CHAPTER 1. The promise of blended finance

Blended finance is the strategy most talked about but perhaps most underused by donors, development finance institutions (DFIs) and private investors to mobilize the additional finance needed to fill the Sustainable Development Goal 2 (SDG 2) investment gap (see Box 1). This is a missed opportunity because blended finance offers these actors an innovative way to combine their resources, experience, expertise and risk appetite to achieve development impacts that are otherwise not possible. If donors and DFIs are willing to use grants and concessional loans to expand incentives for de-risking, blended finance can be the greatest opportunity to mobilize private investment for SDG 2. Indeed, the United Nations Addis Ababa Action Agenda underscored the significance of blended finance as a key instrument for leveraging public and private sector finance to advance progress towards the 2030 Agenda for Sustainable Development (United Nations, 2015).

Blended finance and its principles

Blended finance is the use of concessional finance from donors and philanthropic foundations to mobilize commercial finance from DFIs and private investors to invest in projects that are too commercially oriented to be eligible for grants and yet still too risky with insufficient returns for most private investors. Blended finance is therefore an important strategy to bridge the gap between these two sources of finance and contribute to fill the investment gap for achieving SDGs.

Box 1 - Defining blended finance, concessional finance and commercial finance

The OECD defines blended finance as “the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries, where additional finance refers to commercial finance” (OECD, 2020, p. 5). Convergence describes blended finance as “the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development” (Convergence, n.d).

The DFI Working Group on Blended Concessional Finance for Private Sector Projects defines blended finance as “combining concessional finance from donors or third parties alongside DFIs’ normal own-account finance and/or commercial finance from other investors, to develop private sector markets, address the Sustainable Development Goals (SDGs) and mobilize private resources” (DFI Working Group on Blended Concessional Finance for Private Sector Projects, 2023).

What are concessional and commercial finance?

Concessional finance includes grants, equity and loans that are longer-term and offered at below-market interest rates, and loan guarantees that aim to reduce the risk for private investors and DFIs. They are provided by donors and philanthropic foundations.

Commercial finance refers to equity and loans offered at market rates. They are provided by DFIs and private investors.

Blended finance strategies are informed and guided by the OECD blended finance principles and the DFI Working Group on Blended Concessional Finance for Private Sector Projects (see the annex). These principles have shaped the discussion on blended finance, receiving support from various organizations including the United Nations, the European Union, the World Economic Forum, as well as the G20 and the G7.

The OECD blended finance principles establish the rationale for blending as well as the need for regulation, transparency and accountability in the management of blended funds and instruments. According to these principles, blended finance strategies must result in both financial and development additionality.

The DFI Working Group aims to guide the promotion of commercially viable solutions using minimum concessional finance. They specifically call for increased scrutiny to ensure that the concessionality of blended financing does not distort nascent markets in developing countries. They also emphasize adherence to high standards in corporate governance, environmental impact, integrity, transparency and disclosure.

The state of play in blended finance

The share of **official development assistance (ODA) that is directed towards blended finance annually is around 2 to 3 per cent of total ODA** (Convergence, 2021). Over the past 10 years, the blended finance market has seen an annual average of 77 transactions, 41 of which specifically target climate. The median annual financing for the entire market has been approximately US$14 billion, with more than half (US$8 billion) dedicated to climate-focused blended finance deals. Moreover, only 5 to 10 per cent of DFIs' and MDBs' transactions for agriculture mobilize private finance (Apampa et al., 2021).

While the number of annual blended finance deals increased from 79 deals in 2018 to 117 deals in 2022, the total amount of these deals decreased from US$18.5 billion to US$8 billion over the same period (see Figure 1). This indicates that the focus of blended finance is shifting towards smaller transactions (Convergence, 2023).

When considering blended finance deals across geographic regions, **sub-Saharan Africa accounts for the highest share of activities,** with the region's share of blended finance transactions increasing from 41 per cent in 2019 to 68 per cent in 2022 (see Figure 2). Blended finance transactions in sub-Saharan Africa have grown from 27 per cent in 2018 to 40 per cent in 2020, notably favouring agribusinesses. In comparison, blended finance transactions in Latin America and the Caribbean have tended to offer greater support to rural and smallholder farmers and women as end beneficiaries (Convergence, 2021).

Figure 1 - The volume and value of blended finance since 2019 indicate a possible shift towards smaller ticket sizes

Annual volume and value (in billions of United States dollars) of blended finance transactions, 2014–2022

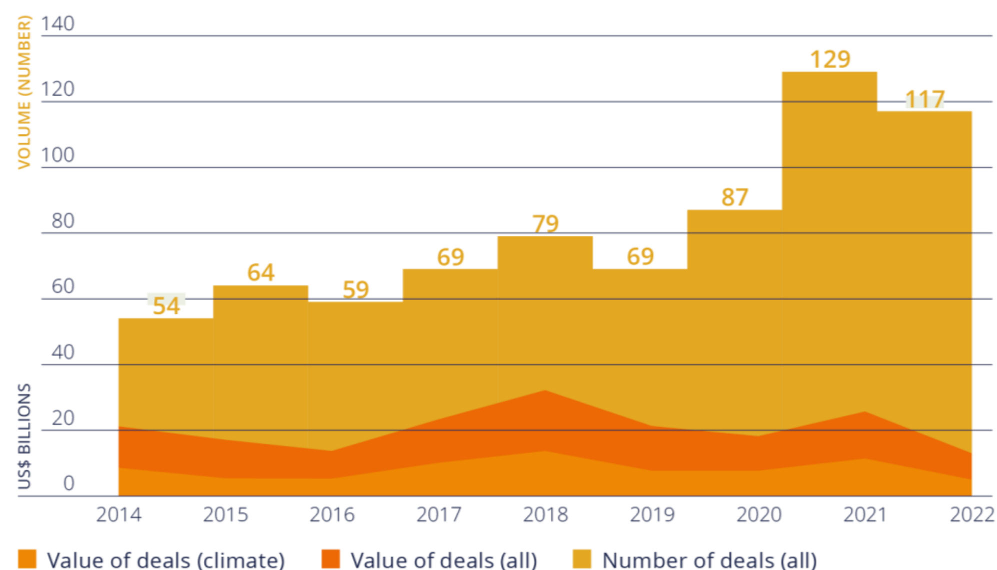
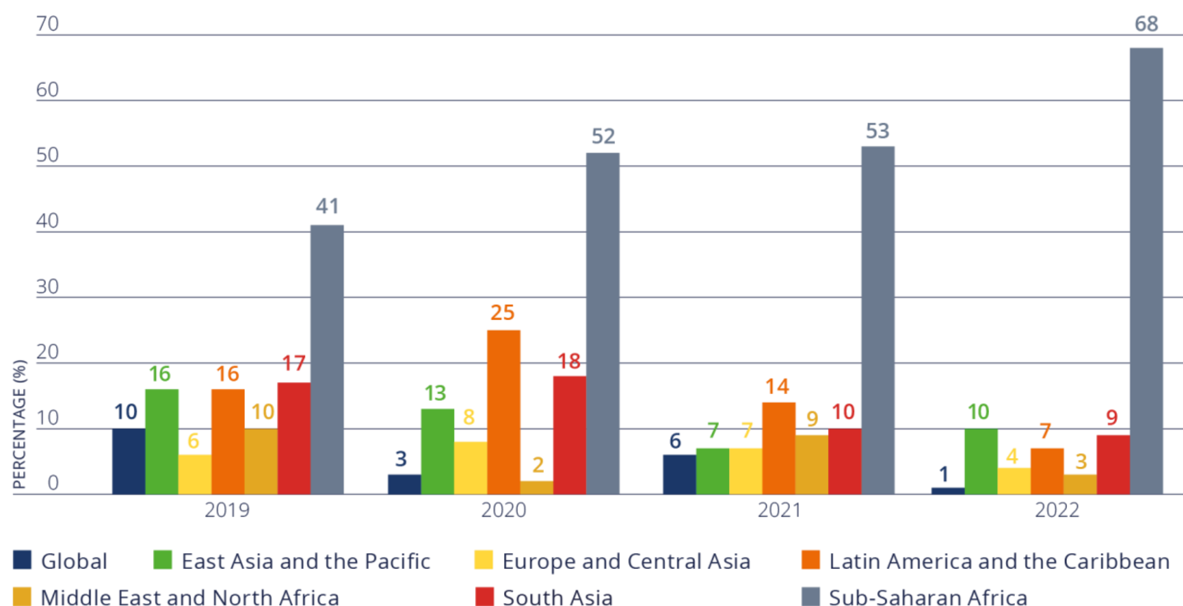


Chart: Lysiane Lefebvre. *Source:* Convergence, 2023

Figure 2 - Most blended finance transactions over the period from 2019 to 2022 have gone to sub-Saharan Africa

Proportion of blended finance transactions by region, 2019–2022

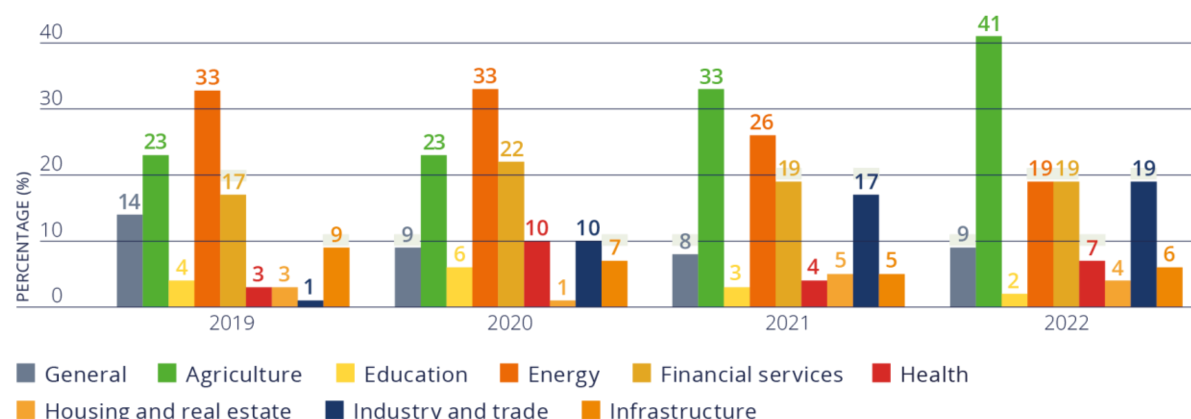


The percentages do not total 100 per cent, as a single transaction may target more than one region.
Chart: Kamal El Harty. *Source:* Convergence, 2021, updated with 2023 data following direct communications

The **proportion of transactions in agriculture has also grown**, from 23 per cent in 2019 to 41 per cent in 2022 (see Figure 3). This increase in the use of blended finance in agriculture has been primarily driven by financing for climate-smart agriculture and agrifood businesses, particularly those involved with agricultural inputs (Convergence, 2021).

Figure 3 - Between 2019 and 2022, the share of blended finance transactions targeting agriculture steadily increased

Proportion of blended finance transactions by sector, 2019–2022



The percentages do not total 100 per cent, as a single transaction may target more than one region.
Chart: Lysiane Lefebvre. *Source:* Convergence, 2021, updated with 2023 data following direct communications

The majority of blended finance transactions, approximately 58 per cent of transactions between 2020 and 2022, targeted lower-middle-income countries, primarily in sub-Saharan Africa, Latin America

and South Asia, with the aim of lowering the risk – both real and perceived – for private investors. Meanwhile, blended finance flowing to low-income and least developed countries represented only 28 per cent and 33 per cent of all transactions, respectively (see Figure 4).

Figure 4 - Blended finance is heavily concentrated in lower-middle-income countries

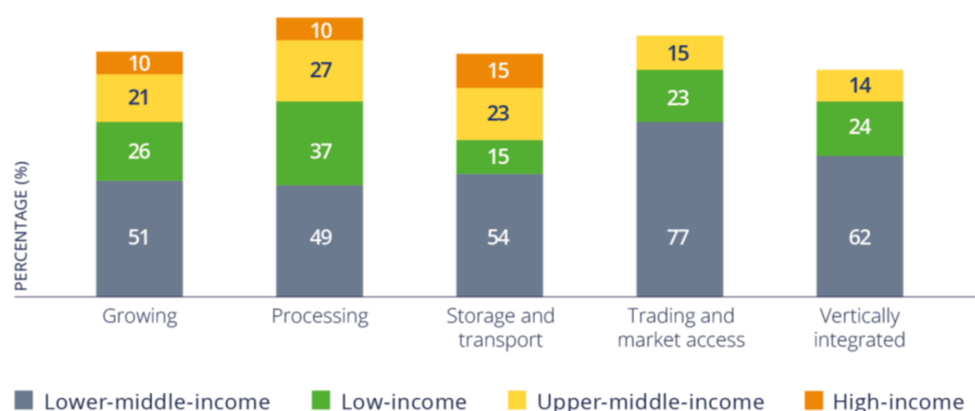
Proportion of blended finance transactions by income level during the periods 2017–2019 and 2020–2022

The percentages do not total 100 per cent, as a single transaction may target more than one region.
Chart: Kamal El Harty. *Source:* Convergence, 2021, updated with 2023 data following direct communications

This trend also persists in agriculture and food value chains. The smaller proportion of blended finance transactions targeting low-income and least developed countries is mainly due to real and perceived risks. These risks include underdeveloped business environments, expensive and time-consuming project pipeline origination, and a shortage of market data (see Figure 5) (Convergence, 2022).

Figure 5- Low- and lower-middle-income countries are the primary beneficiaries of blended finance across the agrifood value chain

Proportion of blended finance transactions by income level across the food value chain



The percentages do not total 100 per cent, as a single transaction may target more than one region.
Chart: Kamal El Harty. *Source:* Convergence, 2022

Blended finance transactions across the food value chain **primarily target agrifood small and medium-sized enterprises (SMEs) as direct beneficiaries, with only a small proportion flowing to financial institutions**. While this recognizes the importance of agrifood SMEs as the backbone of agricultural value chains, it also underscores the need for more concessional financing, guarantees and incentives to support lenders in financing agrifood SMEs (see Figure 6) (Convergence, 2022).

Figure 6 - Agrifood SMEs are the primary beneficiaries of blended finance across the food value chain
Proportion of blended finance transactions by direct beneficiaries across the food value chain

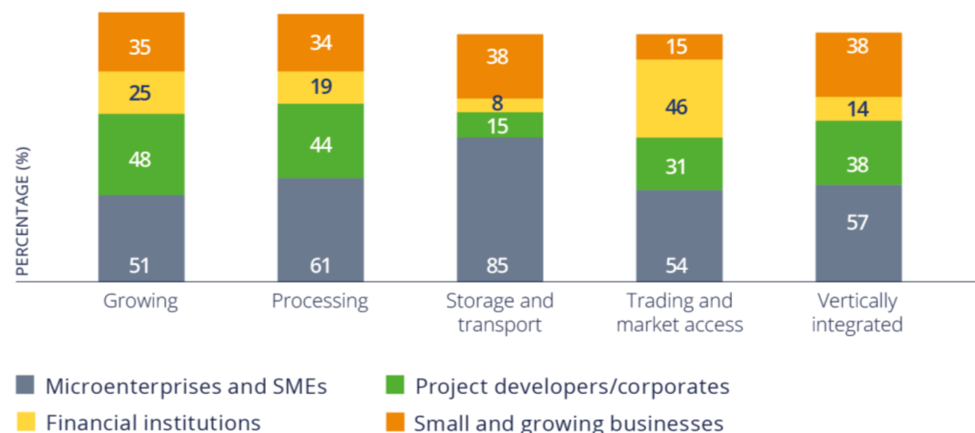


Chart: Kamal El Harty. *Source:* Convergence, 2022

The above trends in blended finance indicate that, while the market is nascent, the potential for its scaling remains significant. This is particularly true in the case of the agrifood sector, where blended finance transactions have increased from 23 per cent in 2019 to 41 per cent in 2022.

Of particular significance is that just 2 per cent of the annual ODA for agriculture is used as concessional financing in blended finance transactions. Furthermore, only 5 to 10 per cent of DFIs' and MDBs' transactions for agriculture mobilize private finance (Apampa et al., 2021). To attain the required scale of development finance for achieving SDG 2, donors need to increase their ODA allocation, and DFIs and MDBs need to mobilize more private financing in their agriculture and food transactions.

How this can be achieved is discussed in the chapters that follow.