

BLENDED FINANCE

June 2018

Maximizing Finance for Development for the Poor

DEVELOPMENT CHALLENGE

Given the significant financing gap to meet the needs of developing countries and achieve the United Nations' Sustainable Development Goals, governments, multilaterals and other development partners are increasingly looking to the private sector to help fill this gap. This means applying innovative financing instruments which address investor risks to help mobilize private capital, optimizing the use of scarce public resources to advance development objectives. However, this leads to another challenge: how do we achieve inclusive development while remaining attractive to the private sector? The case studies in this brief highlight a financial tool to unlock additional resources for development projects while ensuring that the poorest targeted communities benefit from these investments.

RESULTS-BASED BLENDED FINANCE

Results-based financing (RBF) can be broadly defined as a financing arrangement in which payments are contingent upon the achievement of pre-defined and verified results. By shifting the focus to results, RBF enables stronger service provider and/or implementing agency accountability and provides flexibility for innovation and thus efficiency in the means to achieve those results. While a variety of RBF instruments exist to achieve a multitude of objectives, these core features make RBF an important tool for strengthening blended finance investments.

The added value of RBF to blended finance approaches can be summarized by three key points:

- **Reduction of repayment risk:** RBF can make strategic use of private investment by reducing the risk to lenders through performance/results-based grants paid to project implementers against pre-agreed results. This payment reduces the debt burden on the client (utility company, household, or other) while also reinforcing accountability for performance and assurance of results.
- **Inclusion of poor low-income communities:** As private capital providers have been reluctant to lend to projects primarily targeting low-income consumers, RBF can provide the incentive for



them to do so. Specific RBF instruments, such as output-based aid (OBA), link payments to pro-poor investments, improving the financial viability of serving low-income communities.

- **Complementing other de-risking financial instruments:** RBF has successfully been used alongside other risk-mitigating instruments such as partial credit guarantees, further providing incentives to the private sector to lend to projects with high development impact. This is demonstrated in the examples provided further in this brief.

GPOBA EXPERIENCE

During the past 15 years, the Global Partnership on Output-Based Aid (GPOBA) has been building evidence on RBF's ability to mobilize additional resources through a diverse portfolio of pilot projects involving a mix of private finance, results-based grants and guarantees to deliver basic services to the poor low-income communities.

In Kenya, RBF is a key part of a commercial bank lending to water utilities to extend service for low-income communities, supported by a 50 percent USAID partial credit guarantee. Technical assistance

through borrower and lender toolkits, support for negotiations and loan perfection, and utility creditworthiness assessments helped to unblock some of the obstacles in the road to accessing commercial finance by the water utilities.

In Bangladesh, an RBF grant is blended with household loan finance from local microfinance institutions to increase access to hygienic latrines in low-income rural areas. The project has facilitated over \$1 million in small business loans to local construction firms responsible for installing the latrines. RBF grants are supporting pro-poor renewable energy projects in rural Bangladesh and Ghana, where World Bank (IDA) on-lending to domestic financial institutions helps to facilitate household investments in low-cost solar home systems and other sources of clean energy.

Another project in Ghana used an RBF grant to stimulate demand for urban household sanitation, attracting larger contractors to supply toilets to low-income communities as well as financial institutions to enter the market. Case studies developed on these projects provide additional detail on the individual blended finance approaches.

In addition to the sectors mentioned above, GPOBA grants have funded projects in solid waste management, education, health, and telecoms, supporting downstream infrastructure and access to basic services. GPOBA funding is also provided for technical assistance to identify and overcome constraints to commercial lending, including feasibility studies, market and cost assessments, and capacity building. While originally established to focus exclusively on OBA, GPOBA's mandate has since expanded to include more flexible RBF solutions. This has opened opportunities to work in new spaces, such as impact bonds, a type of RBF which leverages private investments for social outcomes, and with cities and municipalities interested in raising commercial finance for investment in better service delivery and revenue generating activities.

EXAMPLES OF RESULTS-BASED BLENDED FINANCE STRUCTURES

The diagrams below depict two approaches to blending RBF with private finance, tailored for GPOBA-funded projects in Kenya and Bangladesh.

FIGURE 1. Service Provider Financing Structure

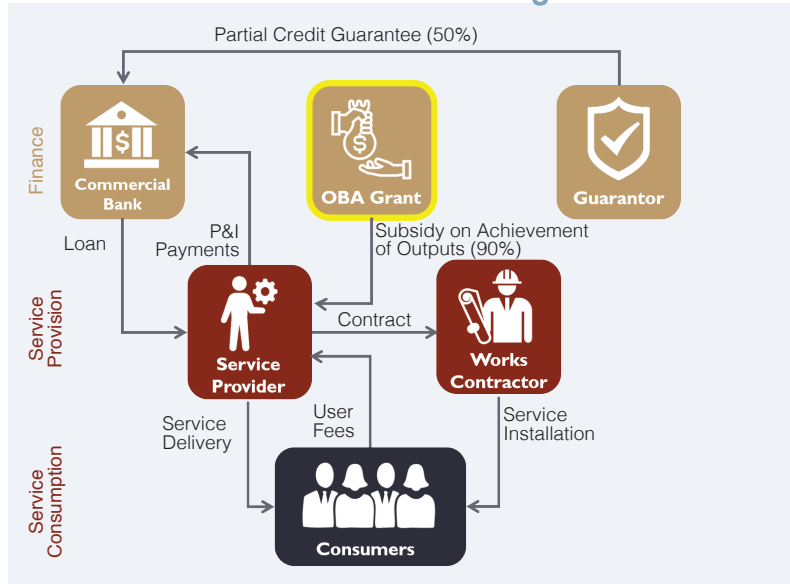


FIGURE 2. Household Financing Structure

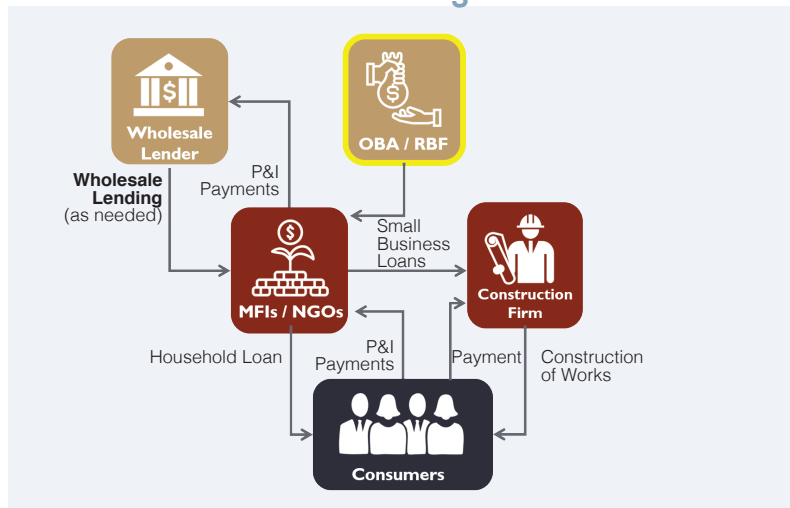


Figure 1 shows a service provider financing model, where RBF is blended with a partial credit guarantee and commercial lending to finance pro-poor investments in downstream water and sanitation infrastructure. Figure 2 shows a household financing model, where RBF is blended with household microfinance loans to increase the provision of sanitation facilities in low-income communities.

ABOUT GPOBA

Part of the World Bank Group, the Global Partnership on Output-based Aid (GPOBA) provides innovative financing solutions that link funding to actual results achieved. Our results-based financing (RBF) approaches provide access to basic services like water and sanitation, energy, health and education for low-income families and communities that might otherwise go unserved.

By bringing together public and private sector funders to maximize resources, and designing effective incentives for service providers to reach underserved low-income communities, we give people the chance for a better life. Visit www.gpoba.org to learn more.