Insight: Blended finance in the national planning process

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“The only way to achieve the sustainable development goals is to use more public capital strategically for unlocking private investment, particularly for infrastructure.”

Amadou Hott, Vice-President, Power, Energy, Climate and Green Growth, African Development Bank

Overview

Blended Finance has emerged as a catalyst to incentivize private capital flows and accelerate development impact in emerging economies. While this approach to public-private financing has leveraged a limited amount of development finance and philanthropic capital to reduce the uncertainty and risks normally associated with investing in underserved markets, it has been insufficient to catalyse the estimated $4.5 trillion a year that is required to meet the Sustainable Development Goals (SDGs) by 2030. National governments and agencies must adapt and take proactive steps to use Blended Finance to drive a portion of the $218 trillion global capital markets flows to these high-potential emerging markets. This primer seeks to highlight the steps governments must take to facilitate the enabling conditions for Blended Finance and highlight critical areas for success to meaningfully catalyse private capital that will support projects that are strategically important and impactful.

What is Blended Finance?

Blended Finance is the strategic use of development finance and philanthropic funds (“public funds”) to mobilize private capital flows to emerging and frontier markets. It allows investors and lenders to reduce the costs related to risk-return expectations in emerging and frontier markets by leveraging a broader suite of financial instruments, access to reputational support, and local expertise that public funders can provide, thereby increasing the potential for deal viability. By combining development finance and philanthropic capital, including Official Development Assistance (ODA), with private investment and lending in a structure to manage and alleviate the allocation of risk-and-return expectations, investors may be able to consider projects that would otherwise be beyond their typical investment scope. Blended Finance can be defined by three key characteristics:

- **Leverage**: Use of development finance and philanthropic funds to attract private capital into deals;
- **Impact**: Investments that drive social, environmental, and economic progress;
- **Returns**: Financial returns for private investors in line with market expectations, based on real and perceived risks.

Challenges Addressed by Blended Finance

Blended Finance can be used by the public sector to address a number of core fiscal challenges:

- **Increasingly stressed sovereign public budgets and balance sheets**: Critical national and regional projects have traditionally been funded through direct government borrowing. However, public balance sheets are increasingly under pressure and cannot continue to meet increasing obligations that may harm their credit ratings and compromise future long-term borrowing while the need for infrastructure continues to grow. Blended Finance offers governments an opportunity to reduce the dependence on government debt and sovereign guarantees, helping to ensure that publically available funds can be most effectively leveraged to access commercial debt and equity.

- **Risk-return profiles that are not competitive with developed markets**: Developing market returns tend to be attractive in the face of a low yield environment in most developed countries, but commercial financiers are reluctant to commit to transactions in less familiar markets due to real and perceived risks which inflate return expectations (as shown for infrastructure in Table 1).

### Table 1: Infrastructure IRRs

![Image](image-url)
perspective on the role that private capital has traditionally played in mobilizing the
funding needed to implement priority public sector projects. Certain institutional
steps are needed to help ensure that the right financial and risk structures can
be put in place to attract capital from the private sector and to help ensure
appropriate risk-return ratios can be realized for the private sector relative to
their alternative options.

Subsequently, Blended Finance needs to be
integrated into national planning processes
to be successful and play a meaningful role
in providing the capital for investments that
can enhance development impacts.

Facilitating Blended Finance in
National Planning

Even with the increasing interest of
private capital providers in developing
countries, national governments still have
an important role to play in establishing an
enabling environment for Blended Finance.
To harness the significant potential of this
approach for critical investment projects,
the appropriate regulatory framework
needs to be put in place.

To achieve this objective, governments
must take the necessary steps to enable
Blended Finance by establishing a
process that can focus on driving towards
“bankable” projects. First, this approach
involves a firm understanding of what
“bankability” means in the context of the
private sector, including the depth and
breadth of project preparation required
with the national needs of the project.
Second, public sector processes must align
with private capital incentives, particularly
in terms of process and procedures. Third,
Once a Blended Finance approach has been
adopted as a strategy at a national level, an
approach for critical investment projects,
the benefits to governments of
facilitating Blended Finance can also be
categorized by better understanding its
operative objectives and links to national
processes (see Categorization of Strategic
Development Funds).  

• Increase and accelerate investment
for critical national development
priorities: Blended Finance can increase
private sector investment in bankable
projects and help ensure that public
funds and ODA remain available for
critical development objectives related
to health, education and other social
projects where commercial investment
may not be feasible.

• Access to expertise and experience:
Blended Finance can provide the
necessary resources to help deliver
projects by utilizing private sector expertise
to improve and accelerate project
execution, mobilizing local capital markets
for investment in projects that reduce
hard currency exposure, and accessing
a broad range of products that can be
incorporated into project capital structures
that reduce risks and enhance returns.

• Crowd-in new sources of capital:
Blended Finance can increase the
investment attractiveness of projects by
leveraging the public sector’s long track
record and balance sheet, providing local
knowledge and experience to reduce
lead times and transaction costs. Public
cos., can act as a signal for the
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FONSIS, the Senegalese Strategic
Investment Fund, is one example
of an expanding network of state-
sponsored strategic investment
funds (SIFs) that have emerged
in developing countries to help
facilitate private sector investment.

FONSIS has built an organization
with significant financial and
transactional experience. It has
taken several steps to demonstrate
alignment with the private sector,
helping it act as a financial
intermediary that provides market
credibility, access to a network of
international investors and capacity
structure, negotiate and transact
debts.

• FONSIS has instituted targets
that are aligned with commercial
interests, requiring a minimum
rate of return on its investments
(hurdle rate) of 12%.

• A target multiplier of $12 for every
$1 committed by FONSIS.

• The investment criteria for
FONSIS have been shared publicly
to ensure transparency with
the private sector and mitigate
pressures to undertake projects
that do not fit these criteria.

• If necessary, FONSIS can provide
return enhancements or risk
mitigation to attract external
capital to high-priority projects.

• FONSIS is actively involved at
all points of the development
process, engaging with technical
and financial partners, from
project origination to financial
close.

www.fonsis.org/en
How can National Governments Incentivize Blended Finance?

Given the positive impact that Blended Finance can contribute to emerging markets, processes that facilitate the engagement of private capital and the collaborative use of public funds should be developed to enable this approach at a country level to help ensure the sustainability and scalability of this approach. Specific programmes can be pursued that support:

• **Institutional coordination**: Provide a mandate for dedicated units (such as public-private partnership units) to serve as a conduit for private sector capital. Key institutional champions need to be identified that are empowered to lead domestic efforts and have sufficient stature to guide government agencies on best practices for structuring these transactions and help ensure this change management process can be implemented.

• **Capacity building**: Help to ensure that the appropriate skill sets are available to work with the private sector across the project development process so that transactions are properly structured. Investment in recruitment and training of staff that are able to properly prepare projects, with experience across a range of financial instruments, may be required.

• **Regulatory environment**: Assess the barriers to investment and work to modify the regulatory environment where appropriate to enable Blended Finance and catalyse investment. Specific policy instruments that could improve the enabling environment for Blended Finance include reducing capital controls, streamlining company registration requirements, creating fiscal incentives (particularly for large investors such as pension funds) and streamlining bureaucracy and red tape (including removing unnecessary barriers).

A number of immediate actions can also be taken to advance these objectives, including:

• **Align** public processes and objectives with the needs of investors early in the project preparation process to help ensure design parameters are consistent with expectations.

• **Engage** with donors and development finance institutions to understand and facilitate access to existing instruments such as guarantees and concessional financing that can give greater comfort to investors.

• **Strengthen** existing dedicated units to help coordinate between government agencies and the private sectors to act as a focal point.

• **Leverage** multi-stakeholder initiatives and platforms that facilitate public-private finance, such as the Sustainable Development Investment Partnership (SDIP).

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**Sustainable Development Investment Partnership (SDIP)**

The Sustainable Development Investment Partnership (SDIP), co-led by the World Economic Forum and the OECD, is a coalition of public and private entities implementing Blended Finance to scale sustainable infrastructure (including climate-resilient infrastructure) investments in developing countries. By providing an open and neutral platform, SDIP connects projects with capital and brings sustainable infrastructure projects to bankability, helping to close the financing gap required to achieve the SDGs by enabling the scaling and replication of efforts to enable broader systemic change.

**SDIP activities include:**

- **Project Investment Review Group**
  Presenting live project opportunities to the members that require some form of blended finance to become commercially viable

- **Pooling Resources**
  Supporting models that address financing challenges by leveraging the combined resources of the membership

- **Policy & Regulation**
  Developing guidance based on member insights and transaction experiences

- **Regional & National Acceleration**
  Building regional hubs to accelerate local and regional solutions

[www.sdiponline.org](http://www.sdiponline.org)

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**End notes:**


2. Sachs et al 2014 op cit, UNCTAD 2014 op cit


7. Ibid


10. Strategic Investment Funds, Opportunities and Challenges, the World Bank, October 2016

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This document was produced by Deloitte Consulting in collaboration with the World Economic Forum’s ReDesigning Development Finance Initiative (RDFI) based on Deloitte’s ongoing support of the Sustainable Development Investment Partnership (SDIP) and Blended Finance. It builds on prior collaborative publications produced by RDFI including, A How-to Guide for Blended Finance, Blended Finance in the Private Sector Context, and Blended Finance Volume 1: A Primer for Development Finance & Philanthropic Capital.

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