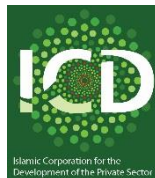


DFI Working Group on Blended Concessional Finance for Private Sector Projects

SUMMARY REPORT

October 2017



AFRICAN DEVELOPMENT BANK GROUP



Creating Markets, Creating Opportunities



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This report was prepared by a group of Development Finance Institutions (DFIs), composed of the African Development Bank (AfDB), the Asian Development Bank (AsDB), the Asia Infrastructure Investment Bank (AIIB), the European Bank for Reconstruction and Development (EBRD), European Development Finance Institutions (EDFI), the European Investment Bank (EIB), the Inter-American Development Bank Group (IDBG), the Islamic Corporation for the Development of the Private Sector (ICD), and the International Finance Corporation (IFC).

I. Executive Summary and Background

Blended concessional finance for private sector projects is one of the significant tools that Multilateral Development Banks and development finance institutions (collectively, “DFIs”) can use, in cooperation with donors and other development partners, to increase finance for important private sector activities, help address the Sustainable Development Goals (SDGs), and mobilize private capital.

Over the last years, and especially since the Financing for Development conference in Addis Ababa in 2015, there has been a **substantial growth in international attention on the role of blended concessional finance** to promote private sector participation in developing countries. More concessional resources for blending have become available, which has provided DFIs with enhanced possibilities for development impact. This trend has also made the imperative of working closer together and having a clear common understanding of the principles for engagement even more pertinent.

To help ensure the **effective and efficient** use of concessional resources in private sector projects, and **avoid market distortion** or **crowding out** private capital, the MDB Heads at their October 2016 meeting called for efforts to build on and further strengthen the principles for the use of concessional finance in private sector operations agreed by the DFIs in October 2013¹.

The specific definition of blended concessional finance for the private sector operations of DFIs, adopted by the DFI Working Group on Blended Concessional Finance for Private Sector Projects (heretofore “the DFI working group”) is: *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.* This definition builds on, and clarifies, the definition adopted by the MDB Heads last April.

This paper summarizes the results of the work over the last year of the DFI working group². The work over the last year included:

- Updating the principles and guidance for providing blended concessional finance, including how to push for commercially viable solutions using minimum concessionality.
- Mapping out the key drivers for use of blended concessional finance, with a focus on reinforcing and creating commercial markets over time.
- Collecting DFI data for the first time on the volume and composition of blended concessional transactions. A presentation of the initial findings is detailed below.
- Sharing best practice about tailoring blended finance to particular development contexts, by examining case studies (summarized **in section IV** of this paper). And finally,
- Defining a clear way forward that will underscore the responsibility of the DFI community for ensuring effective use of donor resources and maximum development impact.

Enhanced Principles. The DFI working group developed a **set of guidelines** for each of the five principles, along with **explanatory and pragmatic lessons** to clarify and illustrate each guideline to make them

¹ Private Sector Development Institutions Roundtable: *DFI Guidance for Using Investment Concessional Finance in Private Sector Operations*. March 12, 2013.

² This working group consists of EBRD, IFC, AsDB, IDBG, AfDB, EIB, ICD, AIIB and EDFI.

more easily actionable. The principles and corresponding guidelines are presented in **Section II** of this report. The five core principles, carried over from the 2013 report³, are 1) additionality/rationale for using blended finance, 2) crowding-in and minimum concessionality, 3) commercial sustainability, 4) reinforcing markets, and 5) promoting high standards. Among other items, the guidelines discuss the importance of blended concessional finance in addressing obstacles to positive market dynamics, processes that can be used to ensure minimum and time-bound use of concessional funds, and sound practices with respect to standards, governance and transparency.

Pilot Data-Gathering. The DFI working group undertook a pilot exercise in data gathering on the blended concessional finance activities of the DFIs in the period 2014-2016. The data was self-reported, and results are summarized in **Section III** of this report. The exercise did not include standardization of the data, but as a preliminary result identified an annual use of **concessional finance from donors by the DFIs** for private sector projects in developing countries of at least **US\$700 million**, with DFIs contributing at least an additional US\$1.7 billion to the projects from their own funds, and supporting **total project costs between 5 and 17 times** the concessional amount (as not all data is comparable), or at least **US\$5 billion annually**⁴.

Infrastructure, banking and agriculture were the sectors most targeted by the concessional resources invested. Climate change and support to SMEs were the most prevalent themes within these sectors. The data shows that the concessional finance products were **tailored to the specific needs in different sectors**, with senior debt predominant in infrastructure, whereas SME and agribusiness support utilized a variety of debt, equity, risk-sharing, and performance grant instruments. **Pioneering technology, creating markets, reaching underserved beneficiaries, and addressing environmental externalities** emerged as the main rationales for the use of blended concessional finance.

A key deliverable from the DFI working group was **clear guidance on how to implement blended finance transactions**. All members of the group have agreed to implement the enhanced principles and, within the next year, to begin to monitor and ensure adherence to these enhanced principles.

The OECD DAC and the Business and Sustainable Development Commission (BSDC) are also currently, but separately, considering blended finance work. These groups are examining blending of both concessional and non-concessional developmental resources alongside commercial resources for development. The DFI working group has a more a narrow focus, namely blending with concessional resources, and only for private sector projects. Thus, the DFI work is complementary but not comparable to the OECD and BSDC work, and we have agreed with these teams to highlight definitional differences for clarity.

³ The 2013 Principles have been updated slightly regarding definitions and consistency with the new guidelines.

⁴ For different reasons, some DFIs did not report total project cost or with exactly the same geographical or product concessionality definitions, so the \$5 billion is an underestimate. For DFIs that did report total project cost, the ratio of total project cost to concessional finance was a range between 5 and 17 to 1, depending upon institution and country group.

II. Enhanced Principles

Below, in italics, are the enhanced DFI principles and explanation of the principles as they apply to concessional finance from the 2013 DFI paper⁵. Then, under each principle, is the set of guidelines developed by the DFI working group that apply to that principle. The common guidelines provide a framework that allows each institution to formalize the Enhanced Principles within their own processes, varying mandates and operational contexts.

Principle 1. Additionality/Rationale for Using Blended Concessional Finance

Principle 1. Additionality (Rationale/Economic Case for Using Blended Concessional Finance).

DFI support of the private sector⁶ should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector.

Application to concessional finance: *It is critical that concessionality is itself not the source of additionality. Indeed, concessionality can undermine additionality if a DFI offers the same financial services on concessional terms as commercial financial institutions are willing to provide on market terms. Such an application of concessionality would crowd-out private finance and should always be avoided. Concessional finance products should only be used in cases where the private sector or DFI finance using ordinary (commercial) terms is not able to provide adequate finance for a project to be viable or achieve the same objectives. An assessment should be made as to whether or not a reasonable investor would proceed with a particular project without the presence of concessional finance.*

Guidelines

- Use blended finance only when there is a relevant case that a specific project or more generally projects in a given sector cannot be structured on a commercial basis (i.e. without the use of blended finance).
- When projects cannot be structured on a fully commercial basis, the use of blended concessional finance can be justified if it addresses externalities, information asymmetries and/or other institutional and market failures, or affordability constraints that are hindering positive market dynamics, and there is an expectation to arrive at commercial solutions over the medium term.
- Where projects address both the commercial need and externality, market and institutional failure, or affordability issues discussed above, use of blended concessional finance should, if possible, be prioritized for projects with high developmental impacts.
- Increase the level of scrutiny of projects commensurate with the underlying risk that concessional resources could lead to market distortion or rent-seeking behaviors.

⁵ There has been some slight editing in a few of the principles to align with the current terminology and the new guidelines.

⁶ These principles would also apply to other commercially-oriented enterprises addressed by the non-sovereign operations of the DFIs.

Principle 2. Crowding-in and Minimum Concessionality

Principle 2. Crowding-in and Minimum Concessionality. *DFI support to the private sector should, to the extent possible, contribute to catalysing market development and the mobilization of private sector resources.*

Application to concessional finance: *Concessional finance crowds-in sustainable private investments if it is structured to provide the missing element in the overall financing that makes private projects commercially financeable and if it successfully creates a demonstration effect of commercial replicability. The concessionality embedded in a financing package should not be greater than necessary to induce the intended investment (“minimum concessionality” principle) and maximise the leverage of private funding.*

Guidelines

- Apply explicit processes in project analysis to determine minimum concessionality.
- Information or data, e.g. of other projects’ pricing structures, level of concessionality, amount of donor concessional funds (compared to total project investment or private investment), donor cost per output, and/or investors’ market returns may help establish a reference point for blended concessional finance volumes and terms.
- Structure blended concessional finance operations to address as directly as possible critical gaps in the financing structure and to minimize the need for future, ongoing concessionality.
- Size, where possible, the level of concessionality relative to the value of the externality/obstacle identified.
- To facilitate the crowding-in of private finance, avoid if possible using concessional finance to enhance the risk/return position of a DFIs own funds in a project financing package without extending the benefits to other investors.
- Increase the scrutiny for the crowding-in effect when the blended concessional finance participation in the financing structure closely resembles, or becomes identical or senior to, commercial investors, including other DFIs investing own funds in private sector projects.

Principle 3. Commercial Sustainability

Principle 3. Commercial sustainability. *DFI support of the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must therefore be expected to contribute towards the commercial viability of their clients.*

Application to concessional finance: *Operations supported with concessional funds should be designed to contribute to the commercial sustainability of the relevant activity or sector, avoid creating permanent dependency on long-term support and prevent rent-seeking behaviour among private beneficiaries. To encourage commercial replication of individual operations supported by concessional finance on market terms and manage the expectations of continuing availability of concessional finance among potential beneficiaries, concessional programs (at the sectoral level) should ideally be time-bound, with credible expectations that they will be phased-out over time. When possible at the programmatic level, sunset clauses should be announced ex-ante to shape such expectations. When considering concessional support to specific projects, there should be an expectation that future investments in similar projects in a given sector will gradually require less concessionality and eventually no support from concessional finance. However, depending on initial circumstances, commercial sustainability and independent*

commercial replication may only be achievable over time, possibly after several rounds of legitimate DFI interventions, that may or may not involve some and declining concessional element.

Guidelines

- Maintain a high level of scrutiny of the commercial viability of clients.
- Reduce demonstrably the level of concessional extended to repeat projects as market failures and/or other obstacles are reduced.

Principle 4. Reinforcing Markets

Principle 4. Reinforcing markets. *DFI assistance to the private sector should be structured to effectively and efficiently address market failures, and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.*

Application to concessional finance: *Concessional finance would ideally supplement, and be consistent with, measures addressing the root causes of market failures and barriers. Concessional funding should not substitute for, nor delay, more sustainable commercial or policy interventions. It should, to the extent possible, help develop a market that responds to appropriate incentive structures to provide the desired goods or services. While this is a desirable goal, it is however recognised that reaching a sustainable market outcome can sometimes only be envisaged over time.*

With that in mind, concessional finance products should aim to align incentives of the project participants with market-compatible behaviour. It should encourage maximum delivery of social/economic outcomes (e.g. emission reductions, or kWh of energy saved) or compensate for the incremental cost of going beyond standard practice in the sector. Ideally, for grant-based payments, disbursement should follow, and be calibrated to, achieved and verified results. Where this is not practical, disbursement should be linked to important milestones towards final results (as is typically the case with infrastructure development projects or when the project is completed but its outcomes are lagged).

Guidelines

- Identify and, where feasible, implement measures to overcome the obstacles identified that are barriers to commercial sustainability.
- Monitor, where feasible, the obstacle identified as giving rise to the need for blended concessional finance.
- Introduce, where feasible, market monitoring and coordination among DFIs to leverage experience, coordinate policy, and demonstrably take steps over time to reduce the root causes for requiring blended financing.
- Structure blended concessional finance to align incentives to accelerate sustainable market development.

Principle 5. Promoting High Standards

Principle 5. Promoting high standards. *DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of Corporate Governance, Environmental Impact, Social Inclusion, Transparency, Integrity, and Disclosure.*

Application to concessional finance: *DFIs apply high standards of conduct in all projects, whether those benefit from concessional funds or not. However, given the nature and purpose of concessional funds, transparency, results measurement and effective governance have special importance. If a project receiving concessional funds is unnecessary or poorly designed, it will undermine the development or functioning of markets and the private sector – the very objective of the DFIs with such operations. Providing concessional finance to the private sector also presents the potential for particularly high reputational risk. It is in the nature of markets that some private sector projects will fail, and if such projects have benefited from concessional support, questions can be raised about the deployment and appropriateness of such public resources. Therefore, the projects benefiting from concessional funds must adhere to particularly high corporate governance, environmental and social standards.*

When confidentiality and other internal DFI considerations permit, DFIs should aim to report on their concessional programs and the results of these programs, including, if appropriate, on incremental impact of concessional finance.

Guidelines

- Identify and require client adherence to international best practice industry standards or guidance, including the environmental, social and governance standards and other policies and procedures of DFI own-account projects.
- Ensure a level of independence or oversight within project teams and decision making bodies managing blended concessional finance operations, to ensure effective and efficient use of concessional resources.
- Where donors have delegated authority to DFIs for blended financing decisions, DFIs should explicitly monitor adherence to the blended concessional finance principles and guidelines, and as applicable, to donor guidelines.
- Develop specific disclosure policies for blended concessional finance, tailored to different stakeholders, that balances transparency with appropriate client confidentiality and DFI efficiency.

III. Pilot Data-Gathering

An important component of the working group activities was to explore various ways of monitoring private sector blended concessional finance activities and track implementation of the enhanced blended concessional finance principles. As an initial effort, the DFIs agreed to collect data in four areas that could contribute to better understanding of the use of blended concessional finance among DFIs:

- **Volume data on blended concessional finance activities of DFIs.** To provide previously unavailable aggregate information on what blended concessional finance activities are being undertaken by DFIs, in what sectors and types of countries, and what instruments are being used.
- **Data on economic rationales for blended concessional finance activities.** This would further help provide information relating why DFIs engage in blended concessional finance activities.
- **Narrative information on recent blended finance projects,** to provide insights on implementation of the principles.
- **Basic survey data on how DFIs manage and make decisions** on the use of concessional finance resources, **address standards, and provide transparency,** to provide insight into *Governance*.

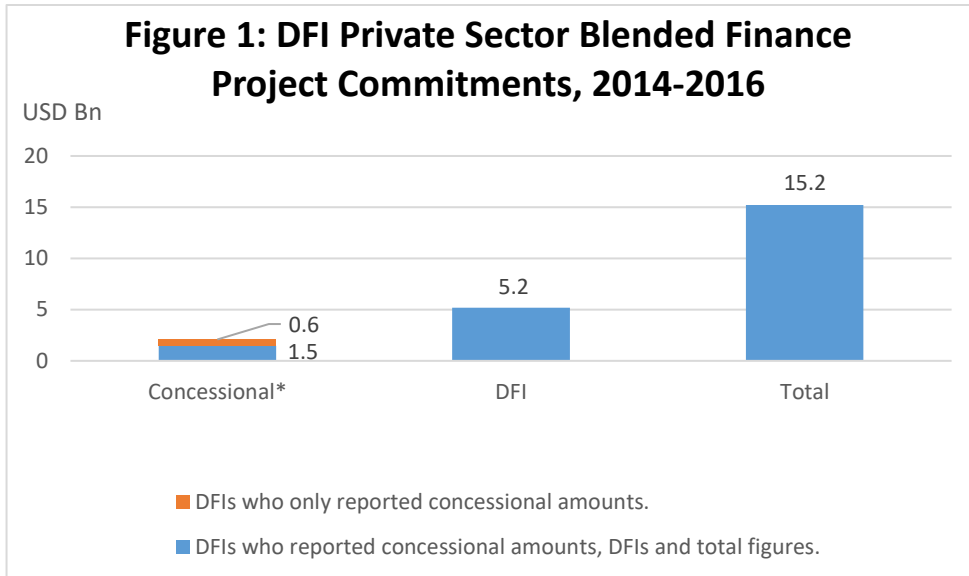
The pilot exercise has yielded some new insights, but has certain limitations. While we estimate that well over 90 percent of the volume of blended concessional finance from participating DFIs has been reported, some additional projects may still be identified and large volumes from other DFIs may result in different conclusions. Also, certain estimates needed to be made, particularly with respect to categorization by sectors, and some institutions were unable to provide certain data points (e.g. total project size, different countries, or products with components having different concessionality definitions). The working group plans to continue to expand and refine both the data scope and quality.

A summary of findings from this data analysis are presented below.

Volumes

Figure 1 shows for all the DFIs in the working group, assuming all the self-reported data is comparable, the total private sector blended concessional finance volumes over calendar years 2014-2016 for developing countries.

- In terms of total volume, the Development Finance Institutions have financed a **total project value of more than US\$15 billion** over 2014-2016 by various blended finance solutions, or on average about US\$5 billion/year.
- Total concessional commitments from donors (for all types of instruments, e.g. debt, guarantees, grants or equity) for these projects was at least \$1.5 billion. These projects also had about \$5.2 billion of DFI own account regular pricing investments, which consisted of \$4.5 billion from the DFIs that arranged the concessional finance, and \$0.7 billion from other DFIs that contributed to the projects.
- This means that **each concessional USD in support from a donor could support approximately USD 10** from development finance institutions and private investors.
- Another approximately US\$600 million of concessional funds supported DFI blended finance projects, where the total project cost is currently not available, bringing the **total concessional funds** supporting DFI blended concessional finance projects over 2014-2015 to **\$2.1 billion or \$700 million per year.**

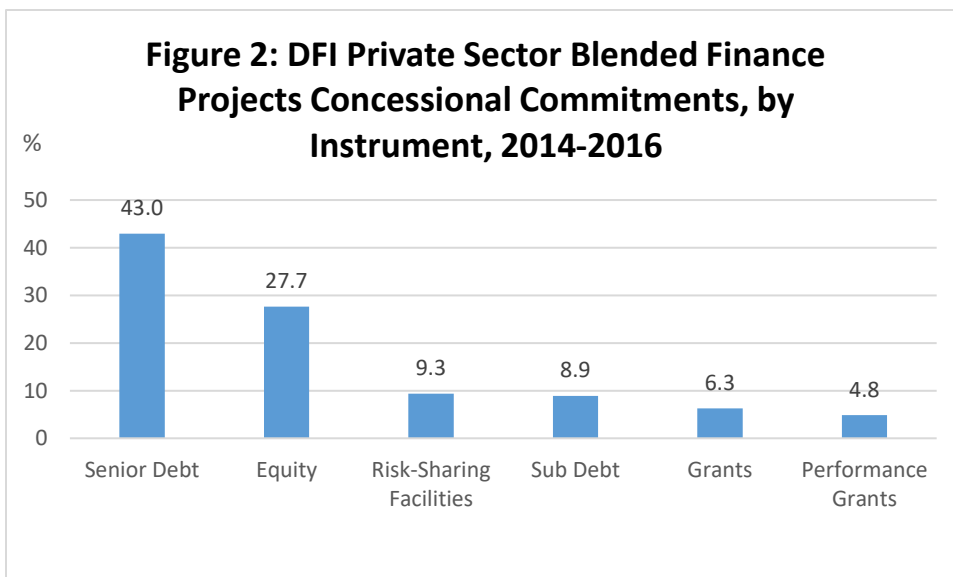


*Concessional finance includes debt, equity, risk-sharing facilities, grants, and guarantees. The blue bars show DFI projects that reported in all three bars: concessional contributions, DFI contributions, and total project costs. The orange shows the additional concessional finance for DFI projects from DFI projects that only reported on concessional finance.

Currently, the annual total project cost of transactions financed by DFIs supported by blended concessional finance of more than US\$5 billion per year is a **relatively small percentage of the total DFI total cost of private projects** financed each year (i.e. around 5 percent).

Sectors and Instruments

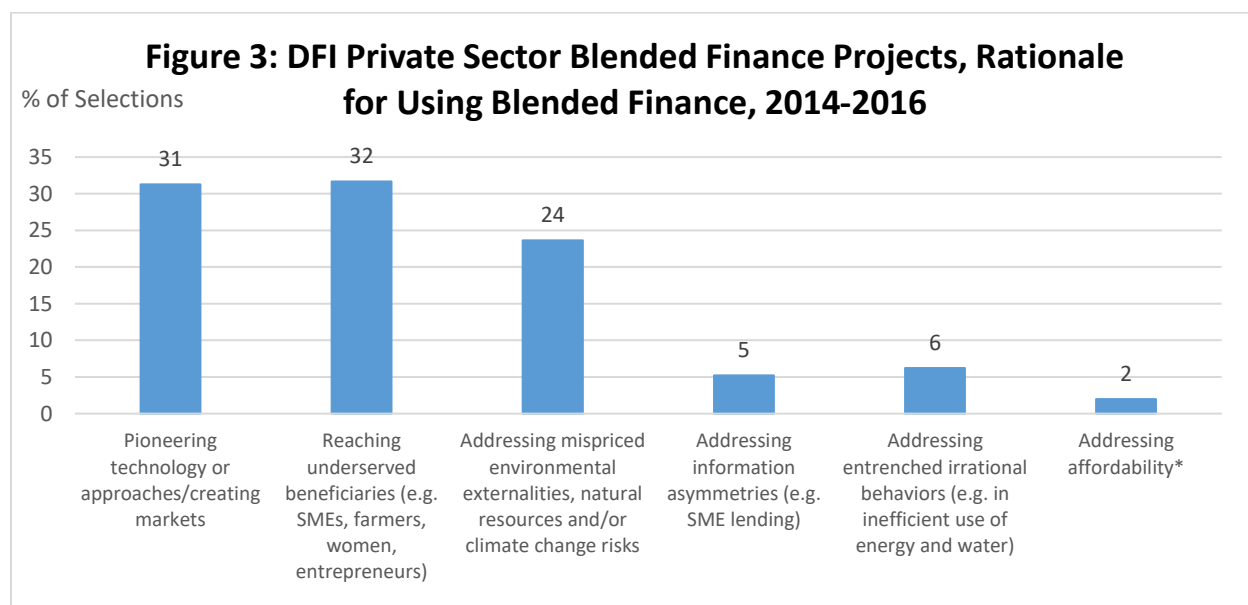
Infrastructure, banking and agriculture were the sectors most targeted by concessional resources, while climate change and SMEs were the most prevalent themes within these sectors. Various financial products were used, primarily senior concessional loans and equity, but also risk-sharing facilities, subordinated loans, and grants (Figure 2).



The data shows that the concessional finance products were **tailored to the specific needs in different sectors**, with senior debt predominant for infrastructure and climate projects, whereas SME and agribusiness support utilized a variety of debt, equity, risk-sharing, and performance grant instruments.

Rationale for Using Blended Finance

Figure 3 shows the major rationales for using blended finance as identified by the DFIs (two selections were allowed per project). In terms of rationale for blended finance projects in 2014-2016, most projects were based on **pioneering technology or creating markets** and projects focused on **reaching underserved beneficiaries or addressing environmental externalities or climate change**.



By sector, the importance of pioneering and creating markets was significant in all sectors except for banking. Reaching the underserved was important in banking, agribusiness and SME projects; and environmental externalities were important in infrastructure, climate change, and banking projects. Affordability concerns were important in some infrastructure and climate projects.

Projects Narratives – Commercial Sustainability and Reinforcing Markets

As part of the DFI data-gathering exercise, the DFIs discussed summaries of blended concessional finance projects committed in 2016, highlighting how these projects led to commercial sustainability and reinforcing markets. The survey highlighted five models of projects that are the focus today of DFI’s blended concessional finance transactions. These are: 1) **renewable energy and energy efficiency investments** through **financial intermediaries**, allowing financial intermediaries and end-users to gain experience in innovative technologies; 2) **pioneering new infrastructure and climate technologies**, improving project operations, and providing proof of concept; 3) **SME support** through financial intermediaries, often with risk sharing facilities, improving information, and building the financial institutions’ credit capabilities; 4) **agribusiness projects**, establishing links to **farmers** and/or addressing new **environmental technologies**, and helping financial institutions build agribusiness markets and/or large agricultural processors develop networks; and 5) innovative approaches to **capital market development**, often with energy efficiency projects, proving innovative approaches and providing comfort to investors.

Advisory services/technical assistance interventions preceding and/or accompanying some of the blended finance transactions have contributed to the origination and structuring of these operations, and are often an essential component to their successful implementation. The availability of advisory resources from donors has been critical to help overcome financial and non-financial barriers holding back private investments, helping deliver development outcomes that achieve commercial sustainability and reinforce markets.

Governance

The survey of DFI governance practices yielded the following results:

- *Addressing Potential Conflicts of Interest.* DFIs use both **separate teams and separate decision-making bodies**, and **single teams and decision-making bodies** with **separate reviews by donors** when processing blended finance projects⁷.
- *Reporting.* Most of the DFIs indicate they report on project structures, donor amounts, and total financing to donors, and many report information on rationales for blended finance. For the public, most DFIs provide information on aggregate donor contributions and aggregate blended financing provided.
- *Applying Standards.* All the DFIs reported using the same standards with concessional finance as with their own account finance.
- *Monitoring Results.* All the DFIs reported tracking level of project success, and many reported tracking level of project success at the sector level.

⁷ In some cases, this may reflect differences in fund agreements.

IV. Case Studies

As input to both the enhancement of the DFI Blended Concessional Finance Principles and the related data gathering, the DFI Private Sector Blended Concessional Finance Working Group discussed a set of case studies of blended concessional finance projects. The cases were selected to cover a range of sectors and country types, and selected to illustrate important lessons. This section includes a summary of major findings and lessons, organized under the five principles.

Principle 1: Additionality (Rationale/Economic Case for Using Blended Finance). *DFI support of the private sector should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector.*

The case studies demonstrate the rationale for blended concessional finance, based on 1) the critical need for concessional finance to make projects viable, 2) the externalities and market failures addressed by the projects, and 3) the high levels of development impact achieved by the projects.

In general, the cases illustrate that blended concessional finance is used for projects with high potential development impact, but where project, financial, and market risks make private implementation impossible. The blended concessional finance is used to fill crucial gaps in the financing plan and help reduce financial risk so that projects can move forward. This is done for projects where there are large societal benefits that exceed what the private investors can capture, e.g. because of project externalities such as environmental externalities, or because of first mover operations that pioneer new technologies and create markets. The blended concessional finance is used as a temporary bridge to allow projects to start operations as they develop efficient operations and financial institutions gain comfort with the sector. The case studies illustrate the importance of understanding the entire market context, and of developing comprehensive plans to address market functioning. While the cases demonstrate a strong case for using blended concessional finance, they also serve as a reminder of the importance of considering blended finance in the context of potential alternative or complementary interventions.

Critical need for blended concessional finance

The cases show that blended concessional finance is used to allow projects to move forward by addressing critical gaps in the financing plan. In many cases, especially for first movers (e.g. for new technologies) and companies addressing new market segments (such as for SMEs, or farmers), particularly in fragile and low income countries, there are a myriad of high risks and costs related to, for example: poor market information and uninformed buyers, a poor supply base, inadequate hard and soft infrastructure (such as credit registries), weak financial institutions with limited long term financing available, inexperienced local contractors or local engineering and maintenance providers, inexperienced sponsors, need for extensive training and capacity building, other high start-up costs such as for feasibility studies and negotiations with regulators, poor regulatory environment, unreliable or unproven off-takers or buyers, and reputational risks.

Expected project returns may not be enough to compensate investors for the risks involved, and expected cash flows may be insufficient for reliable payments to debtors (i.e. debt service coverage ratio may be too low). Raising prices at the market level may not be feasible given affordability issues. Advisory services alone may be well short of what is necessary to develop a market because learning and risk reduction can often primarily be gained through the direct experience of business operations.

Blended concessional finance can address these issues in a number of ways and without demanding market-level compensation, for example by providing:

- More risk capital in the form of equity, subordinated loans, or preference shares to improve the risk profile for senior lenders.
- Below market interest payments to improve the overall project profitability and the debt service coverage ratio, and to help with high start-up expenses.
- Partial credit guarantees to lower risk for lenders and ensure an appropriate risk-adjusted return to the project.
- Portfolio risk sharing to reduce the risk of losses for bank or fund portfolios (e.g. for SMEs).
- Below market loans to provide liquidity and cost support for banks to support excluded high cost/high risk segments (e.g. women-owned businesses).
- Guarantees and credit enhancements for fund structures to mitigate risk so as to attract institutional investors.
- Longer tenor loans or deferred or sculpted payments that reduce payment risk for sponsors and investors.
- Contingent payments, that reduce cash flow risk in a downturn.
- Grants that provide critical investment support in high risk situations or address higher initial costs with innovative technologies.
- Finance to address particularly high or risky early start-up capital requirements.
- Financing to reduce risk to senior lenders by restricting claims in the event of lack of payment, default or a security/enforcement process.

Externalities and market failures addressed by the projects

Many of the cases relate to first movers or new market segments where the high costs and risks involved may be temporary as companies, suppliers, financial institutions, investors, and buyers over time gain experience, personnel are trained, market information is gained, and regulators and government support is improved. The improved operation of the market can be a very important benefit to the country, an externality that can benefit many companies in the sector and country overall, but cannot always be captured by the first movers. This external benefit to the country becomes an important justification for the use of concessional finance.

High levels of development impact

The cases highlight many projects where high levels of development impact are expected, often with high levels of innovation and the potential for scale-up and replication. For example,

- Projects on the forefront of wind and solar power development in a country.
- SME banking in high risk countries, and projects supporting high risk FCS (fragile and conflict-affected situations) SMEs.
- First energy efficiency and renewable energy asset-backed financing.
- Innovative municipal infrastructure investment program backed by revenues from energy savings trust funds, with high potential for scale-up and replicability, and support for climate change mitigation.
- Technologies at early stage of development that have high potential for market transformation.
- Pioneering geothermal power in a country.

- Pioneering nutritious foods supply in Sub-Saharan Africa.
- Pioneering local currency lending for SMEs.
- Pioneering gender inclusivity in municipal employment.

Principle 2. Crowding-in and Minimum Concessionality. *DFI support to the private sector should, to the extent possible, contribute to catalyzing market development and the mobilization of private sector resources.*

Many cases illustrate extensive processes used to develop project structures that crowd in the maximum amount of private capital and minimize the level of concessionality employed. The cases highlight the negotiations that take place to determine what concessional finance is needed, and what benchmarks and market tests are used to test minimum concessionality. The cases also underline the importance of matching the instrument design - and the embedded concessionality – to the constraints and development challenges being addressed.

Examples from the cases of crowding in private capital and minimizing concessionality include:

- Extensive negotiations with clients to determine the minimum level of concessionality, e.g. at times bringing in concessional finance toward the end of project negotiations to fill in a critical financing gaps.
- Market analysis to determine additional end-user costs from innovative technology and related end-user needs for concessional finance.
- Market assessment of commercial interest rates.
- Calculating or benchmarking of levels of concessionality or leverage, and calculating the grant element relative to emissions reductions achieved.
- Comparing the internal rate of return to market rates.
- Targeting of blending resources to address very specific financing gaps, e.g. equity or sub debt to improve senior loan risk profile, reduced interest payments for improved debt service coverage ratio, repayment timing to address cash flow, payment flexibility to address revenue uncertainty, risk-sharing facilities to address bank portfolio risk, below market loans to provide liquidity and address high costs and risks for banks addressing underserved segments.

Principle 3. Commercial sustainability. *DFI support of the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must therefore be expected to contribute towards the commercial viability of their clients.*

The cases illustrate how concessional finance can be used in ways that lead to commercially sustainable operations and time-bound use of concessional finance. They illustrate extensive attention to the potential of the basic business model as well as the likelihood of eventual commercial sustainability. For example:

- Many projects indicate that after the market is successfully developed with the project, subsequent projects in the sector will require less or no concessionality.
- A number of cases indicate that already significant market development has occurred, as subsequent projects are now taking place on a commercial basis.
- A number of cases show a rigorous attention to the success of the basic business model.

Principle 4. Reinforcing markets. *DFI assistance to the private sector should be structured to effectively and efficiently address market failures, and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.*

The cases illustrate how concessional finance can be used to develop market capabilities and push for a dynamic development path, where markets can be created, connected and expanded. The cases show that blended finance can be used to address sector-specific bottlenecks and increase the potential for greater private sector participation. Advisory services can be employed in many cases to help achieve this, for example by providing training for company employees and regulators. Many cases illustrate the strong capacity building and network creation that can occur over time as business operations are initiated. The cases also show specific mechanisms and incentive structures used to encourage company actions that lead to strong market outcomes.

For example:

- Many cases include the provision of advisory services to help build markets by addressing critical company and government capacity issues, regulatory constraints, and technology transfer need.
- Many cases illustrate that the first movers help advance the market via operational capacity building with suppliers, companies, buyers, and supporting infrastructure.
- Some projects have specific mechanisms to make the market sustainable.
- One project incentivizes market building by increasing the level of concessionality for various sub-projects based on the potential for market impact and replicability.
- Many projects use performance incentives to help achieve market-building goals, for example in SME finance or promoting women in business.
- Some of the projects also tie grant support to successful implementation of the project.
- For SME risk-sharing facilities, banks are usually required to have a part of the first loss position so that incentives are aligned for successful market building.
- Some projects also indicate the importance of financial structuring to align the interests between donors and DFIs.

Principle 5. Promoting high standards. *DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of Corporate governance, Environmental Impact, Social Inclusion, Transparency, Integrity, and Disclosure.*

The cases illustrate several approaches to addressing potential conflicts of interest. DFIs generally either use separate teams and decision making bodies to manage concessional funds, and/or they have independent review of the use of donor funds from the donor agencies. For example, the cases show a number of alternatives:

- Separate teams representing the interest of the concessional funds, including when a project faces financial difficulties.
- Single teams but separate input by concessional finance program specialists.
- Separate decision-making bodies for the concessional funds.
- Single decision-making bodies, but separate review or input by concessional finance teams or donors, or independent advisory committee appointees.