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BEST PRACTICES FOR DONOR GOVERNMENTS ENGAGING IN BLENDED FINANCE

CONVERGENCE
BLENDING GLOBAL FINANCE

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EXECUTIVE SUMMARY

This report, produced in partnership with Global Affairs Canada, explores how select donor countries (member countries of the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC)) have designed and operated their blended finance programs. It considers the factors that have guided their decision-making and explores the best practices underpinning efficient resource allocation, optimal development, and climate impact outcomes. This report was constructed through direct engagement with nine donor countries[1], who provided insights on the varied institutional configurations covering a variety of blended instruments and approaches. The report addresses several modalities of blended finance program building, including:

- (i) The mandate of donors and their method of delivery, including what programs and financial instruments have been structured and implemented;
- (ii) The unique organizational architecture of each donor agency, and how this influences the deployment of capital into blended finance vehicles;
- (iii) How human resource capacity and expertise have impacted the design, delivery, and effectiveness of their blended finance approaches;
- (iv) What tools and levels of concessionality are available to donors in approaching the financial management and valuation of their investments;
- (v) Which financial instruments have been authorized and prioritized by donors and how effective have they been in achieving donors' goals;
- (vi) What are the various partnership models within and amongst donors, and how has knowledge sharing and cross institutional coordination impacted program design and evolution; and
- (vii) What has been the donor government experience in integrating gender equality?

[1] Donors include: Australian Department of Foreign Affairs and Trade – DFAT, Japan International Cooperation Agency – JICA, Norwegian Agency for Development Cooperation – Norad, Swedish International Development Cooperation Agency – Sida, Danish Ministry of Foreign Affairs (MFA), Foreign, Commonwealth and Development Office (UK) – FCDO, Dutch MFA, Government of Luxembourg MFA / Finance, Switzerland State Secretariat for Economic Affairs – SECO

This report explores such themes through stakeholder reviews and interviews, providing an evaluation of blended finance programs that have been structured and launched. It assesses how blended finance programs can best be structured to meet institutional requirements and mobilize private capital at scale most effectively.

This report explores best practices on institutional design, capacity building, partnerships, and gender lens integration and identifies the following key takeaways:

- i. For donor funds allocated to mobilize investment to private sector operations in Low Income Countries (LICs) and Middle Income Countries (MICs), donor agencies will need to strategically shift towards better incorporating private sector engagement as part of their business models and adopt a long-term view on program design that incorporates historical institutional considerations when deciding on a participation model to pursue.
- ii. Donor governments should consider the unique political, economic, and financial configurations of their national contexts and seek out areas of comparative advantage to leverage economic and financial institutional resources readily available to them.
- iii. If donor governments prioritize increasing the quantity and quality of projects implemented, they should modify development finance institution (DFI) governance to prioritize private investment mobilization in addition to impact. To maximize efficiencies, donor governments and DFIs should closely coordinate complementary roles and responsibilities.
- iv. Donor agencies will need to manage and address their capacity gaps – donors should closely evaluate how capacity building can impact program design and organizational architecture.
- v. Donor governments should consider their internal composition, level of capacity, and the degree of private sector engagement already embedded within their institutions when making decisions pertaining to financial instruments. Particularly when deciding how concessional funds will be deployed complementarily to the capital of their DFIs.
- vi. Donor agencies will need to be prudent and learn from the experience of other donors by collaborating to share risk, increase capacity, and improve comparative advantages.
- vii. Donors should decide on the trade-off between "high development impact" and "scale mobilization." For example, scale will almost always require partnerships/ collaboration with other donors.
- viii. Although gender considerations have been generally mainstreamed, a closer look at its strategic integration will require more research and examination.

INTRODUCTION

The adoption of the Sustainable Development Goals (SDGs) in 2015 prioritized the mobilization of private sector expertise and investment, with United Nations (UN) member countries signing "Transforming Our World: The 2030 Agenda for Sustainable Development", and major multilateral development banks (MDBs) publishing: "From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance."

Blended finance was advanced at this time as a critically important approach to mobilizing new sources of capital for the SDGs. Blended finance is the use of catalytic funding (e.g., grants and concessional capital) from public and philanthropic sources to mobilize additional private sector investment to realize the SDGs. The Organisation for Economic Co-operation and Development (OECD) uses a broader definition, focusing on the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries). Blended finance addresses the main investment barriers private investors face in developing markets: high perceived and real risk and poor returns for the risk relative to comparable investments. It creates investable opportunities in developing countries, which leads to more development impact.

Blended finance has been recognized explicitly as a policy objective by both member OECD Development Assistance Committee (DAC) Countries and the development finance instiution (DFI) community. In 2017, members of the DAC adopted the five OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs. Moreover, the DFI community has also taken steps to formalize blended finance within their operations, through the formation of the DFI Working Group on Blended Concessional Finance, and the establishment of the DFI Enhanced Blended Concessional Finance Principles for Private Sector Projects.

Despite these positive developments, a massive climate and SDG financing gap has persisted with no tangible increases in private investment mobilization in the eight years since the SDGs and the Paris Agreement laid out a critical role for the private sector, with the annual SDG financing gap increasing from $2.5 trillion to $4.2 trillion. The foundational structure of the official development community has remained in place for over 35 years with little change. A multitude of organizations provide direct or indirect financing to support public sector and private sector projects in developing markets: (i) OECD DAC members allocate official development assistance (ODA); (ii) the World Bank provides loans and grants and the sovereign operations of MDBs provide loans to fund public sector operations; and (iii) DFIs and the private sector operations of MDBs provide financing to private sector operations.

Within this structure, the mobilization of private investment has remained a tertiary business for development organizations (with only around 2-3% of ODA allocated annually to private sector mobilization), and a secondary business for MDBs and DFIs. Very few have meaningful mobilization targets and activities (except for the Multilateral Investment Guarantee Agency (MIGA), which is expressly focused on mobilization). Private capital is crucial to closing the SDG financing gap, but the development finance system has averaged an anemic $45 billion/year of private investment mobilization over the last five years. Indeed, just under half of the commercial financing mobilized by each dollar of concessional financing provided to blended finance transactions has come from private sector sources, with the remainder coming from MDBs, DFIs, and philanthropic investors. With the sovereign risk ratings of most developing countries being beyond the mandate and criteria of many investors (their median risk rating is "B"), private capital will not flow to SDG projects without a mobilization strategy that prioritizes and funds increasing cross-border investment into developing markets. With fewer tools to manage risk in developing markets, private investors need public and philanthropic sector support to invest at the scale required.

For blended finance to achieve its full potential and mobilize significantly greater sums of private investment focused on the world's most pressing challenges, donors must adopt a more catalytic approach, grounded in blended finance principles already practiced by donor governments and philanthropic foundations. That is, what is required is a more intentional strategy to deploy some of the existing public and philanthropic resources strategically, one that emphasizes investing more in the long-term resilience that would begin to diminish the accumulated costs of climate and SDG inaction.

As donor governments continue to introduce innovative financing tools to mobilize additional private investment for the SDGs, there is a need to take stock. How have donors engaged in blended finance, and why have certain structures been chosen over others? What role have donors played in maximizing mobilization, and how can they strengthen the development impact of blended finance? Through Convergence's engagements with the donor community, this report analyses extant and emerging blended finance programs. By leveraging the best practices identified in this report, donors can participate in blended finance transactions that can mobilize private capital at scale more effectively.

The Report is divided into three parts:

- **PART I** provides a backdrop and summary of the blended finance design matrix across the nine donors profiled and describes how blended finance programs are being designed, contrasting the internal (in-house) model with the external (outsourced) model, evaluating delivery methods, and examining organizational architectures of the nine donor countries' blended finance programs.
- **PART II** takes a comprehensive look at donor experiences and provides key learnings on best practices, focusing on the following themes: Mobilization Program Context and Conditions; Partnership and Collaboration Models; Architecture, Mandate, and Strategy; Capacity and Skills; Financial Instruments and Policy Structure; and Gender.
- **PART III** provides an assessment of key considerations and practical guidance on implementation methods and recommendations for donors moving forward.

PART I

SUMMARY AND TABLE

BLENDED FINANCE DESIGN MATRIX

Blended finance is a growing practice for donor governments, with around half of OECD-DAC members identifying in-house programs. Participation can be in-house, or internal when financing from a donor government is deployed directly into a blended finance transaction. In this case, commitments are allocated by national aid agencies such as Global Affairs Canada, other line departments or ministries such as the UK Department for Business, Energy, & Industrial Strategy (BEIS).

Alternatively, participation can be outsourced, or external when a donor government finances a multilateral entity. In this case, a multilateral entity (either a fund or organization) is capitalized by donor government funds and then participates in a blended finance transaction (e.g., Private Infrastructure Development Group (PIDG) and GuarantCo's participation in blended finance transactions).

Although donor nations have commonly provided commitements to blended finance transactions internally, donors also support blended finance transactions 'externally' through contributions to multilateral vehicles using approaches that include: (i) MDBs; (ii) multilateral organizations; and (iii) multi-donor funds and programs.

According to Convergence data, most blended finance commitments have been made through such commitments (Figure 1)

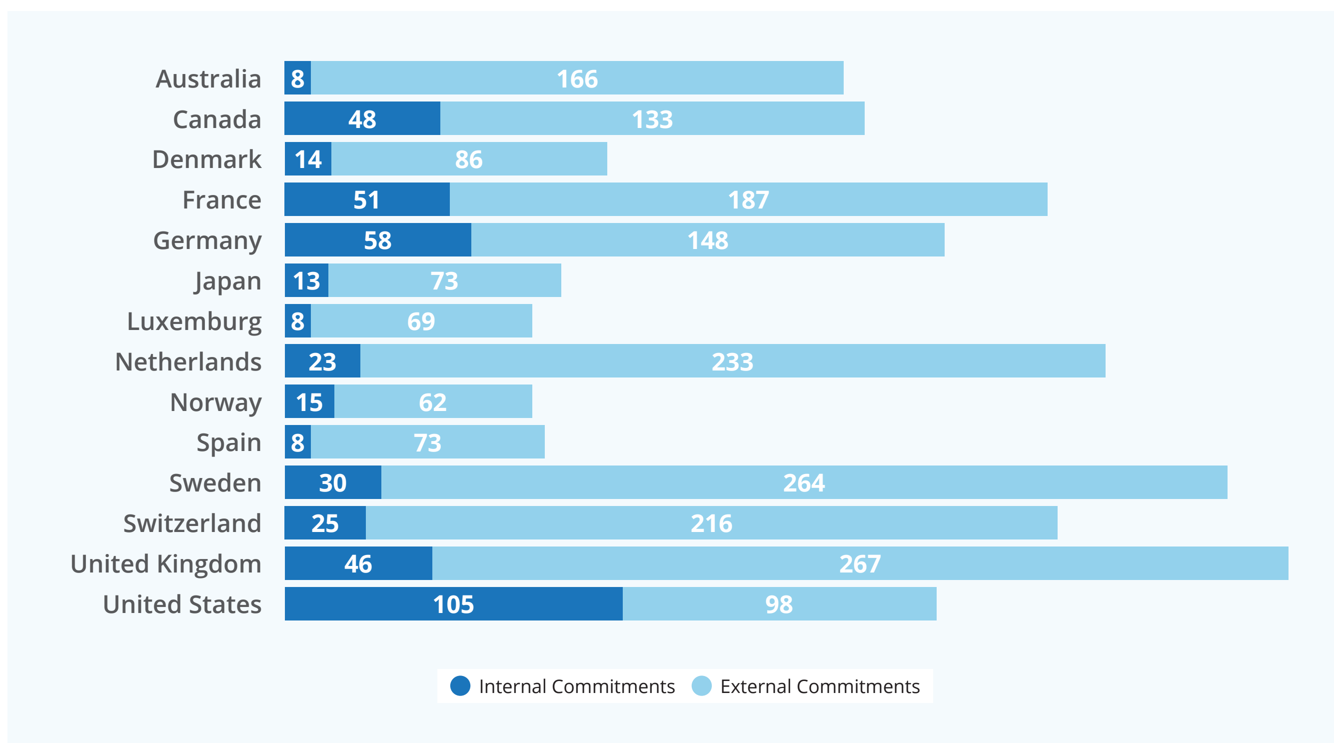


Figure 1: Country commitments to blended finance (direct vs. indirect)

Relatedly, Figure 2 illustrates percentages across four categories for participation in blended finance in-house (internal commitments) or outsourced (external commitments) and are defined as follows:

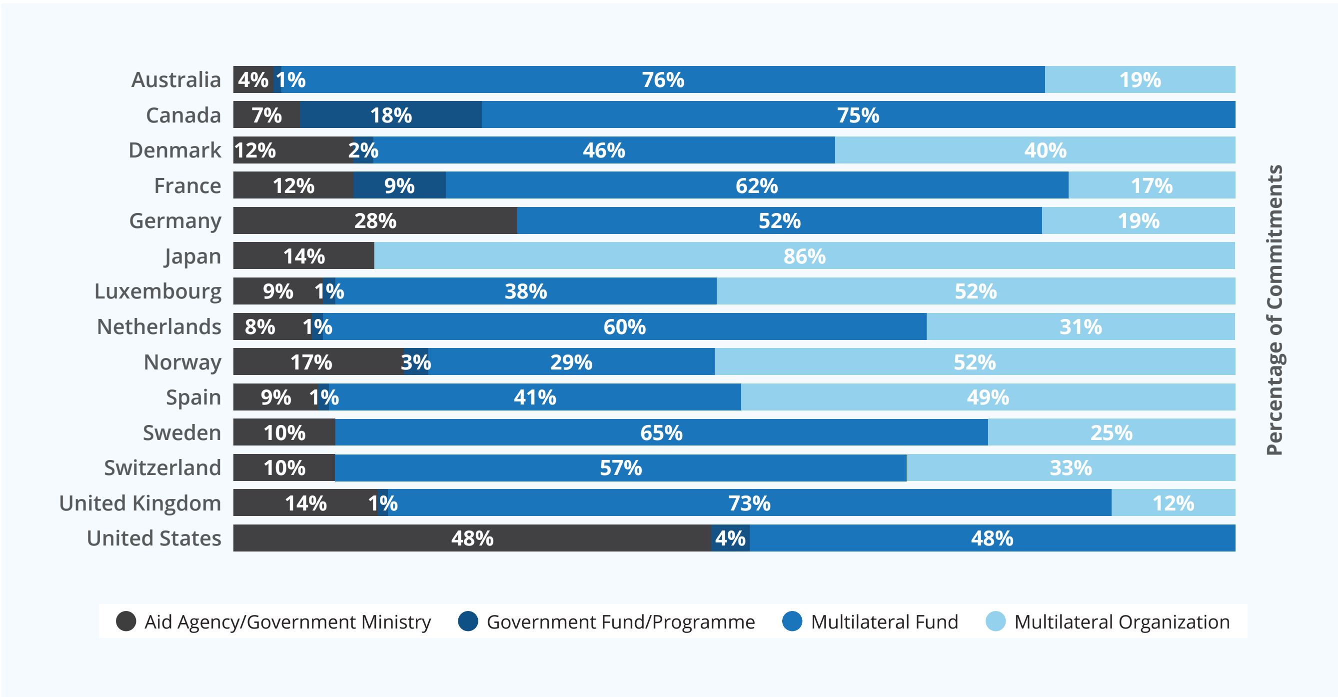


Figure 2: Country commitments to blended finance (by program / agency)

Aid agencies and government ministries display the highest percentage of internal blended finance delivery.

Government fund / program refers to a pool of capital from a singular government funder targeting a specific use or outcome that is allocated either by a for-purpose government agency or a third party (i.e., the Canadian Climate Fund for the Private Sector in the Americas (C2F) funded solely by Canada and managed by IDB Invest)

Multilateral fund refers to a pool of capital capitalized by more than one unique donor government that invests in blended finance transactions and is managed on its own behalf (i.e., Clean Technology Fund (CTF), Emerging Africa Infrastructure Fund (EAIF))

MDB refers to a supranational institution established by multiple member countries, which are shareholders. MDBs like the European Bank for Reconstruction and Development (EBRD) and the African Development Bank (AfDB) finance or co-finance projects through loans and grants for example.

Multilateral organization refers to a multilateral entity funded by more than one unique donor government that invests in blended finance transactions and is managed on its own behalf, but which also has additional mandates and performs additional activities beyond investing (i.e., policy work, market-building mandate). Examples include the European Union (and affiliates), and GuarantCo, a subsidiary of PIDG.

The stratification of deal counts, and the percentage of commitment type is varied as some donors primarily capitalize external outsourced vehicles to mobilize the private sector by deploying financial instruments like guarantees, while others have a greater capacity to deploy in-house. Given the diversity of approaches, there is a need to review donors' roles and explore why different donors choose different pathways.

Of the nine donor countries profiled in this report, all have internal facilities for blended finance that operate in various ways.

- **Norway** is undergoing an internal reorganization to better equip itself for blended finance, with Norad accompanied by the DFI Norfund.
- **Sweden** has internal capabilities through Sida and has funded external parties such as PIDG in addition to working with its DFI Swedfund.
- **Australia** does not operate a DFI but is undergoing a development finance review to assess the need. DFAT also has internal blended finance programming through the Australian Infrastructure Financing Facility for the Pacific (AIFFP) and has as well funded external intermediary PIDG.
- **Japan** operates its blended finance program almost exclusively internally through JICA and its private sector subsection Private Sector Investment Finance (PSIF), which acts as a de-facto DFI. It should be noted that Japan also carries out private sector engagement through its institution, the Japan Bank for International Cooperation (JBIC); however this institution is primarily a Japanese entity.
- **Switzerland** engages in blended finance through what it calls its 'private sector engagement' strategy, operating through the Swiss Agency for Development and Cooperation (SDC) and SECO, which is complemented by its DFI Swiss Investment Fund for Emerging Markets (SIFEM).
- **Netherlands** operates its development programming through thematic directorates that sit within the Dutch Ministry of Foreign Affairs (MFA), which also houses its DFI FMO, and delegates investments via intermediaries and investment funds.
- **UK's** blended finance programming is done through its DFI British International Investment (BII), which is 100% owned by FCDO, along with MOBILIST, UK Export Finance, British Support for Infrastructure Projects (BSIP) and externally through PIDG.
- **Denmark** operates its blended finance programming through the Danish MFA, which is assisted in implementation by its DFI IFU.
- **Luxembourg** has housed its funding capacities within the Ministry of Foreign and European Affairs and has decided to not operate through a DFI following two rounds of consultations within the Ministry of Finance (MOF).

Various levels of collaboration and institutional cooperation exist within the organization matrix reviewed. For example, Sida notes minimal partnership with DFI Swedfund, while JICA highlights an uncommon level of autonomy in its organizational architecture with respect to its interaction with Japan's ministries. What is consistent is that all donor countries profiled are currently building or augmenting their internal capacity for blended finance to establish forward practices to increase cooperation, maximize development results, avoid duplication, and ensure that scarce resources are appropriately directed.

The following table provides a comparative view of donors, organizational composition, instruments used, and institutional mandates.

DONOR COUNTRY	FINANCIAL INSTRUMENTS USED	IN-HOUSE VS OUTSOURCED	DFI	DFI OWNERSHIP STRUCTURE	BILATERAL OR MULTILATERAL CONCESSIONAL FACILITIES FUNDED BY DONOR	SPECIALIST VS GENERALIST	GENDER MANDATE
Australia	Originated in-house: grants, debt, equity, guarantees Originated by third-party: grants (returnable / non-returnable), equity, guarantees, debt (direct / indirect)	In-house via Australian Department for Foreign Affairs and Trade (DFAT): Australian Infrastructure Financing Facility for the Pacific AIFFP, Investing in Women Outsourced via PIDG, Convergence, the Emerging Markets Impact Investment Fund (EMIIF) (managed by Sarona)	None	N/A	**Multilateral via Asian Development Bank (ADB):** Australian Climate Finance Partnership (DFAT-funded blended finance facility housed at ADB	**Regional specialist** for Southeast Asia and the Pacific and **thematic specialist** in gender and climate	Gender mainstreamed across all funding pathways, including PIDG, Convergence, and EMIIF. Created Investing in Women, a grant program that invests in women's empowerment.
Japan	Originated in-house: grants, debt (commercial / concessional), equity (direct / indirect)	In-house via JICA's Private Sector Investment And Finance Scheme (PSIF)	None[3]	N/A	N/A	**Generalist:** Supporting the SDGs and supporting infrastructure and economic growth	Assesses investment alignment with 2X Challenge or DAC gender equality policy marker criteria.
Norway	Originated in-house: grants (including subsidies for guarantees)	In-house via Norwegian Agency for Development Cooperation (Norad)	Norwegian Investment Fund for Developing Countries (Norfund)	Norwegian MFA	**Bilateral via Norfund:** Climate Investment Fund Norfund Business Support	**Generalist:** Climate finance, education, energy, health, financial inclusion and oil for development	Assessed in all development assistance activities. Has begun to support blended finance transactions focused on gender.
Sweden	Originated in-house: grants (incl. technical assistance), guarantees Originated by third-party: grants (returnable / non-returnable), equity, guarantees, debt (direct / indirect)	In-house via Swedish International Development Cooperation Agency (Sida) Outsourced via PIDG	Swedfund	Owned by Swedish Government and Managed by Swedish Ministry of Enterprise and Innovation	**Bilateral via Swedfund:** Swedfund Project Accelerator Swedpartnership	**Operational specialist:** Guarantee deployment	Explicit gender strategy yet to be formalized due to change in government.
Denmark	Originated in-house: grants	In-house via the MFA of Denmark	Investment Fund for Developing Countries (IFU)	Government of Denmark	N/A	**Thematic specialist:** climate finance (nature based solutions, biodiversity), neighbouring areas of conflict	Gender incorporated across all development aid operations as a "checkbox".
United Kingdom	Originated in-house: grants, guarantees Originated by third-parties: grants (returnable / non-returnable), equity, guarantees, debt (direct / indirect)	In-house via: UK FCDO (including UK MOBILIST), UK Export Finance, British Support for Infrastructure Projects (BSIP) Outsourced via: PIDG	British International Investment (BII)	UK FCDO	**Bilateral via BII:** Catalyst Strategies Fund	**Thematic generalist:** Gender, humanitarian, climate finance	Gender embedded into all development aid operations. At least 25% of BII investments must qualify for the 2X Challenge criteria
The Netherlands	Originated in-house: Primarily grants, capacity for debt, equity, guarantees Originated by third-parties: grants (returnable / non-returnable), equity, guarantees, debt (direct / indirect)	In-house via the MFA (Dutch MFA) Outsourced via: PIDG, Dutch Good Growth Fund, Investment Funds	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO)	Dutch Government (51%), Dutch Banks (42%), Employers' Associations (7%)	**Bilateral via FMO:** MASSIF (The Micro and Small Enterprises Fund) Land Use Facility Under Dutch Fund For Climate And Development Building Prospects Fund Access to Energy Fund FMO Ventures Program	**Thematic generalist:** Economic development, social development, climate finance, humanitarian	Increasingly incorporating gender lens investing with an integrated equality focus targeting incomes
Government of Luxembourg	Originated in-house: primarily grants (incl. technical assistance), Guarantees	In-house via: Ministry of Foreign and European Affairs Outsourced: Luxembourg-EIB Climate Finance Platform, International Climate Finance Accelerator	None		N/A	**Generalist**	Early stages of supporting gender-focused initiatives Most gender activity routed through multilateral partnerships, but internal gender KPIs exist for all development aid work.
Switzerland	Originated in-house: grants (incl. technical assistance), first-loss (debt / equity), guarantees, RBF Originated by third-parties: grants (returnable / non-returnable), equity, guarantees, debt (direct / indirect)	In-house via: State Secretariat for Economic Affairs (SECO), Swiss Agency for Development and Cooperation (SDC) Outsourced via: PIDG, Investment Funds	The Swiss Investment Fund for Emerging Markets (SIFEM)	Government of Switzerland, oversight from SECO	**Bilateral via SIFEM:** Swiss Investment Fund for Emerging Markets (SIFEM) – Least Developed Countries (LDC) Risk Support	**Thematic specialist:** Economic reform in middle-income countries	Assess on gender can be best incorporated into all development aid operations, but currently little in terms of gender-exclusive work.

Table 1

[3] The Japan Bank for International Cooperation (JBIC) is not categorically considered a DFI but does perform similar functions as other national DFIs. The independent public financial institution is wholly owned by the Japanese government and was formed through the merger of the Japan Export-import Bank and the Overseas Economic Cooperation Fund. JBIC operates in both developed and emerging markets and is one arm of the Government of Japan's ODA mandate.

PART II

KEY LEARNINGS AND BEST PRACTICES

PROGRAM BUILDING IN CONTEXT

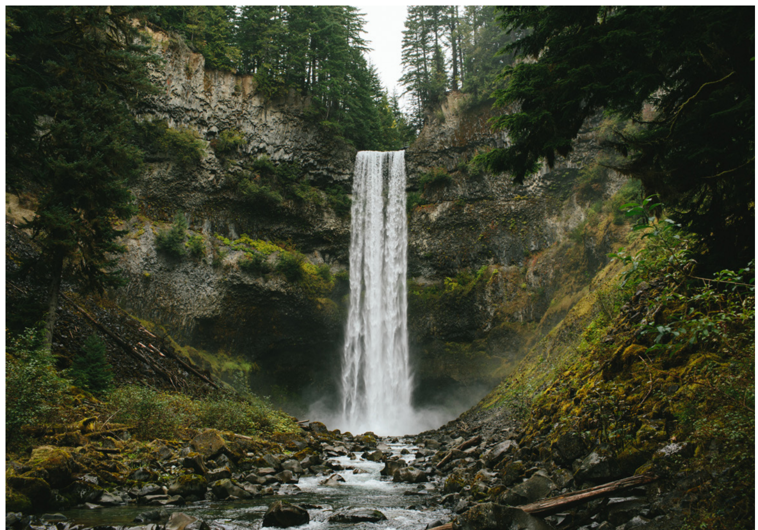
BROAD CHALLENGES

Donors are the primary source of the catalytic funding through which private financing can be mobilized (by adjusting the risk-return profile of transactions in emerging markets), but they have not prioritized and budgeted private sector mobilization as a necessity to significantly narrow the SDG financing gap. Only 2-3% of ODA is directed annually toward private sector mobilization, and very few MDBs or DFIs have meaningful mobilization targets and activities. Additionally, donors often lack the necessary skills and knowledge to engage the private sector effectively. Donors are thus faced with the challenge of designing blended finance programs that can efficiently and effectively draw in private sector investment that delivers development impact.

EFFECTIVE PROGRAM BUILDING

To build more effective blended finance programs, donors must assess their institutional mandates and designs and align them with a longer-term strategic vision that considers their historical institutional contexts and areas of comparative advantage. Donors must also decide upon a blended finance participation model, whether in-house (internal) or outsourced (external), while considering macro, mezzo, and micro factors, such as regulatory, budgetary, policy, and political influences. Forward-thinking leadership can also be critical to launching this process of reviewing, assessing, and ultimately reforming traditional grant-based models. In Norway, for example, gaining parliamentary approval to reform restrictive public financial management rules that mostly recognized grants was aided by investments in research undertaken by a forward-thinking Director General:

> *"There was a change in the top leadership in Norad three years back, with a new Director General who saw the need to invest in knowledge, with a view to restructuring the organization and developing a new strategy up to 2030. The Director General did something unusual; he set aside staff resources, hired external and internal researchers, and invested time and money in a knowledge project, which we called "Rethinking Development Assistance Towards 2030". This investment in knowledge products helped to convince people within Norad, and then the MFA, and then the financial sector as represented by their industry associations, of how private sector mobilization and blended finance could address the SDG financing gap. Following this first phase, the Norwegian MFA commissioned more written works to elaborate on these themes."*



To effectively plan transformation pathways, donors will need to carefully evaluate their position within the development finance ecosystem, as this can significantly impact their program's success. Donors should establish clear objectives when creating or reconfiguring programs and determine the most effective internal or external pathway for executing mobilization efforts. This involves thoroughly evaluating the organizational structure and identifying specific roles to be pursued, such as implementer, facilitator, manager, or structurer of blended finance or private sector mobilization programs. One respondent noted the importance of defined roles in donor collaborations:

> *"Overall, we have extreme institutional inertia and fragmentation within the sector and have all grown into our various mandates. Everybody wanting to have a flag on different financial products and not really finding the economics of scale brings us back to this question of in-house versus outsourcing or developing further products. By outsourcing I think we need to think twice before we start developing our own in-house products and further fragmentizing the landscape. Rather, we should be trying to work in broad collaborations across the board as this is a very dynamic field. We're all still trying to learn. We're all trying different ways in which we can continue to face some of the challenges out there in how we design things."*

DESIRED ROLES AND OTHER CONSIDERATIONS

Donor agencies should be purposeful and intentional about their objectives when building or restructuring programs while considering strategic modes of engaging the private sector. For instance, one country may focus on managing programs with third parties, while another may opt for an in-house deployment model. FCDO takes an experimental approach by first testing higher-risk investments and nascent markets, which, once proven, are pioneered by BII in the DFI space.

To effectively design their programs, donors need to have a clear understanding of their history, current objective, and desired role and mode of participation. This requires evaluating blended finance participation models and analyzing the implications of incorporating a DFI in its organizational architecture. In-house participation may offer greater impact and mobilization potential, while outsourcing may require fewer resources and less capacity building. However, in such models, the parties to whom the programs are outsourced likely have their own interests and priorities, which could reduce control and influence for the donor. Further, certain historical configurations might enable or impede intended program construction. For example, one donor government's long-standing financial relationship between public and private sectors has eased present sustainable finance initiatives and has allowed funding capacities to be managed within the Ministry of Foreign and European Affairs directly. Norad, however, continues to contend with historical regulatory and policy constraints that inhibit in-house program expansion objectives. Ultimately, by considering these factors and trade-offs, donors can determine available options and decide on the most effective approach for their program design.

Key Takeaways:

While donors have been active participants in blended finance programs, they must remain mindful of their objectives and consider how their position within the development finance ecosystem best supports their stated goals. To do this, donors will need to be deliberate about setting their course by evaluating three areas of work: (i) determining whether their objective is to channel funding towards public sector projects, private sector projects, or both. (ii) scanning which institutions are already delivering on their stated mandate and an assessment of the gap between their own in-house capabilities and the skills needed to operate independently, and (iii) weighing the issues of timeline, budget, and program control.

ENVIRONMENTAL FACTORS

Blended finance programs within donor agencies have been shaped by environmental factors operating at two key levels: (i) the strength of domestic ecosystems of financial intermediaries and the extent of donors' histories of private sector engagement; and (ii) the development goals set by the political class, and the extent to which donor agencies see private sector engagement as an avenue to achieve them.

DOMESTIC ECOSYSTEMS OF FINANCIAL INTERMEDIARIES AND DONORS' HISTORIES OF PRIVATE SECTOR ENGAGEMENT

The strength of domestic ecosystems of financial intermediaries and the extent of donors' experience in private sector engagement affects: (i) the institutional and political buy-in to mobilizing the private sector for development; and (ii) whether donors' blended finance programs can operate via networks of third-party implementers, or whether this implementation capacity must be developed internally within the donor agency.

INSTITUTIONAL, POLITICAL, AND CULTURAL BUY-IN TO BLENDED FINANCE

Donors with stronger domestic ecosystems of financial intermediaries and longer histories of private sector engagement generally face fewer challenges in establishing the positive force of blended finance. As noted by one donor, its country's status as a first-class center of international finance quickened the acceptance that finance can make positive social change, in alignment with the broader mandate of its MOF to make finance more sustainable. Similarly, while SECO does not explicitly use the term 'blended finance' in its communications, because it can become quite technical and too hard to explain to parliamentarians and NGOs, they have found greater success with the broader terminology of 'private sector engagement' in which they have a multi-decade pedigree.

Donors with shorter histories of private sector engagement, meanwhile, have tended to face larger challenges in obtaining political buy-in. Our respondents from the Danish MFA, for example, recalled that with ministries of finance generally not used to investing in higher-risk development aid countries, convincing the Danish MOF of the benefits of the guarantee instrument took one year, supported by presentations from Swedish Sida:

> *"Sida came to visit us and did a presentation on the guarantee instrument to our MOF. We also brought our MOF colleagues to Sida, to understand the underlying data from the past decade. Our MFA also formed a steering committee with the MOF and presented three papers which answered three questions: (i) is there a need for development guarantees in the world; (ii) how does the Swedish model work in terms of data, structure, the balance sheet, the income statement etc., and (iii) how would the governance side of it be structured, to ensure there was a separation between the political level and the risk assessment."*

EXTERNAL AND INTERNAL IMPLEMENTATION OF BLENDED FINANCE

The different partnership and collaboration models commonly navigated by donors can be conceptualized on three levels: (i) intra-institutional, or donors' partnerships with their DFIs; (ii) inter-institutional, or donors' collaboration with third-party implementing agencies; and (iii) collective cross-donor partnerships, such as the collaboration between the guarantee programs of Swedish Sida and the Danish MFA. While considering each model, donors should evaluate the trade-off between "high development impact" and "scale mobilization" as the latter will almost always require partnerships/collaboration with other donors.

Donor agencies with stronger domestic ecosystems of financial intermediaries have tended to operate their blended finance programs externally through a network of third-party implementing partners. One donor, for example, noted that the strength of their domestic financial ecosystem enabled them to conduct blended finance via public-private partnerships and a network of implementing agencies, while Swiss SECO's history of private sector engagement stretches back to investing in impact funds through first-loss investments and technical assistance in the 1990s. Indeed, it was based on the critical mass of private sector organizations active in Switzerland and globally that Swiss SECO launched SECO17, an open, competitive call for technical assistance for funds contributing to SDGs 8 (Decent Work & Economic Growth) or 13 (Climate Action). Swiss

SECO followed SECO17 with the SDG Impact Finance Initiative, in which private sector organizations like UBS Optimus Foundation and the Credit Suisse Foundation participated as founding members.

Under this model, there is a demarcation between the ministry formulating its development policy, and their implementing partners being sourced and then provided with the subsidies and other instruments needed for them to achieve this policy. Grant funding provided by donors, for example, can then be converted by their implementing partners into market-based instruments like debt and equity. Donor agencies operating through such networks will still rely, however, on strong internal capacities to effectively engage with their private sector partners, including by recruiting staff with the requisite financial skillsets. This in turn is easier in countries with stronger domestic ecosystems of financial intermediaries. Strong internal capacities also allow donors to effectively direct implementers in achieving specific development objectives, giving donors a degree of control even under this external implementation approach.

Meanwhile, donors with shorter histories of private sector engagement have sometimes focused on building their internal capacity to implement blended finance programs themselves, leveraging the practical knowledge of donors with greater experience in mobilizing the private sector for development. The Danish MFA, for example, has prioritized building the internal capacity of its DFI, IFU, to deploy guarantees by leveraging an institutional partnership with Swedish Sida in a pilot program running to 2025, and is currently working to develop IFU's own risk assessment capacity, to be able to complete transactions without depending on risk assessments from the Swedish Risk Analysis Public Office.

THE DEVELOPMENT GOALS OF THE POLITICAL CLASS

The development goals set by the political class and the extent to which donor agencies' leadership conceptualizes private sector engagement as an avenue to achieving them have also shaped how different donors' private sector mobilization programs have developed. Private sector mobilization has emerged mainly on an opportunistic basis within donors rather than as a set pillar of development policy. Of all the donors interviewed for this report, only UK FCDO has specifically enshrined private sector mobilization as an explicit goal within its development strategy. Under the British Investment Partnerships (BIPs) toolkit, the UK has committed to mobilizing £8 billion a year by 2025 in UK-backed finance for low-income countries. For most other donors, private sector mobilization has historically been a peripheral concern, appearing mostly as a new strategy for governments to be more efficient with limited ODA funding or to achieve specific SDG goals, with mobilization targets often left unquantified and private sector engagement teams often being under-resourced.

Donors look to develop areas of comparative advantage within their blended finance programs, based not just on the strength of the domestic private investment community and their history of private sector engagement, but also according to the development goals set by the political class. A key question for donors to answer relates to the breadth of the development mandate their private sector mobilization programs will serve, which in turn will reflect donors' political priorities and their institutional and economic capacities. For example, donors like Swiss SECO and JICA have opted for broader development mandates, with Swiss SECO focusing on promoting economic reform in its (typically middle-income) priority countries, while, the Danish MFA has adopted a more specific focus on the green climate transition and fragile states.

Key takeaways:

Overall, in designing their blended finance programs, donors should consider the unique political, economic, and financial configurations of their national contexts and the depth of their experience in private sector mobilization, seeking out their areas of comparative advantage and leveraging the economic and financial institutional resources already available to them.

ARCHITECTURE, MANDATE, AND STRATEGY

A core decision for donors revolves around whether to create a separate DFI with the explicit goal of financing private sector development. DFIs have played an increasingly crucial role in leveraging private financing to achieve the SDGs. While DFIs have significant financial resources (in 2017, bilateral DFIs managed over $65 billion in assets) they are also grappling with how to boost the amounts that they invest in low-income countries, and how to effectively mobilize private commercial capital rather than potentially crowd out investors. In this context, DFIs have viewed blended finance specifically as a solution to increasing private sector mobilization.

DONORS WITHOUT DFIS

Three of the nine donors interviewed do not have DFIs: Japan, Luxembourg, and Australia. This can be attributed to various factors, including: (i) an already existing close collaboration between the MFA and the MOF and an embedded culture of working with the private sector; (ii) in-house programming equipping the donor's internal private sector mobilization unit with a toolkit and autonomy comparable to a DFI; and iii) existing external programming and implementation agencies effectively carrying out the functions of a DFI.

For example, a review conducted by one donor country's MFA and MOF concluded that that they would be better placed to use their comparative advantage, namely a vibrant investment community and conducive regulatory regime, by investing via investment funds rather than developing a separate DFI. Moreover, the close collaboration between the government's MFA and MOF means that decision-making is simplified without the presence of a DFI. As a representative noted:

> *"The fact that [our government] doesn't have a DFI means that we can literally go straight to the Minister [for decision-making]."*

In contrast, in lieu of an external DFI, JICA houses many of the functions and capabilities of a DFI within its PSIF scheme, which has the authority to deploy corporate loans and equity. Australia, meanwhile, is currently undergoing a Development Finance Review to investigate the need for a DFI. Australia currently deploys its private sector financing through both in-house programs (AIFFP), investment funds (EMIIF), and external entities (PIDG, Convergence).

DONORS WITH DFIS

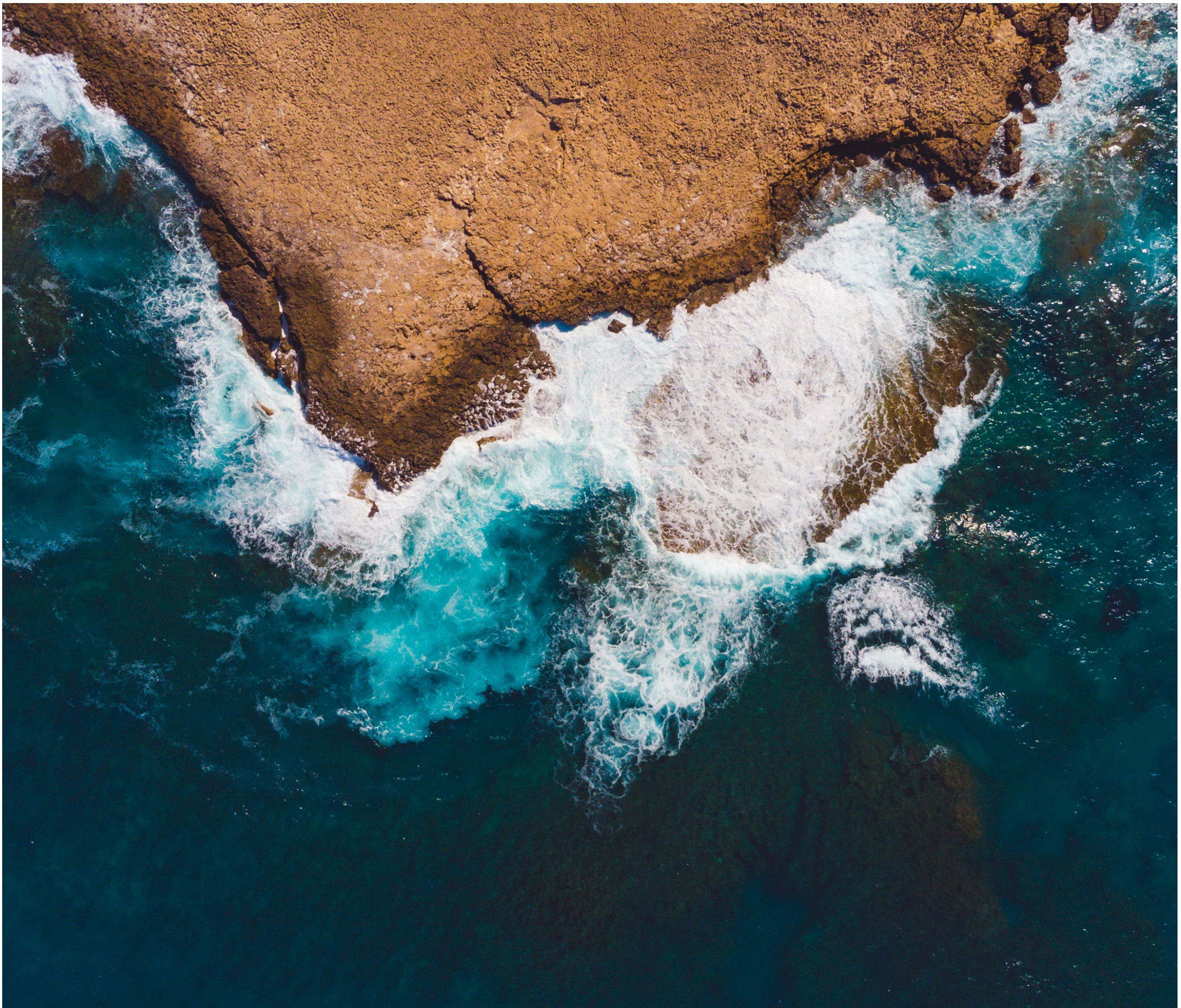
Most interviewed donors (six out of nine) are in countries with DFIs: Swiss SIFEM, Dutch FMO, British BII, Swedish Swedfund, Norwegian NORAD, and Danish IFU. The levels of collaboration and strategic coordination between donors and DFIs vary. However, in all cases, the donors' core considerations are similar, including:

- (i) how best to harness and leverage their comparative advantage as a donor agency vis-à-vis the DFI;
- (ii) how donors can deploy their financing to be most catalytic;
- (iii) how much mobilization should occur directly and indirectly; and
- (iv) how much concessional capital should be made available to the DFI (See Tables below).

DFIs are guided by their mandate to operate on commercial, market-rate terms. In recent years, DFIs have been critiqued for not taking on greater investment risk, for example, by investing in least developed markets or in the health and education sectors. The conservative investing profile of DFIs is partly due to the capital adequacy ratios required by their government shareholders, which mandate high amounts of reserved capital, as well as their desire to maintain high credit ratings which allow them to borrow at low interest rates in the global capital markets.

Development agencies can take on a strategic role here, by incentivizing DFIs to invest using new instruments or new markets. For example, some donor agencies have chosen to take on a leadership role in incubating and piloting new financial instruments or programming. The Danish government has similarly employed this approach with piloting its guarantees. The Danish MFA has worked closely with Sida to understand the instrument and encourage the Danish MOF to approve the financial instrument, which will be housed within IFU until a political mandate is secured to continue it permanently.

Importantly, DFIs have increasingly looked to blended finance as a strategy to increase their ability to invest in riskier markets and sectors. DFIs defined blended finance, as adopted by the DFI Working Group on Blended Concessional Finance for Private Sector Projects, as



"combining concessional finance from donors or third parties alongside DFIs' normal own account finance and / or commercial finance from other investors, to develop private sector markes, address the SDGs, and mobilize private resources." DFIs therefore view blended finance, in which concessional funding is provided by donors, as a strategy to de-risk their own commercial financing first and foremost, with the mobilization of third-party private finance constituting a secondary goal. Convergence analysis finds that the majority of investments made by DFIs into blended finance transactions are on commercial terms (75%), with concessional investments accounting for only 25% of investments. Convergence's recent Data Brief on Leverage Ratios found that for each $1 of concessional finance, $4.1 of commercial finance is mobilized, with approximately $2.3 provided by MDBs and DFIs. Similar data was reported in the DFI Working Group on Blended Concessional Finance for Private Sector Projects in their 2023 Update; in calendar year 2021, DFIs provided $1.9 billion in concessional funds, leveraging $5.3 billion in their own DFI investments, and a lesser $4.6 billion in private sector finance.

To this end, all DFIs, with the exception of IFU, host concessional facilities capitalized with donor funding. The volume of concessional capital provided to DFIs varies widely; as evidenced from the below table, FMO hosts the largest number of bilateral concessional facilities (pools of financing provided bilaterally from donor countries to be deployed by national DFIs). Not surprisingly, FMO has recorded the highest number of concessional capital commitments across all DFIs, given its high volume of concessional facilities.

BILATERAL DFI	CONCESSIONAL PROGRAM
Swiss Investment Fund for Emerging Markets (SIFEM)	SIFEM – Least Developed Countries (LDC) Risk Support
Netherlands Development Finance Company (FMO)	Pipeline development, investor outreach, developing pitch deck and business plan, conducting gender analysis
	Land Use Facility via the Dutch Fund for Climate and Development
	Building Prospects Fund
	Access to Energy Fund
	FMO Ventures Program
British International Investment (BII)	Impact Fund
	Catalyst Fund (also Catalyst Strategies)
Swedfund	Swedfund Project Accelerator
	Swedpartnership
	Funds for Technical Assistance
Norfund	Business Support Facility (earlier Norfund Grant Facility)
Investment Fund for Developing Countries (IFU)	None

Table 2 [4]

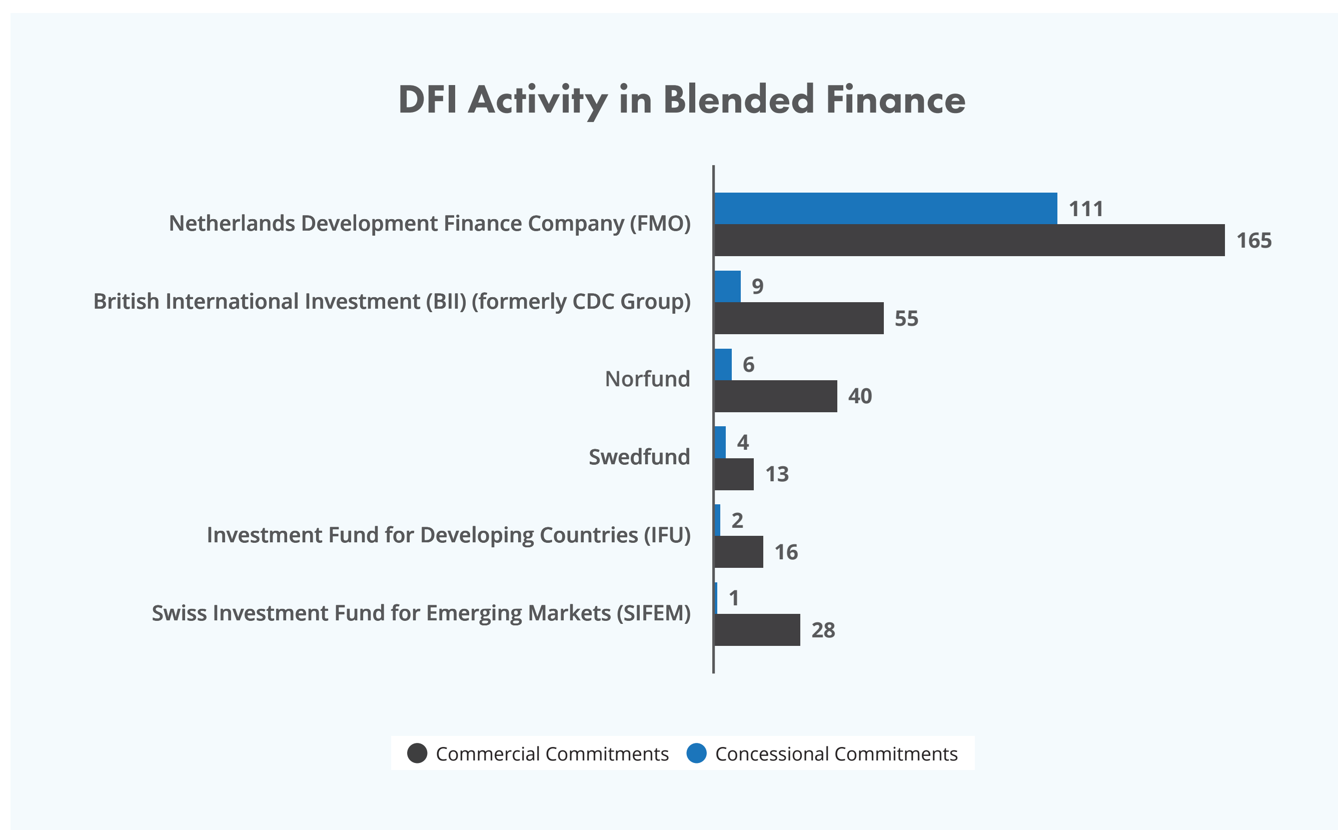


Table 3: Number of financial commitments made by select DFIs on concessional vs. commercial terms to blended finance transactions (Captured across all time periods in Convergence's Historical Deals Database)

[4] Note, this Table does not include concessional financing provided by donors to multilateral development banks (e.g., the Australian Climate Finance Partnership is a DFAT-funded blended finance facility housed at the ADB, or multi-donor concessional facilities such as the Green Climate Fund).

DONOR-DFI AUTONOMY

DFIs are mostly autonomous from donor agencies when fulfilling their day-to-day operations. However, donor governments can exercise influence over DFIs by providing them with concessional resources to experiment with investing in low-income markets.

For example, one donor shared that they provide a high degree of autonomy with regards to how the DFI invests its capital and its activities on the capital markets:

> *"We [MFA] jointly set their [DFI] strategy for the coming five years in collaboration with the MOF. After that, the implementation is up to [DFI], and we don't intervene. We don't sit on their board of directors or their investment committee; it's all up to them."*

Nevertheless, donors can better support low-income countries and additional sectors by equipping the DFI with a risk-tolerant, off-balance sheet pool of capital. This gives the DFI the flexibility to do high-risk activities without exposing its balance sheet, where its more traditional banking business resides.

For example, as its sole shareholder, FCDO expects BII to undertake risks and challenges when investing, by providing it with "the balance sheet and tools" that enable them to extend their risk appetite for higher impact investments. FCDO also ensures development impact through BII's Impact Score, which is a key performance indicator reported to FCDO.

As with other donors and their DFIs, FCDO sets the overarching strategy for BII but does not interfere with its investment decision-making. As shared by FCDO:

> *"BII needs to be able to work in a commercial manner in order to mobilize, to gain the trust of potential private sector partners their investment decisions need to be seen as free from political interference".*

Similarly, part of Swiss SECO's concern in building its private sector mobilization practice was to ensure that a "shadow [duplicate] DFI" was not established internally within SECO, and instead to look to see where it could be complementary to the commercial activities of its DFI SIFEM. As shared by our respondent:

> *"SECO, in consultation with the Ministry of Finance, supervises SIFEM, and it intends to ensure that the DFI ultimately remains commercially oriented, since positive returns in developing markets are needed to provide a demonstration effect to the private sector, and too much of a subsidy element detracts from that."*

To this end, SECO's early investments were transferred to SIFEM, and SECO focused on assuming additional risk by deploying concessional funds. In a similar vein, the Danish government placed its guarantee instrument within the Danish DFI IFU to ensure sufficient separation between political considerations and investment risk assessments. Like the off-balance sheet funds created at [another DFI], Swiss SDC has also provided concessional funds to SIFEM to enable it to experiment with issuing partial guarantees in more difficult, low-income markets.

Donors have also provided additional assistance to their DFIs. For example, after setting its overall thematic and geographical strategy, the Danish MFA has helped IFU with networking at the intersection between specific asset managers and owners and political discussion forums and has also set up a project development facility in IFU to improve project origination.

Key takeaways:

There is widespread agreement that DFIs should be given a high-level of autonomy from development agencies to make prudent investment decisions and operate commercially. Yet, donors should play a strategic role in incentivizing DFIs to be catalytic and prioritize impact. To this end, it is advisable that donors form a complementary and coordinated relationship with their DFI to avoid duplication of effort. This could be through awarding concessional funding with the intent of achieving specific targets on a catalytic basis. This could be to invest in new regions, investment instruments, or markets, or to prioritize third-party mobilization as an express goal, beyond the DFI's own financing. In order to ensure additionality, impact frameworks can provide important assurance to shareholders that their funding is being used to achieve high development impact.

EXAMPLE: BII'S IMPACT SCORE (2022-2026 STRATEGY PERIOD)

For 2022-2026, BII developed an Impact Score to replace the Development Impact Grid which had previously been used since 2012, as one of they key performance indicators reported to FCDO.

BII's impact score is comprised of a productive score (raising productivity of economy) + sustainable score (climate impact) + inclusive score (reaching low-income populations and gender). The sum of three scores will result in a Total Impact Score, which can range from -1 to 10.

Impact score	= Productive score	+ Sustainable score	+ Inclusive score
What does this mean?	Raising the productivity of an economy so that it can support a decent standard of living for all.	Helping transform the economy to reduce emissions, protect the environment and adapt to the changing climate.	Sharing the benefit of higher productivity and greater sustainability with poor and marginalised sections of society
How will we measure it?	1. Degree of need 2. Intensity 3. Economic enablers 4. Catalysing markets	1. Climate mitigation 2. Climate adaptation and resilience	1. Reach to low-income populations 2. Poor and fragile countries 3. Gender and diversity

A particular area of interest is the "catalyze markets" measurement under the productive score. This indicator is closely tied to the issue of private sector development and mobilization; the score assesses key factors such as: i) pioneering new business models that can be replicated, ii) reinforcing demonstration, and iii) improving the enabling environment. Indeed FCDO and BII see catalyzing markets as a key component and precursor to "private sector mobilization". As shared by FCDO *"We want BII to be catalyzing markets, which will eventually mobilize more private finance"*.

Another point of interest is the "gender and diversity" indicator under the inclusive score. Additional points are awarded for investments that meet the 2X Challenge criteria to determine which investments enhance women's economic participation. The UK has set a new target for 25% of all new investments to qualify under the 2X Challenge.

All investments will be re-scored at regular intervals to track whether they are performing against their original thesis. Scores can remain constant or move up or down depending on performance. A re-score will automatically be triggered at exit.

More information can be found here.

CAPACITY AND SKILLS

Although there is recognition of the need to retain and build in-house capacity across the donors profiled in this study, there is an evident incongruence between existing capacity and financial skills required for innovative finance, blended finance, and private sector mobilization. Further, developing policy, assessing programs, and interacting with DFIs and other finance partners require a certain level of skill and capability that may not always be readily available within donor organizations. Subsequently, this challenge has directly impacted program building and design and is a consistent barrier for donors.

As financial expertise is necessary to develop blended finance programs and work closely with the private sector, donor agencies should consider the following four themes as they develop and strengthen resources and capacity relating to this skill set.

First, donors must identify their theory of change motivating the build-up of capacity by recognizing the skills and expertise gaps and determining why and how they can be overcome. Understanding the logic will enable donors to evaluate whether capacity is being built for the right purpose. For example, as a donor, are you looking to participate through an in-house blended finance model, capitalize and manage external parties, create coalitions across institutions, improve generalists, or specialize in a specific instrument?

Second, capacity building should be intentionally linked to other stated development objectives, mandates, and/or instruments. For example, a donor might aim to bolster private sector engagement in a specific region like the Asia Pacific or for a particular segment such as infrastructure. There might also be an intention to deploy a certain instrument like guarantees or implement and evaluate a clear mobilization strategy like blended finance. In each case, a precise financial skill set is needed to execute the stated objectives as well as improve efforts to take on central roles in institutional knowledge building across an organization.

Third, after identifying the private sector skills required and linking that capacity building to an objective, donors should unpack the future direction and define time horizons in longer terms. Although new program design might be in five-year windows, it could take longer to build capacity. The donor has to anticipate where the market is going beyond the exact programming interval.

Finally, donor countries should reflect on an incentive structure to help sustain a capacity building and talent retention model. As one donor points out, *"Several people come here for the mission, and it's difficult to make the package attractive."* Another donor similarly explains, *"Our biggest concern is how to make those jobs interesting enough to get the right people in. You need to have people that left the private sector purposely and want to go back, to be frank. But that often comes at a cost financially."* Financial sector salaries are typically higher, and while some donors have managed to get some flexibility in their salary structures, there are often rigid legal and institutional constraints like state budgets that prevent modifications. As a result, the narrative of incentives and being able to build a story around visible results becomes imperative.

In practice, different donors contend with the capacity and skills challenge in various ways. For example, SECO has tried to build the private sector expertise of staff within its different operational divisions: *"[SECO] is creating a common understanding of 'private sector engagement' across the organization by placing a private sector engagement liaison within every operational division. The private sector lead in the private sector development division organizes exchanges amongst these liaisons approximately three times a year. In this way, SECO looks to ensure that there's a common understanding of private sector engagement; currently, there's a lack of understanding about the subsidy element, or how to go about engaging the private sector efficiently and effectively."*

Meanwhile, another donor agency has remained more generalist in focus, electing to shift the skills burden onto implementers. *"By making sure that everything we do is being carried out by implementers, we also move the problem of limited blended finance expertise away from the ministry towards implementers to find the people with the skillsets to work with blended finance. Those organizations are often very capable of finding the right people to do the job, so there's not a big concern there. It is also difficult to get financial specialists within ministries of foreign affairs."*

Sida has attempted to align capacity building with instrument deployment. *"Capacity to help build the more advanced guarantee structures [is] being placed at our various embassies or financial hubs globally. We are looking at other instruments within the blended finance portfolio and determining whether we should now have a a centralized hub where we keep certain capacities."*

Norad contemplates capacity building against its institutional regulatory and policy barriers and further incorporates their DFI in a capacity and talent building model. *"Now when we are trying to work more on blended finance with financial instruments, we do see several challenges on building up staff skills. As an older agency, we are bound by the salary structure of the public sector and regulatory constraints where we need Parliament approval to expand the room to maneuver. We also maintain good enough dialogue with our national DFI and can identify where we have complementarities and get their buy in [on] joint efforts."*

In order to effectively address the myriad considerations and apply an appropriate capacity building approach, donor governments will need to reflect on available options, outcomes, and trade-offs. For example, one donor resolved the lack of financial structuring capacity in its MFA by drawing on the country's strength in investment funds, resulting in the absence of a DFI. In this sense, conclusions formed on the capacity gap have informed program management and design and indirectly shaped the participation model employed.

Alternatively, when the capacity gap is addressed as a variable that must be solved for in-house, it can more directly impact program construction and drive institutional design. This is demonstrated by the Danish MFA's focus on deploying specific instruments and developing thematic specialists to drive their in-house mobilization program. Donors can make more informed decisions about their institutional structure and participation models by recognizing the capacity gap as a crucial component that influences program design.

Key takeaways:

Donor countries can choose to tackle identified capacity gaps within their donor agencies broadly by building internally or finding expertise in their institutional surroundings. But more specifically, identifying the gap can also inform a country's program design decisions, like setting up a DFI. The study suggests that there is some advantage in delivering through a DFI as there is less needed capacity building and incentivization for talent retention. Consider the Danish example compared to other donors without DFIs. While some governments elected to forgo creating a DFI, the Danish MFA has used its DFI to address its capacity gap: ***"While building the specialized skillsets of finance and blended finance within the MFA would be useful, the main instruments are deployed by IFU, which already has more specialized finance staffing."*** The trade-off then becomes balancing ambition and ability. To strike the right balance, donors should weigh the pros and cons of internal versus external participation in blended finance. While the former can bring about significant impact, addressing associated capacity gaps and skill constraints requires a long-term strategic plan. In contrast, the latter is more immediately achievable but may only partially align with institutional mandates and result in mostly short-term outcomes.

FINANCIAL INSTRUMENTS

While the toolkit of financial instruments offered by donors varies, most governments continue to prioritize grants (non-repayable capital) as their primary instrument. For many donors, grants remain the easiest instrument to deploy because of their fit within ODA criteria. Nevertheless, some donors possess a more robust toolkit of financial instruments including loans and equity capital. Moreover, guarantees have been prioritized as a specific tool for some donors (Swedish, Danish).

GRANTS

Many donors have confronted limitations with grants in the following ways i) providing grants directly into investment vehicles or implementing agencies that function as risk-bearing capital, for example as first-loss debt or equity, ii) capitalizing intermediaries with grants, iii) using grants to subsidize other financial instruments such as guarantees, iv) and using grants to establish new programs with partners. We explore these strategies below:

i. **Providing grant capital as direct investments that function as risk-bearing capital:** one government deploys grants directly into investment funds, which serve as first-loss debt and equity. Speaking to this, representatives of this government shared: *"We've set up a range of first-loss tranches, including in SDG500 and Agri-Business Capital Fund."* Similarly, another donor agency mostly deploys grants, but targets the private sector via investment funds and in-house concessional programs, *"We have twenty to twenty-five programs that convert our grant funding into more market-based instruments."*

ii. **Intermediaries:** Donors may also capitalize external programs with grant funding, and these programs go on to conduct investment activity. A good example of this is GuarantCo; the entity is capitalized with grants and provides guarantees for local currency loans.

iii. **Workarounds with grants:** In addition to capitalizing investment funds and implementing agencies, the Norwegian government shared an innovative approach they are using to support guarantees with grant funding. While they cannot deploy guarantees, they can use grants to pay for subsidies on guarantee premiums (up to $25 million).

iv. **Grants beyond blended finance:** Lastly, donors also shared how they use grant funding to engage with the private sector in strategies that target private sector mobilization but not always strictly blended finance.

To this end, it is important to consider what ultimate development goal the government is looking to achieve, and whether blended finance and grants at the deal level are appropriate or whether other interventions are better suited. As shared by the Swiss: *"It may not always be about more blending; rather, it may be important to look at other things; is the competition policy in the developing country at hand fit for purpose? Are there other regulatory impediments preventing investments? Beyond just focusing on greater subsidies, blended finance practitioners should advocate for more structural reforms and analyze why some investments do not happen in certain sectors."*

Another donor government offering similar thinking: *"We've been looking more for solutions without blended finance, because we feel that sometimes markets get distorted by the large amounts of blended finance currently being deployed and might hamper investors looking to enter markets without blended finance. These conversations are also helpful to ascertain where our exit strategy could be; is blended finance needed because it's a first-time fund manager, and after they've gained experience, it's no longer needed; or is the sector intrinsically risky, and so blended finance will be needed longer term?"*

GUARANTEES

Guarantees have emerged as a tool of interest for donors in recent years, spurred by an increasing body of evidence documenting the instrument's mobilization potential and capital efficiencies. At the same time, introducing guarantees into the donor toolkit can be a complex and prolonged process, due to both staff capacity and policy hurdles. Below we summarize some of these experiences and strategies:

Developing donor partnerships – Sida and IFU: As profiled in Convergence's report, Profiling Sida's Guarantee Program, integrating guarantees as an instrument in-house can be a long but rewarding process. As such, it is recommended that donors looking to integrate guarantees within their

development program do so in close partnership with other development agencies. Sida and the Danish MFA provide an important example for the field here, whereby Denmark has launched a four-year pilot guarantee facility in partnership with Sida to build out its internal risk capacity and pilot the instrument until a political mandate and budget are secured.

Determining Guarantee Capacity: Another core consideration for donors is where the guarantee should be housed. Donors face the following options: i) deploy internally (e.g., Sida), ii) deploy via a DFI (e.g., the Danish via IFU), or iii) through a multilateral agency (e.g., PIDG). A variety of strategies have been employed here. The Danish government considered multiple options, including the IFU, the MOF, and National Bank. Ultimately, the Danish chose IFU, given its specialized skillsets and political autonomy.

Navigating Issues with Ministries of Finance and Treasury: A key consideration when integrating guarantees is how best to obtain approval from the respective government's MOF. For example, guarantees might have strict ceilings that prevent them from being deployed on a routine basis. Similarly, since guarantees do not qualify as ODA unless called, which happens rarely, there is little incentive for development agencies to deploy guarantees as part of their development budget. With overall ODA budgets shrinking for many donors, this incentive is reduced further, with other instruments being prioritized. Intermediaries such as PIDG provide good avenues for donors wanting to add guarantees to their toolbox who do not have expertise in-house. Moreover, partnerships are one strategy to bring Ministries of Finance onboard, as demonstrated through the experience of Sida and the Danish MFA.

Guarantees as a private sector mobilization tool: Given the above hurdles, guarantees have been prioritized by many donors on a select basis to achieve specific financing goals. A significant focus of Denmark's guarantees, for example, will be mobilizing climate finance. Another example is infrastructure, with multiple donors capitalizing PIDG, whose sole focus is infrastructure development.

LOANS

Donor agencies have incorporated loans into their financial toolkits both directly (direct loans) and indirectly (through implementing agencies and intermediaries). The following donors reported debt within their instrument portfolios: DFAT, JICA, FCDO, the Dutch MFA, and SECO, although the extent of deployment varied (for example, some donors reported that while they had the ability to lend, the majority of funding remained grants).

DFAT has found one interesting pathway for deploying debt through internal programming. Here, DFAT established AIFPP to expand DFAT's toolkit beyond grant financing, with a specific focus on the Pacific region. To this end, the program uses $500 million in ODA financing to leverage $1.5 billion in loans provided by Export Finance Australia, Australia's export credit agency. In this way, Export Finance Australia functions as the "back office" of AIFPP.

Meanwhile, on the indirect side, DFAT is also a shareholder of PIDG. Through this implementing agency, DFAT's funding is leveraged to provide loans and equity. Meanwhile, JICA can provide debt (corporate loans and project finance) through PSIF. Here, PSIF provides loans with ODA grants attached, whereby the grant must be more than 25%, which they achieve by setting longer maturities or lower interest rates than private financiers.

EQUITY

Equity is considered a challenging investment instrument for many donor governments because of the specialized expertise it requires to manage ownership of, and exit from, entities, and because of the political exposure that could come from having a shareholder role. As such, not many development agencies include equity within their financial toolkits. Consider the fact that many DFIs have only recently added equity to their suite of investment instruments (for example, one of the new authorities awarded to US DFC after its transition from the Overseas Private Investment Corporation (OPIC) was the ability to make equity investments). As such, among the donors, only FCDO and JICA can expressly invest equity. One noteworthy example is FCDO's MOBILIST program, enshrined under its BIPs.

Under MOBILIST, FCDO is providing equity and technical assistance to develop listed products that can absorb large flows of institutional capital into developing countries.

As discussed earlier, donors have also used grants to capitalize intermediaries that invest equity (e.g., PIDG), or provided grants directly into investment funds to serve as risk-bearing capital (e.g., first-loss debt or equity). One interesting example is DFAT's approach to equity, through the establishment of the Emerging Markets Impact Investment Fund (EMIIF). An investment fund set up by DFAT but managed by Sarona, the Fund uses non-grant financing to crowd in private funding and is managed through a trust. As a fund of funds, EMIF invests in SME funds or intermediaries, using debt and equity, that invest in SMEs. DFAT used some innovating accounting rules to fund EMIIF – instead of funding EMIIF under Bill 1, which is used for funding aid initiatives including PIDG and Australian Climate Finance Partnership, EMIFF was funded under Bill 2, which is for financial assets.

EXPERIENCES WITH MINISTRIES OF FINANCE, TREASURY, AND APPROVAL OF INSTRUMENTS

The MOF as well as Treasury departments are an important component of determining the budget and allocation of instruments for donors. Governments have employed different approaches when working with their respective Ministries to pilot new instruments and obtain approval. At the same time, complexities associated with this working alongside other Ministries have also incentivized donors to become more creative with how they deploy traditional grants. These experiences are elaborated on below:

As indicated earlier, donors will capitalize implementing agencies and intermediaries that deploy investment instruments such as guarantees as opposed to extending them directly. Expanding on challenges, one donor shared: *"Doing new guarantees is extremely difficult, because it would need approval from the MOF, and we have a regulation in our country instituting a ceiling per ministry on the number of guarantees that can be deployed."* As a result, the donor instead extends guarantees indirectly, through its role as a shareholder of GuarantCo.

While it is generally agreed that DFIs should be commercial to provide demonstration effects to the market, donors will capitalize their DFI with specific pots of grant capital meant to incentive the DFI to be more catalytic. As referenced earlier, although the Swiss DFI SIFEM does not have concessional funds beyond a small amount used for technical assistance, SIFEM was provided a new concessional component from SDC to encourage the DFI to enter more difficult, low-income markets using partial guarantees for certain investments. This will allow more experimentation and learning between SIFEM and SDC.

Government Treasuries are also increasingly interested in the use of repayable grants / contributions and non-grant instruments. As shared by DFAT, the Australian Treasury and the MOF are more cognizant of the terms of financing being deployed and the possibility of repayment, stating, *"Our treasury and finance departments are a close counterpart in discussing the capital being deployed and terms."*

Another government shared they have a close relationship with its Ministry of Finance, which allows them to draw on more diversified instruments on an ad-hoc basis. While the government traditionally uses grants.

"There are multiple pots of money that we can use, and I can speak to the MOF, but we have a rough budget every year, but the budget we can use for blended finance or other instruments is flexible and dependent on the needs. It is very people driven".

Key takeaways:

Overall, donors have demonstrated novel approaches to using ODA more strategically to engage with the private sector. A core consideration donors must face when determining their internal toolkit of instruments is the level of capacity and private sector engagement already embedded within the institution. For organizations that already have a track record of working with the private sector and deploying catalytic capital, expanding one's toolkit to more catalytic investment instruments, including guarantees and equity, is advisable, particularly because of the demonstration effect for the market. The catalytic approach taken by FCDO and Sida in this regard is palpable. At the same time, for development agencies that do not have buy-in from the government, or small ODA budgets, deploying traditional grants in strategic ways, including through intermediaries, and implementing agencies such as PIDG or investment funds, is advisable. Similarly, deploying grants that can be used to subsidize or front other instruments is also a welcome strategy.

GENDER

Gender considerations have been mainstreamed within donor agencies across the board. Donors have commonly included gender as an impact metric against which transactions are scored, with internal guidelines regarding the application of a gender lens often being set. As our respondents from the Danish MFA note:

"Gender is mainstreamed across Danish development aid; whenever we do a new program or contribute to any fund, whatever the theme may be, there is a gender checkbox to be checked, to see whether this criterion has been considered in conceiving the program."

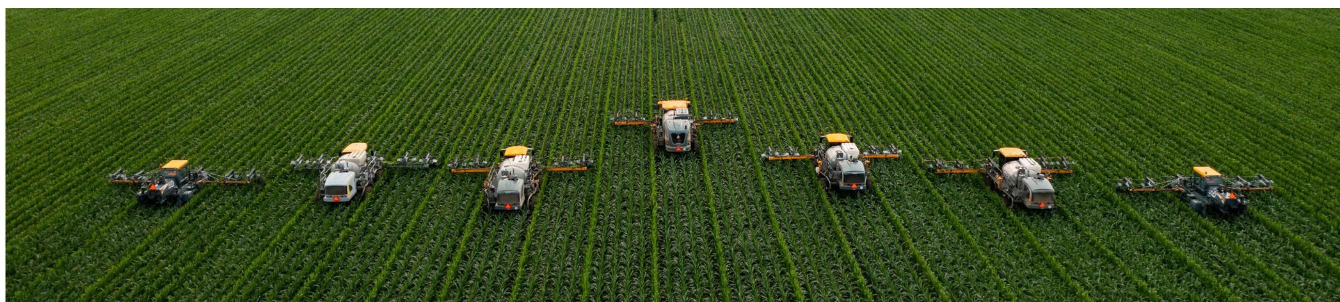
Some donors, like Japanese JICA, have gone beyond just applying a gender lens to transactions by establishing internal teams focused on women's rights and gender equality, providing advice to project teams on how a gender lens can be applied to investment projects and then providing an ex-post evaluation of how well gender has been incorporated. Other donors have mainstreamed gender by funding initiatives in which women's empowerment is prioritized or a gender lens is integrated, as Australian DFAT has done through the Investing in Women program or through its support for PIDG. Meanwhile, at other donor agencies, gender considerations have constituted, at one point, a critical political priority. The Swedish government, for example, adopted the world's first explicitly feminist foreign policy in 2014, with gender equality becoming a flagship policy for Swedish Sida. The election of a new government saw this prioritization shift, however, which hints at how development policy and gender policy may be subject to the vagaries of shifting political realities.

Beyond gender having been mainstreamed within donor agencies, additional details on challenges in or different approaches to the construction of gender strategies were not touched upon by our respondents, indicating the need for further research.

PART III

KEY CONSIDERATIONS AND PRACTICAL GUIDANCE

What steps can the donor community take to build more effective blended finance programs? Based on the interviews conducted with different stakeholders, Convergence has identified the following action items that the donor community should consider when designing and implementing their blended finance interventions:



Donors should tailor the features of their blended finance programs to their unique domestic economic and business contexts to maximize comparative advantages.

All donors operate within a particular set of economic, business, and institutional circumstances that shape their options in designing development interventions and blended finance programs. Donors should identify the inherent comparative advantages resulting from their unique domestic, economic, and business contexts and align their blended interventions accordingly. One government noted that their robust financial ecosystem, for example, enabled a quicker acceptance of the role of finance in development and informed its decision to conduct blended finance via its network of implementing partners in place of creating a DFI:

"We tried to find ourselves a niche where we really added value. So, most of our blended finance is done through what we know, which is investment funds. We have the ecosystem and it's nothing out of the ordinary. So, we do what we know instead of trying to reinvent the wheel."

Additionally, donors should prioritize learning from those with similar economic and institutional configurations in building their blended programs to develop niche and priority areas, as shown by Denmark's partnership with Sweden on its guarantee facility. Furthermore, Denmark has aligned its institutional and policy commitment to climate with blended finance and mobilization solutions, including its pilot guarantee program, to maximize its comparative advantage.

"Denmark is one of the few countries delivering on the $100 billion annual target from COP15 in jointly mobilizing additional climate finance, and currently meets approximately $1 billion of that figure. The MFA expects that going forward, the guarantee instrument will be essential to delivering on this target."

ii Donors should determine and define their blended finance mobilization objectives and align program design accordingly

Blended finance is the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries. The large majority of donor funds deployed in blended finance to date has been used to mobilize public sector, non-concessional (commercial) finance from MDBs and DFIs. Donors should therefore decide whether they are trying to mobilize additional finance towards public sector projects, private sector projects, or a combination of both as the mechanisms, partners, and skillsets required will vary. To that end, when designing blended finance programs, donors should determine whether they are aiming to mobilize MDB and DFI finance, or private sector investment.

iii Donors should ensure that their internal capacities and resources are aligned with the strategic objectives of their blended finance programs.

Donors should ensure that their internal capacities and resources are aligned with the strategic objectives of their blended finance programs. Norwegian Norad, for example, has undergone an organizational restructuring to better align its internal operations with its overarching strategy; Norad is now organized such that its various teams and sections are linked to specific SDGs, with sections for clean energy, climate, forests, and economic growth. Sida, meanwhile, has prioritized building the capacity for its country desk officers (CDOs) to identify synergies with the private sector for delivering upon Sweden's development objectives. Ensuring that the internal teams focused on mobilization receive the budget and staffing required to deliver a new private sector-oriented approach will be an ongoing imperative. Further, donor agencies should explicitly define the reasons and ways in which the skills & capacities being developed are necessary and germane to their stated mandates and objectives.

iv Donors should be strategic in navigating their pathway to behavioral change and organizational buy-in at all levels.

Donors must be strategic to encourage behavioural change and secure buy-in from ministries of finance and other political stakeholders for their blended finance programs. Our respondents from the Danish MFA, for example, noted the difficulties donors face in this regard:

"The biggest obstacle for donors looking to implement a [blended finance] model is convincing their ministries of finances of its merit and proving that it is not just taking on additional risk without any clear purpose. In general, ministries of finance are not familiar with development aid countries and are hesitant to work with those with high country risk ratings. "

Swiss SECO, meanwhile, provides an example of how donors can address this challenge by being nimble with how their blended finance programs are framed; instead of using the term blended finance, they simply use the umbrella term of "private sector engagement".

The Swiss and Danish examples illustrate the importance of navigating pathways to behavioral change for program building. While one donor underwent a multi-step multi-year process to gain acceptance for blended finance activity, the other was able to strategically sidestep lobbying for institutional change by configuring and classifying assorted activities under one singular simplified rubric to streamline change and enable program building.

v Donors should integrate an evaluation of the necessity of blended finance within program design

Donors should look to avoid potential market distortions by evaluating whether blended finance is an appropriate and necessary solution to the development problem at hand. That is, donors should apply an intentional level of analysis, whether market-based, policy-based, or otherwise, to support their program-building approach and recognize the development problem as the starting point for constructing a mobilization or private sector engagement program. Meaning it would be inadvisable for donors to start with a financial instrument and look for problems to solve using guarantees or loans. Rather, the development problem should be considered the independent variable for which blended finance can be assessed as an appropriate or necessary solution. As one donor observes:

"We try to ascertain whether blended finance is absolutely necessary and what the exit strategy is, which is not an easy question to answer; is blended finance needed because it's a first-time fund manager, and after they've gained experience, it's no longer needed; or is the sector intrinsically risky, and so blended finance will be needed longer term?"

Our Swiss SECO respondents raise a similar question, emphasizing that the larger policy and regulatory environment must be assessed when considering if blended finance is appropriate:

"It may not always be about more blending; rather, it may be important to look at other things. Is the competition policy in the developing country at hand fit for purpose? Are there other regulatory impediments preventing investments? Beyond just focusing on greater subsidies, blended finance practitioners should advocate for more structural reforms and analyze why some investments do not happen in certain sectors."

vi Donors should evaluate and modify DFI governance models to more clearly integrate private sector mobilization.

Donor agencies seeking to magnify their impact through a blended finance program, and that have decided to do so indirectly via their DFIs, should modify DFI governance models by integrating private sector mobilization targets within the DFI's key performance indicators (KPIs).

Donors should also explicitly identify private sector mobilization as part of their institutional mandates and quantify their mobilization targets to shift blended finance from a periphery to a core activity.

PART IV

CONCLUSION

Donor governments interviewed in this report have adopted a patchwork of blended finance and private sector mobilization strategies, lacking common objectives or guiding principles. The diversity of approaches to designing blended finance programs indicates that no single blueprint universally applies. Nonetheless, donors should consider several strategic factors addressed in this report to encourage long-term mobilization success. Donors must tailor their blended finance programs to their unique domestic economic and business environments, align their internal skills and capacities to the mandates of their programs, and partner with other donors to more efficiently fund blended finance vehicles and share learnings.

The development community must scale up effective blended finance structures and adjust public financing mechanisms to mobilize greater private sector investment and meet the funding objectives required to tackle the most pressing sustainable development challenges facing the world today.

This study will be critical in stimulating conversation and knowledge-sharing on blended finance best practices for donors. The learnings and insights shared should increase the understanding of existing market players, encourage new donor organizations to engage in blended finance and private sector mobilization activity, and offer guidance to existing stakeholders and new entrants into the development finance ecosystem.

GLOSSARY

AIFPP	Australian Infrastructure Financing Facility for the Pacific
BEIS	UK Department for Business, Energy, & Industrial Strategy
BII	British International Investment
BIPs	British Investment Partnerships
BSIP	British Support for Infrastructure Projects
C2F	Canadian Climate Fund for the Private Sector in the Americas
CTF	Clean Technology Fund
DAC	Development Assistance Committee
DFAT	Australian Department of Foreign Affairs and Trade
DFC	Development Finance Corporation
DFI	Development Finance Institution
EAIF	Emerging Africa Infrastructure Fund
EMIIF	Emerging Markets Impact Investment Fund
FCDO	Foreign, Commonwealth and Development Office (UK)
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslande
JICA	Japan International Cooperation Agency
IDB	Inter-American Development Bank
IFU	Investment Fund for Developing Countries
MDB	Multilateral Development Bank
MFA	Ministry of Foreign Affairs
MOF	Ministry of Finance
NGO	Non-Governmental Organization
Norad	Norwegian Agency for Development Cooperation
Norfund	Norwegian Investment Fund for Developing Countries
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation

PIDG	Private Infrastructure Development Group
PSIF	Private Sector Investment and Finance Unit (Japan)
SDC	Swiss Agency for Development and Cooperation
SDGs	Sustainable Development Goals
SECO	Swiss State Secretariat for Economic Affairs
Sida	Swedish International Development Cooperation Agency
SIFEM	Swiss Investment Fund for Emerging Markets
SMEs	Small and Medium-Sized Enterprises

CONVERGENCE is the global network for blended finance. We generate blended finance data, intelligence, and deal flow to increase private sector investment in developing countries.

BLENDED FINANCE uses catalytic capital from public or philanthropic sources to scale up private sector investment in emerging markets to realize the SDGs.

Our **GLOBAL MEMBERSHIP** includes public, private, and philanthropic investors as well as sponsors of transactions and funds. We offer this community a curated, online platform to connect with each other on blended finance transactions in progress, as well as exclusive access to original market intelligence and knowledge products such as case studies, reports, trainings, and webinars. To accelerate advances in the field, Convergence also provides grants for the design of vehicles that could attract private capital to global development at scale.