University of Zurich[UZH]

Initiative for Blended Finance at the University of Zurich

# Blended Finance: When to use which instrument?

## Phase 1: Clusters and decision-making factors

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# Contents



This research project by the Initiative for Blended Finance at the University of Zurich was conducted by project partners the Center for Sustainable Finance & Private Wealth (CSP) at the University of Zurich, Roots of Impact and the Bertha Centre for Social Innovation & Entrepreneurship at the UCT Graduate School of Business. We would like to thank especially Natasha Dinham and Rory Tews at Roots of Impact, and Pearl Kolwane at Bertha Centre for their research contribution and project management. We also thank UBS Optimus Foundation for financially supporting the study.

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# I. Executive Summary

# Executive Summary

As blended finance moves from the sidelines of financing instruments toward center stage, the sector has seen the rapid growth of diverse, innovative tools and practices. As approaches have diversified, guidance on which instrument to use and when has not followed at the same pace.

The project Blended Finance: When to use which instrument, conducted by the Center for Sustainable Finance & Private Wealth (CSP) at the University of Zurich, Roots of Impact and the Bertha Centre for Social Innovation & Entrepreneurship at the UCT Graduate School of Business, attempts to fill this gap.

Over the course of the research, we identified several blended finance instruments that can be clustered into two premises: those that blend within a transaction and those that blend over time. The instruments falling into the first category include concessional debt and equity or guarantees. The instruments that blend over time are, for instance, grants or technical assistance used with the intention to be catalytic.

We intentionally decided to include instruments that also blend over time for a wider scope that allows us to investigate the full spectrum of instruments available. The full list of instruments is: guarantees, first-loss, outcome funding, concessional debt and equity, subordinated debt, impact-linked finance, impact bonds, grant, and technical assistance.

This publication focuses on the findings from the first phase (October 2020 to August 2021) of our research. We take an in-depth look into current best practices across 33 transactions and identify how practitioners currently make decisions in terms of which instrument to choose.

The key results of the research project are:

## 01

### Clustering instruments clarifies the utility of diverse approaches.

- **Cluster 1:** Grants, technical assistance
- **Cluster 2:** Outcome funding, impact-linked finance, impact bonds
- **Cluster 3:** Market-rate debt and equity, subordinated debt, concessional debt and equity
- **Cluster 4:** First-loss, guarantee

In the course of the research, we also noted that practitioners often used the terms “subordination” and “concessionality” interchangeably.

In many cases, the blended capital has both characteristics, yet a clearer use of terminology could help clarify expectations, constraints, and opportunities between different stakeholders.

## 02

### Knowing the organizational and investee context, the purpose of the transaction, and the resources available is key in choosing the most suitable instrument.

We identified 12 questions that can help guide practitioners as they select financing instruments as initiators of a transaction. Unlike other decision-making frameworks, the questions identified are holistic and pragmatic in nature, supporting decision-making from the very beginning and allowing the full spectrum of instruments to be taken into consideration.

The questions can be grouped across 5 themes:

**ORGANIZATIONAL CONTEXT**

1. What is my institutional setup or mandate?
2. Which role do I play in the transaction, and what can I bring to the table?
3. How much capital can I deploy?
4. What is my target financial return / what are my financial requirements?

**PURPOSE OF THE TRANSACTION**

5. What is my primary motivation?
6. What kind of impact problem am I addressing?
7. How do I want to ensure impact?

**INVESTEE CONTEXT**

8. What is the maturity level of the target market (sector/region)?
9. How does the investee want to scale? What is their growth trajectory?
10. What is the maturity level of the intervention?

**COST AND RESOURCES**

11. What are the costs associated and resources available?

**RISK AND RETURN**

12. What kinds of risks do I need to consider, and for what kind of return?

We note that unlike other decision-making frameworks, the questions we have identified are holistic and pragmatic in nature. However, we also observe an absence of focus on the end beneficiary or entrepreneur, who are the recipients of such blended capital.

We aim to explore how current practices can be adapted to be more inclusive of end beneficiaries and entrepreneurs, and provide further guidance for decision-making as a result of our next phase.

# II. Introduction

Despite the best efforts of a growing community of blended finance pioneers, the concept and associated capacities are still at a nascent stage. The question remains open as to how to select an appropriate and effective blended finance instrument to address a given problem. There are numerous factors that must be considered when deciding upon an approach. At the same time, there has not been enough research done on what these factors are, and which combinations make which instruments relevant.

Historically, structures and similar concepts, such as public-private partnership (PPP), have existed, and the practice of blending different sources of capital is not necessarily new. Nevertheless, it is only recently that the term "blended finance" has received such attention, especially with a development and impact angle. Research on PPP, for instance, primarily focuses on infrastructure projects—mostly without an impact angle—and aims at identifying best practices in stakeholder management or project management practices rather than the various financing instruments.

Of the research that has been conducted explicitly on blended finance, the majority has focused on the effectiveness of instruments in terms of mobilizing private investment in a broadly defined development context as opposed to solving a concrete problem or achieving specific outcomes. More specifically, the focus has been almost exclusively on "risk-reducing" mechanisms (e.g., structured funds or guarantees).

**There has been less research conducted on the entire spectrum of blended instruments and approaches suitable to effectively target specific development outcomes.** More generally, the issue of how to decide upon the most appropriate instrument is a topic that has received virtually no attention. In addition, since the focus has been primarily on the crowding in of capital, the level of analysis in blended finance research has mostly been on the investor level and not necessarily on how entrepreneurship-friendly or market-friendly the capital is.

In order to plug this gap, our research project establishes the decision-making factors that influence the appropriateness of a given instrument in a given context. We selected a list of diverse instruments that fall into the category of the broader blended finance category: **guarantees, first-loss, outcome funding, concessional debt and equity, subordinated debt, impact-linked finance, impact bonds, grants, and technical assistance.**

Some instruments, such as grants or technical assistance, might not be seen as "blended" in themselves. However, **we acknowledge that there is blending within a transaction and blending over time. While the former refers to blended capital that exists simultaneously within the same transaction structure, the latter refers to capital that is provided with the intention to catalyze other forms of capital over time**—e.g., grants provided at seed stage to make a social venture investible for private capital at a later stage. For this research project, we took the broader scope and included both forms of blending within the scope of our research.

We selected 33 transactions that we deemed particularly insightful and revealing, then conducted an in-depth case study based on desk research, as well as interviews with the initiating organization(s). Through an inductive coding approach based on a grounded theory methodology, we identify: **a) how different instruments are clustered together in decision-making,** and **b) key questions considered for decision-making between clusters (and instruments).**

The following sections are structured as follows: First, we provide a brief overview of all the blended and innovative financial instruments that we included in the research project and how we define them in this context. Then, we provide more details into the methodology of our research, including research design, sampling, data collection, and coding and analysis. We then share our findings by presenting four different instrument clusters and the key questions that influence decision-making between the different clusters.

We hope that this paper provides a deeper and more precise understanding of the various blended and innovative financial instruments, as well as the key aspects that are being considered among practitioners and researchers for choosing them. In addition, we provide insight into which factors should be emphasized more but have not received much attention. Our findings will serve as a basis for our next phase of research, which will focus on developing a more detailed and holistic decision-making guideline.

While our current research was based more on micro-factors that are directly related to the transaction, the next phase of research will look more into macro factors, such as the market condition and sector. At the same time, we plan to take a strong entrepreneurship lens, with the aim of constructing a guiding tool that can be used by different actors wishing to engage in a blended finance transaction that fosters innovation and entrepreneurship for impact.

# Definition

The sector of blended and innovative finance uses many terms interchangeably, which can be confusing. In this section, we provide definitions of the various terms used throughout this paper. While we do not attempt to provide a definitive way of using these various terms, the definitions are based on extensive desk research and a general agreement within the sector.

| | |
|---|---|
| **Blended Finance** | An approach for combining finance of different sources (e.g., public with private sources), types (e.g., concessional with non-concessional), and purposes (e.g., using funds for development purposes to mobilize funds with commercial purposes)[1]. A blended finance transaction should be catalytic in nature and contribute to development results. |
| **Innovative Finance** | A range of strategies to make effective use of and/or generate financial resources to achieve international development goals. This includes blended finance, impact investment and outcomes-based finance[2]. |
| **Guarantee** | A risk mitigation instrument that promises to repay all or some of the invested amount to the lender or investor in the case of default[3]. In this paper, we focus on guarantees used specifically for development purposes. |
| **First-loss** | A risk mitigation instrument in which a donor or other entity agrees to be the first to take losses if a business is unable to pay back investors[4]. |
| **Outcome Funding** | An umbrella term for transactions that pay upon accomplishment of results rather than efforts to accomplish those results. Instruments including impact-linked finance or impact bonds are subtypes[5]. |
| **Concessional Finance** | Repayable capital offered on terms substantially more generous than generally available commercial terms. The concessionality is achieved either through rates below those available on the market or grace periods, or a combination of these[6]. |
| **Subordinated Debt** | Subordinated debt, also called mezzanine finance, has many of the characteristics of both debt and equity. A subordinated creditor agrees to rank after senior creditors but before ordinary shareholders in the event of liquidation[7]. |
| **Impact-linked Finance** | An approach to linking financial rewards for market-based organizations to the achievements of positive social outcomes, often used as a means of aligning positive impact with economic viability[8]. |
| **Impact Bond** | Impact bonds use investor capital to cover the working capital required for a provider to set up and deliver a service. The service is designed to achieve measurable outcomes specified by the commissioner. The repayment to the investor depends on the outcomes achieved[9]. |

Table 1: Definition of Key Terms

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# III. Methodology

# Methodology

The research process so far involved three main activities: (A) Desk Research, (B) A Case Study including interviews with experts and practitioners, (C) Coding and Analysis of the collected data.

## A. Desk Research

To understand the landscape of blended and innovative financial instruments and approaches in more depth and avoid replicating existing efforts, we conducted an extensive literature review on different instruments that have already been used by impact-oriented actors, especially focusing on six sectors: education, healthcare, WASH, conservation, renewable energy, and inclusive finance.

In order to do a systematic literature review, we selected relevant keywords, such as "blended finance," "innovative finance," and "results-based finance" and conducted a search on the Web of Science. Given that blended and innovative finance is a relatively recent topic, we focused on papers that had been published since 2016. In addition, given our lens on entrepreneurship (in contrast to large-scale infrastructure), we selected entrepreneurship-related journals and reviewed all publications that might be relevant to the topic since 2010, with the goal of finding publications relevant to financing enterprises through blended capital. The journals we selected are: Journal of International Entrepreneurship, Journal of Development Entrepreneurship, Journal of Social Entrepreneurship, Journal of Business Venturing, and the Strategic Entrepreneurship Journal.

Given the nascent state of academic literature, we also included grey literature. To limit the scope of this search, the publications were limited to those published by noteworthy actors in the blended and innovative finance sector. These actors were selected based on an internal discussion and include OECD iLibrary, World Bank, AfDB, EBrD, EIB, IDB, IFC, KfW/DEG, CDC Group, OPIC, USAID, Sida, UK Aid, ODI, and CGD.

The list of reviewed literature can be found here in the appendix.

## B. Case Study

Based on the literature review, we put together a list of factors that appeared in the research as relevant for selecting instruments. In order to gain a deeper understanding informed by practice, we selected relevant cases that we deemed particularly interesting and revealing across the sectors of education, healthcare, WASH, conservation, renewable energy, and inclusive finance. We focused on transactions that had new and innovative structures, a combination of instruments, and that we deemed entrepreneurship- and market-friendly, or those deemed noteworthy by other practitioners.

For the case study, we interviewed a total of 33 practitioners involved in transactions and supplemented these with text data, resulting in 12 case studies. We also conducted interviews with several field experts who had experience with multiple instruments, thus gaining perspectives that were less embedded in the transactions. The list of interview questions was put together based on our literature review and was iterated throughout the interview phase.

The list of cases and contributors can be found here and here in the appendix, as well as the interview protocol.

## C. Analysis

To analyze the data collected, we used an inductive approach, which creates general conclusions based on specific observations. This allows our findings to be explorative and reflect more what we observe in practice, rather than being based on definitive assumptions created within the team and confirming them through data.

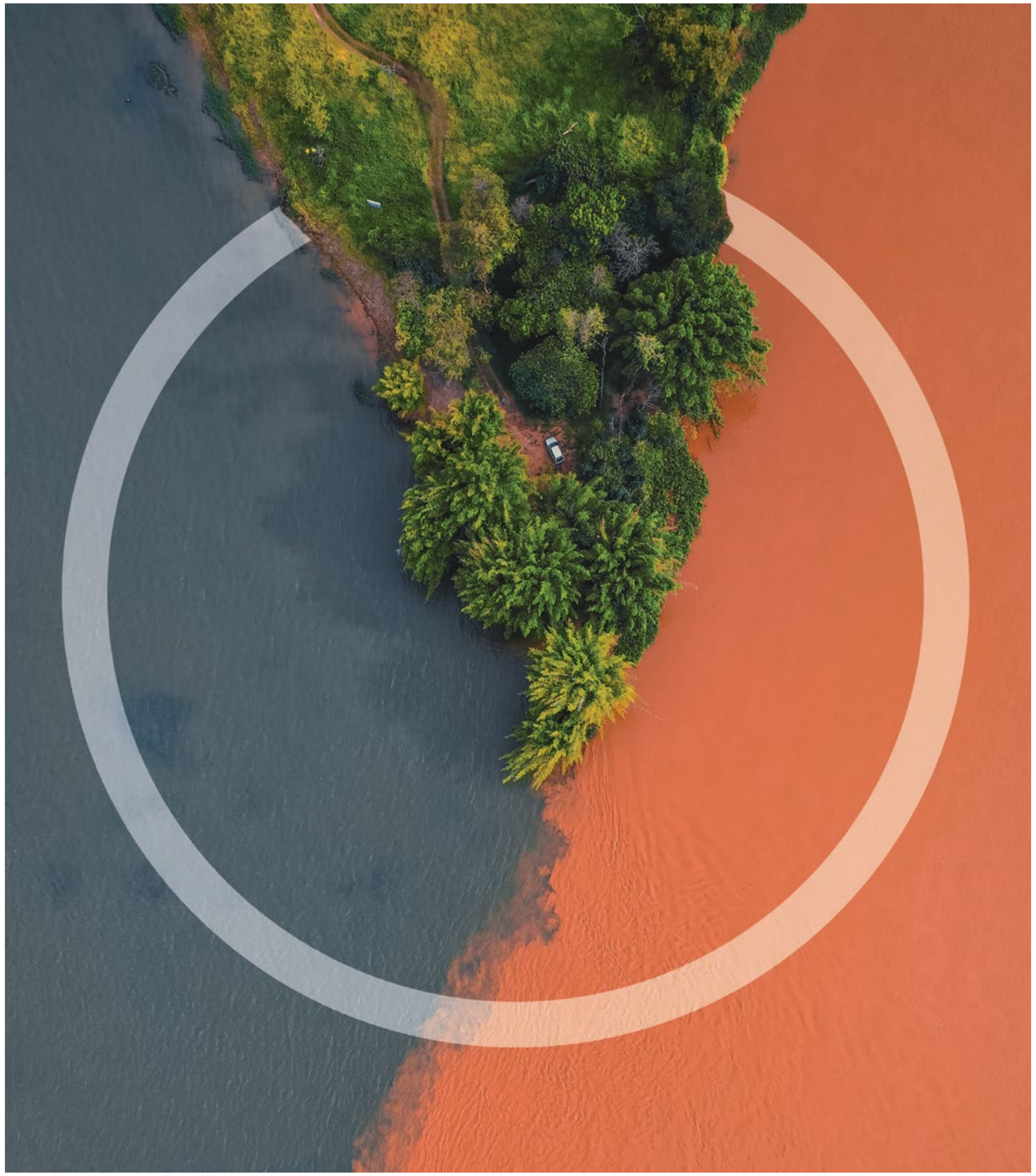
In order to process the data, we coded the transcripts and case studies through an iterative process. First, the lead researcher coded four documents to identify recurring themes within the interviews. Then, the team had a discussion about building a coding structure based on the initial coding results. The team had collectively participated in all interviews or conducted the case studies, then read the interview summaries and notes for the remaining ones, which ensured everyone was familiar with all the material, even without having coded it.

The findings resulting from the analysis are presented in the following sections. The first section shares how the various instruments can be clustered based on their similarities. The second section focuses on the key questions that influence the decision of which clusters (and perhaps which instruments) to choose.





# IV. Findings | Instrument Clusters



# Findings | Instrument Clusters

Based on our analysis, we first found that there are conceptual clusters of the various instruments used within blended and innovative finance.

Instead of developing a long list of all possible instruments and comparing them, **decision-makers seemed to have a subset of instruments that are deemed similar in their consideration, and they choose an instrument from within that group.**

The clusters enable more effective decision-making by comparing conceptually similar instruments, rather than comparing apples and pears all at once that serve different purposes or function differently.

While different actors might have different ways of clustering, for this study, we take the perspective of the initiator or initiating consortium of a transaction. This would usually be a donor or intermediary, actors who represent the perspective of catalytic capital providers. In most cases, these are the decision-makers in the position of choosing the instrument and shaping the transaction, while other actors, such as private capital providers, are more often in the position of joining a transaction that has already been set up.

There is room for criticism, though, that the investees, beneficiaries and their perspectives are largely overlooked.

We address this issue by adding these aspects to the second section of our findings: key questions for instrument selection and how they influence or should influence decision-making.

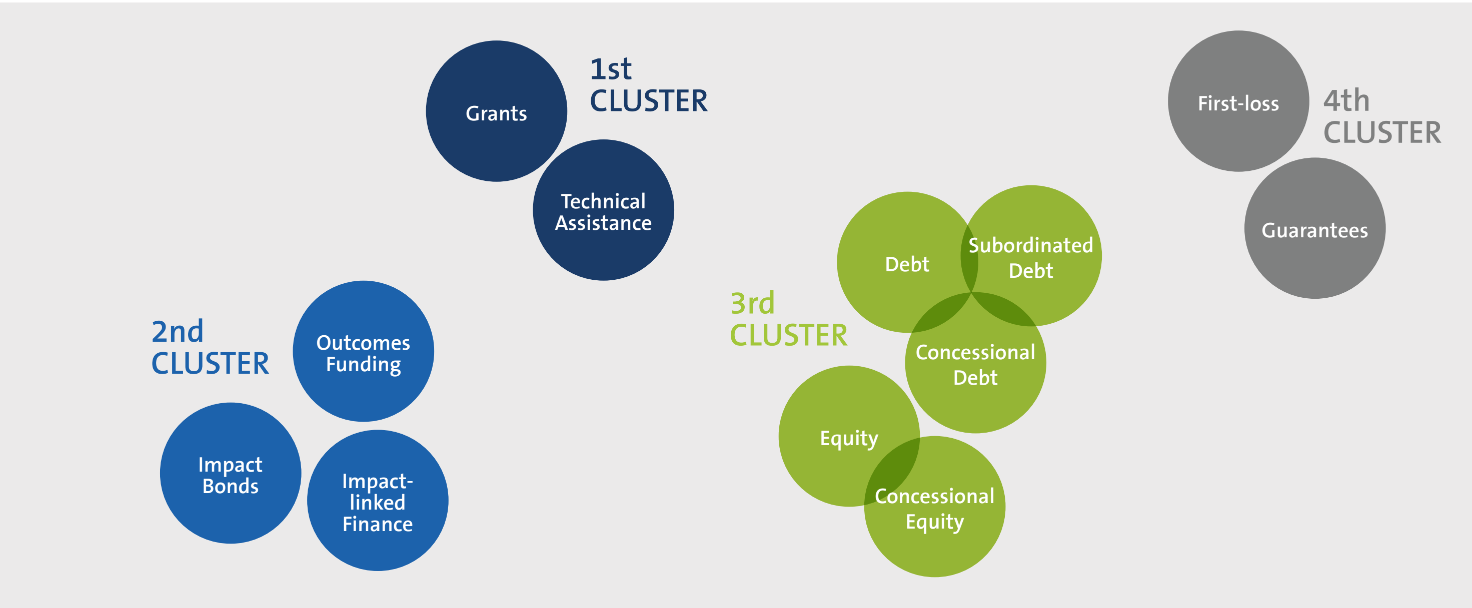



Figure 1: Cluster Map



In our analysis, we find that the instruments can be largely divided into four clusters.

There is a clear **first cluster** consisting of grants and technical assistance, mostly due to the fact that they come from the same source of capital.

The **second cluster** is also distinctive and includes outcome funding, impact bonds, and impact-linked finance, which are unique from the rest in that they connect impact with financial rewards.

The **third cluster** consists of the various debt and equity instruments, like market-rate, concessional, or subordinated debt, while the fourth cluster comprises first-loss and guarantees.

When it came to instruments in the **third and fourth cluster**, the lines were initially blurry, and it was contested among practitioners during our interviews how to group them together. Every practitioner would group them slightly differently, which made our analysis challenging at first.

We dug deeper into what interviewees would mention regarding the purpose and function of the instruments and were able to obtain more clarity. We found consistency in the logic by which they would group these instruments, even when they would do it differently, indicating that while there is a general agreement on the sense of clustering the various instruments, the blurriness stems from the confusion on terminology. For instance, many interviewees used concessional and subordinated debt interchangeably.

We eventually created clear clusters based on a more precise definition and grouped the instruments accordingly.

# A. First Cluster: Grants, Technical Assistance

## General Explanation

Grants and technical assistance come from the same source of capital, which is usually development and philanthropic actors. The biggest characteristic that sets these instruments apart is that the capital is provided with no intention of seeking any financial return.

## Reasons for choosing

The primary intention of providing a grant or technical assistance is to support the achievements of impact goals. For instance, grants may be given out to support programmatic activities or for design funding; technical assistance may be provided for training local partners or for adding a gender-lens to program activities. One of the interviewees stated that "No blended transaction can be legitimate without a grant or technical assistance."

Both instruments play an important role when entering new markets. They are often used for market research and market development prior to and during main investment activities. By mapping out investment opportunities or developing the pipeline through grants, or by providing operational expertise through technical assistance, these instruments also improve the risk and return profile of transactions.

## Characteristics

- **Capital with no financial return expectation.** In terms of pre-requisites, grants and technical assistance require a philanthropic or public capital provider that does not have a financial return expectation.
- **Require less financial knowledge.** Grants and technical assistance do not demand much financial knowledge to implement, and many development and philanthropic actors are familiar with these instruments.
- **Supporting instrument.** In many cases, they are used in combination with other instruments to support and ensure that impact goals are achieved.

## Point of Caution

For grants and technical assistance, it can be difficult to strike a balance between making sure the capital provided is having the intended impact and not encumbering the recipient with too much of a bureaucratic burden. Historically, stand-alone grants and technical assistance have been criticized for their lack of effectiveness. Due to the lack of financial knowledge among providers, they can lead to poor use of resources, which is why their use in combination with different instruments in other clusters offers a path to being more catalytic.





# B. Second Cluster: Outcome Funding, Impact-linked Finance, Impact Bonds

## General Explanation

The second cluster, comprising outcome funding, impact-linked finance, and impact bonds, can be seen as a collection of instruments falling into the outcome funding or results-based financing category. These instruments diverse in their focus on different stakeholders, with impact bonds involving governments and NGOs, while Impact-Linked Finance addresses market-based solutions. They do, however, share the linking of impact creation directly to financial rewards. "They focus on 'structuring' the impact first and try to work backward to financing it," explained one of the interviewees partaking in an impact bond. Due to the focus on structuring a transaction that leads to an outcome pre-agreed by all parties, these results-based financing instruments allow various stakeholders with different interests to be aligned.

**Instruments in this cluster address an impact-specific need that has targets that are measurable[11]. This focus on output is particularly in contrast with traditional grants, which focus more on activities.** While other clusters can address more general problems or multiple problems within one transaction, that is difficult with outcome funding. For instance, providing a financial reward based on specific results, such as the number of girls graduating from elementary school, is more fitting, while providing the same for addressing climate change is less so. Also, impact verification is a much more central part of these instruments, since it is tied to financial rewards.

Transactions involving results-based financing instruments have up to now tended to be smaller in size and higher in complexity, which is due to the specificity of the impact they are targeting. Also, they often try to establish new market rules and attempt to create a market for impact compared to other clusters that simply accept market rules, i.e., the third and fourth clusters.

## Reasons for choosing

**The primary reason for choosing results-based financing instruments is to directly create impact, and strengthen the relationship between the impact created and the financial payment.** Within the cluster, the initiator or initiating consortium might choose one instrument over another depending on their strategic focus. For instance, philanthropic organizations that would like to avoid bearing the implementation risk will consider a straightforward pay-for-success scheme, whereas another actor that wishes to bring different capital providers into the sector might consider an impact bond. Nevertheless, the primary motivation is to achieve certain impact goals.

Due to the innovation happening in results-based financing and the nascency of the instrument use, **another strong motivation for initiators choosing this instrument cluster is the demonstration effect of the instrument.** Keywords strongly associated with this cluster were scalability and replicability of the instrument, indicating that actors were also choosing these instruments in order to demonstrate their viability. While this can be a legitimate reason, it needs to be scrutinized whether the instrument really does need further demonstration or whether there are learnings from previous transactions, and thoughts on how the viability can be demonstrated ex-post need to be gathered.

## Characteristics

- **Capital financially rewarding impact.** Instruments in this cluster require capital that is willing to financially reward impact. In many cases, this is a philanthropic or development actor with donor capital, but it can also be a lender willing to sacrifice financial return.
- **Impact-specific need.** For results-based financing, there needs to be an impact-specific need that is addressed. The need addressed is typically more specific than for instruments in other clusters, such as early childhood education or addressing patients at the bottom of the pyramid, in comparison to tackling climate change or poverty. Capital providers for rewarding the impact side join the transaction under the premise of achieving certain impact goals that address these needs.
- **Smaller transaction size.** The specificity of the impact need addressed also explains why the size of the transaction tends to be smaller. The narrow scope limits the number of investible opportunities and programs.
- **Knowledgeable stakeholders.** The transaction typically has stakeholders with pre-existing knowledge and expertise on the impact sector and region that is being addressed. They provide reassurance to other stakeholders who are new to the sector and region, and they share their knowledge and expertise throughout the transaction.
- **Clear impact measurement.** The measurement for impact targets should be clear so that all stakeholders—e.g., outcome funders, investors, capital recipients—all have a common understanding of what is being measured. This is also why measurements are usually set at an output and/or outcome level, rather than on the impact level, which is more difficult to measure.
- **Easily obtainable impact measurement.** While the measurement needs to be a valid indicator of the final impact, it should also be easy to obtain, and it should not put additional reporting pressure on the capital recipient. **Especially for impact bonds, best practice is to work with the public sector.** If there is a standardized public measurement, such as the defecation-free rate in Cambodia, which is a government standard with assessments done every 12 months, it is best practice to align the impact measurement to it. This not only makes it easier and less costly to obtain data, but it also allows for a smoother transition for the public side to take over the intervention at the end of the transaction.
- **Rigorous impact reporting.** Due to the nature of financial payment being linked to impact, impact reporting has higher rigor. Many practitioners involved in transactions using results-based financing instruments mentioned that the impact reporting is more granular, regular, more informative, and offers better visibility. There are more frequent exchanges between stakeholders, which lead to deeper learning about the impact sector and region. At the same time, the level of rigor also has cost implications that need to be considered.
- **Combination possibilities.** The instruments in this cluster can be combined with the first or fourth clusters. Typically, a grant is provided to conduct a feasibility study and pay for the design phase of setting up the transaction. Technical assistance can be added in the execution phase to help capital recipients to achieve the targeted impact and receive the financial payment for it. Sometimes a guarantee or first-loss layer is added to reassure private capital providers. Since the risk assessment for this transaction is different from a financial risk assessment, having such a de-risking layer could be helpful, although not mandatory, and such layers add to the complexity.



## Point of Caution

When it comes to results-based financing, the effectiveness of the instruments in incentivizing entrepreneurs to create more impact is contested among practitioners. It largely depends on the materiality of the amount being paid out; if the amount is not high enough, entrepreneurs might feel that it is not worth the effort of going through stringent reporting. Some practitioners commented that outcome funding does not incentivize behavior change to focus more on impact, and that there is no causality between results-based financing and impact. Nevertheless, those involved in such transactions pointed out that it is not about establishing causality but reward impact to establish a market.

An additional point of caution is scalability. Transactions involving instruments in this cluster can be complex to scale because structures get complicated with an increasing number of stakeholders. Larger transactions are expensive to set up due to the resources required for stakeholder alignment. Thus, there needs to be a clear reason that justifies the high transaction cost.

Sometimes results-based financing instruments can invite public scrutiny because they can be misunderstood as subsidizing the private sector. Instruments that reward investors financially for taking risks (e.g., impact bonds) can be especially contested for using public capital to subsidize private capital. Instruments rewarding companies for their impact can also be perceived as public capital giving money to private companies. One practitioner commented that such transactions are “optically not good.” While this should not be a reason to turn away from these instruments, it indicates that such instruments might require more education and training of stakeholders to overcome such misconceptions.

# C. Third Cluster: Market-rate, Subordinated, Concessional Debt & Equity

## General Explanation

While there are various instruments bundled together within this cluster, there is a clear distinction between debt and equity capital and investors.

In general, equity takes a higher risk and is required at earlier stages of the company to scale. It allows companies to invest capital for growth without having to immediately think of generating a return or becoming profitable. Equity investors benefit from the higher return potential, both in terms of financial and impact return, when investing in companies at an earlier stage. They are interested in taking more risk in return for a higher uptake potential. Equity comes with partial ownership of the company, which might limit the use of it for certain organizations that are not allowed or reluctant to take ownership in private companies, such as foundations or government entities.

On the other hand, debt takes a lower risk and is required at later stages of the company. It provides capital to the company without diluting ownership. Debt investors benefit more from the lower risk than equity investments while still being additional by providing capital in the private market. In general, debt investors are more interested in a lower risk for a lower target return.

Once the choice of using equity or debt has been made, the question of market rate, subordination, and concessionality comes into question. This is where there was a lack of clarity in terms of the concept and use of terminology among practitioners. We provide a more coherent framework for how to see these concepts in the characteristics section below.

## Reasons for choosing

Debt and equity instruments have multiple motivations that range from directly creating impact and developing the market to crowding in private capital, depending on the investment strategy of the transaction. The primary focus also shifts, depending on whether it is a subordinated position and the level of concessionality. One large reason for choosing instruments in this cluster, though, is the fact that these instruments are very established. The financial sector understands how to structure them and assess their risk and return profile. Thus, less effort is required for educating stakeholders. This might also explain why these instruments are often chosen when initiators aim to crowd in private capital, since they are used and understood among traditional investors.



## Characteristics

- **Clearer terminology.** Using this instrument requires clearer language to help stakeholders align their interests and expectations to allow for appropriate structuring. **While the terms "subordinated capital" and "concessional capital" are used interchangeably among many practitioners, subordination is about risk expectation, while concessionality is about return expectation and time horizon.**
  - **Subordinate.** Subordination refers to taking a junior position and a lower priority when it comes to repayment. Thus, subordinated capital takes on higher risk, which usually comes with a higher return expectation. Conceptually, subordinated equity—mostly called junior equity—exists, but it is not used in an impact context due to the fact that it can create complications for the entrepreneur while not adding much value from an impact perspective.
  - **Concessional.** Concessionality refers to accepting a lower return and/or longer time horizons, also referred to as patient capital. Since there is a lower return expectation, capital providers are reluctant to take a high risk.
  - **Capital providers can be both subordinate and concessional, but this does not necessarily need to be the case.** For instance, several practitioners lamented that concessional debt providers, such as development agencies, are often the least risk-taking, even though they have a mandate to create impact. In this case, the capital was perhaps concessional, accepting a lower return, but not subordinate or willing to take a higher risk. Clarifying the terminology can help align expectations and avoid frustrations when implementing the transaction.

| | Equity | Debt |
|---|---|---|
| Market-rate<br>Traditional risk-return expectation | Market-rate Equity<br>• Higher risk, higher return expectation<br>• Earlier stage of a company<br>• Ownership | Market-rate Equity<br>• Lower risk, lower return expectation<br>• Later stage of a company<br>• No ownership |
| Subordinate<br>Taking junior position<br>Taking higher risk | – | Subordinated debt / Junior debt<br>• Higher risk, higher return expectation |
| Concessional<br>Accepting lower return<br>Accepting longer time horizon | Concessional Equity<br>• Lower return and/or longer time horizon (patient capital)<br>• Lower risk expectation | Concessional Debt<br>• Lower return and/or longer time horizon (patient capital)<br>• Lower risk expectation |

Table 2: Clarifying market-rate, Subordinate, Concessional capital

## Characteristics (continued)

- **Influence of the legislative environment.** Different legislative environments or market contexts need to be in place for equity and debt instruments. Equity investments are more agile and easier to implement across multiple regions, as long as the minimum regulatory environment around ownership is in place. Equity investments, especially in earlier stages, are less stringent on requiring a financial track record and collateral. There are also fewer regulations for being an equity capital provider, which allows equity to be simpler and faster to deploy. On the other hand, debt investments are more suitable for frontier markets and are effective in developing the local financial market. Debt investments are usually less risky to recover due to their nature of requiring collateral and regular interest payments. While equity investors have a tendency to seek out high-growth companies, debt investors are happy to invest in SMEs with more stable growth, which is required for a healthy local economy. Providing direct debt to entrepreneurs demands that regulatory requirements, which differ across regions, are met. This complicates the roll-out and decreases the speed of implementation. Thus, debt instruments are usually executed in partnership with local financial institutions, which provides the added benefits of a deeper understanding of the market and a lower due diligence cost.
- **Financial knowledge.** In comparison to the first cluster, equity and debt instruments require more sophisticated financial knowledge to implement. They also require more market knowledge for doing due diligence on investments in comparison to the second cluster. Instruments in these clusters are structured in the same or a similar way to traditional financial market instruments, following the same market logic. This requires financial expertise, which does not always exist within a development or philanthropic organization but is increasingly being built up these days. The instruments are more familiar to the financial market, which makes crowding in different types of capital providers (e.g., institutional investors) easier in comparison to other clusters. This also indicates that the capital recipient needs to be a company based on market mechanisms and cannot be a nonprofit organization.

## Point of Caution

For transactions involving equity and debt instruments, the impact factor is not explicitly built into the structure. While the investment strategy does aim to create impact, the impact is not always measured post-ex, and there is little accountability for not achieving impact goals. Thus, the contribution to impact goals through such transactions can be thin, and they can also result in mission drift in the process of aligning stakeholder interest. This is why best practices in our research had a strong stakeholder alignment with creating impact, accompanied by technical assistance on the ground and a rigorous impact measurement scheme to mitigate impact risks.

Another point often brought up in the interviews as a point of caution was the financial and impact additionality of these instruments. Subordinated or concessional capital often faces the criticism of displacing or crowding out other investors, instead of crowding in, as many of them intend to do.



# D. Fourth Cluster: First-loss, Guarantee

## General Explanation

First-loss and guarantees are instruments primarily chosen for de-risking a transaction and crowding in capital. In our cross-code analysis, crowding in capital was the single most associated motivation for using first-loss and guarantees. The instruments are used mostly as an additional, supporting layer for other instruments.

First-loss capital and guarantees cannot and should not be mapped on a risk-return spectrum, like the third cluster, because that is not their primary intention. Guarantees and first-loss capital are not provided with the intention to seek a return. It is possible to view first-loss capital as an extreme form of subordinated capital, but while subordinated capital usually comes with higher return expectation, first-loss capital is provided with the intention to crowd in and not necessarily to preserve capital or seek a return. Thus, taking a junior position is distinctively different and should be distinguished from providing first-loss capital.

## Reasons for choosing

The primary reason for choosing instruments in this cluster is to de-risk the transaction and crowd in further capital. Ideally, the instruments should crowd in private capital that otherwise would not participate in impact-driven investments—e.g., institutional investors, such as insurance and pension funds, sovereign funds, and family offices. This indicates that the transactions using first-loss capital or guarantees are more suitable for later stage investments, since such capital usually requires a financial track record and scale that can be found in later stages[12].

## Characteristics

- **Large asset size.** The capital provider of first-loss capital or guarantee needs to have sizable assets, especially in the case of a guarantee. The guarantee or first-loss layer is usually provided by a single organization, since having multiple organizations providing the capital complicates the structure and would require more time in terms of stakeholder alignment. Due to the main motivation for using these instruments being crowding in capital and scaling a transaction, the size of the transaction aims to be large, meaning the de-risking layer needs to reflect that as well. This leaves the instrument, especially guarantees, to be suitable for rather larger development and philanthropic actors.
- **Financial knowledge.** Similar to the previous cluster of debt and equity instruments, these de-risking instruments also require sophisticated financial knowledge to implement. Especially in the case of guarantees, the implementation demands expertise in risk assessment of a given sector or region, which in many cases is a less developed one and is challenging to assess.
- **Familiarity.** The instruments are familiar to the financial market and larger institutional investors, which is why they require less education or training on the instruments for crowding in private capital (although education on the transaction and investment strategy might be required). They are often combined with any of the debt or equity instruments in the third cluster in order to scale the transaction.

## Point of Caution

While de-risking instruments no doubt help, practitioners express that they do not solve the problem of needing capital in the first place, especially in the case of guarantees. As an initiator, you still need to go fundraising and secure capital.

Another challenge with first-loss capital or guarantees is striking a balance between achieving impact goals and crowding in. Much of the de-risking capital is being provided by development or philanthropic actors with a specific mandate regarding impact goals. To ensure that the de-risked transactions contribute to achieving these goals, capital providers attach certain restrictions—regional or sectoral—to the use of de-risking capital.

Yet, too stringent restrictions complicate the structure and make crowding in capital challenging. These factors need to be considered when using first-loss and guarantees to strike a good balance.





# Practical Relevance

Practitioners choosing instruments for creating development impact have a long list of instruments to choose from. Yet, the process of selecting the right instrument seems to be one that many struggle with. The four clusters laid out above address that struggle in several ways:

**01. Clearer framework**

The clusters provide a clearer way to group and conceptualize the different instruments, and how to think of them. By having clusters, practitioners can identify a group of instruments according to their functions and suitability much easier and faster than when there is a long list of instruments to choose from.

**02. Consider different instruments**

Often, practitioners seem to be limited to using tools they or their organization is familiar with. The clusters help identify other instruments with similar functions within the same group. Additionally, they also help them consider a completely different set of instruments that function differently but might achieve a similar outcome sought by the organization.

**03. Better alignment between purpose and instrument choice**

Ultimately, the clusters provide a guideline between the purpose of a transaction and the choice of an instrument by laying out how they function in a clearer manner.

A beginner chef can easily be overwhelmed by the long list of spices that can be used for seasoning; however, once they are grouped in terms of making a dish more savory, sweet, or spicy, the chef has an easier task. He/she can now effortlessly select and combine the right ones and substitute one for the other. Similar to cooking, selecting an instrument can be an easier task once the clusters provide a clearer framework for how to think about the long list of instruments that can be used and how to consider their different trade-offs.

| Cluster | Characteristics | Uses | Strengths & Weaknesses |
|---|---|---|---|
| **Grants/TA** | • Same source of capital, development and philanthropic actors<br>• No financial return expectation | • Supporting instruments, intended to help achieve impact goals<br>• Important when entering new markets | • Requires less financial knowledge<br>• Needs to strike a balance between accountability and flexibility<br>• Historically criticized for lack of effectiveness |
| **Outcome Funding** | • Links impact creation directly to financial rewards<br>• Allows stakeholders with different interests to be aligned<br>• Addresses an impact-specific need with measurable targets<br>• Establishes new market rules and does not accept market rules | • Directly creates impact and strengthens the relationship between impact and the financial payment<br>• Demonstrates the effects of the instrument<br>• Can be combined with grants and TA | • Creates knowledge sharing of an impact sector or region among stakeholders<br>• Clear impact measurement and reporting<br>• Tends to be smaller in size and higher in complexity—needs to answer the question of scalability and replicability<br>• Requires appropriate and material financial reward to be effective<br>• Can invite public scrutiny when misunderstood as subsidizing the private sector |
| **Market-rate Debt & Equity, Subordinated Debt, Concessional Debt & Equity** | • Clear distinction between debt and equity capital<br>• Equity takes a higher risk, higher return, and ownership; debt takes a lower risk, lower return, and no ownership<br>• Subordination is about risk—taking a junior position and a lower priority for repayment<br>• Concessionality is about lower return and/or longer time horizons<br>• Capital providers can be both subordinate and concessional, but are not necessarily so | • Varying motivations depending on debt vs. equity, market-rate vs. subordinate vs. concessional capital<br>• Chosen for being an established instrument<br>• Important to align risk and return expectations by using clearer terminology | • Established instruments easily understood by the private sector and other stakeholders<br>• Requires financial knowledge<br>• Impact not explicitly built into the structure<br>• Financial and impact additionality is contested |
| **First-loss & Guarantee** | • Chosen for de-risking a transaction and crowding in capital<br>• First-loss capital is distinctively different from subordinated capital in terms of return expectation | • De-risk the transaction and crowd in further capital<br>• More suitable for later stage investments | • Familiar to the financial market and larger institutional investors<br>• Requires a large asset size and financial knowledge<br>• Requires striking a balance between achieving impact goals and crowding in |

Table 3: Summary of blended finance clusters and selected practitioner implications





# V. Findings | Key Questions for Instrument Selection

# Findings | Key Questions for Instrument Selection

Based on the analysis of the codes, we identified themes that influenced the decision-making or pivoting of various transactions. The factors that influenced decision-making shed light on which key questions practitioners ask themselves when choosing an instrument. The factors that influenced the pivoting of a structure revealed instances where there might have been a misfit of instrument choice or structure over time, and which key questions should have been asked at the beginning.

The analysis resulted in eight key questions that should be considered when setting up a transaction and deciding which instrument to choose. The key questions can be divided into five major themes: organizational context, purpose of transaction, investee context, cost and resources, and risk and return elements. Some factors are more complex in how they influence instrument choices, such as the role played in the transaction, while others are more straightforward in ruling out some clusters, such as the target financial return.

In the section below, we lay out a short description of what the key question entails and how it manifests itself in decision-making. We support it with examples from our research and connect it with possible cluster or even instrument choices in terms of which come into question and which can be ruled out. While these questions cannot be considered a definitive guide or algorithm that will result in the identification of one perfect instrument—this would require more quantitative evidence—it could form the basis of a more comprehensive and detailed framework for initial decision-making and could help prevent missteps.

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# Organizational Context

Organizational features such as mandate and resource availability anchor or constrain instrument selection. Instruments that build on an initiator's organizational context are more likely to gain internal buy-in and resource support.

## 1. What is my institutional setup or mandate?

Institutional setup relates to the initiator's organizational type, mission, and operational structure. We consider these influences from the perspective of initiators; the most common institutional setups were **financial intermediaries, philanthropic organizations, new impact investment entities, and development actors.** In the following section, we explore how such setups influence decision-making in terms of which instrument to use.

| | Attributes | Selection Preferences |
|---|---|---|
| Financial Intermediaries | • Commonly an advisory firm or fund manager responsible for coordinating instrument development and fundraising. Role may extend to implementation.<br>• Often experienced with specific financial tools, possibly with a sector lens.<br>• Often interested in instruments that attract traditional investors over the long term.<br>• Possess limited internal funding for project development. | • Prioritize tools that have used before.<br>• Eager to include market-rate debt/equity.<br>• Seek grants/TA for development costs. |
| Philanthropic Organizations | • Private sector donors, typically with sector-related sustainable development mandates.<br>• Aim to achieve strong multiplier effects with their giving.<br>• Often more capacity to make grants than invest for sustainable development. | • Seek grant-based involvement in blended facilities.<br>• Prioritize options with clear, measurable ties to improved funding and impact. |
| Impact Spinoffs | • New blended facility managers established by existing fund managers or development-focused organizations.<br>• Focused on establishing commercially sustainable facilities to address ecosystem funding gaps.<br>• Often need to establish complementary operational capabilities and experience.<br>• Primarily influenced by parent's priorities and organizational attributes. | • Grant/TA for establishment.<br>• Concessional funding to attract external investment. |
| Development Actors | • Aid agencies and development banks focused on large-scale deployments.<br>• Subject to public sector determined development priorities and mandate.<br>• Face elevated governance and reporting requirements that reduce flexibility.<br>• Development banks subject to commercial investment standards. | • Preference for larger transactions.<br>• Development banks: limited use of concessionality.<br>• Aid agencies: provision of conditional grants. |

Table 4 : Common initiator organizational archetypes and cluster selection influences

## Intermediaries

Intermediaries are organizations that are responsible for coordinating a transaction, such as an advisory firm or fund manager. Advisory intermediaries take on the role of structuring transactions and engaging stakeholders, making the process more efficient and cost-effective. Fund managers, or investment/capital supply intermediaries, deploy the capital based on regional/sectoral expertise and presence on the ground. Sometimes intermediaries can also play both roles[13].

> "Making the process more efficient and cost-effective.

> "Regional/sectoral expertise and presence on the ground.

Intermediaries are typically resource-constrained and require third-party development funding. Delivering the instrument, in terms of its operationalization and sustainability, is their central objective. Intermediaries generally exhibit a high level of decision-making flexibility, which enables them to effectively respond to other stakeholders' inputs and requirements. Familiar instruments offer an economy of cost and effort, as well as improve the likelihood of successfully implementing the structure.

Social Finance Israel is reputed for its work on developing impact bonds. Although it actively assesses the relevance of other financing tools, the organization recognizes its depth of expertise with the instrument. It thus considers impact bonds and other outcome-based mechanisms as its main point of departure. Similarly, BlueOrchard, an investment manager with significant experience in deploying structured funds, was able to rely on its experience with structured funds when developing the Regional Education Finance Fund for Africa (REFFA.)

Collectively, intermediaries are flexible and support development activities across a range of sectors and instruments. They regularly employ a variety of tools across the sectors and clusters to address needs, including the costs of establishing and responding to the needs of prospective stakeholders.

## Philanthropic Organizations

Philanthropic organizations often target specific needs, such as supporting access to services, improving the strength of business models and the bankability of projects, or eliminating key gaps in funding tools, e.g., ticket size, tenor. Delivering results on a scale that exceeds their available resources is often a priority. For larger foundations, this extends to supporting and catalyzing entire sectors or regions. At any rate, a closer alignment with the mission increases their likelihood of engaging with blended finance.

Smaller foundations face operational resourcing constraints, and their staff may specialize in grant administration. Opportunities that allow them to contribute using established grant-making protocols enable their participation. For instance, one particular philanthropic organization provided a small support grant to The Nature Conservancy and its NatureVest impact investment team to develop the Seychelles' debt conversion structure. The organization providing the grant reportedly found the proposed instrument complex, but it extended the development grant upon understanding how their contribution could unlock significant funding for conservation downstream.

> "Using most diverse set of instruments, reflecting their decision-making flexibility.

Depending on the region, philanthropic organizations are limited to grant-making activities, not only due to their core expertise but also to the limits of these organizations' structures, such as tax-advantaged status. An expert stated, "For donors, the legal boundaries within which they can or cannot move are very important and play a very important role in making them choose one instrument or another. They are guided by the legal implications of their actions."

Nevertheless, philanthropic organizations demonstrate an openness to considering or supporting experimental instruments within their limitations. In our data, they have been the organization type using, by far, the most diverse set of instruments, reflecting their decision-making flexibility. Although larger organizations with less decentralized hierarchies may take longer to initiate or support financing activities, private foundations, such as family-owned institutions, are likely to preserve a greater level of flexibility when responding to new opportunities.





## Impact Investment Spinoffs

Several philanthropic organizations have established or seeded affiliated fund management entities that develop and host blended finance facilities. These spinoffs possess the sector-based competencies of their parent organizations and are tasked with applying them to address investment-specific needs and creating conduits for interested capital to participate.  Kawisafi Ventures is a for-profit venture capital firm focused on scaling renewable energy enterprises serving East Africa's off-grid population. The fund was established by Acumen, a social enterprise support nonprofit. Kawisafi's blended finance model employs debt, equity, and technical assistance, with an emphasis on scale-ready companies with proven track records. This complements Acumen's existing focus on early stage businesses.

> "Possess sector-based impact competencies of their parent organizations and create conduits for interested capital to participate.

Established fund managers also initiate new instruments while expanding to new sectors and geographies. As relatively mature entities, these initiators are focused on opportunities to grow their overall assets, involve new investors, and address market gaps. Ecobusiness is a blended fund featuring subordination and technical assistance that is focused on food, forestry, and tourism. The fund sits within an umbrella fund platform that facilitates the creation of new funds or funding windows to pursue new market opportunities. Initially focused on Latin American investments, the management team responded to interest in investments in Sub-Saharan Africa by creating a sub-fund focused on the region.

Spinoffs often need to secure sufficient working capital and may require anchor funding. Their parent organization and its priorities are often the major design influence. The new organization may rely on the parent's operating backbone and be subject to its constraints.

## Development Actors

The public sector links between aid agencies and development banks shape their priorities over time and influence their propensity to initiate blended activity in specific sectors or geographies.

Development actors are typically well resourced, both in terms of their staffing and range of execution abilities. They are also mandated to make larger funding commitments and thus deploy capital at a meaningful scale for catalyzing development.

Development actors are often willing to explore opportunities with good scale potential, including assessing requests to provide establishment funding and catalytic investment to promising initiatives. However, stringent governance frameworks can increase deployment lead times, rule out certain instrument types, such as concessional finance for development banks, or present added restrictions on the recipient's use of funding.

> "Willing to explore opportunities with scale potential.

For instance, the US International Development Finance Corporation (DFC) invested in the Cameroon Cataract Development Impact Bond (DIB), a $3.5m blended finance transaction focused on providing low-cost, quality cataract treatment to low-income patients. As the organization's first experience with a DIB, the DFC found entry to the transaction labor-intensive. Parts of its standard investment appraisal and accounting process had to adjust for the transaction and the internal approval process was less streamlined. DFC would not ordinarily have made such a small investment ($1.7m).However, it did so in the interest of testing new innovations and becoming more familiar with investments in eyecare.

In the case of the Regional Education Finance Fund for Africa (REFFA), the facility was initiated by the German Development Bank (KfW) and funded by the German Ministry for Economic Cooperation and Development (BMZ). The initiator, KfW, was interested in improving the quality and the affordability of education in Africa and issued a tender for asset managers to structure and manage a scalable and replicable transaction for the sector. The initiators then went on to fund REFFA's junior tranche to crowd in further private sector capital.

## 2. Which role do I play in the transaction, and what can I bring to the table?

When structuring a blended finance transaction, it is important to consider the various roles of stakeholders, the power dynamics, and what they each bring to the table. The initiator (or initiating consortium), who usually chooses the instrument and impact theme, then needs to assess its own capabilities and decide which role to play within the transaction, and how to bring in stakeholders that can fill the gap. In the following section, we lay out the different roles within a transaction, the key elements required for a successful transaction, and how they shape a transaction in general.

### Roles within a transaction

There are different roles within a blended finance transaction because it requires different competencies and elements. The following table lays out some key roles, and some of them might overlap with each other. For instance, an initiator or initiating consortium can also include a donor or a player with structuring capabilities.

| Role | Description |
| --- | --- |
| Initiator | The initiator (or initiating consortium) is typically a mission-driven organization looking for a way to finance solutions to create impact. It is the initiator (or the consortium) who chooses the instrument and impact sector. |
| Donor | Donor s commonly fund the design/structuring and development of the transaction in the initial phase. They provide the catalytic capital—for instance, as an outcome funder or a provider of de-risking capital—at a later stage. This role is usually played by a philanthropic organization or development actor. |
| Structurer | Structurers are knowledge partners that manage or assist in the implementation of the blended finance transaction. This role is usually played by financial intermediaries. |
| Beneficiaries | Beneficiaries are recipients of the investments. In most transactions, the beneficiaries are end beneficiaries and the public sector, but in some cases, they can also refer to social enterprises and the private sector, such as corporations. |

Table 5: Key roles played by stakeholders

In general, there is a lack of consideration of social enterprises and beneficiaries when it comes to discussing instruments. Beneficiaries only seem to be explicitly considered for transactions with grants, concessional capital, or other types of capital with no financial return expectation, and even then, they are mostly treated as a recipient rather than a stakeholder that should be involved in shaping a transaction.

To ensure that the blended finance transaction focuses on its impact mission and achieves its intended effect, it is important to place the power with those who are closest to the problem by letting the social enterprise or end beneficiary shape the transactions as a key stakeholder.





### Key elements for a transaction

For initiators, assessing the organization's own core competencies and gaps is an important step. Based on our analysis, there are four key elements that a stakeholder can bring to the table: capital; structuring capabilities; sector and/or regional knowledge; and reputation and creditworthiness. For instance, when a donor organization is initiating a transaction and lacks structuring expertise, it is common for such organizations to fund the design/structuring and development. However, regardless of who the initiator is, it is always crucial to have an anchor investor and partners with sector expertise and creditworthiness to play these critical roles in transactions.

| Institutional setup | Capital | Structuring | Knowledge | Creditworthiness |
| --- | --- | --- | --- | --- |
| Intermediary | ○ | ○ ○ ○ | ○ ○ ○ | — |
| Philanthropic organization | ○ ○ | — | ○ ○ | ○ |
| Impact investment spinoff | — | ○ ○ | ○ ○ ○ | — |
| Development actor | ○ ○ ○ | ○ | ○ ○ | ○ ○ ○ |

Table 6: Institutional setup and key elements

The coordination of contributions from a wide range of multi-stakeholder partners provides the opportunity to remove barriers that impede scale and investment potential. Some forms of multi-stakeholder partnerships within an initiating consortium include:

- Capital + Knowledge: Capital providers leveraging intermediaries' sector expertise or pipeline.
- Capital + Knowledge: Scaling smaller, successful blended finance transactions that have been tried and tested. For instance, Sida asked Beyond the Grid to scale from Zambia to four other countries.
- Knowledge + Knowledge: Combining sector expertise with market expertise, and overcoming uncertainty with knowledgeable partners. For instance, Sanlam InfraWorks BV combined the renewable energy expertise of Phoenix Infraworks and the capital raising, asset management, and local market knowledge of Sanlam.
- Capital + Structuring: Making use of more complex transactions with layers. Typically, DFIs support a transaction with guarantees/first-loss initially, and a foundation provides a follow-on round with concessional investments.

## Capital

Development cost. Grants and TA play an enabling role in meeting the costs of establishment in the initial phase of a transaction. If there is in-house expertise, the cost of setting up the transaction will be lower, whereas for no expertise, the development cost needs to be budgeted and also justified. In many cases, philanthropic organizations or development actors provide grant funding for the design and development of blended finance transactions. For instance, the Rockefeller Foundation's Zero Gap initiative provides early stage support for the development of blended finance vehicles using grants and PRI funds.

Some examples from the facilities that we reviewed are provided below.

| Facility | Who bears the development cost? |
|---|---|
| Crossboundary Energy | USDFC provided the fund with a grant of $420k to fund initial setup costs. |
| Cameroon Cataract Bond | Fred Hollows Foundation, Sightsavers and the Conrad N. Hilton Foundation. |
| The Global Health Investment Fund | The Bill & Melinda Gates Foundation. |
| The Cambodia Rural Sanitation DIB | The Stone Family Foundation. |

Table 7: Development cost responsibilities across selected transactions

Catalytic capital. Once the instrument has been chosen and the transaction structured, the blended finance transaction requires catalytic capital, which refers to investment capital that is patient, risk-tolerant, concessionary, and flexible[14]. Depending on the instrument, the capital can be provided by an outcome funder or an organization that de-risks the transaction. Finding catalytic capital is critical for further fundraising.

## Structuring expertise

The initiator or initiating consortium is mostly involved in the design and structuring of the transaction. In some cases, the initiator is a mission-aligned organization, such as a foundation, that lacks the necessary structuring expertise and thus looks to an intermediary or an internal team that has a financial background and the required structuring abilities. For instance:

- In the case of the Cameroon Cataract Bond, Africa Eye Foundation partnered with Volta Capital, which had the structuring capabilities to set up an impact bond.
- For the Regional Education Finance Fund for Africa (REFFA), the German Development Bank, the German Ministry for Economic Cooperation and Development (BMZ) and Blue Orchard worked together, relying on Blue Orchard's structuring and fund management capabilities.





## Knowledge of sector and/or region

Knowledge of and expertise in a sector or region is another key element for a successful partnership and transaction. In many cases, it is an intermediary or impact investing spinoff that contains knowledge on the ground, providing a pipeline of potential investments.

However, some capital providers, such as foundations with a specific sector focus, can also bring in their sector expertise. For instance, for the Cameroon Cataract Bond, DFC stated that having the Fred Hollows Foundation and Sightsavers, two organizations with deep expertise in eye care, was a key element that made them decide to join a transaction where they had less experience in the sector and the instrument.

## Creditworthiness

Having a player that provides creditworthiness within the initiating consortium is also critical in the following rounds of setting up a transaction. This element is typically brought to the table by a larger institution with an established reputation.

For Crossboundary Energy, it was crucial to get USAID as a de-risking organization because it provided a lot of comfort to the subsequent investors, not only financially, but also through its reputation. Another pure commercial player also tried to play a catalytic role by being an early investor in transactions and offering its creditworthiness to make further fundraising easier.

## 3. How much capital can I deploy?

Instrument clusters are sensitive to the degree of funding an initiator can deploy and the transaction's capital requirements once it is operational.

Initiators with limited funding may be unable to provide sufficient resources to mobilize a large-scale blended transaction. Instead, they are likely to concentrate funding on supporting early development processes that may leverage funding downstream. Smaller foundations often play an enabling role by financing project development costs through Cluster 1 or providing a portion of the catalytic capital used in other clusters.

Where sectors and their business models are nascent, the limited number of bankable projects may lower the level of funding facilities can deploy. Diminished capital needs lower the appeal of instruments focused on leveraging large amounts of risk capital, e.g., within Cluster 4, where catalytic funders may consider leverage potential too small, and Cluster 3, where despite enhanced financial terms, ticket sizes may remain too small to make targeting traditional investors worthwhile.

Smaller initiatives face higher transaction costs on attempting more complex instruments, e.g., in fulfilling the performance management or monitoring functions of Cluster 2. Facilities that mobilize large amounts can better justify more complex instruments relative to the degree of capital mobilized.

## 4. What is my target financial return / what are my financial requirements?

Organizations often have a target financial return or financial requirements set by the institutional mandate. For instance, institutional investors have a fiduciary duty to aim for market-rate return, while development actors have less stringent financial return requirements or access to cheaper capital. This can also differ within an organization. The programmatic side of a philanthropic actor usually does not have any financial return expectation, while its investment side needs to achieve certain financial targets.

The financial requirements or target can largely be divided into:

- No return - having no financial return requirement. Typically, philanthropic and development actors have no return requirements.
- Partial return - aiming for partial recovery of the principal. Organizations with no return requirement sometimes target partial return as well, in an attempt to introduce more discipline for the capital recipient and recycle the recovered capital. Recently, some impact-driven asset holders (e.g., religious endowments) have been observed spending down, in which case they would also aim for a partial return.
- Below market-rate return - aiming for a full recovery of the principal and an additional financial return that is below the market rate. Many impact-driven investors have financial requirements that belong in this category. A below market-rate return allows them to be financially sustainable and profitable on an absolute level, while still having a strong focus on achieving impact rather than maximizing profit. Family offices or UHNWIs that have more flexibility can also be seen targeting below the market rate with parts of their portfolio.
- At or above market-rate return - having traditional financial targets. Typically, institutional investors bound by fiduciary duty (e.g., pension funds) require an at or above market-rate return.





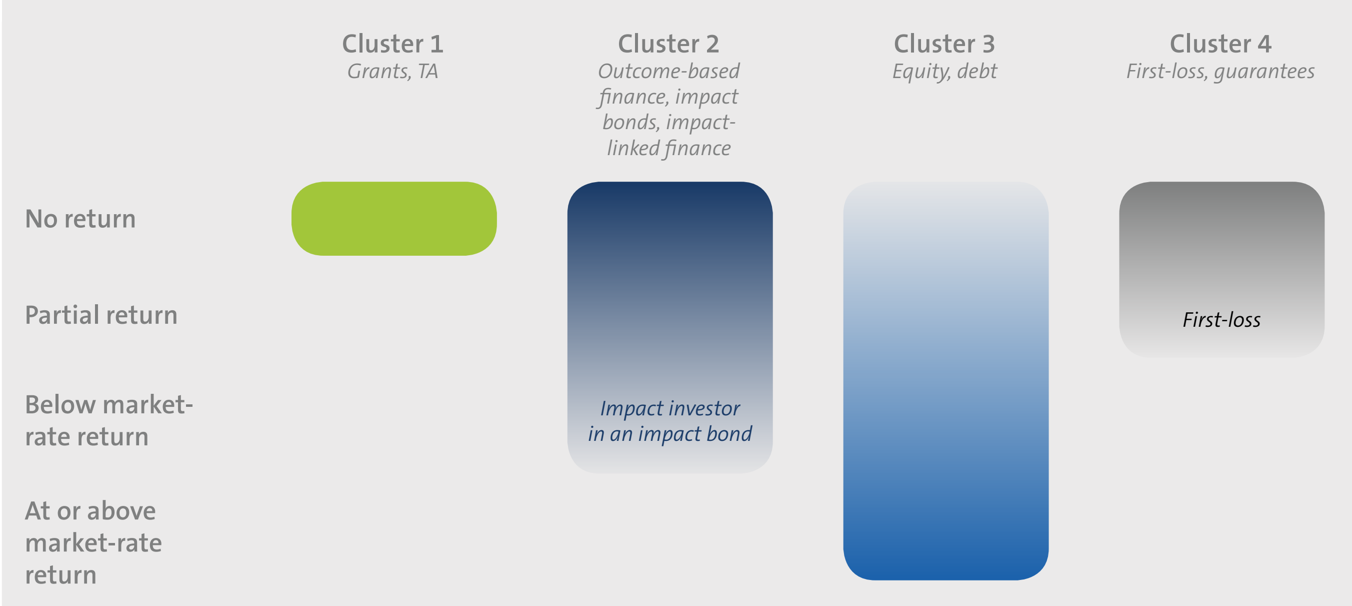



**Figure 2: Financial target/return expectation and cluster choices**

The mandated financial return of an organization easily rules out certain instrument clusters. For instance, any organization that needs to recover at least some of the capital cannot make use of Cluster 1 or some instruments in Cluster 2. Having a below market-rate return requirement also limits the use of instruments to Cluster 3. Considering financial return requirements is usually more relevant when stakeholders start to join the transaction. For instance, when an institutional investor joins a renewable energy fund in frontier markets, the fund needs to meet a certain return level in comparison to the risk it takes. The requirements are seen as a limiting factor, since they quickly rule out instruments and transactions for actors. However, considering return requirements for the initiator or initiating consortium can be an exercise that rather expands than limits. Since initiators are usually less restricted by financial return requirements, being aware of the flexibility can enable them to consider diverse instruments to use.

# Purpose of the transaction

The design of blended finance transactions needs to be anchored in the transaction-specific objective and context. Several context-specific factors influence the nature of additionality, concessionality, mobilization, and commercial sustainability in blended finance, which need to be taken into account when designing a blended finance structure. Purpose-built instruments tailored to the context and intended stakeholders may simplify the process of attracting and aligning stakeholders.

## 5. What is my primary motivation?

Depending on their motivation, investors' intentions range from broad commitments, such as a) to target impact, b) to mitigate risk, to more specific goals, such as c) demonstrate proof of concept for a nascent sector or instrument, or d) build a market for a sector or region.

### Directly targeting impact

Associated with

* Cluster 2: outcome funding, impact-linked finance, impact bonds

Some organizations are motivated to respond to impact needs because the creation of positive change for people and the planet is the reason that they exist. Although most players join a blended finance transaction with the motivation of having an impact, there is a difference between those who aim to create impact directly through the transaction and those who focus more on other motivations, such as de-risking and scaling, demonstrating, or market building.

The motivation to respond to impact-specific needs is strongly associated with Cluster 2, which comprises financial instruments like outcome funding, impact-linked finance, and impact bonds. These outcome funding or results-based financing instruments link impact creation directly to financial rewards.

As would be expected, the stakeholders that were motivated by responding to impact-specific needs had lower financial return expectations and a willingness to take on more risk. However, most of the investors still noted that it is important that they could receive a return of capital that could be recycled.

### Crowding in and de-risking

Many organizations initiate or join a blended finance transaction to crowd in more private sector capital by financially de-risking the transaction. Their intention is to achieve impact through leverage and scale. The crowding-in motive is associated with a combination of instruments that cut across several of the clusters. Cluster 3 and Cluster 4 are especially strongly linked to the crowding-in motive.





Associated with

* Cluster 3: market-rate, subordinated, concessional debt & equity

* Cluster 4: first-loss, guarantee

Within our research data, when de-risking was the primary motivation, it was used to attract commercial investors with higher return expectations. To crowd in capital with higher return expectations, a transaction that blends additional instruments is necessary to offset risk. This requires the role of a donor, such as a DFI or a foundation, to de-risk and meet the requirements of commercial investors. De-risking is mostly addressed through a combined use of instruments, such as first-loss capital, guarantees, subordinated debt, and, sometimes, impact bonds.

However, it is important that the concessional rates do not distort the local market. Additionally, simply providing more concessionary capital for early stage investments does not necessarily crowd in commercial capital. Commercial capital requires a financial track record, which can typically be found in the later stages of the financial supply chain. Thus, a focus on later stage investments is most appropriate.

### Demonstration

Associated with

* Cluster 2: outcome funding, impact-linked finance, impact bonds

* Cluster 3: concessional debt

The field of blended finance is nascent and there are a lot of innovative structures being developed with the potential to create impact more effectively and efficiently. Another strong motivation among actors engaging in blended finance transactions is the demonstration effect of such new structures.

In our analysis, the motivation to create demonstration effects is associated most strongly with the second cluster of financial instruments. Scalability and replicability were important considerations for investors when choosing these instruments.

In addition to results-based financing, concessional debt was also found to have a strong emphasis on the demonstration effect, perhaps more related to the viability of the transaction itself than the instrument.

### Market building

Associated with

* Cluster 1: grants, TA

* Cluster 4: first-loss, guarantee

When building the market by financing a new market segment or underserved region, risk expectations need to be managed by using a range of instruments. Several of the insights shared during the interviews suggest that there is a large overlap between the demonstration of business models, sectors, and geographies, and the market building that happens as a result of that.

Market building is especially relevant for sectors that require scale to make the economics work. For instance, five to six years ago, the clean energy sector required a significant amount of concessional capital to establish the market and business models. Since then, the costs have dropped drastically and commercial returns are achievable with no concessional capital required, drawing in private sector capital. This is why blended finance is critical for entering the market. It allows a sector or region to be tested and proven until the economics work for private sector capital.

In terms of instruments, the appropriate choice depends on the level of maturity of the market. Based on our interviews, grants and TA were often used to develop pipelines and build the capacity of investees to develop a market that is deemed too risky or has too few investable opportunities for traditional investors. At a later stage, Cluster 4 instruments appeared to play a critical role in de-risking investment opportunities, in combination with Clusters 2 and 3.

## 6. What kind of impact problem am I addressing?

### Specificity of the impact problem

Investment opportunities can be targeted at general or specific social and/or environmental impact needs. A general impact theme may focus on a broad problem, such as the conservation of a natural habitat, whereas a specific problem could be a project that has clearly defined parameters and impact objectives. For instance, the Utah High-quality Preschool Program SIB provided high-quality education for low-income children to prevent at-risk kids from entering expensive special education programs. Another relevant example is the Cameroon Cataract Bond, which is helping the Magrabi ICO Cameroon Eye Institute (MICEI) to provide as many as 18,000 cataract surgeries over a five-year period. Both transactions address very specific impact needs.

Depending on the specificity of the impact problem, instruments can be largely positioned along a spectrum (Figure 3). For results-based financing, there needs to be an impact-specific need that is addressed. The need addressed is typically more specific, such as early childhood education, than for instruments in other clusters, which could be used for a broader set of solutions at the same time. If the problem is rather specific, providing capital directly through grants or TA, or linking it with incentives like outcome finance can be more effective, while if it is a more general problem, outcome finance would not be a good fit.

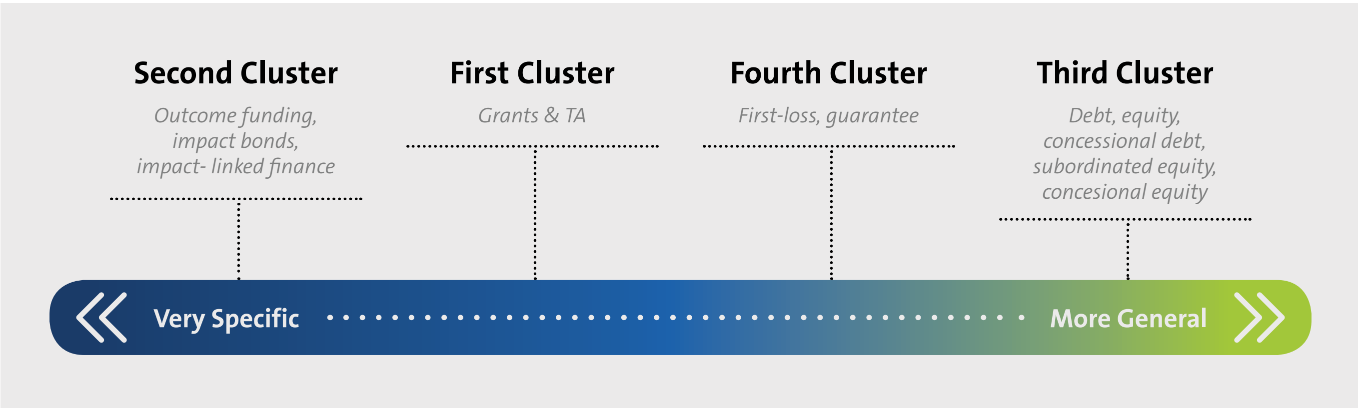



Figure 3: Specificity of impact problem and cluster alignment

### Time horizon required to address the impact problem

A key factor in any investment is time, and different instruments have different limitations when it comes to the time horizon. For instance, outcome-based financing typically deals with a shorter timeline than equity investments. This is why the time horizon required to address the impact problem can be relevant for choosing instruments, or should be a consideration for structuring.

Impact projects, by their nature, tend to need long development cycles to come to fruition, and the time horizons may differ significantly depending on the sector and specific intervention under consideration. For instance, conservation projects generally require much longer time horizons compared to a health service project. The table below provides examples of interventions and the related timeframe for benefits to be achieved.



| Intervention | Benefits/outcomes | Timeframe |
|---|---|---|
| Healthcare services<br>Surgeries | Quality healthcare to poor / underserved populations | Short to medium term |
| Education<br>Early childhood development | Quality education for vulnerable children | Medium term |
| Conservation | Land conservation and restoration | Medium to long term |

Table 8: Examples of interventions and the related timeframe for benefits to be achieved

**In terms of instruments, Cluster 2 has a typically shorter time horizon in comparison to Clusters 3 and 4, and within Cluster 3, equity transactions have a longer time horizon than debt transactions. Thus, impact problems that require a more long-term intervention might limit the choice of instruments** for an initiator, or the transaction would require additional structuring and stakeholder management to address the misfit between the different time horizons.

## 7. How do I want to ensure impact?

Blended finance has attracted a wide variety of investors, several of which have formal requirements to ensure impact, such as DFIs and foundations, and others who have more aspirational impact objectives but no formal requirements, such as institutional investors or impact funds. **As an initiator, there are largely two approaches to ensuring impact: either through explicitly linking impact to financial reward, or through implicit agreement by aligning stakeholders.**

Explicit impact assurance is strongly related to Cluster 2, comprising outcome funding, impact-linked finance, and impact bonds. These instruments link impact creation directly to financial rewards, making it an explicit goal of the transaction to achieve impact. Actors involved in such transactions expressed that “the structure allows players with different motivations to align.” In a way, the alignment around creating impact is being outsourced to the structure.

Ensuring implicit impact is more related to Cluster 3 and Cluster 4. These instruments do not have a formal link between impact and financial reward, so the impact is instead implied. This also invites the criticism of whether such transactions are truly effective in creating impact, especially since evaluation of the impact on end beneficiaries is done by only a limited number of funds—only 32% of funds surveyed by the OECD annual survey[15]. Nevertheless, more and more investors seem to require rigorous impact reporting from blended finance transactions in general, creating more transparency. Some transactions in our research also had impact-based incentive structures for implementers, which could create further accountability and transparency by making impact achievements an explicit part of the transaction.

The question of whether such explicit structures truly motivate actors to achieve impact, and at which level the incentives should be aligned, seemed to be contested among our interviewees. Additionally, the cost of creating such an explicit structure, as well as measuring and evaluating impact, also needs to be weighed against the cost of stakeholder alignment and management.

# Investee Context

## 8. What is the maturity level of the target market (sector/region)?

The maturity of the target market has an influence on the choice of instruments. Cluster 1 plays a crucial role in entering new markets, for instance, while Cluster 2 requires interventions that have been proven to be effective. Cluster 3 can be deployed across various stages of maturity. More risk-taking instruments such as equity are fitting for younger target markets (especially in the form of patient capital), while debt instruments are appropriate for more mature target markets. Cluster 4 is typically more fit for markets that have a track record and are ready to be scaled but are perceived as risky by private sector capital.

### Region

Blended finance investments into a region or country depend strongly on the macroeconomic state of the private sector and the regulatory environment that accompanies it.

#### Fledging Private Market

In regions where there is an underdeveloped financial sector and little commercial interest, blended finance can play an important role in creating the foundation required for building a market. Fledging private markets are characterized by regulatory and legal frameworks that are difficult to navigate, a nascent pipeline with few investable opportunities, little precedent for complicated financial transactions, and limited investor interest[16]. These markets are generally common in least developed countries (LDCs). The OECD estimates that LDCs receive just six percent of private capital mobilized by blended finance interventions, despite being the furthest away from achieving the sustainable development goals (SDGs)[17].

In this context, Cluster 1 can play an important role in creating an enabling environment for commercial viability through feasibility studies, providing technical assistance to local financial institutions, and building market capacity and pipelines. Cluster 2, specifically impact-linked finance, can also be used to directly create impact and demonstrate viability in the absence of a mature market. While transactions using tools like Cluster 2 instruments can be complicated and difficult to replicate, they can stimulate market development and can be subsequently followed by simpler instruments.

#### Developing Private Market

Once there is some precedent for commercial viability and evidence of opportunity, blended finance can be used to reinforce and strengthen a developing market. Developing private markets generally have a growing evidence base of transactions, emerging pipelines of investable deals, and a developing financial sector. Developing private markets are common in lower-middle-income countries (LMICs) and receive an estimated 33 percent of private finance mobilized by blended finance interventions[18].





In these markets, the use of Cluster 3 instruments can be effective. For instance, concessional debt and equity can be useful as patient capital to develop the market. Cluster 2 instruments continue to be useful for locking in missions for enterprises that are proving commercially viable.

#### Maturing Private Market

In markets where there is a relatively established financial sector and private sector interest, blended finance can crowd in institutional capital to gradually allow the market to become self-sustaining[19]. Maturing private markets are common in upper-middle-income countries s and receive an estimated 41 percent of private finance mobilized by blended finance interventions[20].

At this point, blended finance largely focuses on financing along commercial rather than concessional terms[21]. In maturing private markets, Cluster 3 and Cluster 4 instruments can be used to de-risk transactions and crowd in further capital to scale investments.

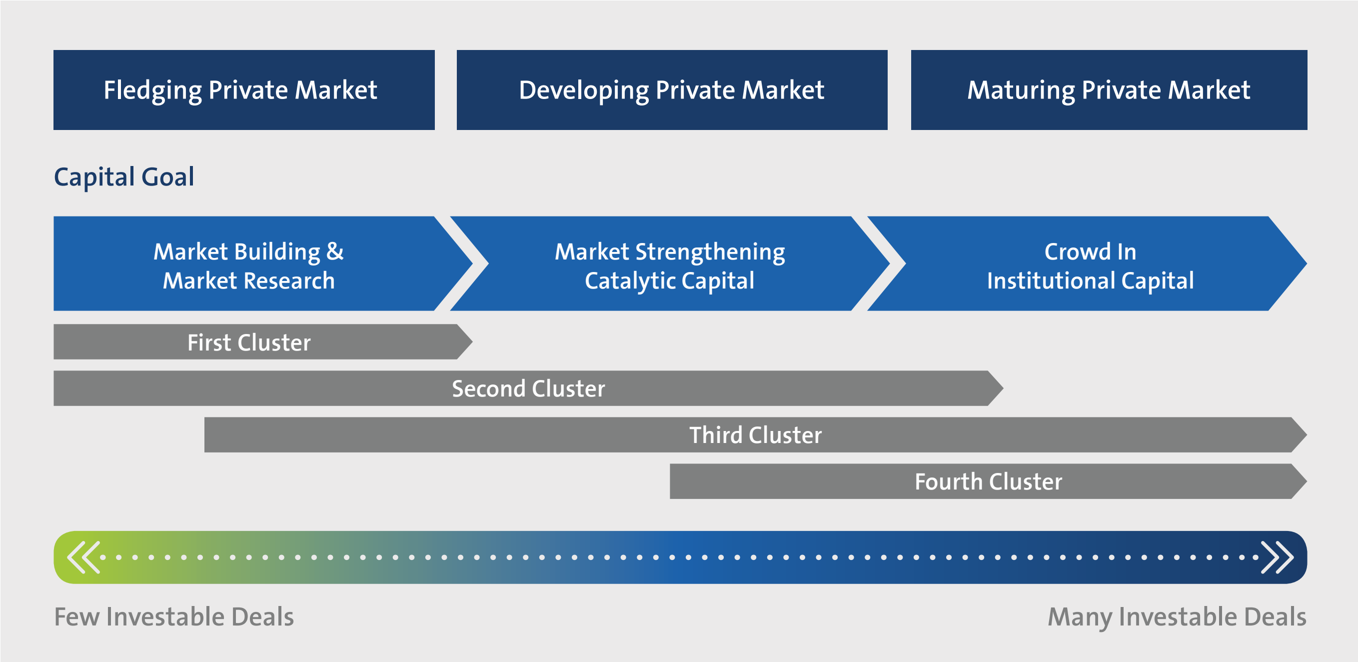



Figure 4: The role of clusters at various stages of market development

## Sector

Blended finance investments in some sectors have a longer track record and maturity level than others in terms of commercial viability and business model development. The maturity level of target sectors is an important consideration when structuring such investments.

### Renewable Energy

Track record of blended finance in sector: High

The energy sector has consistently been a darling for blended finance investment and accounts for most of the blended finance transactions in the market[22]. Early on, concessional capital allowed the sector to experiment with novel business models, as well as to build the economies of scale and technology needed to build a market. Today, investments into the sector are mostly commercial and are predominantly made up of Cluster 3 and Cluster 4 instruments. From the practitioners interviewed, the strongest motivators for blended finance transactions in the sector were crowding in capital, followed by de-risking.

A unique feature of blended finance transactions in the renewable energy sector is that they seem to include intermediaries more often than other sectors and have a greater focus on the involvement of enterprises. This could be the case as the structures need specialist intermediaries that have an active pipeline of impactful enterprises, making it common for transactions to have a Cluster 1 technical assistance element to them.

### WASH

Track record of blended finance in sector: Low

Blended finance transactions in the WASH sector are relatively low. Only 1.36% of capital mobilized by development finance between 2012 and 2017 went to WASH[23]. The highest cited motivations for transactions into the WASH sector are directly targeting impact, crowding in capital and maximizing impact per dollar. The lowest cited motivation is the demonstration effect. The motivation profile matches the lower return expectation in this sector as funders respond to major impact challenges and need to use combinations of instruments to offset risk and crowd in more commercial capital.

Moreover, creating a larger impact in the sector often involves expanding coverage to rural areas, and as a result, the risk profile increases, requiring a strong missional alignment to be created between all stakeholders and the blended finance mechanism. Therefore, WASH blended finance transactions seem geared toward Cluster 1 and Cluster 2, with some use of guarantees in Cluster 4.

### Education

Track record of blended finance in sector: Low

Education is a relatively underdeveloped sector for blended finance transactions. Between 2017 and 2019, Convergence estimated that just 2% of transactions took place in the sector[24]. For the practitioners we interviewed, directly targeting impact and demonstration effects are strong motivators for transactions in the sector.



The education sector is one of the most well-researched sectors worldwide, especially in relation to outcomes. To date, 75% of blended finance transactions in education have used Cluster 2 instruments[25]. This plentiful research reduces the cost of impact measurement and management (IMM), and makes education favorable for Cluster 2 instruments.

The education sector has had few commercially viable blended finance transactions. However, there are pioneering transactions that are aiming to change that. For instance, BlueOrchard's Regional Education Finance Fund for Africa (REFFA) uses a Cluster 1 technical assistance facility and Cluster 4 first-loss capital to try to create a market for education finance products in emerging markets.

### Conservation

Track record of blended finance in sector: High

Blended finance in the conservation sector is well established. Practitioners interviewed cite that in the sector, blended finance is primarily used to directly target impact-specific needs. Other motivators include de-risking and crowding in capital. In the past, Cluster 1 design-stage grants and technical assistance funds have been vital in designing financial mechanisms that generate cash flow and developing impact targets[26].

To date, blended finance transactions with conservation mandates have largely focused on sustainable agriculture and sustainable forestry[27]. But, as a practitioner in the sector notes, "your return in food and agriculture is lower than in most other industries." The predominant impact focus and need for patient capital means that it is likely that the conservation sector will continue to require concessional capital as it matures. However, there are increasing opportunities for innovation in the sector by combining conservation targets with ecotourism and sustainable fashion to make investments more commercially attractive.

### Healthcare

Track record of blended finance in sector: Medium

The COVID-19 pandemic has provided renewed urgency for investment in the healthcare sector. Blended finance transactions in healthcare cover a wide spectrum of risk and return. From seed funding for early stage healthcare innovations or funding infrastructure to targeting a specific disease or scaling an existing intervention, commercial viability can vary significantly depending on the needs or outcomes targeted.

Among the practitioners we interviewed, crowding in capital is the most important motivation for blended finance transactions, followed by directly targeting impact-specific needs and creating demonstration effects. Similar to education, the healthcare sector has a plethora of research available, especially related to outcomes. This makes healthcare interventions in the sector particularly suitable for Cluster 2. There is a high track record of using outcome-based funding in the healthcare sector.

As a practitioner notes, "Healthcare is one of the most researched areas globally. This research should be leveraged to offset some of the cost and time that goes into impact measurement and management."

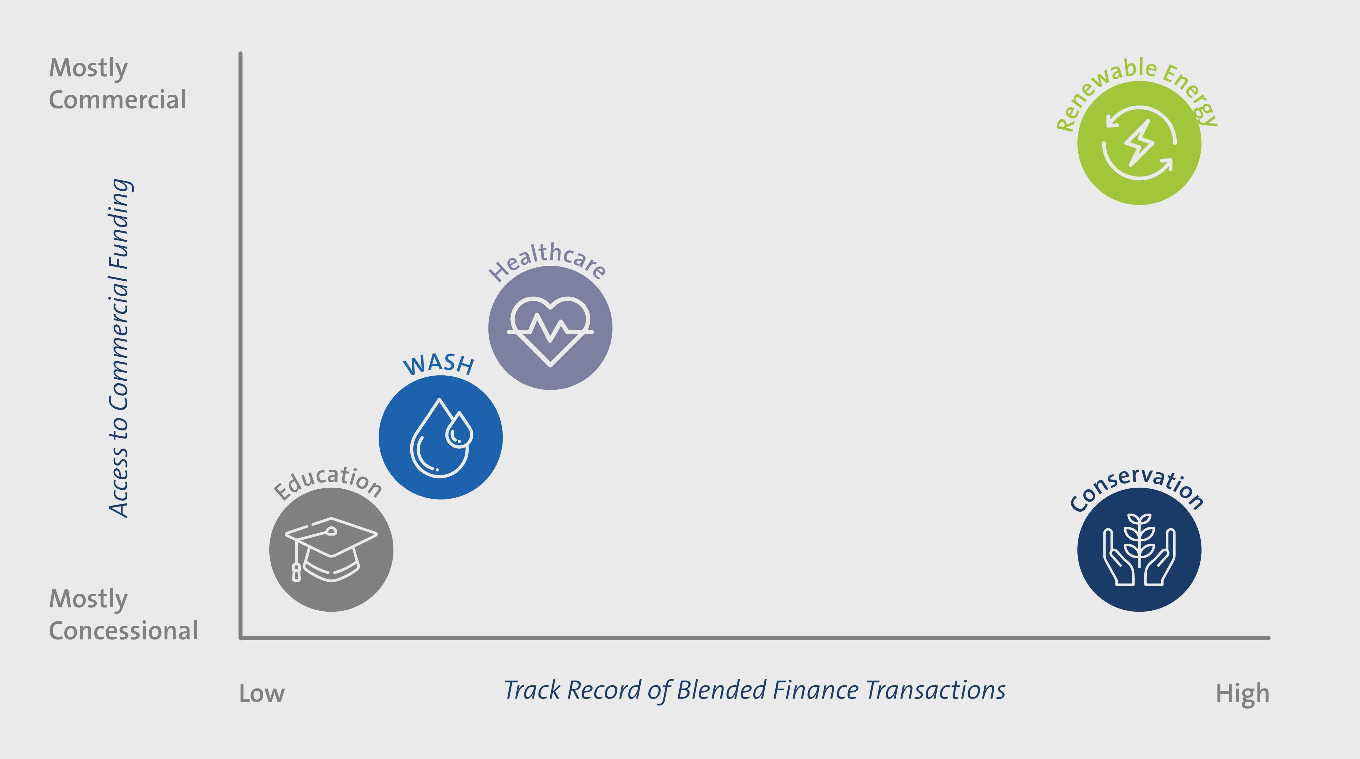



Figure 5: Access to Commercial Funding and Blended Finance Track Record by Sector

## 9. How does the investee want to scale? What is their growth trajectory?

### Scaling through the public sector

There are some interventions in the social sector that are suited to scaling through the public sector. These interventions are generally difficult to make commercially viable, as they may target bottom of the pyramid populations, involve basic service delivery, or target very specific impact goals.

Cluster 2 impact bonds are typically used to experiment and incubate ideas for long-term scaling, usually through the public sector. An example of this is the Rahat Social Impact Bond, which is aimed at increasing the number of students matriculating with levels 4 and 5 mathematics in Rahat. The SIB additionally acts as a pilot for the Israeli Ministry of Education as part of a five-year socio-economic development plan for the Bedouin communities and will be replicated and scaled if successful. Overall, the success of an SIB can be a step toward scaling the intervention and long-term government funding. As one of the practitioners we interviewed notes, "demonstration is not only relevant for investors. For the Utkrisht Impact





Bond, part of the motivation was to demonstrate to the government a cost-effective way to channel public funding to private facilities. This is relevant for impact bonds in general."

Scaling through the public sector is also a viable route to scale for some nonprofit interventions. There are few private sector credit models for nonprofits and it is not possible to take an equity stake. Finally, for investees looking to scale in this way, it is also important to note that public capital has a lower tolerance toward risk, and it is naturally harder to scale an intervention using less risky capital.

### Scaling through the market

For some interventions, large amounts of capital are required to make an impact at scale. These interventions cannot be supported through grants and concessional capital in perpetuity. Take, for example, the problem of a lack of finance for micro, small and medium enterprises (MSMEs). The IFC estimates that a financing gap of up to $5.2 trillion exists in developing countries alone[28]. Such a gap requires investment beyond what the public sector is able to offer. In contexts where an intervention has high commercial potential in the long run, blended finance mechanisms can build a bridge of concessional and commercial finance to reach sustainability.

"Public funding is only a drop in the ocean; concessional finance is simply not equipped to deal with the scale of the need to deliver market transformation." (Investor roundtable minutes)

Here, it is important to match blended finance mechanisms with the risk profile, transitioning from concessional to commercial capital over time. Even for interventions that look to scale through the market, capital can be flexible or concessional at an early stage but needs to be reviewed and justified based on additional impact compared to grants.

The riskier nature of private capital also makes it suitable for interventions that aim to scale rapidly. Therefore, scaling through the market is ideal for interventions with high commercial potential and interventions that function in areas where the government or public sector is generally less active.

## 10. What is the maturity level of the intervention?

The level of maturity of the project or intervention will impact how blended finance is used and which instruments are selected.

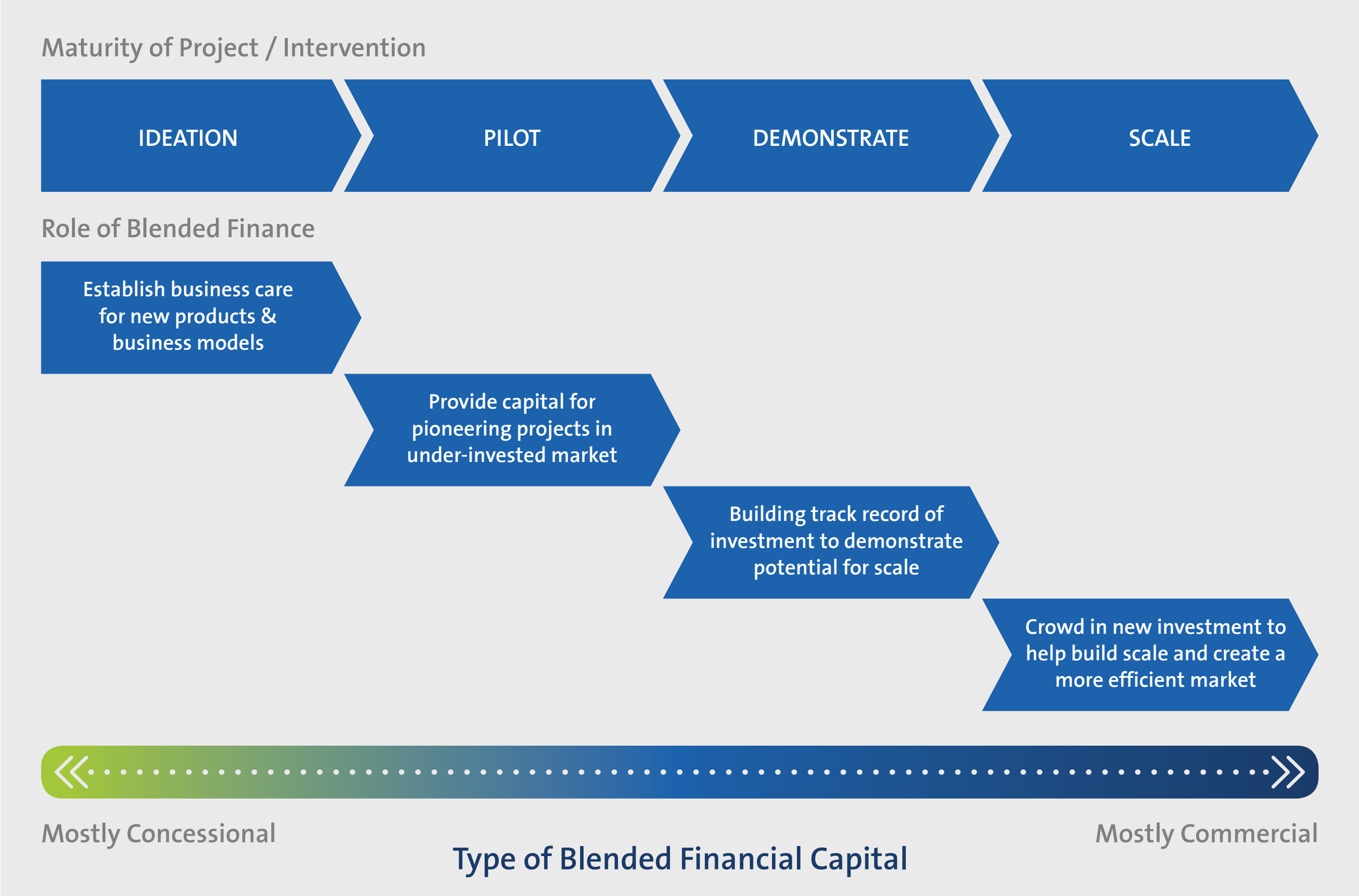



Figure 6: Role of blended finance at different stages (Adapted from IDFC, 2019 and Zero Gap Fund)

### Ideation stage

In the ideation stage, blended finance interventions will largely focus on demonstrating the viability of the project or business. In this phase, the business model or product is underdeveloped and has insufficient commercial viability. Here, Cluster 1 instruments are appropriate to establish financial or impact feasibility or establish the necessary partnerships required to begin building. Sectors like WASH, which have limited precedent for commercially viable business models and suffer from knowledge constraints, can benefit from mechanisms like grants and technical assistance to build this capacity.



Associated with
* Cluster 1: grants, TA
* Cluster 3: concessional, subordinate debt & equity
* Cluster 4: first-loss, guarantee

"Technical assistance is key for assessing the financial viability and feasibility of investment projects, improving the bankability of utilities, and supervising project implementation, reassuring lenders of their investment choices. Technical assistance has been instrumental in overcoming capacity and knowledge constraints during the nascent phase of commercial finance developments for the water and sanitation sec tor in Kenya." (OBA for WASH for Kenya)

To an extent, some Cluster 3 and Cluster 4 instruments can be used to fund research and development at an early stage. However, when Cluster 3 and Cluster 4 instruments are deployed at this point, they are largely concessional and impact-driven. An example of this is the Global Health Investment Fund (GHIF), which uses Cluster 3 and Cluster 4 instruments to advance the development of health interventions that disproportionately burden low- and middle-income countries.

"For the Gates Foundation in the GHIF, one of the main motivators was catalyzing additional capital. As a large philanthropy with deep pockets, they could easily just give funding away. They want to ensure that they create lasting impact." (Anonymized interviewee)

### Pilot phase

Associated with
* Cluster 3: concessional subordinate debt & equity
* Cluster 4: first-loss

In the pilot phase, there can be uncertainties due to novel business models that have not been tested in the market. Consequently, there are still few commercial investors with a high enough risk appetite to invest. Here, blended finance can be used to mitigate the risk of an unproven business model or a model that has a higher perceived risk using catalytic capital. For instance, a fund looking to provide seed capital to enterprises can use Cluster 4 instruments, like a first-loss facility, to de-risk commercial equity capital and fund pioneering enterprises. A similar outcome can be achieved by using Cluster 3 concessional instruments.

"For instance, five to six years ago, the clean energy sector required a significant amount of concessional capital to subsidize commercial capital. Since then, the costs of investors or batteries have dropped drastically, and commercial returns are achievable with no subsidy required whatsoever. Having a subsidy come in to test and prove an industry until the economics work." (Crossboundary Energy)

### Demonstration phase

Associated with
* Cluster 2: outcome funding, impact-linked finance, impact bonds
* Cluster 3: concessional, subordinate debt & equity
* Cluster 4: first-loss

Once there is some evidence of commercial viability, blended finance vehicles can be impactful by using capital to invest in projects with the potential to produce the demonstration effects needed to scale. These effects can be achieved by using concessional Cluster 3 or Cluster 4 instruments to attract commercial capital that perceives the project at this phase as too risky.

Alternatively, Cluster 2 tools can also be used to prove the impact and demonstrate viability to funders later. As one of the practitioners we interviewed notes, "Demonstrating that a structure works is a market-building exercise. If you can demonstrate that it works, it removes some of the perceived complexity." (Cameroon Cataract Bond Volta)

## Scale phase

Associated with

* Cluster 3: market-rate, concessional, subordinate debt & equity

* Cluster 4: first-loss, guarantee

The scaling phase is strongly associated with de-risking investments and crowding in commercial capital to achieve sustainability. Cluster 2 instruments become less relevant as they are difficult to scale. Cluster 1 instruments, if used, are focused on technical assistance. As a result, Cluster 3 and Cluster 4 instruments are most commonly used at the scaling phase.

Finally, blended finance vehicles can also traverse multiple phases of maturity of an intervention. Using a melting pot of instruments, practitioners can pilot novel business models and show commercial feasibility concurrently. An example of such an intervention is the Climate Investor One (CIO). The CIO mobilizes blended financing to invest in private sector renewable energy projects in low- and middle-income countries. To achieve this, the CIO bundles multiple funds under one facility to address different stages of the project cycle, with a range of instruments offered to achieve goals at each stage.





# Costs and Resources

## 11. What are the costs associated and resources available?

Instrument selection influences facility lifetime resource needs and costs. Practitioners can often anticipate project development and operational costs and determine which elements to avoid, assume, or secure third-party support for.

The question could also be turned around, and the choice of instrument can depend on the amount of budget and resources available.

Pre-launch, initiators require access to development and structuring expertise (both internal and external), as well as networks and operational resources. Post-launch, facilities may require time to establish a track record and develop the operational strength and networks necessary to achieve sustainability or consider replication. Some costs, including professional services or pipeline development are relevant across phases.

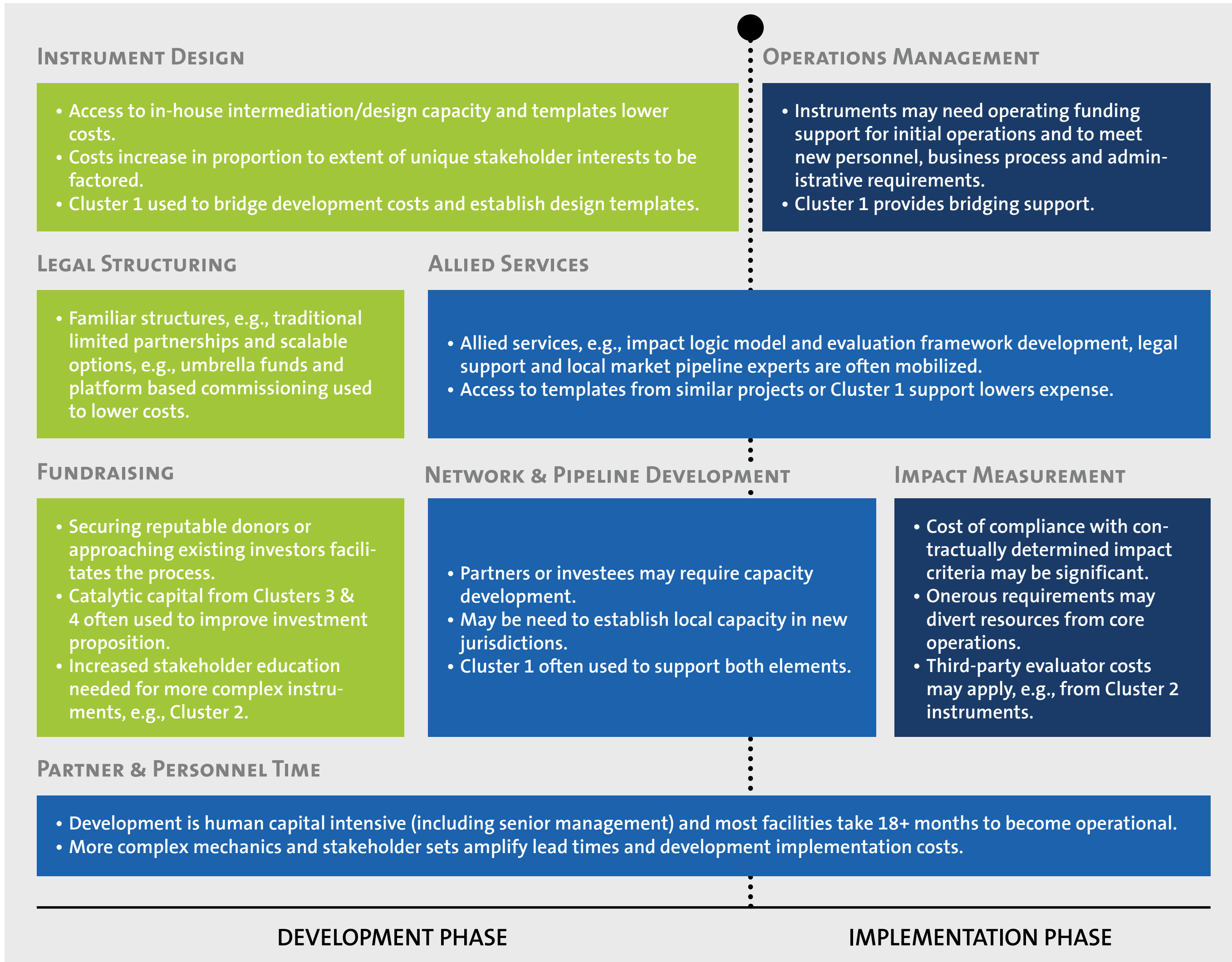



Figure 7: Resourcing and costs over the instrument development and establishment cycle

# Risk & Returns

## 12. What kinds of risks do I need to consider, and for what kind of return?

As seen across the transactions investigated and interviews, risk-return expectations and requirements will largely be dependent on the type of transaction structuring and investors involved in this process. Similarly, the motivations of the stakeholders could have a major influence on the risk-return profile. For instance, risk-return profiles across the various transactions investigated seem to be highly context-specific and transaction-specific. Thus, when solving for the risk-return profile of a transaction, decision-makers need to develop a product that solves both sides of the equation in an appropriate balance. To achieve this, practitioners highlighted various considerations when selecting instruments or clusters.

### Risk Considerations

When designing and structuring a blended facility, practitioners emphasized multiple types of risk across facilities which should be considered from multiple stakeholder perspectives. The following list of risks might not be mutually exclusive and collectively exhaustive, but it serves to ensure that the key risk elements of a transaction are taken into consideration.

#### Financial risk

A core premise of blended finance is bringing various capital providers together. These stakeholders will carry varying tolerance toward risk. In general, public actors have a lower tolerance toward risk, even in the face of higher financial return, while private capital is more divergent and there are many actors that are willing to take more risk for a higher return. When involving more traditional investors, they will often compare the risk-return profile they could receive in other private investment vehicles. These investors prefer liquid markets where project exit and returns are more predictable. However, with blended facilities, it is often less predictable. Thus, they expect a higher return for that higher risk. To address this risk, blended facilities can also harness the de-risking mechanisms that are part of Cluster 4 or use Cluster 1 instruments to offset the risk of underlying entities failing.

#### Operational risk

New structures or those with multiple layers often have a number of stakeholders, processes, and systems involved, and run the risk of becoming too complex to effectively achieve activities on a day-to-day level. Some facilities, such as those in Cluster 2, are often critiqued for their complexity. Therefore, it is essential to understand why the instrument would work for a certain context to ensure the appropriateness to the underlying operational environment. One practitioner noted that sometimes "stakeholders that are good at structuring might not be good at investing." As a result, it is key to create enough lead time in the design phase to determine the feasibility of the model in the market. Having said this, at times, a model requires multiple layers of instruments to attract the right players and capital. Over time and as evidence emerges, the model can be simplified or adapted.





#### Market and investability risks

The mapping of various blended facilities revealed that certain sectors, such as renewable energy, could have more developed commercial markets and, therefore, the potential to absorb capital with higher return profiles. Other markets, such as education, provide strong opportunities for development returns but the commercial case is not necessarily as strong. When considering instrument selection, especially when taking an entrepreneurial lens, it is essential to match the appropriate structure to the demand in the underlying market and its ability to absorb certain types of capital. For example, Cluster 2 instruments are most prevalent in education and healthcare transactions, Cluster 3 instruments are used across sectors but are especially prevalent in renewable energy transactions, and Cluster 4 instruments appear to be important in WASH facilities. Similarly, developing new markets carries a higher risk, and some instruments are more suited when this is the goal, such as those in Clusters 1 or 2. As highlighted by a practitioner, "Expanding to new businesses and new markets increases the risk expectations and will most likely require a cushioning to attract investors." (Crossboundary Energy)

#### Reputational risk

Larger organizations are most likely to take less risk as the implications of failure carry a higher reputational risk for both the organization and the involved individual's career. A mitigating factor for this risk was the importance of having stakeholders involved that have some track record of setting up a blended facility or deep expertise within the targeted development impact. For example, an interviewee highlighted that "partnering with a leading, recognized foundation was critical for our clients and an important part of creating impact authenticity."

#### Macro risks

Consideration of the targeted country's political and regulatory climate is critical when determining the appropriate market-risk premiums. For instance, one practitioner noted that "within Sub-Saharan Africa, political developments and sovereign credit risks vary from country to country and are to be analyzed thoroughly. Sometimes there is great alignment and the transaction is well-suited, but then a period of delay can occur due to regulatory approvals, and in the meantime, high or volatile hedging costs may change the pricing of the transaction." (BlueOrchard, REFFA) As a result, it is key to consider currency and country risks when looking to invest in developing markets. There is potential to consider instruments in Cluster 4 to provide a risk cushion within a facility for these risks and give senior investors more comfort.

#### Tenor and liquidity risks

Longer tenor financing requirements result in more risk, which should be compensated for. As one interviewee commented, "somebody translated a Chinese [saying for me] the other day: the longer the loan, the nightmare will come." There is a risk that rigid, long-term financing structures may become outdated if operating realities change a few years in.That said, blended finance is more suited to longer tenors than traditional finance, as it fits well with the longer term thinking needed for sustainable development impact. Instruments across the clusters can be used to overcome these risks. For instance, the food system transition requires a longer timeframe for financing than banks are often willing to accept. A longer time translates to longer loan tenors, which translates to higher risk. To catalyze private financial resources toward forest protection and sustainable agriculture, the AGRI3 Fund provides guarantees (Cluster 4) and subordinated loans (Cluster 3) to commercial banks and other financial institutions, mobilizing capital by de-risking and catalyzing investments in sustainable agriculture, forestry and rural livelihoods.

### Impact risk

A priority of blended finance is to catalyze finance toward achieving development results, but there is also the risk of not achieving the impact that was targeted. A useful starting point is to develop a theory of change and plot various impact risk factors across the results chain in terms of the likelihood, as well as the consequences for social and environmental dynamics. Although the concept of impact risk and mitigation factors is still a fairly nascent concept in the blended finance space, the Impact Management Project's market-building effort has created some consensus around factors to consider. Some of these impact risks are mapped onto the theory of change framework below (Figure 5). In order to identify, monitor, and mitigate perceived risks, practitioners suggested building a risk management framework as part of the design process. The identified risks can be classified in accordance with their likelihood, scale of impact, and the measures put in place to mitigate such risk from materializing.

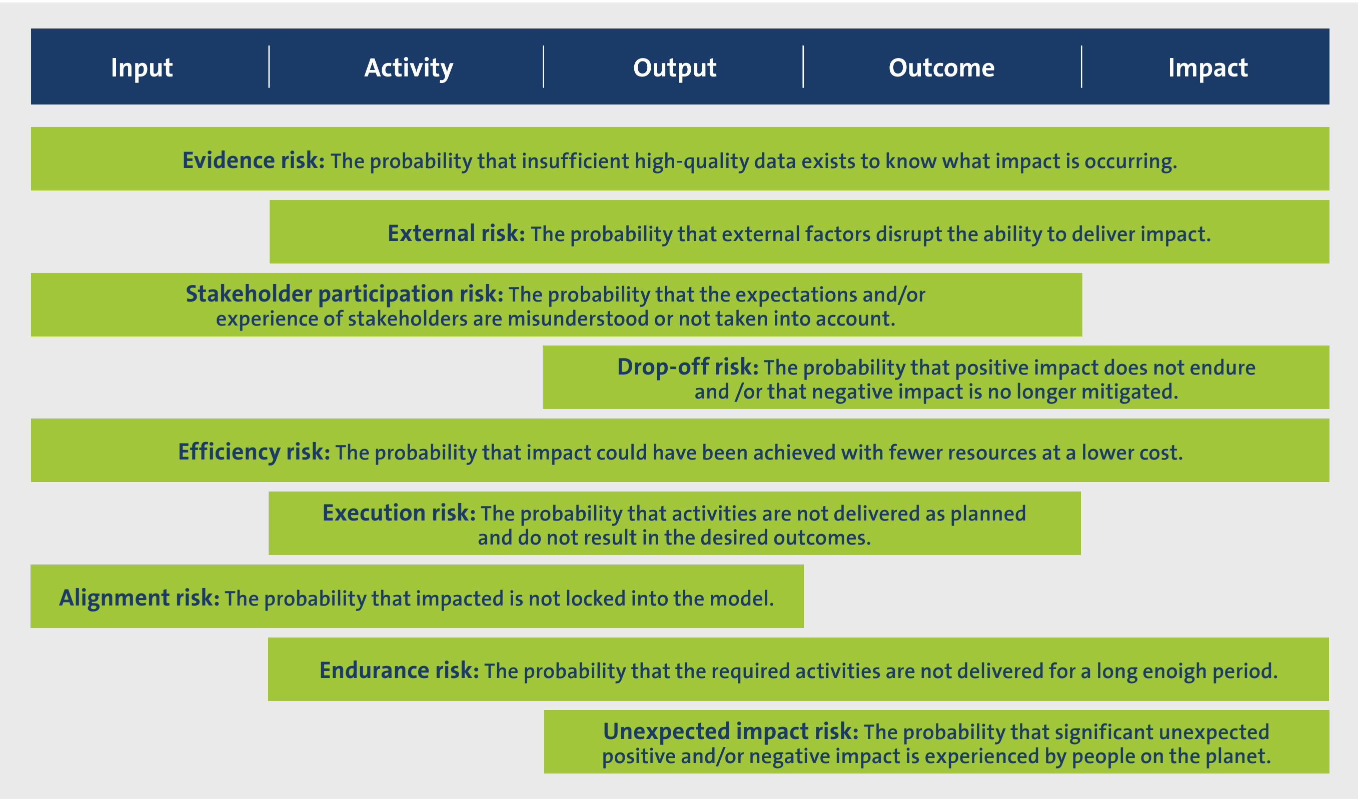



Figure 8: Illustrative theory of change framework (Source: Impact Management Project, 2021)



## Return Considerations

### Financial return considerations

Blended finance structures bring a variety of risk-return expectations together, create alignment, and launch a product that addresses the needs of different role players. Therefore, it is crucial to develop a good understanding among stakeholders what their financial return profiles are for a certain level of risk, considering the targeted sector. For this to happen, those structuring the facility need to take the willing stakeholders through an engagement journey. A frequently overlooked stakeholder in this process is the end beneficiary. Given that these facilities often aim to foster the development of underserved stakeholders and the success could rely on generating some level of return from them, it is valuable to bring their insights into the room during the engagement journey.

As highlighted in the section on organizational context, stakeholder types have varying financial return expectations or requirements set by institutional mandate. Therefore, it is important to consider the different return expectations of individual stakeholders in a multi-stakeholder transaction, as well as the appropriate instruments, where various investors will sit in the capital stack, whether the timing of anticipated return differs among investors (who receives what return and when), and, in the case of underperformance, what is the coverage for each stakeholder (for example, capped upside gains or downside losses).

Various stakeholder types can hold different positions in the capital stack. As a result, some clusters are more appropriate to their institutional mandate than others given their return expectations and requirements.

- Philanthropic investors have low to no return expectations and are able to take on more risk. It could be that they expect a return of capital so that they can recycle it.
- Public capital often has strict development objectives and therefore low return expectations. It can, therefore, play a strong catalytic role.
- Development finance institutions (DFIs) seemingly engage within a mid-tier risk-return expectation but can move up and down that spectrum depending on the DFI's goals and mandates. However, it was also seen that they were risk averse and took a position in the top tier of the capital stack. They often use debt or provide a cushion for other more commercial investors.
- Impact investors appear to have a range of financial return expectations. Depending on their motivations, these span impact-first to more finance-first impact investors. This range allows them to take more subordinate positions in the capital stack at times, while within other facilities, they hold more senior positions.
- Private capital—e.g., pension funds, insurance, banks—has the highest return expectations and requirements given their mandates and fiduciary duty.

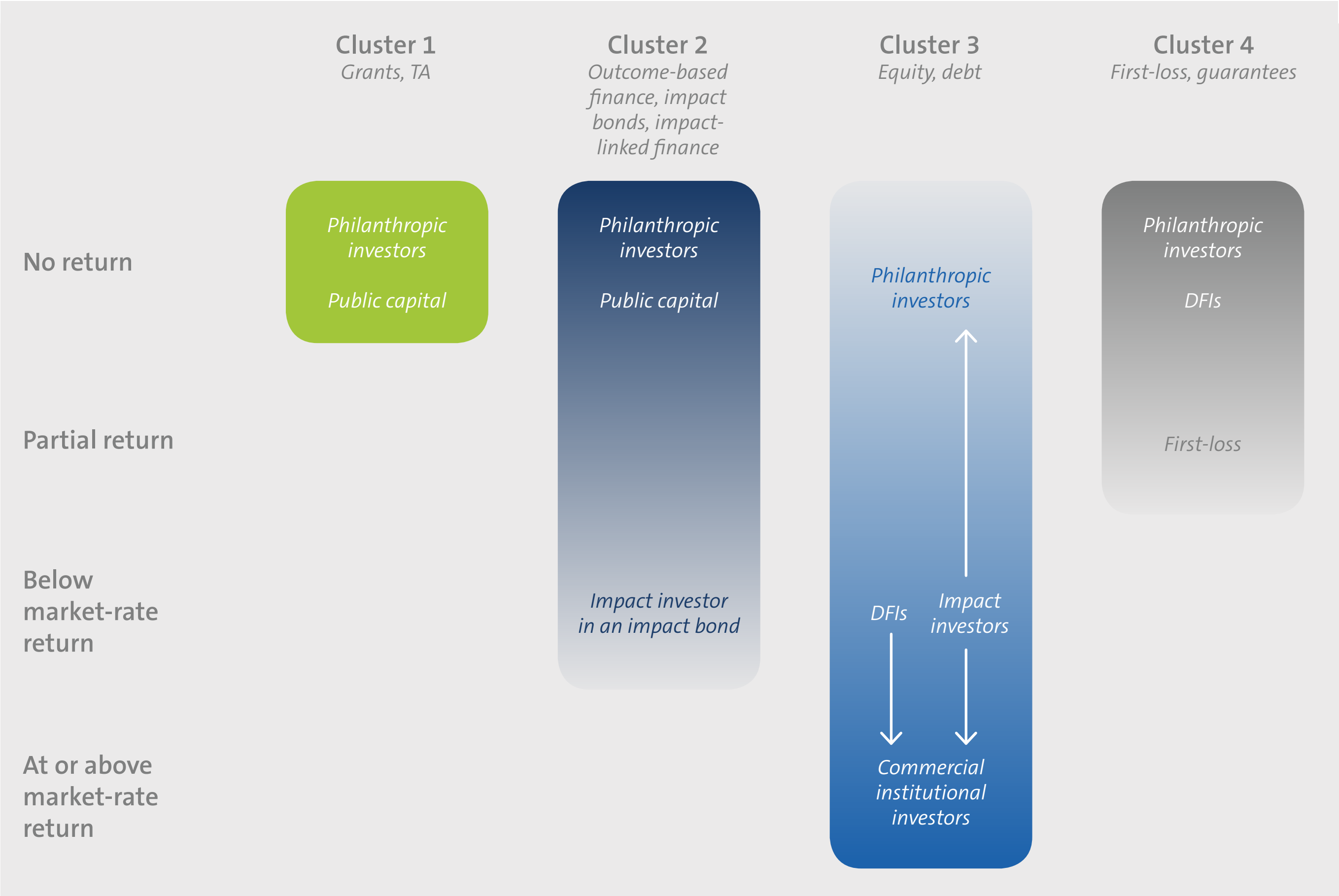



Figure 9: Financial return considerations of various stakeholders

### Impact return considerations

Blended finance has impact at its core. With that being said, there are a variety of motivations for targeting impact, as well as expectations for the impact generated. Three core elements in defining the approach to generating impact are intentionality, contribution, and measurement. At the highest level, impact goals need to be explicitly defined to determine the type of impact return targeted and then provide a clear causal pathway that outlines the intended results chain to achieve these goals. Similarly, these models look to make a contribution to development impact that is differentiated to or above what is occurring at present. When plotting out the scale of contribution, it is advised to consider the degree to which changes in outcomes can be influenced, as well as the duration of impact. Lastly, the approach to the measurement of impact should be framed when considering the type of impact returns targeted so that impact performance can be effectively monitored, reported and managed.

Within the context of the clusters, certain groupings enable more targeted or intentional impact, defined contributions and measurement. Cluster 1 will have high impact return expectations, given that they are used to explicitly support the achievement of impact goals. Similarly, instruments in Cluster 2 are used to intrinsically link impact and financial returns and will have a high impact return expectation, especially at a lower cost. Cluster 3 instruments are usually associated with a financial-first lens but can be used to generate impact at a larger scale due to the amount of funding that can be catalyzed. Cluster 4 instruments are often used as de-risking tools to crowd in capital and, as a result, can contribute to impact occurring at scale within a blended finance mechanism.





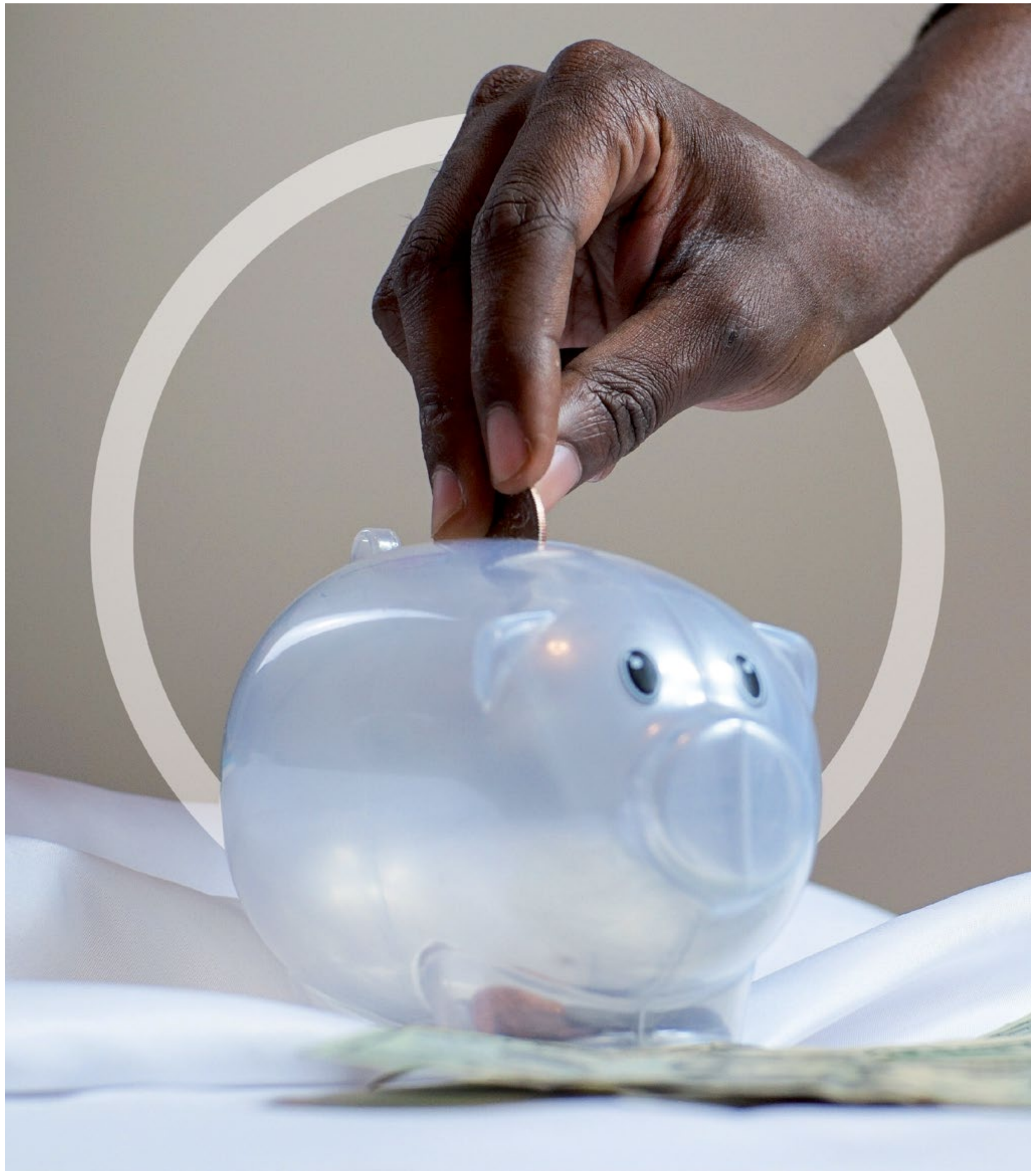
# Practical Relevance

Based on our analysis, we put together twelve key questions that encompass the organizational context, the purpose of a transaction, the investee context, relevant cost and resources, and risk and return. Together, they form a holistic list of decision-making factors that practitioners have answered or should answer before choosing a cluster or specific instrument.

| Theme | Selection |
|---|---|
| **Organizational context** | • Organizational context anchors and bounds the preferences of initiators.<br>• Initiators should build an awareness of where their initial circumstances and capabilities may constrain the range of solutions considered, especially in relation to investee context needs. |
| **Transaction purpose** | • Across the clusters, there are tools that are more readily associated with some blending motives than others (e.g., sector development vs. addressing a narrowly specified development issue or achieving a demonstration effect).<br>• Understanding the blending priorities and the specificity of the challenges to be addressed helps to match them with the strengths and weaknesses of the identified clusters |
| **Investee context** | • Differences in sector maturity—including the macroeconomic conditions, legal and regulatory environment, and the general strength, maturity, and profitability prospects of enterprises within it—affects access to investable opportunities and the level and types of capital accessible.<br>• Lower maturity and low profitability potential often signal greater demand for concessionality and route to scale.<br>• Business models in the conservation, education and WASH sectors oftentimes demand more patient capital than, e.g., the renewable energy and healthcare sectors. |
| **Costs & resources** | • Consider the resource intensity and cost-effectiveness of different instruments. Often, sunk development costs are not explicitly factored in.<br>• Costs include personnel, pipeline development and professional services and vary in relation to the instrument, actor types and the organizational context.<br>• Stakeholder-intensive or structurally complex instruments can increase development times and demand more resources to implement. |
| **Risk & return** | • Practitioners must articulate the financial return and impact expectations of potential capital sources and reconcile these with their choice of blended instrument.<br>• A risk management framework is necessary to address the financial, operational, pipeline and impact risks that manifest over the course of a blended finance transaction. Practitioners' choice of instrument can amplify or mitigate the relevant risks. |

Table 9: Summary of instrument selection influences

# VI. Conclusion & Key Learnings





Our research project investigates a total of 33 selected transactions, including 33 interviews and 12 case studies, addressing the research gap on key decision-making factors that influence instrument choice and appropriateness. Our findings contribute to the existing body of research in several ways:

### Clearer terminology and framing

By mapping out the different clusters of the various instruments, we provide a clearer framework for practitioners to think about clusters. The clusters make it more intuitive to understand the different functions and characteristics of instruments, making it easier to differentiate between clusters. Increasing clarity will help practitioners choose or rule out certain clusters faster, and also allow them to align better with various stakeholders through coherent communication.

### Holistic list for decision-making

While several frameworks have been outlined for instrument choices, most of them have a distinctive focus, such as the investee context, or are created for certain actors, primarily development actors. Our list is holistic and practical in the sense that it includes organizational factors and purpose, as well as relevant costs and resources, which are often excluded in other frameworks. The list is also intended to be used by various players that are looking to initiate a blended finance transaction.

### Absence of beneficiaries and entrepreneurs

One aspect that stood out in our analysis was how little beneficiaries and entrepreneurs were considered in (let alone involved in) decision-making. Due to our research aim to create a guide for blended finance transactions that foster innovation and entrepreneurship for impact, we selected the transactions also accordingly. Nevertheless, the beneficiaries and entrepreneurs were left out of the narrative for many transactions when we interviewed actors or conducted desk research on them. This indicates a potential oversight within the sector, and we hope to address this gap further in our following paper.

# VII. Appendices



## List of Publications for Literature Review

**Table 1. Selected publications based on keywords**

| Authors | Title | Journal | Year | Sector |
|---|---|---|---|---|
| Havemann, Tanja; Negra, Christine; Werneck, Fred | Blended finance for agriculture: exploring the constraints and possibilities of combining financial instruments for sustainable transitions | Agriculture and Human Values | 2020 | Agriculture |
| Rode, Julian; Pinzon, Alexandra; Stabile, Marcelo C. C.; Pirker, Johannes; Bauch, Simone; Iribarrem, Alvaro; Sammon, Paul; Llerena, Carlos A.; Alves, Lincoln Muniz; Orihuela, Carlos E.; Wittmer, Heid | Why 'blended finance' could help transitions to sustainable landscapes: Lessons from the Unlocking Forest Finance project | Ecosystem Services | 2019 | Conservation |
| Pories, Lesley; Fonseca, Catarina; Delmon, Victoria | Mobilising Finance for WASH: Getting the Foundations Right | Water | 2019 | WASH |
| de Gruyter, Elaine; Petrie, Dennis; Black, Nicole; Gharghori, Philip | Attracting investors for public health programmes with Social Impact Bonds | Public Money & management | 2020 | Health |
| Jacobs, Bert | Can the Addis Ababa Action Agenda Bring about a More Integrated Blend? Facilitating African Infrastructure Development Through Institutionalized Portfolio Approaches | Forum for Development Studies | 2016 | General |
| McCallum, Stephen; Viviers, Suzette; Ramirez, Rafael Robina | Investing in Water Purification Infrastructure in an Emerging Market: Some Considerations for Impact Investors in South Africa | European Journal of Sustainable Development | 2019 | WASH |
| Fillol, Amandine; Lohmann, Julia; Turcotte-Tremblay, Anne-Marie; Some, Paul-Andre; Ridde, Valery | The Importance of Leadership and Organizational Capacity in Shaping Health Workers' Motivational Reactions to Performance-Based Financing: A Multiple Case Study in Burkina Faso | International Journal of Health Policy and Management | 2019 | Health |
| Park, Jong Won; Woo-baik, Lee | A Study on the Social Impact Bond for Implementing the Impact Investment in Korea | Korean Journal of Financial Studies | 2018 | - |
| van Liere, Marti J.; Tarlton, Dessie; Menon, Ravi; Yellamanda, M.; Reerink, Ietje | Harnessing private sector expertise to improve complementary feeding within a regulatory framework: Where is the evidence? | Maternal and Child Nutrition | 2017 | Health |
| Ayalew, Misraku Molla; Zhang Xianzhi; Hailu, Demis Hailegebreal | The finance of innovation in Africa | European Journal of Innovation | 2020 | General |
| Atun, Rifat; Silva, Sachin; Ncube, Mthuli; Vassall, Anna | Innovative financing for HIV response in sub-Saharan Africa | Journal of Global Health | 2016 | Health |
| Shuba, Borys; Sotskyi, Artur | World Experience in Financing Innovative Small Businesses | Baltic Journal of Economic Studies | 2019 | - |
| Squires, Graham; Hutchison, Norman; Adair, Alastair; Berry, Jim; McGreal, Stanley; Organ, Samantha | Innovative real estate development finance - evidence from Europe | Journal of Financial Management of Property and Construction | 2016 | Other |
| Keohane, Georgia Levenson; Madsbjerg, Saadia | The Innovative Finance Revolution Private Capital for the Public good | Foreign Affairs | 2016 | - |
| Atun, Rifat; Silva, Sachin; Knaul, Felicia M. | Innovative financing instruments for global health 2002-15: a systematic analysis | Lancet Global Health | 2017 | Health |

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**Table 1. Selected publications based on keywords (continued)**

| Authors | Title | Journal | Year | Sector |
|---|---|---|---|---|
| Fitchett, Joseph Robert; Li, Julia Fan; Atun, Rifat | Innovative financing for late-stage global health research and development: the Global Health Investment Fund | International Health | 2016 | Health |
| Spiegel, Paul; Chanis, Rebecca; Trujillo, Antonio | Innovative health financing for refugees | BMC Medicine | 2018 | Health |
| Appel, Todd; Bezak, Bethany; Lisle, John | DC Water Green Infrastructure Financing: Pay for Success Can Help Water Utilities Pursue Innovative Solutions | Journal American Water Works Association | 2017 | Water |
| Chamaki, Foroogh Nazari; Jenkins, Glenn Paul; Hashemi, Majid | Social Impact Bonds: Implementation, Evaluation, and Monitoring | International Journal of Public Administration | 2019 | General |
| La Torre, Mario; Trotta, Annarita; Chiappini, Helen; Rizzello, Alessandro | Business Models for Sustainable Finance: The Case Study of Social Impact Bonds | Sustainability | 2019 | - |
| Abdullah, F.; Naledi, T.; Nettleship, E.; Davids, E. L.; Vanleeuw, L.; Shangase, S.; Ramburuth, M.; Majola, N.; Dudley, L.; Nyirenda, M.; Mathews, C.; Kredo, T.; Kinghorn, A.; Gray, G.; de Witt, S. | First social impact bond for the SAMRC: A novel financing strategy to address the health and social challenges facing adolescent girls and young women in South Africa | South African Medical Journal | 2019 | Health |
| Choudhary, Renu; Jain, Vandana | Social Impact Bonds: An Innovative Way for Social Financing | Pacific Business Review International | 2017 | - |
| Paul, Elisabeth; Renmans, Dimitri | Performance-based financing in the health sector in low and middle-income countries: Is there anything whereof it may be said, see, this is new? | International Journal of Health Planning and Management | 2018 | Health |
| Lantz, Paula M.; Miller, George; Rhyan, Corwin N.; Rosenbaum, Sara; Ku, Leighton; Iovan, Samantha | Pay for Success Financing and Home-Based Multicomponent Childhood Asthma Interventions: Modeling Results From the Detroit Medicaid Population | Milbank Quarterly | 2018 | Health |
| Cook, Hadrian; Couldrick, Laurence; Smith, Laurence | An Assessment of Intermediary Roles in Payments for Ecosystem Services Schemes in the Context of Catchment Management: An Example from South West England | Journal of Environmental Assessment Policy and Management | 2017 | - |
| Deleidi, Matteo; Mazzucato, Mariana; Semieniuk, Gregor | Neither crowding in nor out: Public direct investment mobilising private investment into renewable electricity projects | Energy Policy | 2020 | Renewable energy |
| Fuller, Richard L.; Goldfield, Norbert | Paying for On-Patent Pharmaceuticals Limit Prices and the Emerging Role of a Pay for Outcomes Approach | Journal of Ambulatory Care Management | 2016 | Health |
| Nahimana, Evrard; McBain, Ryan; Manzi, Anatole; Iyer, Hari; Uwingabiye, Alice; Gupta, Neil; Muzungu, Gerald; Drobac, Peter; Hirschhorn, Lisa R. | Race to the Top: evaluation of a novel performance-based financing initiative to promote healthcare delivery in rural Rwanda | Global Health Action | 2016 | Health |
| Turcotte-Tremblay, Anne-Marie; De Allegri, Manuela; Gali-Gali, Idriss Ali; Ridde, Valery | The unintended consequences of combining equity measures with performance-based financing in Burkina Faso | International Journal for Equity in Health | 2018 | - |
| Care, Rosella; De Lisa, Riccardo | Social Impact Bonds for a Sustainable Welfare State: The Role of Enabling Factors | Sustainability | 2019 | - |



| Authors | Title | Journal | Year | Sector |
|---|---|---|---|---|
| Bladon, Annabelle J.; Short, Katherine M.; Mohammed, Essam Yassin; Milner-Gulland, E. J. | Payments for ecosystem services in developing world fisheries | Fish and Fisheries | 2016 | - |
| McCallum, S.; Viviers, S | Private sector impact investment in water purification infrastructure in South Africa: a qualitative analysis of opportunities and barriers | Water SA | 2020 | WASH |
| James, Nigel; Lawson, Kenny; Acharya, Yubraj | Evidence on result-based financing in maternal and child health in low- and middle-income countries: a systematic review | Global Health Research and Policy | 2020 | Health |
| Zahran, Kareem; Ezeldin, A. Samer | Finance-based scheduling: optimization of results-based funded multiple projects | Canadian Journal of Civil Engineering | 2020 | - |
| Witter, Sophie; Chirwa, Yotamu; Chandiwana, Pamela; Munyati, Shungu; Pepukai, Mildred; Bertone, Maria Paola; Banda, Steve | Results-based financing as a strategic purchasing intervention: some progress but much further to go in Zimbabwe? | BMC Health Services Research | 2020 | - |
| Chansa, Collins; Mukanu, Mulenga Mary; Chama-Chiliba, Chitalu Miriam; Kamanga, Mpuma; Chikwenya, Nicholas; Bellows, Ben; Kuunibe, Naasegnibe | Looking at the bigger picture: effect of perfomance-based contracting of district health services on equity of access to maternal health services in Zambia | Health Policy and Planning | 2020 | Health |
| Paul, Elisabeth; Brown, Garrett W.; Ensor, Tim; Ooms, Gorik; van de Pas, Remco; Ridde, Valery | We shouldn't count chickens before they hatch: results-based financing and the challenges of cost-effectiveness analysis | Critical Public Health | 2020 | - |
| Chimhutu, Victor; Tjomsland, Marit; Mrisho, Mwifadhi | Experiences of care in the context of payment for performance (P4P) in Tanzania | Globalization and Health | 2019 | - |
| Witter, Sophie; Chirwa, Yotamu; Chandiwana, Pamela; Munyati, Shungu; Pepukai, Mildred; Bertone, Maria Paola | The political economy of results-based financing: the experience of the health system in Zimbabwe | Global Healt Research and Policy | 2019 | Health |
| Marchal, Bruno; Giralt, Ariadna Nebot; Sulaberidze, Lela; Chikovani, Ivdity; Abejirinde, Ibukun-Oluwa Omolade | Designing and evaluating provider results-based financing for tuberculosis care in Georgia: a realist evaluation protocol | BMJ Open | 2019 | Health |
| De Allegri, Manuela; Chase, Rachel P.; Lohmann, Julia; Schoeps, Anja; Muula, Adamson; Brenner, Stephan | Effect of results-based financing on facility-based maternal mortality at birth: an interrupted time-series analysis with independent controls in Malawi | BMJ Global Health | 2019 | Health |
| Correa, Juliano; van der Hoff, Richard; Rajao, Raoni | Amazon Fund 10 Years Later: Lessons from the World's Largest REDD plus Program | Forests | 2019 | Conservation |
| Gergen, Jessica; Falcao, Joana; Rajkotia, Yogesh | Stunted scale-up of a performance-based financing program on HIV and maternal-child health services in Mozambique - a policy analysis | African Journal of AIDS Research | 2018 | Health |
| Zeng, Wu; Shepard, Donald S.; Ha Nguyen; Chansa, Collins; Das, Ashis Kumar; Qamruddin, Jumana; Friedman, Jed | Cost-effectiveness of results-based financing, Zambia: a cluster randomized trial | Bulletin of the World Health Organization | 2018 | - |
| McIsaac, Michelle; Kutzin, Joseph; Dale, Elina; Soucat, Agnes | Results-based financing in health: from evidence to implementation | Bulletin of the World Health Organization | 2018 | - |
| Petrosyan, Varduhi; Melkomian, Dzovinar Melkom; Zoidze, Akaki; Shroff, Zubin Cyrus | National Scale-Up of Results-Based Financing in Primary Health Care: The Case of Armenia | Health Systems & Reform | 2017 | Health |

**Table 2. Selected publications based on journals**

| Authors | Title | Journal | Year |
|---|---|---|---|
| Andersen, Mikkel Munksgaard; Dilling-Hansen, Rasmus; Hansen, Anne Vorre | Expanding the Concept of Social Impact Bonds | Journal of Social Entrepreneurship | 2020 |
| Giacomantonio, Chris | Grant-Maximizing but not Money-Making: A Simple Decision-Tree Analysis for Social Impact Bonds | Journal of Social Entrepreneurship | 2017 |
| Smeets, Dominique Jozef Alfons | Collaborative Learning Processes in Social Impact Bonds: A Case Study from the Netherlands | Journal of Social Entrepreneurship | 2017 |
| Siqueira, Ana Cristina O.; Guenster, Nadja; Vanacker, Tom; Crucke, Saskia | A longitudinal comparison of capital structure between young for-profit social and commercial enterprises | Journal of Business Venturing | 2018 |
| Islam, Mazhar; Fremeth, Adam; Marcus, Alfred | Signaling by early stage startups: US government research grants and venture capital funding | Journal of Business Venturing | 2018 |
| Munari, Federico; Toschi, Laura | Assessing the impact of public venture capital programmes in the United Kingdom: Do regional characteristics matter? | Journal of Business Venturing | 2015 |
| Croce, Annalisa; Marti, Jose; Murtinu, Samuele | The impact of venture capital on the productivity growth of European entrepreneurial firms: 'Screening' or 'value added' effect? | Journal of Business Venturing | 2013 |
| Schwienbacher, Armin | The entrepreneur's investor choice: The impact on later-stage firm development | Journal of Business Venturing | 2013 |
| Stevenson, Regan; Kier, Alexander S.; Taylor, Shannon G. | Do policy makers take grants for granted? The efficacy of public sponsorship for innovative entrepreneurship | Strategic Entrepreneurship Journal | 2020 |
| de Rassenfosse, Gaetan; Fischer, Timo | Venture Debt Financing: Determinants of the Lending Decision | Strategic Entrepreneurship Journal | 2016 |



**Table 3. Selected publications based on practitioners**

| Authors | Title | Journal | Year |
|---|---|---|---|
| Ole Winckler Andersen, Irene Basile, Antonie de Kemp, Gunnar Gotz, Erik Lundsgaarde, Magdalena Orth | Blended Finance Evaluation : Governance and Methodological Challenges | OECD | 2019 |
| Irene Basile, Carolyn Neunuebel | Blended finance in fragile contexts: Opportunities and risks | OECD | 2019 |
| Irene Basile, Jarrett Dutraj | Blended Finance Funds and Facilities : 2018 Survey Results | OECD | 2019 |
| - | Tri Hita Karana Roadmap for Blended Finance: Blended Finance and Achieving the Sustainable Development Goals | OECD | 2017 |
| - | Blended Finance in the Least Developed Countries 2020: Supporting a Resilient COVID-19 Recovery | OECD, United Nations Capital Development Fund | 2019 |
| - | Making Blended Finance Work for Water and Sanitation: Unlocking Commercial Finance for SDG 6 | OECD | 2019 |
| - | Blended Finance in the Least Developed Countries 2019 | OECD, United Nations Capital Development Fund | 2019 |
| - | Making Blended Finance Work for the Sustainable Development Goals | OECD | 2018 |
| Irene Basile, Valentina Bellesi, Vijai Singh | Blended Finance Funds and Facilities - 2018 Survey Results Part II: Development Performance | OECD | 2020 |
| - | Innovative Financing Mechanisms for the Water Sector | OECD | 2010 |
| Elisabeth Sandor | Mapping innovative finance for development mechanisms | OECD | 2011 |
| - | Innovative finance mechanisms and the Convention on Biological Diversity | OECD | 2013 |
| - | Financing innovative entrepreneurship | OECD | 2014 |
| - | Financing innovative business investment | OECD | 2018 |

Table 3. Selected publications based on practitioners (continued)

| Authors | Title | Organisation | Year |
|---|---|---|---|
| - | The financing of innovative firms in Canada | OECD | 2018 |
| - | Financing the Future with the IDB Group | IDB | 2019 |
| - | DFI Working Group on Blended Concessional Finance for Private Sector Projects: Summary Report | IFC etc. | 2017 |
| Andrade, Gabriela; Prado, Gerald | Financial Innovation to Support Women-Led Businesses: Mexico's First Gender Bond and the Role of National Development Banks | IDB | 2020 |
| Armeni, Andrea; Ferreyra de Bone, Miguel | Innovations in Financing Structures for Impact Enterprises: A Spotlight on Latin America | IDB | 2017 |
| Beuermann, Diether; Huppi, Monika; Sembler, Jose Ignacio; Kavalsky, Basil | IDB-9: Lending Instruments | IDB | 2013 |
| Thomas Gietzen | Blended Finance – An investigation into its effect on the success of development interventions | KfW | 2019 |
| Joachim Heidebrecht | Blending: a useful extension of the scope of development finance instruments | KfW | 2018 |
| Nora Scherer, Anja Nina Kramer | Blending 2.0: Could mobilising private capital work in poorer countries, too? | KfW | 2018 |
| Gareth Davies, Tandem | Making the most effective use of grants and technical assistance to support financial institutions | CDC | 2020 |
| - | Catalytic First-Loss Capital | GIIN | 2013 |
| Frans van Gerwen, Knud-Erik Rosenkrantz, Hammou Haidara, Nadia Masri-Pedersen | Mid Term Evaluation of the Sida and USAID Loan Portfolio Co-Guarantee and The Mali Finance for Food Security and Women Entrepreneurs (FFSWE) programme | Sida | 2018 |
| Sarah Gray, Emma Sitambuli, Jens Albråten | Evaluation of the Sida-USAID/DCA Guarantee to Zanaco | Sida | 2018 |
| - | Impact Bonds in Developing Countries: Early learnings from the field | Brookings Institution, Convergence | 2017 |





# List of Publications for Literature Review

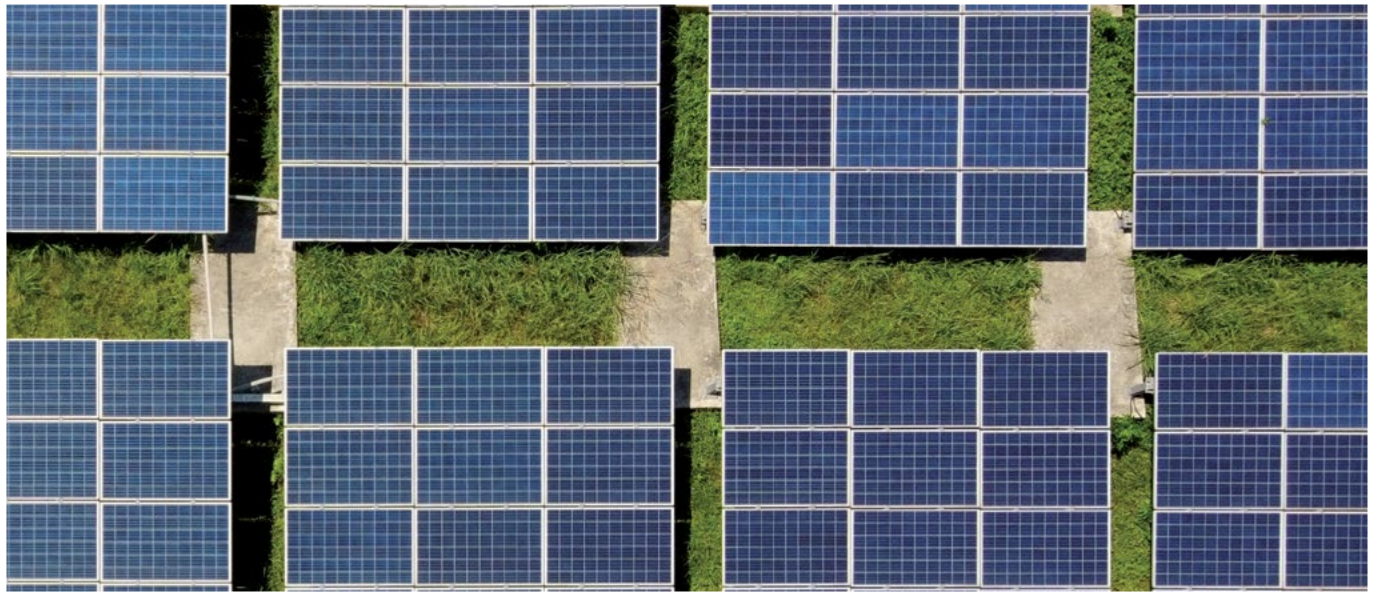
Table 4. List of selected case studies

| Authors | Title | Organisation | Year |
|---|---|---|---|
| USAID, iDE & Stone Foundation | Cambodia Rural Sanitation Bond | - | 2018 |
| Convergence | The Forest Resilience Bond Case Study | Convergence | 2019 |
| Convergence | TLFF Inaugural transaction: Corporate sustainability bond for natural rubber production | Convergence | 2017 |
| IFC | Forests Bond | IFC | 2020 |
| Suzanne Roddis | Literature Review of Blended Finance in the Non-State Education Sector | USAID | 2017 |
| Tanya Scobie, Sam Akyianu | Providing a head start to more Ghanaian children through better primary education | IFC | 2013 |
| Convergence | Medical Credit Fund Case Study | Convergence | 2019 |
| Convergence | Utkrisht Impact Bond Case Study | Convergence | 2018 |
| Green Climate Fund | Funding Proposal - FP099: Climate Investor One | GCF | 2018 |
| Nico Tyabji, Isabelle de Cointet, Ryan Levinson | Scaling Energy Access with Blended Finance: SunFunder and the Role of Catalytic Capital | SunFunder | 2020 |
| World Bank | Scaling Up Blended Financing for Water and Sanitation in Kenya | World Bank | 2013 |
| NIITI Consulting, ANDE India | Social Success Note Playbook | ANDE | 2018 |
| World Bank | Facilitating Access to Finance for Household Investment in Sanitation in Bangladesh | World Bank | 2018 |

# List of Contributors

Table 5. List of experts and practitioners consulted

| Name | Organisation |
|---|---|
| Amy Ahrens Terpstra | United Way of Salt Lake |
| Andrew Apampa | Convergence |
| Ash Sharma | Beyond the Grid Fund Africa |
| Ayesha Berry | Convergence |
| Bill Crim | United Way of Salt Lake |
| Brad Magrath | Zoona |
| Carla Chissell | DFC |
| Eran Mozel | Social Finance Israel |
| Grace Hoerner | DFC |
| Hann Verheijen | Cordaid Investment Management |
| Hans Loth | Rabobank Intl. |
| Hasan Andalib | WaterEquity |
| Janis Dubno | Sorenson Impact Centre |
| Joseph Di Silvio | Volta Capital |
| Keren Morag | Social Finance Israel |
| Kevin Bender | The Nature Conservancy |
| Marcus Watson | Kawisafi Ventures |
| Michael Etzel | Bridgespan Group |
| Michelle Osorio | Kawisafi Ventures |
| Muhammed Sayed | Development Bank of South Africa |
| Omer Snir | Social Finance Israel |
| Pieter Joubert | CrossBoundary Energy |
| Priscilla Boiardi | OECD |
| Rahil Rangwala | Michael Susan Dell Foundation |
| Rosemary Idem | SEforAll |
| Sebastian Worle | Ecobusiness Fund |
| Sheila Okiro | African Development Bank |
| Simeon Bridgewater | GIF |
| Sridhar Sampath | WaterEquity |
| Valerie Harrington | BlueOrchard |







# Interview Protocol

## General Background

1. We would like to discuss the instrument you have been engaged with: [ transaction in shortlist ]. We are particularly interested in how and why the transaction was initiated, and how it has been going.

2. Let's start with some background information. What is your role, and how were you involved in the transaction?
   - Follow-up: How are you involved in blended finance more generally?
   - Prompt: How long have you been in the field?

## Transaction

1. Can you describe the transaction in your own words?
   - Follow-up: What is its aim?
   - Follow-up: Which sector or region is it addressing?
   - Follow-up: What is the approach?

2. What was your role in this transaction: initiator, intermediary, beneficiary, enterprise, donor, partner?
   - Follow-up: How did this role affect the way you approached the transaction?

3. What was the motive/rationale behind using blended finance for this transaction? Were you specifically trying to:
   i. Respond to impact-specific needs
   ii. Crowd in capital
   iii. De-risk
   iv. Contribute to market building
   v. Demonstrate that this would work (demonstration effect)
   vi. Maximize (impact) output per dollar

4. What drew you to this specific instrument (or set of instruments) for meeting this goal?
   - Prompt: Were there any other instruments/transactions that you considered in a similar context? What made you decide on this one in comparison with others?

5. Could you share with us how the engagement with the transaction started?
   - Follow-up: What inspired the idea?
   - In the case of private capital: What made you decide to engage in the transaction?

6. What were the different financial return expectations of the various stakeholders in the transaction? What were their risk profiles like?

## Transaction (continued)

7. When considering the design of the structure and the potential different instruments you could have used, which of the following were most important to you:
    - Familiarity
    - Simplicity
    - Cost of establishment
    - Speed
    - Replicability
    - Scaling
    - Additionality

8. What were the biggest challenges you faced in setting up the structure?
    - Follow-up: Did you change the design of the structure or the instruments you planned to use at any point? Why?
    - Follow-up: Were there any unintended effects?

9. What were some of the key enablers?
    - Follow-up: Do you think these enablers are relevant in all circumstances, or were they context-specific (i.e., country, sector, region, legislation, etc.)?
    -

10. How do you measure the impact of the transaction?
    - Follow-up: Does the structure you've chosen make this measurement any easier or more difficult?
    -

11. Based on your observations so far, how has the transaction been going? What would you change if you could do it all again?
    - Follow-up: What would be different if the instrument were different?
    - Follow-up: What has happened since the set-up of the instrument? Did something become more/less relevant with time/progress?
    - Follow-up: Were there any challenges or unintended effects?
    - Follow-up: What do you believe made the transaction successful?



## Clusters and Decision-making

1. We are trying to cluster instruments that are similar to each other. How would you cluster them?
    - Follow-up: Why did you cluster them in that way?

2. Throughout the discussion, you have not mentioned [other instruments], for instance. Why is that?

3. What would need to change for you to consider some of the other instruments?
    - Follow-up: In which context/way do you think these would make sense?
    - Follow-up: Who would be a good actor to make use of them?

-

4. How do you internally decide to make use of which instrument?
    - Probe: What influences the idea internally when deciding which instruments are viable and which are not?
    - Follow-up: Does the clustering make sense to you?
    - Follow-up: Would you group them otherwise?

## Other

1. Could you give an example of a case where the instrument was well chosen and why?
2. Could you give an example of a case where the instrument was poorly chosen and why?
    - Follow-up: What would have been a more appropriate instrument?
3. How relevant is the choice of the instrument in terms of how the enterprise develops?
4. How appropriate is this instrument in an entrepreneurship context?
5. Is there anything you would like to add? What else would be good for us to know?
6. What other questions would you ask if you were conducting these interviews?

# Footnotes

[1] DCED (2019). Donor Engagement in Innovative Finance: Opportunities and Obstacles, https://www.enterprise-development.org/wp-content/uploads/DCEDWorking-Paper_DonorEngagementinInnovativeFinance.pdf

[2] DCED (2019). Donor Engagement in Innovative Finance: Opportunities and Obstacles, https://www.enterprise-development.org/wp-content/uploads/DCEDWorking-Paper_DonorEngagementinInnovativeFinance.pdf

[3] OECD (2021). The Role of Guarantees in Blended Finance, https://www.oecd-ilibrary.org/docserver/730e1498-en.pdf?expires=1630338732&id=id&accname=guest&-checksum=55C206DB86EC742EDA68BC2FD122E1C9

[4] OECD (2018). Making Blended Finance work for the Sustainable Development Goals, https://read.oecd-ilibrary.org/development/making-blended-finance-work-for-the-sustainable-development-goals_9789264288768-en

[5] DCED (2019). Donor Engagement in Innovative Finance: Opportunities and Obstacles, https://www.enterprise-development.org/wp-content/uploads/DCEDWorking-Paper_DonorEngagementinInnovativeFinance.pdf

[6] IMF(2003). External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary, https://www.imf.org/external/pubs/ft/eds/Eng/Guide/index.htm

[7] OECD(2002). Subordinated Bond, https://stats.oecd.org/glossary/detail.asp?ID=4709

[8] Roots of Impact (2020. Impact-Linked Finance, https://www.roots-of-impact.org/impact-linked-finance/

[9] Oxford GOF (2021). Impact bonds, https://golab.bsg.ox.ac.uk/the-basics/impact-bonds/

[10] The term "blended finance" was first adopted by the UN in 2015 at the Addis Ababa Action Agenda (AAAA) (IDFC, 2019).

[11] It should be noted that instruments in the other clusters can become impact-linked finance instruments by incorporating rewards for achievement of impact. For this reason, impact-linked finance is a structuring approach rather than an instrument per se.

[12] Calvert Impact Capital (2017). Blended Finance: what is it, what it isn't and how to use it for maximum impact, https://www.calvertimpactcapital.org/storage/documents/calvert-supply-chain-framework.pdf

[13] Runde, Cusack, & Tilleard (2019). Investment Facilitation Revisited, https://www.crossboundary.com/wp-content/uploads/2019/09/Investment-Facilitation-Revisited-October-2019.pdf

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# Resources

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### Icons

**From flaticon:**
Framework, businessman, list, health, water, education, conservation, renewable energy, caution, touch, text

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