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Trends in philanthropy 2024

Blended Finance deep dive

Four trends in blended finance that will drive impact in 2024 and beyond

What is blended finance? Blended finance* is a structuring approach to increase investments in sustainable development. It uses capital from philanthropic or public sources to catalyze commercial investment, thereby increasing the pool of available development funding.

Blended finance mobilizes private capital toward high-impact social and environmental projects that may be overlooked by the mainstream market. This approach allows diverse organizations to invest together to meet goals – whether financial returns, social and environmental impact, or both.

Common blended finance structures include:
- Providing a first-loss layer for innovative pilot projects
- Offering credit enhancements such as guarantees
- Supporting transactions with grant-funded technical assistance

Blended finance is gaining momentum and more visibility. In the past decade, blended finance has mobilized over USD 200 billion[1] in capital toward sustainable development in developing countries.

Blended finance is often described as using concessional capital[2] to crowd in private capital. And this is true: the public and/or philanthropic capital needed to mobilize private capital offers concessions by taking on more risk or offering below-market rates on debt. After all, the public and philanthropic funders primarily seek social and environmental impact whereas private investors may be solely focused on financial return.

But does this mean that the so-called concessional capital from the public sector and philanthropists always has lower returns? It isn't always the case in blended finance outcomes. That's why we see momentum in philanthropists being keen to be "catalytic" with their capital to re-risk Blended Finance* structures.

Capital providers are becoming more aware of the potential of having returns when providing catalytic capital. More nuanced approaches are developing where a catalytic capital provider can enjoy higher returns than concessional in the event of exceptional performance from the transaction.

UBS Optimus Foundation has acted as catalytic investor in several blended finance structures that were designed to achieve[3] higher returns than more senior investors if the investment performed exceptionally.[4] The Future of Work Fund with Chancen International provides a promising model of how this can work. Another interesting example where we have seen governments take a leading role in joining forces with private investors is the SDG Impact Finance Initiative (SIFI) which was founded in 2021 together with the Swiss government and UBS Optimus Foundation with the goal of unlocking CHF 1 billion in capital towards the SDGs. At this year's WEF, Luxembourg announced joining SIFI as a new partner.

Designing blended finance* in this way offers public and philanthropic investors the opportunity to offer the concessional terms needed to attract private capital, while also offering all funders returns in the case of exceptional performance in achieving social and environmental outcomes. What's trending as critical about this public and philanthropic capital isn't that it offers concessions – it's that it's catalytic in achieving greater impact.

As blended finance gains momentum – what other trends do our UBS Optimus Foundation and philanthropy experts see as being key to driving its impact in 2024 and beyond? Here are four trends we see for blended finance in the coming years.

* Your capital is at risk. The value of an investment may fall as well as rise and you may not get back the original amount.

[1] Convergence Blended Finance
[2] Concessionary capital refers to funding with below-market terms, such as lower interest rates and extended repayment periods, provided to support social, environmental, or developmental initiatives, often serving as a key component in blended finance models.
[3] Performance figures refer to the past and past performance is not a reliable indicator of future results.
[4] Exceptional performance in blended finance is defined by individual organizational success in achieving their respective social and environmental goals, showcasing measurable positive outcomes, effective collaboration, risk mitigation, and the development of sustainable models for positive change.

1. **More nature, more climate finance**
   A surge in climate blended finance deals is expected in the coming years, particularly in Asia

2. **Measurement will be King**
   Calls for accountability will grow, including increased standardization and transparency

3. **More and more philanthropists are seeking effective leverage**
   Catalytic philanthropic capital will bring in more private investments, multiplying impact both quickly and more efficiently

4. **Designing for local needs**
   Success relies on greater focus on local contexts, market conditions and legal and regulatory frameworks

More nature, more climate finance

Climate-focused blended* finance transactions decreased recently due to macroeconomics challenges such as inflation, debt burdens, and geopolitical instability.

Despite these challenges, climate change remains central to the blended finance market and a surge in deals is expected in the coming years, along with a sense of urgency. Climate-focused blended finance focuses on mitigation of greenhouse gas emissions, adaptation to expected consequences of climate change and hybrid models. Institutional investors have tended to favor hybrid solutions. The attractiveness of adaptation and hybrid solutions is the potential for commercial or near commercial projects. This is likely to continue. A deeper understanding of how climate-focused blended financing can be applied and designed at the local, national and regional levels will contribute to increasing resilience to climate extremes and uncertainties.

Where are the deals? Blended finance transactions of all types – including those targeting climate – have been concentrated in sub-Saharan Africa in recent years. That trend seems here to stay. Latin America and the Caribbean makes up a large proportion of climate-focused blended finance deals. And those tend to be larger transactions, linked as they are to infrastructure and because of the size of geography. The number of deals are not expected to grow dramatically in the future.

Looking ahead, Southeast Asia and South Asia will emerge as crucial players in climate action, given their impact on global emissions, in no small part due to the dependence on coal. We expect to see more blended finance transactions in the region as a result. From fishing communities in the Philippines, our partners Blue Alliance shared some impressive testimonials like this video showing how our early stage blended capital is helping to protect and regenerate coral reefs, increase marine biodiversity, and enhance livelihoods, all while working toward a self-sustainable revenue model.

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Measurement will be King

What's at the core of a successful blended finance deal? Impact.[1] Impact management and measurement not only allows the determination of success, but it is also what's behind the determination of financial returns. As such, there's an emerging emphasis on the development of sound monitoring and evaluation systems to effectively measure and report on achievement of outcomes.

Whether engaging philanthropists, governments or private investors, there needs to be accurate expectations about risk and return. And there's heightened attention in developing nations. Central to scaling and achieving greater financial goals is the incorporation of robust impact management and measurement frameworks. These frameworks serve as essential tools for engaging all stakeholders effectively.

Scaling blended finance to be catalytic is imperative for achieving the Sustainable Development Goals (SDG's). Private investors need to have confidence in these deals, which may be new to them. Transparency and accountability are crucial to engage catalytic capital. We already observe a culture of transparency that is helping to promote a culture of knowledge sharing. This, in turn, is creating an understanding of shared best practices.

As the field evolves, we expect to see greater standardization in impact management and measurement. This will help attract more investors to blended finance, supporting the scale needed for transformational impact.

[1] "Impact" refers to measurable and positive changes in social, environmental or economic conditions, adhering to transparent and accountable assessment criteria in accordance with regulatory standards.

More and more philanthropists are seeking effective leverage

Government and donors are not achieving the outcomes needed to reach the UN Sustainable Development Goals (SDGs). And the USD 1.5 trillion in philanthropic assets is inadequate to fill the USD 3.9 trillion[1] annual funding gap. So, what will get the private markets investing in the SDGs?

Blended finance* in the past has largely utilized catalytic funding from multilateral development banks (MDBs) and development finance institutions (DFIs). We expect that MDBs and DFIs will continue to utilize blended finance and there's room for more engagement of private investment. But to complement that, in the coming years, we expect to see philanthropy play a bigger role in blended finance.

There is an emerging need for larger philanthropic capital integration into blended finance to catalyze greater transactions in developing economies. Philanthropic institutions, with their risk-taking capacity, present an innovative solution for bridging the financial gaps in blended finance solutions, challenging traditional donor paradigms. Furthermore, as noted, there is a growing recognition of the possibility of generating returns while providing catalytic capital.

Philanthropic capital has enormous potential for addressing perceived barriers related to risk and return that keeps private capital out of development. Through increased use of blended finance structures, philanthropists will be able to magnify the impact that they want to achieve. By catalyzing investment of private capital, philanthropy stands to catalyze the ability to close the funding gap and achieve the outcomes needed the reach the SDGs. Take for example the SDG Outcomes Initiative: BII and the DFC joined UBS Optimus Foundation in this pioneering blended finance structure to catalyze and amplify the investments from UBS clients and family offices to deliver social and environmental impact across developing countries.

[1] OECD

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Designing for local needs

One size fits all? Not so. We're seeing a rising trend in tailor-fitted blended finance solutions to specific contexts, unique challenges and opportunities. Blended finance is aimed at maximizing impact. To do that, it's crucial to design operations that respond to local needs – engaging with national, regional and on the ground partners and beneficiaries from the onset – and provide a more inclusive market for blended finance.

Blending catalytic capital and private capital, strategically tailored to local contexts and risk profiles, can drive the necessary investments at scale to achieve real impact. But to achieve this, these tailored financial instruments and risk mitigation strategies need to align with the unique challenges and opportunities within developing economies.

What kind of issues are most pressing? Blended finance needs to add value to local development priorities with an eye toward financial sustainability. Building local capacities and an ecosystem matter, alongside the right institutional, policy and legal regulatory frameworks for scaling. To support systems change, collaboration across public and private sectors is key, with enhanced local ownership.

Achieving the greatest impact means reaching the most vulnerable and underserved communities. So, blended finance transactions must be designed from the very outset with these communities in mind. This requires meaningful dialogue and engagement with local development partners and beneficiaries. We expect to see this become more prominent in the development of blended finance* solutions.

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Sources:

State of Blended Finance 2023, Convergence.
Bartz-Zuccala, W., Ö. Taskin, T. Hos, C. Sangaré, R. Schwarz and P. Horrocks (2022), Scaling up Blended Finance in Developing Countries, OECD, Paris.

With special thanks to our main contributors:
Dhun Davar, Gabriele Guaita, Anita Kover, Sietse Wouters, and Maya Ziswiler.

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