Aligning capital for sustainable impact through Blended Finance

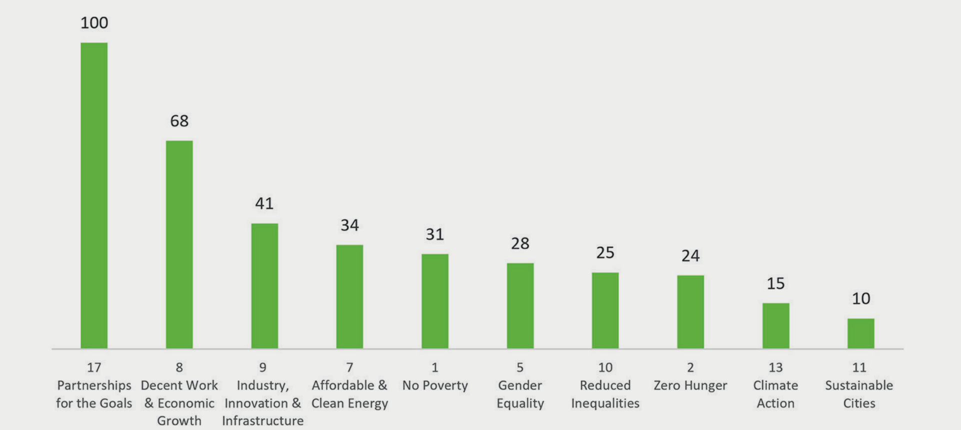
Blended Finance strategically combines public, private, and philanthropic funds to bridge financing gaps for sustainable development. Don Gerritsen, Sander Oudmaijer, and Alicia Burke from Deloitte explore its structure, investment instruments, risk-return dynamics, and key target sectors.

Door *Jolanda de Groot*

What is Blended Finance and what is the specific role of public, private, and philanthropic funds in the financing structure?
Don Gerritsen: 'Blended Finance represents the strategic deployment of development finance to mobilize additional resources aimed at achieving the SDGs. This approach is particularly relevant for developing countries, where financing gaps often hinder progress. Public funds play a pivotal role by providing first-loss or catalytic capital, which absorbs initial risks and enhances the attractiveness of investments for private entities. Concurrently, private funds contribute equity or debt to pursue financial returns, while philanthropic contributions – often in the form of grants or concessional loans – support projects that may not yet be commercially viable. This synergistic combination of funding sources leverages additional investment effectively while addressing critical financing gaps. Engaging stakeholders, including local communities and governments, is essential to ensure that projects are designed and implemented effectively, reflecting the needs and expectations of the populations they aim to serve.'

What instruments are used in Blended Finance structures and where do institutional investors position this type of investment in their portfolio?
Sander Oudmaijer: 'In Blended Finance structures, various instruments are employed to ensure effective capital allocation:
- **Equity** provides ownership stakes in projects, allowing for potential high returns tied to the project's success.
- **Senior debt** is the most secure financing option, offering priority claims on cash flows.
- **Mezzanine debt** acts as higher-risk debt that may convert to equity, presenting higher returns.
- **Subordinated debt** offers another layer of risk and potential return.
- **Guarantees** are issued to reduce perceived risks for investors, making projects more attractive for private capital.
- **Grants and concessional loans** are vital for supporting projects that might not yet be commercially viable, facilitating their early-stage development.

FIGURE 1: SHARE OF BLENDED FINANCE TRANSACTIONS ALIGNED WITH SDGS (IN%)



Source: Covergence (2024). State of blended finance. Retrieved from: https://www.convergence.finance/resource/state-of-blended-finance-2024/view

Institutional investors typically integrate these investments into their impact investing strategies, aiming to achieve both financial returns and social or environmental impact. Furthermore, Blended Finance structures often incorporate various risk mitigation strategies, such as first-loss capital, to attract private investors. Instruments like guarantees and insurance can specifically mitigate the risks associated with investments in developing economies, thereby bolstering their appeal to private sector participants.'

What is the expected financial return and how is it balanced against impact objectives?

Alicia Burke: 'Expected financial returns in Blended Finance initiatives can vary considerably, reflecting the diverse risk profiles and investment structures involved. While equity investments may target higher returns, debt instruments generally offer more stable, lower returns. Achieving a balance between financial returns and targeted social impact is crucial; this allows for the coexistence of competitive financial outcomes alongside meaningful contributions to societal goals. Establishing robust metrics for both financial performance and social impact is essential for measuring progress towards the SDGs and ensuring that both objectives receive the attention they deserve.'

What impact objectives are being pursued? Are these aligned with international standards, such as the SDGs?

Gerritsen: 'Blended Finance initiatives pursue impact objectives that primarily focus on enhancing inclusion, climate resilience, and safety, particularly for marginalized communities. These objectives align closely with the SDGs, which stress the importance of equitable access to resources and opportunities. Innovative financing models, such as social impact bonds and green bonds, have emerged to support these initiatives, reinforcing their alignment with global sustainability priorities.'

Oudmaijer: 'Blended Finance funds often employ Technical Assistance (TA) mechanisms to ensure that both financial and non-financial goals are met. TA enhances the capacity of local stakeholders – such as government officials and project developers – through skills development and training. It aids in project preparation by conducting feasibility studies and providing design support, which improves the bankability of projects.

Additionally, TA identifies and manages risks associated with climate adaptation and mitigation, ensuring effective risk mitigation strategies are in place. By establishing metrics for monitoring and evaluation, TA allows stakeholders to track progress efficiently.

Furthermore, it guides the development of policies and institutional frameworks that facilitate Blended Finance, fostering an enabling environment for investment. TA also promotes stakeholder engagement by building partnerships among local communities, NGOs, and the private sector, ensuring inclusive decision-making.

Ultimately, by enhancing project design and implementation, TA contributes to the sustainability and long-term success of Blended Finance initiatives.'

Which markets or sectors are targeted through these Blended Finance initiatives?

Burke: 'Blended Finance initiatives typically target several key sectors, particularly in emerging markets and developing economies:

- **Climate adaption:** Investments in climate resilience, including ecosystem restoration, and water management.
- **Digital Infrastructure:** Projects aimed at improving internet access and digital connectivity, especially in underserved regions.
- **Healthcare:** Initiatives that enhance access to essential medical services and technology.
- **Agriculture:** Support for sustainable agricultural practices, including financing for smallholder farmers.
- **Renewable Energy:** Investments aimed at transitioning to sustainable energy sources to mitigate climate change.
- **Education:** Programs that enhance educational opportunities through technology and infrastructure improvements.

In conclusion, Blended Finance serves as a powerful mechanism to mobilize diverse funding sources for sustainable development, aligning investments with the urgent goals of climate resilience and social equity while unlocking new opportunities for growth and impact.'

Don Gerritsen

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SUMMARY

Blended Finance mobilizes public, private, and philanthropic funds for sustainable development.

It employs instruments like equity, debt, and guarantees.

Aims align with SDGs, focusing on sectors like digital infrastructure and healthcare.

Financial returns may vary greatly depending on investment structure and risk.