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E4S BRIEF

Blended Finance as the key to Sustainability-led Corporate Transformations

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IN A NUTSHELL

Our project studies the role of blended finance in enabling corporates to transform their business models and bring sustainability into the core of their strategic choices. Blended finance - the combination of private capital with capital from development agencies and philanthropy – not only provides corporations with the financial means to invest in sustainability transformations, they also help bridge the gaps between risks and rewards. Risks can be mitigated when development agencies assume initial losses, for example. Transparency, credibility and trust are increased by the seal of a reputable NGO, helping to reduce accusations of 'greenwashing.' The aim of our research project is two-fold:

1) Demonstrate various models of blended finance, establish a theory of change, and study the necessary pre-conditions for a successful investment.
2) Develop a robust case series and practical guidance for businesses about how best to deploy and mobilize blended finance solutions for business model transformations.

To carry out these objectives, we use multiple research methods. A first paper, currently under review, identifies and map variations of blended finance mechanisms to develop a conceptual model. In a recent book chapter, we have identified stakeholder tensions during project implementation through a comparative case study. We have also communicated the knowledge and insights generated throughout our project through short popular media articles published in NZZ. Finally, we have developed a case series on the first Humanitarian Impact Bond in collaboration with the ICRC, WEF and the Lombard Odier Foundation. The case series serves as the foundation for our new educational program: *Driving Innovative Finance for Impact*.

To find out more, visit IMD Center for Social Innovation

WHAT WE DO AND WHY IT MATTERS

The 2030 Agenda has expanded the number and diversity of financial actors called upon to advance sustainable development. Nevertheless, although development finance institutions and private investors (e.g., impact investing funds) have engaged in blending facilities, institutional investors and corporations have largely been absent from the type of borderline investment opportunities addressed by blended finance. Understanding ways to crowd-in these actors is at the center of the debate around the "additionality" of blended finance; that is, how public and nonprofit actors create financing opportunities that are attractive to private investors but would otherwise go unfunded due to perceptions of risk or project feasibility.

The critical role of institutional capital is illustrated by the magnitude of the challenge. To meet global infrastructure needs that are compatible with low-carbon and climate resilient development, some $7 trillion annually is needed over the next 15 years, of which $3.9 trillion annually is foreseen for developing countries. Compared to the current level of spending of $1.4 trillion, the estimated gap is estimated at $2.5 trillion. With annual official development assistance (ODA) at approximately $145 billion and annual philanthropic contributions of about $30 billion to developing countries, the need to attract institutional investors, who hold some $92 trillion in assets in OECD countries alone, becomes evident.

Through our research, we highlight the promising role of blended finance to help firms de-risk the sustainability transition. We suggest that de-risking occurs through three mechanisms: (1) identification of material ESG issues for firms, (2) subsidy via the use of blended finance facilities, and (3) trust brokering from civil society and the public sector. Our overarching thesis is that finance provides a common language for stakeholders to structure partnerships that identify and scale social innovations attempting to deliver on Agenda 2030.

HOW WE DO IT AND MAIN FINDINGS

Depending on the stakeholder engagement process and type of externality, firms may choose a sector-wide approach or go-it-alone to tackle ESG issues in the value chain. In a recent book chapter, we present the financing structures of two illustrative cases: Transforming Education in Cocoa Communities (TRECC) and Tropical Landscape Finance Facility (TLFF). Both cases use the SDG framework to meet specific social and environmental objectives identified through materiality analysis. Given the complexity of the objectives, each partnership engages actors from the public, private and nonprofit sectors.

The partnerships enacted divergent corporate strategies. TLFF was conceived by the government and directly engages individual firms. TRECC was launched by a nonprofit aiming to crowd-in firms active in the cocoa industry using an industry level approach. The financial mechanisms also differ for each case. TRECC's approach uses pay for success grants while TLFF uses a structured finance facility with supplementary technical assistance grants. The main characteristics of each case are summarized in the table below. We then examined how each project was de-risked through three mechanisms: (1) identification of material ESG

issues for firms, (2) subsidy via the use of blended finance facilities, and (3) trust brokering from civil society and the public sector.

Materiality. While both TRECC and TLFF used materiality concerns as a way to crowd-in corporate partners, they took different approaches. In the case of TRECC, corporate interests were pooled through a sector-based foundation while TLFF directly targeted the materiality concerns of a single firm. The difference in corporate engagement could be attributable to partnership objectives. While child labor is an explicit ESG concern for cocoa companies, the link to education requires a broader view of materiality. For Michelin (and RLU), the partnership enabled them to directly integrate externalities created through the supply chain. There is no risk of free-riding in the RLU case: the land used for the plantation is only contracted to RLU. By contrast, cocoa companies operating in Ivory Coast may want to reap the benefits of child-free cacao but may be unwilling to contribute financially.

Blended Finance Facility. TRECC primarily used pay-for-success matching grants while TLFF used a structured finance facility that catered to a wide range of investors through tranching. The choice of blended finance facility may also relate to nature of the externality created in the supply chain. Since TRECC is tackling a social objective that has been traditionally attended to by the public sector, using an impact fund to seed investments in private education startups might appear as illegitimate, especially since the partnership is still investigating which intervention models will work in the Ivorian context. The use of matching grants encourages experimentation and by opening up funding opportunities to cocoa companies directly, the partnership encourages individual agency on behalf of the cocoa firms. Conversely, the TLFF is a more straightforward financial transaction. In a sense, Michelin could have floated a public note to finance the plantations. However, the Indonesian government may have been unwilling to grant licenses without the environmental protections. In this case, the blended finance facility serves to protect both interests.

Trust Brokering. While the ties to materiality and blended finance mechanism structures differ from case to case, the role of trust brokering appears to have played a significant role in both multistakeholder partnerships. To this end, it appears nonprofit organizations such as the WWF and IPA are integral to the structure of the partnership. By tackling issues that are prone to self-serving such as impact measurement, these actors serve as a bridge between the corporate interests and public accountability.

Table. Overview of blended finance cases

Cases	TRECC *Transforming Education in Cocoa Communities*	TLFF Tropical Landscape Finance Facility
Geographical area	Ivory Coast	Indonesia
Capital allocation	$85 million	$95 million
Implementation year	2015	2018
Private stakeholders	World Cocoa Foundation*	Michelin, BNP Paribas, ADM Capital
Public stakeholders	Ivorian Government	UNEP, Government of Indonesia, USAID
Nonprofit stakeholders	Jacobs Foundation, Bernard van Leer Foundation, UBS Optimus Foundation, Innovations for Poverty Action	World Wildlife Fund, World Agroforestry Centre
Stated SDG objectives	SDG1, SDG4, SDG 8.7, SDG17	SDG8, SDG12, SDG15, SDG17
Financial mechanism	Pay for success grant funds used to pilot and scale up evidence-based programs	Lending platform and grant fund for technical assistance

Other considerations	Program runs from 2015-2030	Maturity dates: 2023, 2025, 2033

Note. Innovations for Poverty Action (IPA) BNP Paribas (BNPP), United Nations Environment Programme (UNEP), World Agroforestry Centre (also known as International Centre for Research in Agroforestry or "ICRAF"), World Wildlife Fund (WWF). The World Cocoa Foundation (WCF) represents the interests of eleven cocoa and chocolate companies (Barry Callebaut, Cargill, Chocolonely Foundation, ECOM, Ferrero, Hershey, Mars Wrigley, Mondelez International, Nestlé, Olam Cocoa, Touton).

CALL FOR ACTION

Too often, firms dedicate resources to the wrong channels, either by going it alone or through non-committal initiatives like the U.S. Business Roundtable's 2019 shift from "shareholder capitalism" to "stakeholder capitalism." We believe that the time for talk is over. Today, firms need to demonstrate credible progress towards a sustainable future. By forcing firms to have "skin in the game," blended finance is a promising solution that also plays to the strengths of government and non-profits. Public actors step in to offer financial guarantees while civil society monitors the predefined social/environmental impact.

Building organizational capacity to lead innovative finance initiatives in the humanitarian and development space will be increasingly important in the coming years. This requires a new set of skills for the many different actors involved. These can be humanitarian or development actors, businesses and investors. Skills include humanitarian and development problem definition and framing, awareness on some financial instruments, building organizational readiness and working collaboratively.

Join us for the second iteration of our program "*Driving Innovative Finance for Humanitarian Impact*" to build your ability to lead an innovative financing project in the humanitarian and development space.

LEARN MORE

- Driving Innovative Finance for Impact – Next program launch date: 12 October 2023, Program Description, URL
- 17 June 2023, Vom Shareholder-Kapitalismus zum Stakeholder-Kapitalismus, Newspaper Article (Neue Zürcher Zeitung, NZZ)), URL
- 14 April 2023, Warum privates Kapital Teil der Antwort sein muss, Newspaper Article (Neue Zürcher Zeitung, NZZ)), URL
- 29 March 2023, Blended finance and the SDGs: Using the spectrum of capital to de-risk business model transformation, Book Chapter, URL
- 05 December 2022, Scaling innovative finance for impact through partnerships, Web Article (IMD), URL
- 05 December 2022, The ICRC (A): Are Your Humanitarian Solutions Investable?, Case Study (IMD-7-2379), URL
- 05 December 2022, The ICRC (B): The Humanitarian Impact Bond, Case Study (IMD-7-2380), URL
- 05 December 2022, The ICRC (C): The Humanitarian Impact Bond, From Concept to Reality, Case Study (IMD-7-2381), URL

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