudan and Yemen had received private finance mobilised in 2012-2015 but not in 2016-2017. Equatorial Guinea, Vanuatu and Somalia received private finance mobilised in 2016-2017 but not in the previous time period. This means a total of 43 LDCs benefited from private finance mobilised for the whole six-year time period (2012-2017).

[10] Last year's report found that private finance mobilised was positively correlated to gross national income (GNI) per capita, perhaps because it is easier to mobilise private finance in contexts where more capital exists, or perhaps because a higher GNI per capita signals either larger market opportunities or a stronger enabling environment.

[11] Bhutan, Central African Republic, Comoros, Eritrea, Kiribati, Lesotho, Tuvalu, and fragile contexts South Sudan and Yemen.

[12] Analysis of annual data indicates that energy and banking and financial services are consistently amongst the top two sectors for private finance mobilised in LDCs (except in 2012 and 2016). In other developing countries energy and banking and financial services are the top two sectors for private finance mobilised for the years 2012, 2013, 2014 and 2017, and in the top three for 2015 and 2016.

[13] Angola (where 10 providers reported private finance mobilised in 2012-2017), Bangladesh (13), Burkina Faso (10), Cambodia (23), Democratic Republic of the Congo (13), Ethiopia (15), Lao PDR (10), Mali (12), Mozambique (17), Myanmar (14), Nepal (10), Rwanda (12), Senegal (12), Tanzania (16), Uganda (17), Zambia (19).

[14] Vanuatu (Australia), Somalia (United Kingdom), Gambia (Netherlands), Chad (France) and Solomon Islands (Korea).

[15] Aid is tied if it is offered on the condition that it be used to procure goods or services from the provider country. Further information can be found here: http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/untied-aid.htm

2 Views from the field: Guest contributions

This chapter contains a curated set of guest pieces by practitioners and experts working in the blended finance space – including from representatives of multilateral development finance institutions, a private impact investor, a research institute, a local intermediary, and a non-governmental organisation.

The evidence and viewpoints that emerge from these pieces add colour and nuance to the analysis in the previous chapter by showcasing the opportunities and challenges of applying blended finance solutions in LDCs and in particular sectors. They also raise a number of important questions about how best to deploy blended finance solutions in LDCs.

2.1. Mobilising private finance for agricultural investments in developing countries

Bettina Prato and Dagmawi Habte Selassie

As an international financial institution dedicated to eradicating rural poverty, and specialised in designing and co-financing public programmes for agricultural and rural development, the International Fund for Agricultural Development (IFAD) has traditionally engaged private investors primarily through its support to the public sector. Its three main focus areas have been: 1) supporting public programmes targeting small farmers and other small rural entrepreneurs (their productivity; their access to key services, finance, and technology; and their access to markets); 2) facilitating public-private-producer-partnerships (4P) in agricultural value chains; and 3) strengthening the institutional and policy environment for private investment.

In recent times, IFAD has sought to build on this experience and to deepen its capacity to engage with the private sector directly, including via a new Private Sector Engagement Strategy. This aims, first, to expand investments in small-scale agricultural and rural enterprises; and second, to develop markets, income and job opportunities for poor rural women and men, notably youth. How will IFAD expand investments in small-scale enterprises? Its approach is to use traditional and not-so-traditional financial instruments to attract and scale up funding from a range of financial institutions. Traditionally, IFAD-funded programmes have used, among others, lines of credit and risk-sharing arrangements with banks and non-bank financial institutions. The fund is now developing new financial products and collaborating with new blended facilities and impact funds serving this market. IFAD's interest in blended finance is growing and the fund has initiated and catalysed some new initiatives in this space. For example, it sponsored the Agribusiness Capital Fund (ABC Fund) that was launched in Rome in mid-February 2019. This impact fund is managed by Bamboo Capital Partners in partnership with Injaro Investments, with an initial first loss capital of EUR 50 million from the European Union and African, Caribbean and Pacific Group of States (ACP), the Government of Luxembourg and the Alliance for a Green Revolution in Africa (AGRA). It has a fundraising target of EUR 200 million. The ABC Fund will provide loans of less than EUR 5 million to local financial intermediaries and make direct investments of below EUR 1 million in small and medium-sized agribusiness enterprises in ACP countries.

In 2017 IFAD also initiated the Yield Uganda Investment Fund in partnership with the European Union. The Yield Fund is an innovative social impact investment fund targeting agricultural SMEs[1] and producer groups in Uganda that are part of the unbanked "missing middle" (see Box 1.2 in Chapter 1). It uses grant resources from the European Union to finance first loss protection capital in the fund and a cost-sharing business development services technical assistance facility to bring on board financing from other investors. It offers patient risk capital products such as equity, quasi-equity and debt funding to small and growing agribusinesses, investing between (USD 250 000 and USD 2 million) in companies that offer a solid social impact proposition with attractive financial returns. The fund is managed by Pearl Capital Partners, a Uganda-based manager with extensive experience in agricultural investments.

The Yield Fund was established as a Ugandan company. This was partly to support the development of the country's financial sector, which remains relatively underdeveloped, as does its legislation supporting the operation of equity funds. Most similar funds choose to register themselves in third countries, which allows for the smooth transfers of funds, taxation and potential dispute resolution.

Partly due to the specific challenges of this context, as well as those related to the target sector, the fund initially found it hard to attract new capital. Investors were put off by its one-country, one-sector targeting; its relatively small ticket size; and the local legislative challenges. However, the combination of the business opportunities in the sector and the fund's risk-sharing grant resources eventually convinced three investors to contribute a total of EUR 10 million. One of the investors is the National Social Security of Uganda, which committed EUR 2 million. This is particularly significant, illustrating how this sort of instrument can attract the growing volume of assets managed by pension funds in Africa which are

struggling to find the right vehicles that match both their countries' development needs and their clients' return expectations. Their contribution helped attract the other EUR 8 million from international impact investors.

The Yield Fund has made five investments to date in various value chains, including coffee, soya and moringa. While the investee companies offer great potential to meet the return objectives of the Yield Fund, which has an expected 7% internal rate of return, they tend to have capacity gaps in their operations. The fund's business development services facility has helped to address these through training and capacity building, while also promoting compliance with environmental, social and governance (ESG) standards.

What lessons do we take from our first 18 months of work?

- **Agricultural SMEs lack adequate and affordable capital**. There is indeed a "missing middle" in SMEs' access to the capital they need to grow, as neither commercial banks nor micro-finance institutions have the capacity or products that match their requirements.
- **Even impact investors have limited appetite for risk**. Many potential investors found the Yield Fund too small and risky because of its single-country, single-sector focus, even in the presence of first loss protection. But the mixture of opportunities and grant funding did help to crowd in private finance.
- **Local presence is important**. The Uganda-based location of the fund manager has proved to be an important factor for the success of the Yield Fund. In-depth local knowledge opens the door to a wealth of information on potential risks associated with individual investments. Constant presence and proximity enable investees to benefit from sustained capacity support.
- **Technical assistance plays a key role**. Strengthening investees' capacity – including in areas like ESG compliance, improved operational efficiency, and building smallholder farmer supply networks – was critical for mitigating risk and increasing investor confidence. The technical assistance facility of the fund involved a linked model, contracting a third party (KPMG Uganda) to assess the company's operational and ESG compliance gaps to feed into an independent assessment of financial and developmental value added and to support pipeline development.
- **Co-ordination between financiers is necessary for success.** It is important for the various types of financing (grant, concessional loans, impact capital and commercial capital) to be well aligned, and for financiers to take responsibility for not unduly distorting markets - including in LDCs and fragile contexts.

Box 2.1.About the authors: Bettina Prato and Dagmawi Habte-Selassie

Bettina Prato is the Senior Coordinator of the Smallholder and Agri-SME Finance and Investment Network (SAFIN) and a Senior Global Engagement Specialist at IFAD. She has almost 20 years of experience in international policy engagement and advocacy, strategic planning, and policy research, spanning the United Nations, the NGO and think-tank communities. At IFAD, she has covered a range of policy issues, including responsible private investment, gender equality, post-conflict transitions in rural contexts, and the global architecture of development co-operation for food security. She holds a PhD in Political Science from the University of California at Berkeley, a Masters in International Affairs from The George Washington University, and an undergraduate degree in Oriental Languages from the University of Venice (Italy).

Dagmawi Habte-Selassie has over nine years of professional experience working in private finance and international development. Most recently, he was the technical specialist working in setting up the Smallholder and Agri-SME Finance and Investment Network (SAFIN), which aimed to foster a more effective and inclusive ecosystem for agri-SME finance. He is now leading IFAD's engagement in the Yield Uganda Fund in Kampala. He also held various positions at the institution in Rome, South Sudan

and Ethiopia, including as task manager for the RUFIPII project in Ethiopia, a USD 252 million partnership between IFAD, commercial banks and the Government of Ethiopia. Prior to development work, Dagmawi spent a number of years working in the private sector in pension administration as well as retail management in Canada. He holds a Graduate Diploma in International Business Management from McGill University and a Masters Degree in Management of Development from the Università degli studi di Torino.

2.2. Ensuring blended finance respects national ownership

Andrea Ordóñez

The past decade has been marked by significant progress on promoting development effectiveness. It is now clear that to ensure sustainable development that meets local needs we must keep in mind how programmes and projects are designed and implemented. The principles of country ownership, transparency and accountability have become central to development co-operation. The new wave of blended finance has brought with it the question of which principles should guide these operations. As last year's instalment of this report emphasised, where ODA is involved, blended transactions should meet these long-standing development effectiveness principles. One aspect that is often overlooked in both practice and research is how to ensure that blended finance supports national ownership of the development agenda.

Southern Voice[2] recently reviewed the relevance of the development effectiveness principles in different country contexts. This revealed that country ownership is a decisive principle for co-operation, underpinning all the other effectiveness principles. Ownership of development projects encompasses a variety of dimensions. First, it entails an active role for national actors in planning and enunciating the need and demand for development projects. Second, ownership during the implementation of projects means that project beneficiaries have the opportunity to make tangible contributions, such as co-investing in projects, or providing in-kind support. Finally, it involves national actors being committed to and supporting a project's success over the long term, so that its impacts are sustainable.[3] This means that national actors advance strategies to implement projects and deals that are aligned with their objectives and needs. This not only requires the involvement of the government, but also other actors in society, including civil society and affected communities. In practice, this means there is a negotiation in which different interests are balanced.

When it comes to blended finance deals, ensuring ownership can be complicated. Blended transactions can involve multiple partners, including development co-operation agencies or development banks, commercial partners, national governments, and the domestic or international private sector. There are concerns that blended finance may be used as a back door to increase the use of tied aid. Significant government involvement, especially when a government does not have private transaction experience, may be a deterrent to private investors seeking to move quickly.

So how can ownership work in the context of these complex arrangements?

Southern Voice carried out four scoping studies on blended finance in 2018, on Bangladesh, Nepal, Senegal and Uganda. These case studies shed light on some of the key ingredients for ownership in the case of blended finance. Three issues are worth highlighting.

First, LDC governments need **more consistent and better organised information** on who is deploying blended strategies and the practices and opportunities for accessing concessional finance through blended transactions. This will help them to assess when and where blended finance can best be used. The scoping studies suggest that LDC officials are often unaware of blended finance approaches. While each beneficiary government could invest in researching the sector, making this knowledge publicly accessible

to all governments through a common platform would help create a better understanding of how blended finance fits within their integrated financing frameworks for meeting the SDGs.

Second, it is important for LDCs to establish the right **institutional frameworks** that will allow them to analyse and structure blended transactions that share risks and rewards fairly; and to deploy blended strategies where and when they are appropriate and in line with high environmental, social and governance standards. The scoping studies found that in some countries the institutions that are currently in place are usually in the context of public-private partnerships (PPPs); these may therefore need to be updated in terms of their skills, capacities, and mandates to cover blended transactions more broadly. Some governments are already moving in this direction. In other countries, it is not clear which institution would be a natural leader for blended finance initiatives – clarifying this would be an important first step. Providers of concessional finance and development partners overall can also help to build the capacities of national and subnational authorities to engage meaningfully in the design and implementation of blended finance deals.

Third, governments need to be able to **co-ordinate** different development initiatives and ensure their coherence. For example, blended finance initiatives to provide credit lines to sectors that have been traditionally underserved require well-functioning credit reference bureaus to ensure that the various financing offers do not all reach the same beneficiaries. Concessional finance providers can help with this, by engaging more systematically with LDC governments – and other key national stakeholders – to ensure that projects support national development goals.

If blended finance is to be used more and more to leverage private investment for reducing the SDG financing the gap, beneficiary countries must be able and supported to exercise ownership effectively. Practical knowledge and capacities relevant to the practices of blended finance are essential for them to take the lead and to put in place the right institutional frameworks and arrangements to ensure that blended finance deals align with national priorities and are deployed appropriately.

Box 2.2. About the author: Andrea Ordóñez

Andrea Ordóñez is Director of Southern Voice, a network of think tanks devoted to bringing research from the Global South to international debates on the development agenda. She co-edited the book *Southern Perspectives on the Post-2015 International Development Agenda*, which lays out an agenda for sustainable development by researchers in Africa, Latin America and Asia. Her work focuses on linking researchers from the Global South with their counterparts in other countries, strengthening their presence in international debates and fostering policies that promote sustainable development. She is also a board member of Publish What you Fund. Andrea has developed projects on public finance, natural resource wealth management, and financing for development.

2.3. The potential of blended finance for global health

Priya Sharma

The world has signed up to ambitious health goals – but recent trends in the health financing space threaten to limit our ability to achieve them. Development assistance for health reached an all-time high in 2014, but has since plateaued. This, along with increasing but still insufficient government spending on health, has resulted in a USD 134 billion annual health funding gap in low-and middle-income countries. If funding trends continue, this gap is expected to reach USD 371 billion annually by 2030 (USAID, 2019[11]).

Importantly, growing interest from the private sector in investment opportunities in the health sector in low- and middle-income countries is offering donors and governments an opportunity to fill this gap in innovative

ways. Blended finance, for example, can allow donors and governments to use their existing resources more strategically and catalytically to leverage new resources for health. However, despite increasing interest in blended finance on the part of key stakeholders, a number of unresolved issues and challenges must be addressed if blended finance is to achieve its full potential for health.

First and foremost, it is important to remember that blended finance is a means to an end, and not an end in itself. Blended finance alone with not help fill the funding gap—more domestic public sector resources will be needed to do so. Blended finance is also not intended to replace development assistance for health, but rather to complement it by expanding the toolkit available to donors and country governments for funding the health sector and improving health outcomes. Ideally, blended finance is used to attract private investment into areas where the private sector can function adequately, freeing up limited public and philanthropic resources for those areas where traditional grant funding is still needed. As health is a public good, and market failures often leave the poor and vulnerable at highest risk, donors, the private sector, and governments have to be aware that blended finance strategies will not be appropriate in all circumstances.

A related criticism often levelled at blended finance has to do with equity: the most "investable" opportunities in health tend to benefit the middle or upper classes rather than the poor. This has been the case with a large portion of blended finance transactions focusing on health infrastructure projects or investing in tertiary and specialty care facilities. But this need not be the case – there could be deals that focus on the poorest segments of society that are also investable, such as in the social enterprises and SMEs that predominantly provide health services to the poor. In any event, this criticism highlights an important potential tension embodied in blended finance transactions in the health sector: the trade-off between financial return and ensuring no one is left behind. Unfortunately, most assume there is no trade-off, and that it is possible to make impact-first investments and still earn a competitive rate of return. While this might be true in sectors such as energy, infrastructure and agriculture, it is not always so in health. Resetting expectations, especially among private investors, will be important. Addressing social equity considerations may also require greater levels of concessionality in blended transactions – so that the prices set for health services are affordable and do not exclude the poorest segments of society.

This might mean that many large or more commercially oriented investors will be less inclined to work in the health sector. But those investors and foundations that are more intentionally impact-focused will still be interested. These types of investors are also more likely to share definitions of impact, as well as metrics and methods for measurement and evaluation. Commercially oriented private sector investors will often define and measure impact according to the needs and demands of their primary stakeholders. In some cases, this definition is at odds with how the public sector may be thinking about impact and outcomes. For example, the public sector might focus on more outcome-related indicators, i.e. reduction in mortality or disease prevalence, while the private sector might be looking at their return on investment or dollars mobilised. Both sets of indicators are needed to provide a holistic picture of the impact of a blended finance transaction, but all parties need to agree at the outset of the project on the indicators for monitoring a specific transaction.

Another complication is that in health it can take a long time for impact to be felt. Often proxy indicators or measures are used to estimate impact and additionality. Also, data collection, monitoring and evaluation are costly, and differing expectations of what *can* be measured versus what *should* be measured can further complicate matters; if private actors are required to undertake the monitoring, they may also require extra returns to offset the cost of ESG compliance and impact measurement. Thus, careful partner selection, a focus on aligning interest and outcomes, and agreeing on roles and responsibilities for data collection, can help ensure that future blended finance transactions do not exclude the poorest and most vulnerable, and instead benefit them specifically.

There is real opportunity to use blended finance to achieve our health goals if we are mindful of these limitations, and thoughtful and strategic in our use of public finance to mobilise additional resources for

global health. At USAID's Center for Innovation and Impact, a new report, *Greater than the Sum of its Parts: Blended Finance Roadmap* (USAID, 2019[12]), lays out a six-step framework to help global health practitioners determine when blended finance might be more appropriate than traditional grant-based aid, and to fully understand the implications and trade-offs between the two. By being more deliberate in our approach, this roadmap can help donors, governments, and the private sector harness the full potential of blended finance and improve the health of millions around the world.

Box 2.3. About the author: Priya Sharma

Priya Sharma is a Senior Policy and Innovative Financing Advisor working for CAMRIS International, Inc. in USAID's Global Health Bureau's Center for Innovation and Impact. In her current role, Priya uses innovative and blended financing mechanisms and market-shaping interventions to accelerate development, introduction and access to life-saving commodities, and leverage private sector funding to achieve global health goals. She currently manages USAID's first global health development impact bond, and co-authored Investing for Impact, an educational resource for development practitioners interested in learning more about trends and non-traditional approaches to financing global health. Priya also led the development of a Blended Finance Roadmap, designed to provide guidance to the Global Health Bureau and missions interested in using blended finance to implement health programmes.

Priya received her MSc in International Health Policy (with Health Economics) from the London School of Economics and Political Science, and she completed her undergraduate studies at Tufts University.

2.4. Blended finance in Nepal's cities: challenges and prospects

Maniram Singh Mahat

Over 59% of Nepal's population lives in its 293 urban municipalities, which together contribute more than 60% of GDP. The pull exercised by cities stems from aspirations for jobs and a better life. However, urban centres with poor infrastructure cannot live up to their potential as engines of economic growth. According to the Municipal Finance Framework 2016, the capital investment needs for basic urban infrastructure in Nepal's municipalities were equivalent to NPR 2.3 trillion (some USD 20 billion) over 15 years (Government of Nepal, 2016[13]). This is about double the resources available for capital investment. Blended finance could be one way to cover this deficit.

There are several financing challenges in Nepal. At the macro level, the growing balance-of-payments and trade deficits, and decreasing current account surplus, have constrained the investment capability of Nepal's public sector. Commercial funding from domestic sources is limited as the banking sector suffers from a dearth of loanable funds.

Nepal's new federal constitution grants borrowing rights and significant tax autonomy to municipalities, along with a subnational borrowing regulatory framework, to mitigate chances of fiscal crises caused by defaults. The key institution that finances municipalities in Nepal is the Town Development Fund (TDF) – a domestic financial intermediary that lends subject to debt ceilings and project viability. TDF was set up to provide long-term financing for municipal infrastructure, but has limited capital, stressed loan assets and low earnings. At present, TDF functions more as an agent for on-lending multilateral loans for pre-selected municipalities and projects, rather than as a lender of significance. It accounts for less than 5% of annual municipal capital spending.

Nonetheless, TDF has financed municipal bus terminals, vegetable markets and several other revenue-generating projects where private companies manage the operation and maintenance of facilities. TDF's big success has been in the water sector, with over 70 towns supported through blended financing. In this arrangement, TDF provides 30-50% of the project value in the form of a loan, 5% of the project value is an

upfront cash contribution from water users and the remaining 45-70% of the project involves a grant from the Government of Nepal. Thanks to this model, 87% of Nepal's population has access to safe drinking water and basic sanitation facilities, sustainably run by water users and sanitation committees. This type of financing will contribute immensely to the achievement of SDG 6 (Ensure availability and sustainable management of water and sanitation for all).

Expanding TDF's support depends on a number of factors. First, TDF needs to establish debt financing as the main option for municipalities to finance investments, instead of depending on their current revenues alone. This shift would allow municipalities to complete bankable projects more quickly than when depending on their own funds. This will be especially true while they still have very low debt ratios, giving them scope for future borrowing. Municipal bonds could possibly be a future source of financing, but issuing such bonds requires an assessment of the financial strength of municipalities as well as the ability of TDF to service long-term debt. Looking ahead, TDF is helping certain municipalities to obtain credit ratings and is itself preparing to get credit rated to tap into capital markets in the near future. Action on this front also calls for municipalities to be able to identify and design projects that generate revenues, so that investors can make a return.

The second critical area is reforming the municipal finance system. Municipalities need to have the incentives and support to build their capacities to manage projects better and to collect taxes. For example, fast-growing land values in Nepal offer a source that could be tapped to mobilise revenue. A fast-growing tax base would mean municipalities will be better able to pay off debt in the medium to long term.

Finally, TDF has drafted a public-private partnership (PPP) financing policy as part of its investment policy, which needs to be approved to allow TDF to finance municipal PPP projects in the near future. This framework could build on TDF's recent collaboration with the Government of Nepal, municipalities, private operators and other stakeholders to finance urban utilities, including the public transport sector. Specifically, TDF helped 61 individual bus operators create a so-called special purpose vehicle (the Sustainable Transport Co. Ltd.) which was able to replace the fleet of older three-wheelers, minibuses and microbuses with modern buses. The new buses were jointly financed by TDF (80% as a subsidised loan) and private capital (20% as equity investment). This blended finance approach has unlocked the possibility of upgrading public transport and improving levels of service.

These measures will help provide the financial resources that municipalities need to grow in ways that are sustainable and inclusive. As municipalities seek to access funds from a wide variety of sources, blended strategies can help crowd-in private investments into localities where they otherwise would not go. In the process, it is important to ensure that the debt burden of municipalities is carefully managed as blended approaches grow in use, and that domestic financial intermediaries such as TDF are supported to help mobilise public and private resources for development.

Box 2.4. About the author: Maniram Singh Mahat

Maniram Singh Mahat is the Executive Director of the Town Development Fund (TDF), Nepal. He has worked extensively in the areas of urban policy making; investment decision making; urban development; municipal finance and property tax management; PPPs: project development; conflict and development; local economic development; and planning, monitoring and evaluation. He has conducted research on urban finance, conflict and development, fiscal federalism, housing, property taxation, subnational governance and infrastructure financing. He has served as Director, Planning, Monitoring and Evaluation at the TDF for about six years, and as an Advisor, Senior Program Officer, Municipal Finance Expert, Multi-disciplinary team Coordinator and Planner with the Urban Development through Local Efforts Program of GTZ, Nepal and the Subnational Governance Program of GIZ, Nepal for about 20 years. He received his Masters degree in Geography from Tribhuvan University, Nepal, and his post-graduate diploma in Urban Development Finance from International Housing Studies, Erasmus University Rotterdam.

2.5. Blended finance - Uniting the yin and the yang

Jean-Philippe de Schrevel

In the last 20 years spent building two impact-investing companies – BlueOrchard and Bamboo – I have been confronted an endless number of times with the same situation when talking to potential investors (be they a family office, a corporation or a pension fund). I would hear from the investment team: "Sorry, we love what you do, this is very commendable, we see the potential, but this is too risky, there is not enough track record and the expected returns are clearly too low for us given the risks you are taking, why don't you talk to our foundation?". I would then turn to the foundation and hear: "Sorry, we love what you do, this is truly exciting and clearly impactful, but you are taking an investment approach and we are a charity, so we must give out money without expecting any sort of return or capital back, why don't you talk to our investment team?". And nothing would move.

Fortunately, an increasing number of institutions and people, especially younger generations, are beginning to align how they invest with their values. They have understood that our world is facing major problems and that traditional philanthropy alone will not be up to the challenge. They recognise that many solutions will have to come from sustainable, scalable and profitable companies where private capital will have to be invested, and that making those investments is actually much less risky than not investing at all. Think, for example, of climate change. The risk of inaction far outweighs the risk of investing in clean solutions.

This is where a small but growing group of investors – so-called impact investors – step in, intending to generate sustainable development impacts alongside financial returns. In addition, more and more investors are interested in sustainable investing and in reflecting impact frameworks in mainstream investment products. But there is a long way to go to align sufficient private investments with the Sustainable Development Goals.

Blended finance offers an exciting way forward: it is a tool which can help solve the commonly-observed paradox described above. The idea is in fact pretty simple – when structuring a fund, for instance, one can create several layers of risks and returns, with a "first loss layer" and then "senior layers" on top. All layers share the same investment portfolio. But if there is a loss, the first loss takes the hit first, thereby protecting the senior layers of investors.

So what does this do? Well, first, one could argue that the first loss should be appealing to traditional donors. Instead of investing a dollar in a cause they support, they can now invest in a first loss of an impact fund dealing with that very same cause, but they will have a major catalytic effect by attracting other investors. This way they can grow the overall resources for the cause they support. On top of this, if the investment manager has done a proper job, this concessional dollar may actually not be lost and could even generate a return, meaning the donor gets to invest it again. This is truly efficient philanthropy.

Second, investors coming in to the senior layers will not expect the same level of financial returns as they would have otherwise, because they are protected by the first loss, and the apparently somewhat lower returns generated by the investment portfolio suddenly meet their risk-return requirements. This can help overcome a major barrier to investment by institutional and other investors with strict fiduciary responsibilities who will generally consider expected financial returns to be too low for the perceived risk.

Third, by having a first loss layer funded by concessional money, the return required from the overall portfolio is considerably lowered, enabling the investment manager to take a riskier and less extractive approach when dealing with its portfolio target companies. This means, for instance, that more investors may be willing to invest in enterprises in the missing middle in least developed countries – deals that they otherwise would likely have overlooked.

Blended finance is an exciting approach for both philanthropists and investors as it allows for their efficient collaboration towards a common objective while respecting their own capital attributes. This also means that both will have to track not only the financial returns generated, but also the extent to which the intended social or environmental impact has been realised. And this will be at the heart of what we do, and not just an add-on. Every impact investor should therefore have a theory of change laying out clearly why investing in a particular fund or company will produce outputs which will eventually be conducive to the intended outcome. Much progress has been made in standardising the impact metrics today, allowing the industry to speak the same language and to make meaningful comparisons. But a lot of work remains to be done, in particular on a method for linking basic output results collected from individual portfolio companies to the broader results at the institutional or market level. Today, most investors still rely on common sense and general inference between outputs and outcomes. Measuring outputs is in itself good progress, and transparency about outputs achieved is a great step forward. We now need to push further research and seek to link outputs observed and desired outcomes.

By combining public and private resources, blended finance can raise additional resources for development. This is not to say blended finance will be the right approach in every situation – official development assistance (ODA) should continue to support services with public good features, and pure philanthropy should still be pursued (it should actually be increased). Nor is this to suggest that impact investing must always take a blended finance approach – it can work without it in some instances. But, where appropriate, this blending of several types of capital within one single investment vehicle can increase the scale of the beneficial impacts. For this reason, Bamboo is now working with CARE USA, the International Fund for Agriculture Development, and UNCDF, and soon many others, in structuring impact investing solutions using a blended finance approach. As these and similar types of approaches grow in popularity, we need to make sure that we have the right metrics and tools in place to track and measure impact – so that we can be confident that the resources we help catalyse will contribute to leaving no one behind.

Box 2.5. About the author: Jean-Philippe de Schrevel

Jean-Philippe de Schrevel is the founder of, and a managing partner at, Bamboo Capital Partners, an impact-investing company. He has dedicated most of his career to developing the “impact investing” field, in which he is considered to be a global pioneer, having launched eight investment funds and raised over USD one billion to date across a variety of asset classes (fixed income, private equity, venture capital, structured finance) and many sectors (microfinance, energy, healthcare, education, agribusiness, affordable housing). Jean-Philippe’s journey began with his early personal exposure to extreme poverty while travelling, working and living in Eastern Europe, Africa, Asia and Latin America. His work objectives are driven by his deeply rooted faith and values and an ambition to contribute to solving at scale some of the most critical problems of our planet. Realising “investments that matter” is the path he chose to follow some 20 years ago. In 2001 Jean-Philippe notably co-founded BlueOrchard Finance (a pioneer commercial lender to microfinance banks) and has worked for McKinsey & Co, the United Nations as well as various NGOs. He holds an MBA from the Wharton School of Business and speaks French, English and Spanish fluently.

2.6. Investing to overcome fragility

Izabella Toth and Romy Miyashiro

In states that are fragile and affected by conflict, ODA plays an essential role. It helps increase access to essential services, develop national capacities and support policy reforms that, among other objectives, can help to boost economic development. ODA can also help attract private finance to these states, such as through blended transactions. However, blended approaches here must be especially transparent and accountable, and must of course do no harm.

People often assume that foreign investment is always good for the economies of fragile and conflict-affected states. This can certainly be the case when investments aim to diversify the local economy, and retain value in the country in an inclusive and equitable way. Investments – whether through blended strategies or otherwise – can be development-friendly in certain conditions: when they respect national ownership, align with national priorities, and where the country's legal framework protects workers' rights and includes guarantees that foreign investors will support the local economy. This can be achieved through local content rules, sharing know-how with local actors, ensuring that linkages are built with local suppliers and entrepreneurs, etc. But it does mean that fragile countries need to have a certain level of preparedness to allow investments to contribute to leaving no-one behind.

Supporting sustainable and equitable outcomes also means that those launching blended transactions should consult with the communities affected, that robust accountability and transparency mechanisms are attached to deals, that risks and rewards are shared fairly between private investors and project beneficiaries, and that relevant local organisations can participate in a meaningful way.

Cordaid Investment Management BV (CIMBV) is the asset management branch of the Netherlands-based Catholic Organization for Relief and Development Aid (Cordaid). CIMBV has been a frontrunner in opening markets to impact investment since 1997. Recently, CIMBV has reinforced its promise of investing to overcome fragility. For this purpose, and in order to guide its decisions in the coming years and to further increase its social impact, CIMBV has strengthened its mission statement: "CIMBV invests in decent job creation, sustainable economic development, and building resilient communities; by deploying growth capital and technical assistance to MFIs and SMEs [microfinance institutions and small and medium-sized enterprises] in the most underserved fragile and emerging communities; catalysing system change, opening up markets in which organisations otherwise wouldn't have access to finance; supported by like-minded investors who balance financial return with social impact, with the help of a highly skilled and committed team".

CIMBV serves small-scale entrepreneurs and often tier 2 and tier 3 (smaller or medium-sized) microfinance institutions. It applies concessional terms on a case-by-case basis. For instance, CIMBV might invest in small-scale entrepreneurs with limited financial needs (a minimum of EUR 100 000) that are not attractive to other lenders. It can also operate in situations that other lenders consider to be too risky. CIMBV's long experience in investing in fragile contexts means it is well positioned to selectively take more risk than other lenders. For instance, CIMBV lends in local currency whenever possible and has used royalty-based or revenue participation repayment restructuring at times when inflation or depreciation rates are very high. Over the last two decades, CIMBV has benefitted more than 2 million microentrepreneurs and provided financing to more than 250 MFIs and small and medium-sized enterprises (SMEs) globally.

One important lesson CIMBV has learned from its work in fragile countries is that the capacities of investees are often weak. Therefore, in some cases CIMBV accompanies its financial investments with non-financial support, such as technical assistance or access to networks. In terms of its financial investments, CIMBV provides either senior and/or subordinated debt, or equity. Equity investments are made in specific scenarios, such as to help reinforce the balance sheet of the investee (such as an MFI) as requested by the regulator. By combining financial support with non-financial support, CIMBV aims to

increase the social impact of the investee, support their growth in a sustainable manner and de-risk the investment so as to encourage others to invest.

For example, Hekima is a small MFI in the Democratic Republic of the Congo, focusing on poor women market traders, artisans and teachers. Hekima has 11 000 clients (74% of them women). In 2017, CIMBV provided over EUR 250 000 in equity to support Hekima's portfolio expansion, and to strengthen its equity and governance position so that it could transform into a public limited liability corporation. This small injection of cash helped Hekima to become a deposit-taking institution, meaning it could attract less expensive funding and continue to expand. Its stronger equity position enabled Hekima to attract additional international funding. As a result, Hekima will be able to expand its portfolio, and especially further support its low-income female clients – often the main earners in the household – by offering them a safe place to save.

Similarly, WARC in Sierra Leone is an SME with three lines of business, including rice and maize production (and a training farm). CIMBV was the only lender who dared to support WARC in post-Ebola Sierra Leone, initially approving a loan of EUR 140 000 to help it expand its rice production. CIMBV also worked together with WARC to develop its environmental, social and governance action plans – on occupational health and safety, and community stakeholder consultation. As the first international lender, CIMBV played a catalytic role, helping WARC obtain grants from USAID as well as an international equity investor. More recently, CIMBV approved two follow-up loans to expand WARC's rice production still further, also boosting its position with other international lenders. These investments will not only allow WARC to create over 170 jobs, especially for women and young people, but will also help to increase food security in the country.

Building on 20 years of experience as an impact investor, CIMBV now aspires to increase its social impact. It has recently designed the Stability Impact Fund Africa. This aims to create jobs and spearhead inclusive economic growth in selected countries in sub-Saharan Africa. The fund uses a blended model, as its focus is on fragile countries where actual risks are higher. In order to absorb the higher risk and attract investors, the anchor investor, Cordaid Foundation, is committing up to EUR 4 million as a first loss tranche. CIMBV is also seeking like-minded investors that are willing to accept capital preservation in order to create significant social impact in these areas.

Undoubtedly, the risks of investing in fragile and conflict-affected states are high, including through blended transactions. To mitigate these risks, using blended finance effectively in challenging markets requires a mix of concessional finance and non-financial (technical assistance); tailoring financing instruments to the deal at hand; respecting country ownership and aligning deals with national priorities; and focusing on transactions with strong development impact. While the risks are higher in these contexts, the return on investment could potentially be higher and the impact greater, as access to finance can contribute to inclusive local economic development and hence to greater stability. This is where blended finance can truly make a difference – by attracting investors to deals they would otherwise overlook.

Box 2.6. About the authors: Romy Miyashiro and Izabella Toth

Romy Miyashiro, Investor Relationship Manager, joined Cordaid Investment Management BV in March 2017. Romy is responsible for fundraising and managing investor relationships. She has 13 years of experience in commercial banking at Banco de Crédito del Perú. Romy holds an MBA from Cranfield University, UK, and a Business Degree from Pontifical Catholic University of Peru.

Izabella Toth, Senior Strategist at Cordaid in the Netherlands, has an academic background in Humanities (ELTE University in Budapest, Hungary) and Dutch Law (ERASMUS University in Rotterdam, the Netherlands). In 1998, she joined Cordaid/Memisa, first as Policy Advisor for Institutional Funding, and later as Senior Strategist, with portfolios on Strategic Relation Management with the

European Institutions and the World Bank. External mandates include six years as a board member in CONCORD, the European NGO Confederation for Relief and Development in relation with European institutions; and European region representative on the CPDE (Civil society Partnership for Development Effectiveness) Coordination Committee.

2.7. Bringing private investment to challenging environments: lessons from the World Bank Group's Private Sector Window

Federica Dal Bono and Barbara Lee

In April 2017, as part of the 18th replenishment of the International Development Association (IDA – the fund for low-income countries), the World Bank Group created the IDA18 International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) Private Sector Window[4] to catalyse private sector investment in the world's poorest countries (i.e., only those eligible for IDA funding).[5] The Private Sector Window is based on the recognition that the private sector is central to achieving the Sustainable Development Goals, yet private investment is difficult to attract to the most challenging environments. It is an integral part of the World Bank Group's effort to ramp up its support to attract private investment to IDA and fragile and conflict-affected countries. It complements IDA's work with the public sector to strengthen the business environment and support sector policy reform, IFC's support for private-sector capacity building and investments, and MIGA's guarantees against non-commercial risks. It helps mitigate the uncertainties and risks for specific high impact private investments, and is an option when there is no fully commercial solution or when the World Bank Group's other tools and approaches are insufficient. The initial three-year allocation for the Private Sector Window totalled USD 2.5 billion, with USD 2 billion allocated to IFC and USD 500 million to MIGA.

The Private Sector Window is a blended concessional finance instrument that helps to enable investments that are aligned with the World Bank Group's country strategies. It does not fund private investment on its own. It deploys IDA's concessional funding to backstop or blend with IFC investments or MIGA guarantees to support private sector investments through four facilities:

1. A Risk-Mitigation Facility to provide project-based guarantees without sovereign counter-guarantee to crowd-in private investment in large infrastructure projects and public-private partnerships supported by IFC.
2. A MIGA Guarantee Facility to expand the coverage of MIGA guarantees through shared first-loss and risk participation akin to reinsurance.
3. A Local Currency Facility to provide long-term local currency investments through IFC in countries where capital markets are not developed, and market solutions are not sufficiently available.
4. A Blended Finance Facility to blend Private Sector Window support with pioneering IFC investments across sectors with high development impact, including SMEs, agribusiness, health, education, affordable housing, infrastructure, and climate-change mitigation and adaptation.

In short, the Private Sector Window makes strategic use of IDA's public resources together with investments and guarantees from IFC/MIGA's own capital, and taps synergies across IDA, IFC and MIGA to de-risk or provide concessional support to specific transactions in the most difficult markets.

The Private Sector Window leverages IFC's and MIGA's business models and client relationships, working *upstream* to identify development challenges and private sector solutions, *midstream* to structure deals, and *downstream* to process the actual investment. To ensure that the Private Sector Window is well-targeted, the World Bank Group has developed eligibility and prioritisation criteria, governance arrangements, and a performance and results framework to monitor performance and outcomes. Each potential transaction is reviewed through a rigorous process applying the five concessional blended finance

principles developed by the development finance institutions' working group, led by IFC:[6] 1) rationale for blended concessional finance and additionality of the project; 2) crowding in and minimum concessionality; 3) commercial sustainability; 4) reinforcing markets; and 5) promoting high standards.

Over the initial two years of the Private Sector Window pilot, the fund deployed some USD 540 million to support about USD 1.3 billion of IFC investments and MIGA guarantees – in turn expected to mobilise an additional USD 1.7 billion of external financing for projects. To date, the Private Sector Window has supported small local businesses, renewable energy projects, agribusiness, infrastructure, housing development, equity funds, bonds and projects in other job-generating sectors, with support for SMEs and housing finance emerging as the most prominent sectors. Engaging local sponsors has been a key feature of the Private Sector Window; many of IFC's Private Sector Window projects directly support local financial institutions and businesses, and MIGA's projects include linkages to local contractors, suppliers and businesses. There is also strong demand for local currency financing from the Private Sector Window. Some examples of investments are described here:

- In West Africa, an estimated 94% of the population lacks access to housing finance. The Private Sector Window's Local Currency Facility enabled an IFC investment of up to USD 18 million in local currency to support a mortgage refinance company (CRRH) to expand the availability of mortgage finance by up to USD 500 million in the eight countries of the West African Economic and Monetary Union. To complement this, the Local Currency Facility will also provide up to USD 45 million for the construction and purchase of approximately 2100 affordable housing units in Côte d'Ivoire. The IFC investment, in the form of a cross-currency swap, will provide long-term local currency developer mortgage finance to two local banks for on-lending to developers and buyers to increase both supply and demand for affordable housing.
- In order to support SME financing and create local private equity markets across Africa, IFC is investing USD 7.5 million from its SME Ventures Program together with USD 7.5 million from the Private Sector Window in an African entrepreneurs' investment fund (IPAE2). The investment has increased IPAE2's investment capacity to EUR 75 million to support investments, primarily targeted to African countries with significant equity-financing gaps.
- In Afghanistan, an investment in the Rikweda Fruit Processing Company will help expand the country's raisin processing capacity, help 3 000 small-scale raisin farmers improve yields and incomes and create 50 new jobs. IFC is providing a working capital facility of up to USD 2.5 million and a long-term loan of up to USD 500 000. MIGA is providing guarantees, with Private Sector Window support, against the risk of war and civil disturbance to cover the investors' equity and quasi-equity investments of up to USD 7.8 million.

Efforts to develop the internal infrastructure and initial projects for the Private Sector Window during its start-up phase have resulted in a robust pipeline, with projects identified under all four facilities to be delivered in the coming one to two years.

A number of lessons are emerging from the Private Sector Window's early experience:

- **Blended concessional finance must be well-designed** and used only when there is a strong rationale. The rationale for using the Private Sector Window is grounded in the blended finance principles mentioned above. Awareness building and developing familiarity with these principles – which are not applicable to traditional IFC and MIGA transactions – have been needed across a broad segment of World Bank Group staff. The concepts of "additionality", "minimising concessionality" and building the economic case for using blended finance are complex and require discussion and judgement. Establishing a minimum subsidy level is especially difficult, as it must be demonstrated to be "just enough" but "not excessive" and the beneficiaries of the subsidy must be clearly justified. Data are also key to determine levels of concessionality; for instance, IFC and IDA use benchmarks from projects in comparable sectors in similar country contexts and

benchmarks from equity and debt provider returns to ensure that there is no profit windfall for IFC, the co-lenders or the private sector sponsors.

- **Strong governance is required**, with the decision-making process and team managing the concessional funds operating independently from the teams investing for IFC's and MIGA's balance sheets. This ensures that the blended finance principles are applied without regard to other institutional incentives for traditional IFC/MIGA projects.
- **Dropped projects are a fact of life** for blended finance. Many projects identified at the upstream stage have not resulted in Private Sector Window financing, largely due to ineligibility. This can stem from factors such as the lack of an economic case for concessionality; the ability of IFC and MIGA to undertake the project on their own; and the lack of project viability despite the Private Sector Window's potential support. In addition, projects can be dropped by the potential private investor due to perceived insufficient de-risking or inadequate pricing subsidies being offered by the Private Sector Window.
- **Using programmatic approaches to deploy the Private Sector Window helps to enhance efficiency** by reducing processing costs and leveraging economies of scale. Programmatic approaches provide financing indirectly to multiple smaller projects (such as SMEs and microfinance institutions) through pooled or platform solutions rather than directly to each small business or microfinance institution.
- **Higher risk tolerance is needed** to support blended concessional finance. The Private Sector Window supports projects that are riskier than non-subsidised commercially viable projects. All Private Sector Window projects undergo a risk analysis to determine the level of overall risk as the portfolio of investments grows. The Private Sector Window is likely to expose IDA as an institution to higher levels of financial risk; these must be weighed against the greater development impact likely to be achieved. Additional controls and the offsetting of any potential losses with loan-loss provisioning has also been critical in the use of the Private Sector Window.

The World Bank Group is bringing many of these early lessons to the blended finance community, governments and think tanks to inform discussions on modalities and good practice in deploying blended finance.

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World Bank (2019), *IDA18 Private Sector Window*, https://ida.worldbank.org/replenishments/ida18-replenishment/ida18-private-sector-window (accessed on 1 July 2019). [5]

Notes

[1] The Yield Fund defines SMEs as companies with a turnover of less than USD 5 million, having fewer than 150 employees and needing capital in the USD 250 000 to 2 million range.

[2] Southern Voice is a network of 50 think tanks from Asia, Africa and Latin America. The case studies highlighted in this article can be read at www.southernvoice.org.

[3] Summarised from (Gibson et al., 2005[25]).

[4] For further information, see: (World Bank, 2019[27]) https://ida.worldbank.org/replenishments/ida18-replenishment/ida18-private-sector-window

[5] There are some 75 countries currently eligible for IDA resources on highly concessional terms. IDA eligibility depends on a country's lack of creditworthiness, as well as on its level of development, defined as a per capita gross national income below a threshold that is updated annually (USD1 165 in fiscal year 2018). Countries transitioning out of IDA Regular status are designated as Gap and Blend countries and are not eligible for Private Sector Window financing.

[6] For details, see (DFI Working Group on Blended and Concessional Finance, 2017[28]) https://www.ifc.org/wps/wcm/connect/30635fde-1c38-42af-97b9-2304e962fc85/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations_Summary+R....pdf?MOD=AJPERES

3 Key questions and next steps for how blended finance can best support least developed countries

This final chapter provides a short conclusion to the report – drawing on the latest data presented in Chapter 1 and the expert views from the field in Chapter 2. It summarises the emerging issues, including ideas and guiding principles for handling the risks and maximising the opportunities of blended finance, especially for the "missing middle". Finally, it asks what's next for UNCDF's action agenda, and for the blended finance community more generally, using a series of questions to help shape the next steps.

3.1. Making blended finance work for LDCs

While turning the “billions into trillions” is essential to bridge SDG financing gaps, there is a need also to focus on the quality of resources mobilized, how they reach those being left behind and to what extent they may actually contribute to achieving the SDGs. Data analysed for this report show that of all private finance mobilised by official development finance interventions between 2012 and 2017, approximately USD 9.3 billion, or 6%, went to LDCs, whereas over 70% went to middle-income countries. Owing to data gaps, it remains unclear whether this represents a relative drop compared to the 7% of private finance mobilised for LDCs observed for 2012-2015. This nonetheless implies that little is changing when it comes to using blended finance to encourage private investment in the most vulnerable countries.

Coupled with the recent decline in ODA to LDCs, this further suggests that the financing for development architecture is not yet providing LDCs the support they need to achieve the SDGs, something that risks hardening exclusions between and within countries, rather than overcoming them. Some donors are taking steps to increase their engagement in LDCs, but the data suggest that many providers still tend to overlook such markets when it comes to blending. This in turn implies the need for further risk taking and experimentation at both the balance sheet and project level to get more private finance invested in those LDCs where blended finance is an appropriate solution.

As the 2018 report found (Box 3.1), the difficulty of blending finance in LDCs may reflect objective challenges in attracting private capital to riskier, smaller and less-tested markets – even when concessional resources are deployed to mitigate risks. Some providers may also shy away from such markets for several reasons: they may have a low appetite for risk given the need to preserve their triple-A credit ratings; they may lack awareness of investable projects; institutional incentives may push them to close deals, leading to a focus on “easier” markets or projects; or their mandates may favour commercial returns.

Nevertheless, the experts and practitioners whose voices are heard in Chapter 2 reveal that an increasing number and variety of players – impact investors, NGOs, think tanks, domestic financial intermediaries – are entering this space and are interested in ensuring that blended finance transactions are effective and efficient and can work in even the most challenging contexts to allow LDCs to achieve their development goals. While the support required will vary by project type and sector, a flexible and hands-on approach is necessary in blended finance transactions in LDCs; such transactions typically also require greater levels of concessional support than in other developing countries.

The many and varied examples given in Chapter 2 suggests that blended approaches can help mobilise much-needed additional resources to help LDCs bridge SDG financing gaps – and create demonstration effects that narrow the gap between actual and perceived risks of investing in these markets. But such approaches need to be considered and deployed carefully, and risks associated with blended finance approaches will need to be addressed. Even in those blended transactions supported by concessional finance, a higher risk tolerance is typically necessary when entering LDCs. In crisis-affected contexts, where ODA plays an essential role, blended approaches must be particularly transparent and accountable, in addition to doing no harm by, say, widening disparities. In LDCs there is an especially large gap in the ability of SMEs in the "missing middle" to access the capital they need to grow, as neither commercial banks nor micro-finance institutions tend to have the capacity or products that match their requirements (Box 1.2, in Chapter 1). A local presence, be it an investor or a fund manager, can help build local capacity and understand risks and opportunities attached to each investment. Technical assistance can be essential to generate investable opportunities, including as it relates to strengthening investees’ capacity in areas like ESG compliance and improved operational efficiency. Blended finance transactions need to demonstrate clear sustainable development additionality, and there is a need for further research and efforts to strengthen SDG impact measurement.

While blended approaches seek to increase overall financing for the SDGs, without an increase in the overall level of aid, using more ODA for blending may reduce its availability for development sectors not

usually suitable for blending, such as helping to fund basic infrastructure or social services in LDCs. Given concerns about LDC governments not being fully involved in decisions about the allocation of concessional resources, or blended finance being a back door to tied aid, concessional finance providers and donors should ensure that blended transactions align with national priorities and respect national ownership. LDCs may also need support to put in place the right capacities and institutions to identify, analyse and structure blended operations. In light of indebtedness concerns, LDC governments should institute sound fiscal risk management frameworks that account for contingent liabilities arising from blended finance projects.

Monitoring and evaluation and knowledge-sharing are very important to improve the evidence base of blended finance impact in LDCs, and contribute to the formation of best practices. More broadly, blended finance solutions should be applied as part of a broader national SDG financing strategy that takes into account domestic and international, public and private sources of finance.

3.2. Principles and a roadmap to guide blended finance in the least developed countries

There are long-standing principles of development effectiveness related to the use of ODA. Where ODA is involved, blended transactions should meet those same standards. To improve the effectiveness and efficiency of blended operations, and to address some of the risks mentioned above, specific principles for using blended finance have emerged in recent years. For instance, as part of the Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development, United Nations Member States agreed on a set of overarching principles for blended finance and public-private partnerships (PPPs) (UN, 2015[1]). In October 2017, the OECD Development Assistance Committee approved a set of blended finance principles for unlocking commercial finance for the SDGs (Section 3.3). Also in October 2017, a working group of DFIs proposed five principles, enhanced with detailed guidelines, on blended concessional finance for private-sector projects.[1]

As the 2018 report found, these sets of principles share many common elements that are of relevance to the use of ODA in blended transactions in LDCs. Two critical principles it highlighted are:

- Sustainable development additionality, meaning that the intervention has direct development impact, is aligned with the SDGs, and has the goal of leaving no one behind.
- Financial additionality, meaning that the project will not be funded by commercial sources alone without concessional support. Ensuring the minimum amount of concessionality is critical to avoid oversubsidising the private sector while also not crowding out private investors or unduly distorting local markets. Still, determining the amount and structure of concessionality is difficult, especially in LDCs.

The 2018 report also underscored that providers of concessional finance should ensure that blended transactions:

- support alignment with, and ownership of, the national development agenda
- comply with high standards of transparency and accountability
- promote the fair allocation of risks and rewards
- apply rigorous environmental, social and governance (ESG) standards; promote local participation; do not widen disparities or inequalities – gender, income or regional – within a country; and ensure a focus on the empowerment of women.

3.3. How do the OECD Principles and Tri Hita Karana Roadmap apply to the least developed countries?

The OECD principles on blended finance provide a policy framework to ensure the sustainability of blended finance as one approach in the donors' toolbox for development co-operation (Figure 3.1). The principles aim to ensure that blended finance is deployed in the most effective way to address the financing needs for sustainable development as set out in the AAAA, by mobilising additional commercial capital and enhancing impact. The principles have also been referred to in the G7 commitment on innovative financing for development agreed in Canada (G7, 2018[2]).

Figure 3.1. The OECD Development Assistance Committee Blended Finance Principles

Source: (OECD, 2018[3]) *Making Blended Finance Work for the Sustainable Development Goals*, https://doi.org/10.1787/9789264288768-en

The OECD is currently working on more detailed guidance for donor governments to support the implementation of these principles. The guidance will provide best practice examples, support the development of effective policies and facilitate accountability, and will have important applications in LDCs, given that bilateral donors are increasingly prominent mobilisers in these countries (Section 1.9). More specifically, the policy guidance will work towards ensuring blended finance is designed to deliver development additionality where it is needed most, that it is tailored to specific contexts and helps build local financial markets which are often nascent in LDCs. In particular, Principle 4, which advocates a more targeted, balanced and sustainable allocation of risks between partners, will be important for blending in LDCs where actual or perceived risks are often higher (OECD, 2018[4]).

In recognition that blended finance is a multi-stakeholder concept, the OECD is also undertaking broader co-ordination work with others in the blended finance field. The Tri Hita Karana Roadmap (Figure 3.2) was launched on the side-lines of the IMF/World Bank Meeting in Bali, Indonesia in October 2018 (OECD, 2018[5]). The roadmap establishes a shared value system amongst a slew of international actors, including multilateral development banks; development finance institutions; governments, such as Indonesia, Canada and Sweden; private sector actors; civil society organisations; and think tanks. Guided by the roadmap, international actors are working to deliver on five action areas: practice, mobilisation, transparency, inclusive markets and impact.

Figure 3.2. The Tri Hita Karana Roadmap for blended finance: Action areas and working groups

Source: (OECD, 2018[5]), Tri Hita Karana Roadmap for Blended Finance, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/tri-hita-karana-roadmap-for-blended-finance.htm

Heightened transparency will help better inform investors and grow blending opportunities in LDCs. Promoting the measuring and reporting of impact will help ensure that blended operations implemented in LDCs achieve their expected development results. The Tri Hita Karana working groups aim to ensure the promotion of good practice and common frameworks to ensure the potential of blended finance can be delivered in LDCs and beyond. The guidance developed through the OECD principles will feed into the working groups and vice versa.

3.4. What's next for UNCDF's action agenda on blended finance for least developed countries?

Since the launch of the 2018 report in November (Box 3.1), UNCDF has been working to build a coalition of partners – LDC governments; DFIs and multilateral development banks (MDBs), private investors, multilateral and bilateral development agencies, philanthropic foundations, civil society, and think tanks – to take forward the action agenda proposed in that report.

This has included convening a wide range of public and private stakeholders for launch events in London, Paris, Dakar, Ottawa, Bangkok, and Kampala, as well as convening or participating in widely-attended webinars and expert group meetings, including during the 2019 Financing for Development Forum. UNCDF has used these events to: share the findings and messages of the 2018 report; bring LDC governments, providers of concessional finance, investors, and civil society to the table; provide an open platform for sharing knowledge and experiences; and push for blended finance to work better for LDCs.

Anecdotally, partners have informed UNCDF that the 2018 report has helped bring to discussions on blended finance a focus on LDCs and leaving no one behind. Some providers of concessional finance have stated that they are using the findings of the 2018 report to develop or refine their investment strategies.

Box 3.1. Messages and action agenda from UNCDF's 2018 blended finance report

The 2018 report "Blended Finance in the Least Developed Countries" (UNCDF, 2018[6]) examined the opportunities and challenges for deploying blended strategies in LDCs, and how to pursue them effectively. It noted that blended finance approaches can help mobilise much-needed additional capital for LDCs. In addition, blended finance in LDCs can create demonstration effects that support commercial replication over time, inform government-led policy improvements and potentially support the development of local markets.

Still, blended projects are not without their limitations and risks. They also need to be considered carefully and should be applied as part of a broader SDG financing strategy. Ultimately, project and country characteristics, macroeconomic conditions and national policy priorities should determine which financing model—public, private or blended—is best suited for which SDG investment.

UNCDF proposed a five-point action agenda to improve the practice of blended finance and help ensure that its application can support LDCs to achieve the SDGs:

- **Encourage risk taking and experimentation,** as appropriate: Providers of concessional finance should engage with their boards, donors and LDC governments to find innovative ways to take more risks and experiment with new solutions, as part of broader efforts to get more private resources flowing to LDCs. Where blended approaches are the right ones, this could mean establishing and/ or sufficiently resourcing existing dedicated funds, facilities, entities or special purpose vehicles that will support blended projects in LDCs throughout their lifecycle.
- **Bring LDCs to the decision-making table**: Global policymaking discussions on blended finance should purposefully engage LDCs and other developing countries as active participants. It would be important to convene these discussions in universal forums, such as the Financing for Development and Development Cooperation Forums held at the United Nations. To strengthen national capacities in LDCs, providers of concessional finance and donors should support national and local government officials and national development banks with targeted capacity-building and training.
- **Deploy blended strategies to support sustainable outcomes:** It is essential that blended finance transactions have SDG impact, with the goal of leaving no one behind. Providers and other development partners in LDCs should, where appropriate, actively seek out suitable domestic investors and support blended transactions in local currencies. To respect ownership, providers should proactively engage at a strategic level with LDC governments so that they can determine which financing model is best suited for a given investment.
- **Improve impact measurement and transparency**: Strengthening SDG impact measurement means that providers should ensure that ex-ante SDG impact assessments and ex-post evaluations are undertaken and made publicly available. To improve transparency, it is important that concessional providers also publicise such information as how much ODA is going into blended transactions.
- **Increase knowledge-sharing and evidence to inform blended finance best practice**: Providers should work with all stakeholders to maximise the sharing and transfer of knowledge on blended finance in LDCs. All stakeholders should also continue generating additional evidence as to how blended finance can work in LDCs and riskier markets.

Source: (UNCDF, 2018[6]), Blended Finance in the Least Developed Countries

Internally, the 2018 report has helped to influence how UNCDF approaches its own growing portfolio of blended finance deals to support projects in the missing middle. After the launch of the report – and in line with its recommendation that there be more focus on taking blended finance to the LDCs where appropriate – UNCDF also announced a partnership with Bamboo Capital Partners. This partnership will seek to establish a blended finance impact investing vehicle to attract concessional and commercial growth finance to a pipeline of SMEs, financial service providers and local infrastructure projects supported through UNCDF's programmes in LDCs.

More broadly, and in line with the findings of the 2018 report, the outcome document of the 2019 Financing for Development Forum (UN, 2019[7]) calls on providers of blended finance to engage strategically with host countries at the planning, design and implementation phases to ensure that priorities in their project portfolios align with national priorities. The same outcome document also requests the Inter-agency Task Force on Financing for Development, as part of its 2020 report, to assess the risks, opportunities and best practices in relation to different financing instruments, including blended finance, and how they can be best tailored to specific country contexts, including LDCs – something to which this edition of the report will be contributing.

Going forward, UNCDF will continue its outreach. This edition of the report adds to the now-growing evidence base of how best to make blended finance work for LDCs – and UNCDF is committed to sharing its findings widely and building momentum to ensure that more resources go to where they are most needed.

3.5. Questions to shape the next steps

Blended finance in LDCs is an evolving concept. This report therefore concludes with several suggested areas for further research based on the guest pieces and the issues and limitations revealed in the data analysis.

The data presented in Figure 1.2 and in Box 1.3, along with the findings of the 2018 report, suggest that blended finance transactions in LDCs mobilise smaller amounts of private finance than in middle-income countries. Given the need to mobilise larger amounts of finance to meet the SDGs, MDBs and DFIs are looking to make optimal use of their balance sheets and strengthen the catalytic role of their interventions. A question some stakeholders have raised is whether setting hard mobilisation targets is the best way to achieve this goal. While higher leverage ratios can play an important role in bridging SDG financing gaps, setting hard mobilisation targets for providers of concessional finance raises concerns. Careful analysis is necessary to consider the impact of mobilisation targets on development finance envelopes and allocations for LDCs and other vulnerable countries. More broadly, if blended finance continues to become an increasingly important modality of development co-operation, as this report suggests is the case, then development partners will need to ensure that this does not come at the expense of support for LDCs and other vulnerable countries – those where blending has been more challenging. Moreover, hard ratios can lead to a focus on meeting quantitative targets, as opposed to focusing on quality or the impact on sustainable development. It may be that there is a need to accept that the mobilisation agenda in LDCs will be different – but that those blended finance deals, where they are appropriate, are pursued because of their sustainable development additionality.

The data in Figure 1.19 show that the amount of private finance mobilised by investors in the beneficiary LDCs themselves has declined over the six-year period. This raises the question of whether blended finance transactions should focus on attracting domestic or foreign investors. Certainly, there can be instances where either domestic or foreign private capital might provide the best financing option for a particular deal. While FDI can also bring benefits in the form of know-how, technology and expertise to LDCs, proactively focusing on domestic investors can have positive side effects on local market development and ownership.

These issues could be the subject of further research, guided by the specific questions listed in Box 3.2.

Box 3.2. Suggestions for further research on blended finance in LDCs

- Is external private finance crowding out domestic investors, and does the decrease in private finance mobilised from domestic investors have any links with tied aid – both questions raised by Figure 1.19?
- How do blended finance approaches fit into integrated national financing frameworks, and how do these relate to questions of ownership?
- How much blending is taking place thanks to concessional providers from the South, something not captured in the OECD data?
- What is the role of philanthropy in blended finance transactions in LDCs?
- Why is there a weak but positive correlation between ODA received and private finance mobilised (see Section 1.6)?
- Does the difference in focus sectors between domestic and foreign investors reflect domestic versus foreign priorities?
- What is the impact of increased blending and mobilisation ratios on development financing envelopes overall, and for LDCs in particular?

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Notes

[1] The principles can be found in the working group's Summary Report: (DFI Working Group on Blended and Concessional Finance, 2017[8]) www.ifc.org/wps/wcm/connect/30635fde-1c38-42af-97b9-2304e962fc85/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations_Summary+R....pdf?MOD=AJPERES

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Blended Finance in the Least Developed Countries 2019

The world's 47 least developed countries (LDCs) are among those most at risk of being left behind. While official development assistance and domestic public resources remain essential for their development prospects, they alone will not be sufficient to meet the Sustainable Development Goals. With the Addis Ababa Action Agenda, the international community acknowledged the need for significant additional public and private finance, and development partners are increasingly focusing on blended approaches.

What are the trends in blended finance for LDCs? What can it achieve and how? The OECD and UNCDF are working together to shed new light on these issues. Building on a 2018 publication, this edition presents the latest data available on private finance mobilised in developing countries by official development finance, extending the previous analysis to cover 2016 and 2017 as well as longer-term trends from 2012 to 2017. It discusses the most recent international policy trends shaping the blended finance market, and what these might mean for LDCs. Stakeholders and practitioners also share their views on the challenges and opportunities in designing and implementing blended finance operations in LDCs.

Consult this publication on line at ***https://doi.org/10.1787/1c142aae-en***.
The work can also be found at ***https://www.uncdf.org/bfldcs/home***.

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