IFC International Finance Corporation WORLD BANK GROUP

THE FUTURE OF AID: SCALING PRIVATE SECTOR INVESTMENTS THROUGH BLENDED FINANCE

Key messages

- **Blended Finance as a catalyst:** when used in private sector operations, blended finance can effectively mitigate risks in emerging markets. The UN Sustainable Development Goals (SDGs) face a significant annual funding gap, estimated at trillions of dollars. Blended finance is a critical tool to address market failures and scale both private solutions and private capital mobilization in priority areas for EMDEs. Judiciously used concessional funds can unlock substantial private capital for high development impact projects in emerging markets and developing economies, paving the way for other investors and sustainable development to follow.

- **Governance and Transparency:** strong governance procedures to safeguard the effective, efficient, and transparent use of concessional funds are key. Disclosure of the level of subsidy in blended finance transactions ensures transparency and accountability in the use of scarce public funds and supports benchmarking in the market.

- **Collaboration and partnerships:** To step up investment for global challenges, such as climate change, fragility, inclusion, and food security, in both low-income and middle-income countries (MICs), expanded support for blended finance will be key. Active dialogue amongst development finance institutions, multilateral development banks, sovereign states, multilateral organizations, philanthropies, and the private sector, will help scale the blended finance market by ensuring appropriate levels and types of financing are available to address key global challenges.

Problem statement

Since the UN Financing for Development Conference in Addis Ababa in 2015 and the formulation of the Addis Ababa Action Agenda, blended finance has gained further traction as an effective approach to crowd in private capital to investments that support sustainable development. More than ever, private sector development is critical for sustainable, inclusive economic growth. The private sector creates capital, innovation, and employment, as well as tax revenue for public goods and services. Blended Finance is one of the most significant tools that a development finance institution like IFC can use, in cooperation with development partners, to address market failures and to help

RELEVANT ACTION AREAS

Domestic and International Private Business and Finance

ABOUT THIS SERIES

The Financing Policy Brief Series has been prepared by the Inter-agency Task Force on Financing for Development to inform the substantive preparations for the Fourth International Conference on Financing for Development (FfD4), to be held in Sevilla, Spain, from 30 June to 3 July 2025.

The Inter-agency Task Force on Financing for Development is comprised of more than 60 United Nations Agencies and international organizations. The policy briefs in this series were not subject to review by Task Force Members, and represent the views of the authoring organizations.

The full series is available at: https://financing.desa.un.org/iatf/report/financing-policy-brief-series mobilize private investment in pioneering projects and challenging environments. However, there is potential for further growth. In many emerging markets and developing economies (EMDEs), perceived risks of first-of-their kind projects outweigh the potential rewards for private investors. Blended finance is employed under strict discipline to help rebalance this equation by using targeted amounts of concessional funds blended with own-account commercial resources to crowd in private capital. Rationale for using blended finance could be to address either a 'participation' constraint (e.g., lack of adequate collateral or cash flow volatility) or a 'behavioral' constraint (e.g., incentives needed to change client behavior to an intended development outcome.)

As the private sector arm of the World Bank Group and the largest global development institution focused on the private sector in emerging markets, IFC uses blended finance to facilitate investments in high impact private sector projects. In fiscal year 2024, IFC's blended finance commitments surpassed $1 billion in investments that address global challenges like climate, gender, food security, health, and fragility. Depending on the specific risks and context, blended finance can be structured as senior or subordinated debt, junior equity, and pooled first loss risk-sharing guarantees. In certain cases, IFC uses performance-based incentives, where a grant is paid if a project reaches pre-specified milestones – such as loans to women-led SMEs, or for green buildings. Viability gap funding can be provided as a grant to buy down high capital cost of a nascent technology and support its commercialization at an early stage. Blended finance can also be used to reduce the transaction cost of local currency financing.

IFC's investments using blended finance follow the DFI Enhanced Blended Concessional Finance Principles for Private Sector Projects, emphasizing the use of minimum concessionality and targeting companies on the path to commercial viability and bankability. The principles were established by the DFI Working Group on Blended Concessional Finance for Private Sector Projects and provide a common framework for 25 DFIs to deploy concessional finance. Applying the minimum concessionality needed to catalyze an investment, blended finance can help ensure that pioneering climate projects, vital investments in food security and nutrition, lending to women-owned small and medium-sized enterprises, and reconstruction efforts in fragile settings like Ukraine, can proceed when commercial funding alone is insufficient or unavailable in the market.

Despite notable successes and a growing need for the private sector to contribute to filling the sustainable financing gap, blended finance has yet to reach sufficient scale. Reasons include:

- **Perceptions of risk and limited understanding of blended finance's ability to de-risk:** Many investors have remained wary over emerging markets, despite evidence that investments in EMDEs are less risky that once imagined[1] . Using blended finance can help rebalance the risk in high impact investments and demonstrate the commercial viability of new markets.

- **Lack of transparency:** Underpinning this skepticism is the lack of transparency in project finance in emerging markets. IFC and others have pushed for greater transparency in the blended finance system to empower the market with more information – and clearly showing rigorous application of the principle of minimum concessionality.

- **Limited availability of concessional capital:** concessional capital is limited, and demand far outstrips supply. Without enough concessional capital to absorb early-stage risks or offer guarantees, it is difficult to attract private investors, especially to higher-risk projects in emerging markets.

Policy solutions

Policy solutions include enhanced transparency; scaling blended finance operations through standardized platforms; and an expanded concessional contributor base.

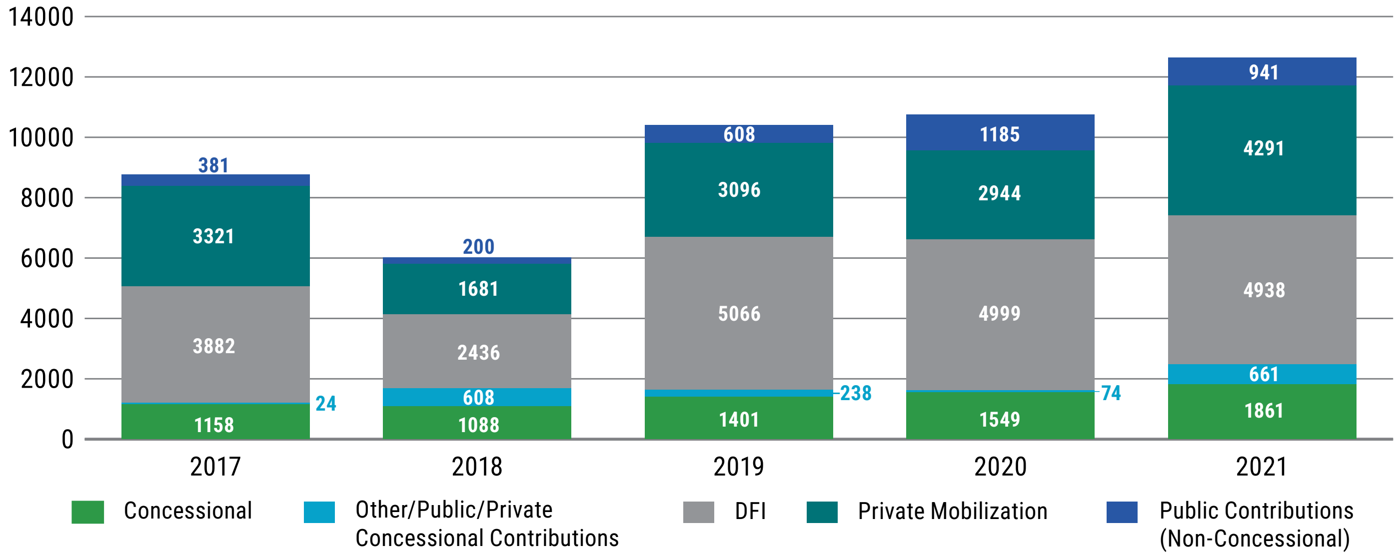
1. See new publications by Global Emerging Markets Risk Database (GEMs) Consortium

It is important to continue to encourage more transparency in the blended finance ecosystem to further its use for sustainable development. Steps towards more disclosure in blended finance transactions can help build confidence in the use of blended finance. Since 2018, IFC systematically discloses to the public information on the sponsor, structure, expected development impact, instrument, and amount of donor partner funding for every eligible project. To date, IFC is the only DFI that publicly discloses transaction-level subsidy estimates along with justification for why it is necessary.

An example in Uzbekistan illustrates how transparent disclosure of subsides can support a more complete picture of a successful investment and inform how subsequent investments can be structured, minimizing concessionality. In 2020, IFC supported the country's first utility-scale renewable energy project through a $40 million financing package that included a $20 million concessional loan from the Government of Canada. This enabled the generation of 100 megawatts of solar energy at one of the lowest tariffs ever seen in emerging markets—just 2.7 U.S. cents per kilowatt-hour. The success of this project demonstrates that once blended finance mitigates first-mover risks, projects can stand on their own. In fact, one of the co-investors, went on to finance an additional 250 megawatts of solar energy with battery storage in Uzbekistan with a smaller subsidy – and an investment in wind followed, without the need for concessional finance. Transparency remains an important issue that could improve the overall efficacy of the blended finance ecosystem but requires commitment from both the providers and deployers of blended finance.

In an unprecedented global context, MDBs and DFIs must continue to scale their blended finance operations. DFIs see strong demand for blended finance, driven by increasing needs to address global inflation and food shocks, scale up projects related to climate change (e.g. green and innovative technologies), improve healthcare, address SMEs, gender and youth finance, support digitalization, and support programs to help refugees/ displaced persons[2] (figure below shows DFI growth in blended finance over time). DFIs are expanding use

Figure 1.
DFI Private Sector Blended Concessional Finance Project Commitments, 2017-2021
(USD Millions)



Source: 2023 DFI Working Group joint report.

2. https://www.ifc.org/content/dam/ifc/doc/mgrt/2023-03-dfi-bcf-joint-report.pdf

of programmatic approaches with blended finance to scale up activities by using standardized products and processes and delegated approvals. Standardized platforms can also facilitate wider access to blended finance products by local companies through publicity related to offerings. For example, IFC has expanded its existing programs and platforms (for small business, medical equipment, trade finance, and base of the pyramid projects) with new ones for food security, venture capital, and Ukraine support.

Expand blended finance contributor/donor base to address issue of limited blended finance resources. There is a limit to what DFIs and MDBs can do on their own. For instance, multilateral institutions can help decarbonize emerging economies at a much faster rate if they can optimize the use of money from development banks, philanthropies, institutional investors, and private companies[3]. By providing flexible, patient, and risk-tolerant capital, foundations and philanthropies can significantly contribute to helping bridge the gap between public and private investors and support the development of innovative blended finance structures that address critical development challenges[4]. Sovereign governments continue to play a critical role in the provision of concessional capital for high development impact projects from the least developed countries to fragile settings to high-emitting middle-income countries.

Specific recommendations for FFD4

- **Continued recognition of the role of the private sector. Blended finance has the potential to unlock significant private capital to address the SDG finance gap.** Through its ability to reduce the risk in first-of-their kind investments, in challenging regions and/or new technologies, and to drive in private capital, blended finance will continue to play a key role in addressing global challenges. Efforts to carve out blended finance funding for private sector investments that support the SDGs will be critical.
- **Enhanced transparency.** By providing visibility into project governance, decision-making processes, and financial flows, transparency helps prevent misuse of funds. Data transparency promotes responsible stewardship of resources and strengthens the integrity of development efforts by supporting benchmarking in the blended finance ecosystem.
- **A holistic approach.** A combination of "upstream", policy/regulatory interventions, advisory services to strengthen local capacity, and innovative blended finance structuring have proved to be the most effective in catalyzing high impact investments and supporting market creation (see example: Belgrade Waste-to-Energy)
- **Open dialogue and continued coordination** among DFIs, governments, investors, civil society organizations, and the private sector ensures that diverse perspectives are considered and integrated into project design and implementation. The 2025 FfD4 conference can be a forum for further exchange on blended finance amongst key stakeholders.

3. https://www.weforum.org/agenda/2022/02/the-blended-way-how-to-mobilize-private-capital-to-fight-climate-change/
4. convergence.finance/resource/state-of-blended-finance-2024/view