CGAP

BRIEF

Navigating the Next Wave of Blended Finance for Financial Inclusion

Blended finance is at the heart of the discussion on how to attract private investors to close the estimated $2.5 trillion annual gap to finance the Sustainable Development Goals (SDGs) (UNCTAD 2014). In financial inclusion, the use of blended finance is not new and has attracted private investments from international and local sources (see Box 1). How will this most recent emphasis on using blended finance to mobilize private capital for development affect funding for financial inclusion? This Brief presents opportunities for the new wave of blended finance and points to areas that deserve further attention to optimize the use of different funding sources to advance responsible financial inclusion.

Increasing role of private capital in development finance

The signs are clear, even if progress is slow: More private capital will become available for the SDGs and development, including financial inclusion. More than 160 blended finance facilities have been launched since 2000, and US$81 billion has been mobilized from the private sector between 2012 and 2015 (OECD 2018). Budgetary constraints on public funds and changes in rules for measuring official development assistance that reward donors for mobilizing private capital have prompted public donors like the World Bank and the European Commission to use blending instruments to raise private capital.[1,2] Foundations are also committed to help close the SDG funding gap and use blended finance mechanisms to mobilize private capital.

In financial inclusion, blended finance has a long track record. The State of Blended Finance Report (Convergence and BSDC 2017) notes that the financial sector accounted for the largest number of blended finance deals (26 percent), including a total of 187 deals from 1980 to 2016.[3]

The development community's call for private investments is mirrored by an increasing interest from private investors who seek investments that generate social or environmental benefits beyond financial returns, as evidenced by the expanding impact investing industry. Impact investors project a 17 percent increase in their impact portfolios for 2018 (GIIN 2017). Mainstream asset managers and investors (including Blackrock, Bain Capital, and TPG[4]) have recently entered the impact investment sphere, and Deutsche Asset Management (now DWS), UBS, and Morgan Stanley are constructing larger funds and platforms to accommodate large institutional and retail investors. Digital platforms for impact investing are also emerging, and asset managers report that the boards of public and some private pension funds are urging them to pursue market rate investments aligned with the SDGs.[5]

In financial inclusion, the maturity and track record of the microfinance sector as an impact investment asset class has attracted private investors focused on impact. Private investments accounted for 26 percent of total commitments for financial inclusion as of December 2016 (Tomilova and Dashi 2017). Private institutional investors (e.g., insurance companies and pension funds) rank as the largest funding source of microfinance investment vehicles (MIVs).

Box 1. What is blended finance?

The Organisation for Economic Co-operation and Development (OECD) defines blended finance as "the strategic use of development finance for the mobilization of additional finance towards the SDGs in developing countries." The risk-return profiles of investments in developing countries often do not meet the expectations of commercial investors. Blended finance can improve the risk-return profile to attract commercial investments by managing, mitigating, or transferring risks to funders with a higher risk appetite (e.g., public or philanthropic funders). Several mechanisms can be used to this end, and this paper focuses on three principal ones: (i) junior or subordinated capital, which incurs losses before senior investors, thus minimizing risk to senior investors; (ii) guarantees and insurance mechanisms that fully or partially protect investors against risks; and (iii) grant-funded technical assistance, deployed either alongside an investment vehicle for building the capacity of investees, or to fund the preparation and design of funds or individual deals.

Advancing financial inclusion with blended finance

Financial inclusion is an important enabler of the SDGs, and it is a sector that is successfully leveraging private capital.[6] Development finance institutions (DFIs) and donors that want to use blended finance in financial inclusion should focus on areas where private investors are not (yet) comfortable investing and where there is promise in terms of impact and

1 OECD's Development Assistance Committee introduced a new development assistance statistical concept—Total Official Support for Sustainable Development—which complements bilateral aid data with information on all "officially-supported resource flows" (including private capital).
2 The World Bank recently introduced a $2.5 billion Private Sector Window that, along with IFC and MIGA, will facilitate private sector investments in low-income countries. The European Commission`s External Investment Plan is projected to mobilize Euro 44 billion or more for SDG-related financing.
3 While financial sector development is broader than financial inclusion, it is assumed that most blended finance deals in the financial sector seek to improve financial inclusion. In terms of amount of capital (as opposed to number of deals), the clean energy/climate and health sectors surpassed the financial sector, reflecting larger deal sizes in these sectors.
4 TPG is a global private investment firm that has raised an impact investment equity fund—The Rise Fund—with commitments of over $2 billion and support from several celebrities, U.S. West Coast technology entrepreneurs, and institutional investors.
5 ImpactUs and Align 17 (a World Economic Forum Young Global Leaders Program initiative with UBS support) are two digital platforms for impact and SDG investing.
6 Financial inclusion is explicitly targeted in seven SDGs, and there are four financial inclusion indicators to track progress, including one that tracks the proportion of adults with a transaction account (SDG 8, Economic Growth).

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