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Blended finance in Bangladesh: A scoping paper

Mustafizur Rahman
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Preface

Southern Voice is a network of 50+ think tanks from Africa, Asia and Latin America.

Since its inception in 2012, it has served as an open platform. It provides structured inputs from the Global South into the debates on the 2030 Agenda, and the SDGs, with a view to addressing the 'knowledge asymmetry' and 'participation deficit' that usually afflict such global discussions.

In 2017, Southern Voice started to explore the use of blended finance as part of the strategies to finance the 2030 Agenda in Least Developed Countries (LDCs). It is a joint effort with the United Nations Capital Development Fund (UNCDF) and the United Nations Foundation. In this context, four country case studies, along with a synthesis paper, were carried out in Bangladesh, Nepal, Senegal and Uganda. These were inputs also for the UNCDF's report "Blended Finance in the Least Developed Countries," published in November 2018.

The present study constitutes the analysis of the limitations and possibilities of blended finance in Bangladesh. It examines the potential role of the instrument of blended finance which promotes the implementation and achievement of the Sustainable Development Goals (SDGs). The study offers concrete recommendations to strengthen the regulatory and institutional framework in the use of blended finance.

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Abstract

Blended finance offers countries such as Bangladesh a vital opportunity to mobilise additional financial resources to address the complex development challenges set out in the 2030 Agenda for Sustainable Development. As a lower-middle-income country, Bangladesh will increasingly experience the reduction of available concessional financing for development. In this scenario, blended finance has the potential to attract investment in areas and sectors that are critical for the attainment of the SDGs in Bangladesh. This study argues that the achievement of positive development outcomes should be the main purpose of blended finance in Bangladesh. Against this backdrop, blended finance should not only benefit large companies but also small and medium enterprises (SMEs). Gains accruing from availing concessional finance should also be passed on to the consumers. This paper cautions that blended finance should not lead to market distortion and undermine the interests of the local financial market. The concerned entities in Bangladesh should carefully address debt management and debt servicing obligations arising from blended finance. The study also makes recommendations to strengthen the regulatory and institutional frameworks to address the challenges emerging from blended finance in Bangladesh.

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Acronyms

ADB	Asian Development Bank
AfD	French Development Agency - Agence Française de Développement
AIMS	Aid Information Management System
BDT	Bangladeshi Taka
BIDA	Bangladesh Investment Development Authority
BIFFL	Bangladesh Infrastructure Finance Fund Limited
BPDB	Bangladesh Power Development Board
CCEA	Cabinet Committee on Economic Affairs
CDC	Commonwealth Development Corporation
CPD	Centre for Policy Dialogue
DFI	Development Finance Institution
DoE	Department of Environment
ERD	External Resources Division
GDP	Gross Domestic Product
GED	General Economic Division
GoB	Government of Bangladesh
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communications Technology
IDA	International Development Association
IDB	Islamic Development Bank
IDCOL	Infrastructure Development Company Limited
IFC	International Finance Corporation
IFI	International Financial Institutions
JICA	Japan International Cooperation Agency
KFW	German Reconstruction Credit Institute - Kreditanstalt für Wiederaufbau

KII	Key Informant Interview
LCG	Local Consultative Group
LDCs	Least Developed Countries
LIBOR	London Interbank Offered Rates
LMIC	Lower-Middle-Income Country
LNG	Liquefied Natural Gas
LoI	Letter of Interest
MoU	Memorandum of Understanding
NPDC	National Policy on Development Cooperation
OBU	Offshore Banking Unit
ODA	Official Development Assistance
OECD	Organisation for Economic Development and Cooperation
PPA	Power Purchase Agreement
PPP	Public-Private Partnership
PPPA	Public-Private Partnership Authority
SDGs	Sustainable Development Goals
SMEs	Small and Medium-sized Enterprises
SSC	South-South Cooperation
UN	United Nations
UN DESA	United Nations Department of Economic and Social Affairs
UNFPA	United Nations Population Fund
WEF	World Economic Forum

Blended finance in Bangladesh: A scoping paper

Mustafizur Rahman; Towfiqul Islam Khan; Sherajum Monira Farin

Introduction

> **Blended finance can play a significant role in achieving the Sustainable Development Goals.**

Bangladesh's strategy for the successful implementation of the Sustainable Development Goals (SDGs) calls for adequate preparedness since the country is set to graduate out of the Least Developed Country (LDC) group of the United Nations (UN) by 2024. Against this backdrop, awareness about financing challenges has emerged as an urgent necessity. Financing is one of the significant challenges for the implementation of the SDGs in developing countries (Bhattacharya, Khan, Rezbana and Mostaque, 2016). The United Nations (2018b) indicates that along with conventional financing options, new innovative sources of financing such as blended finance can play a significant role in achieving the SDGs. According to the Blended Finance Taskforce report (2018), blended finance can significantly contribute to bridging the current SDG financing gap estimated to be between USD 2 trillion to USD 3 trillion. In this context, Official Development Assistance (ODA) could be used as a catalyst for mobilising other forms of private financing (Samans, 2016). Indeed, there is a growing global interest among the global development community in blending concessional ODA to catalyse private finance to achieve development outcomes. The United Nations (2018a) recognised that the private sector's contribution to the SDGs could play an important role (including finance, expertise and know-how). However, the report also acknowledged that blended finance is not a substitute of but rather a complement to public financing. This study will explore the scope and prospects of blended finance in Bangladesh by examining its potential role in financing the implementation of the SDGs in the country.

The concept of blended finance is evolving. A consensus-based definition is yet to emerge, and no single definition has received wide-ranging acceptance. The OECD (2018c) defines blended finance as "the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries" (p.3). Further development of this concept refers to commercial finance (from both public and private sources) that is not currently or usually deployed to support development interventions. UN DESA (2015) defines blended finance as the combination of grants or grant equivalent finance and non-concessional finance to facilitate more investment at lower market interest rates or with longer maturities than those provided by the market. It may be concluded from contemporary literature that the concept of blending in blended finance varies across development partners, concessional or commercial finance providers, implementing agencies, and also across stakeholders in recipient countries. For instance, Eurodad (2015) defines blending as a mechanism that links a grant element, provided by the ODA, with loans from publicly owned institutions or commercial lenders. Similarly, the International Finance Cooperation (IFC, n.d.) considers blending as deploying concessional funds (usually from development partners) alongside IFC's commercial funding for projects with high development impact.

Also, the ongoing policy discourse of development finance lacks a sound understanding of the scope and the opportunities of blended finance as an alternative source of funding. As discussed above, recent literature posits prospects of blended finance in terms of bridging the SDG financing gap; but there exists a considerable amount of debate regarding the role of blended finance in terms of meeting the development objectives due to lack of adequate evidence. Along with the definitional issues, there are also debates regarding the methodology to account for ODA for blending and mobilised finance. Due to the lack of standard methodology, often ODA is double counted resulting in an inflated ODA figure (Pereira, 2017). Moreover, blended projects are also said to be easier to align with the providers' political and economic priorities. In addition to that, blended finance mechanisms also pose the risk of diversion of the development partners' concentration from high-risk profile economies to low risk profile economies due to its inherent financial sustainability requirements.

The experience in Bangladesh is similar to the rest of the world. Although blended finance has been widely discussed, the Government of Bangladesh (GoB) has not adopted an official working definition of the term. Policy documents, officials from key government institutions, and development agencies tend to use the definition of blended finance that best suits their contexts and purposes[1]. An encouraging fact is that blended finance has recently attracted growing attention from experts, development researchers and policymakers. In this context, government agencies have acknowledged the need for conceptualising blended finance related issues in the context of Bangladesh. This study considers a working definition for blended finance, which is – a particular financing deal is regarded as a blended finance deal when it involves the following key features:

a. foreign funding of concessional nature;
b. private sector financing leveraged through concessional foreign financial flow;
c. commercial interest of at least one implementing agency; and
d. the impact on the development of the projects financed with blended finance.

The foreign concessional funding may originate from a diverse range of sources: funds from multilateral organisations (e.g. World Bank Group), bilateral financing deals between governments, loans from investors, private philanthropies, ODA or other financial

1 For instance, the Economics Relations Division (ERD) of the Government of Bangladesh, the principal agency responsible for the management of external resources for public investment in the country, use blended finance as simply a blend (mix) of concessional and non-concessional finance.

flows. In Bangladesh, a blended finance deal should have this type of foreign concessional funding mobilise additional private funding for development, with the potential to reduce the risks and enhance the expected returns.

> **During recent years in Bangladesh, a growing industry and a strong services sector have outpaced agriculture.**

Bangladesh's growing economy and its ever-rising demand for investment offer ample opportunities for blended finance initiatives. Such opportunities have the potential to generate high economic returns and strengthen the project's sustainability but also to harness additional resources for development. During recent years in Bangladesh, a growing industry and a strong services sector have outpaced agriculture. Indeed, CPD's (2018) analysis of the contribution to GDP growth in fiscal year 2016-2017 and a comparison with the previous performance of the fiscal year 2015-2016 shows that the incremental growth of the economy is owed primarily to an increased contribution from the services sector[2], and in particular, from the wholesale and retail trades sector. In the case of the agricultural (broad) sector, the contribution decreased to 0.44% in the fiscal year 2016-2017. The demands arising from the expansion and diversification of the modern sectors of the economy, particularly in several sub-sectors (including financial, ICT etc. alongside the traditional manufacturing sector such as apparels), call for new sources of finance for investment. Moreover, attracting more investment from the private sector to implement the SDGs is essential to translate the benefit of accelerated economic growth into inclusive development outcomes, as envisaged in the 2030 Agenda.

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2 Incremental contribution by the services sector increased from 3.2% in fiscal year 2015-2016 to 3.41% in fiscal year 2016-2017.

Bangladesh became a USD 664 billion (in purchasing power parity terms) economy in 2017 (World Bank, 2018). A large population of 164 million in 2017, a significant middle class[3], and growing purchasing power reflected in expanding consumer base[4] promise a fast-paced growth of domestic demand in Bangladesh. Increasing global integration of the economy is set to enhance its export opportunities (World Bank, 2018). All these will lead to high demands for the investment of the blended finance type, especially those that have the potential to generate attractive commercial returns. To reap the potential benefits of the demographic dividend[5] Bangladesh will need to ensure that its growing working-age population has good health, quality education, decent employment, and a lower proportion of young dependents. UNFPA (2016) stressed that realising a demographic dividend requires multiple investments. Young people need the opportunity to gain the education and experience to succeed in a competitive global workplace, which demands more skills, education, and technical expertise than ever before. Blended finance has the potential to play a vital role in this perspective as well.

Due to the size of the economy and the scale of demand, project size in Bangladesh tends to be larger than in other LDCs. Blended finance-supported projects are no exception. In general, terms, as we can conclude from the case studies we conducted for this research, blended finance projects have financial resources exceeding the USD 1 million thresholds.

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3 A study by Bangladesh Institute of Development Studies (BIDS) showed that the number of the country's middle class has already reached 50 million in 2015; the share of the middle class (who earn from USD 2 to 13 a day) in total population rose from 7% to 35% in only two decades (UNB, 2018).

4 Munir et. al. (2015) identified Bangladesh as the surging consumer market nobody saw coming, they project that, each year for the next decade, the annual income of around 2 million additional Bangladeshis will reach USD 5 thousand or more.

5 Demographic dividend is the development advantage of a country that may result from changes to the age structure of its population (Ross, 2004). Luoma (2016) further interprets that the change in such age distribution means that fewer investments are needed to meet the needs of the youngest age groups and resources are freed up for what is called the "economic gift." This means that the labour force is growing more rapidly than the population that is dependent on it, creating a window for faster economic growth and family welfare.

Bangladesh's graduation from low-income to lower-middle-income country (LMIC) in 2015 and the imminent LDC graduation will entail a higher cost for the aid it receives. Indeed, with graduation to LMIC, Bangladesh has entered the 'blend country category[6] of the World Bank lending policy.[7] Hence, it might no longer be eligible for the International Development Association (IDA)[8]. Since the IDA loans are characteristically more generous and flexible in terms and conditions or repayment, availing different loans on more stringent terms (e.g. the IBRD loans[9]) will entail higher costs of borrowing for the country.

> **Bangladesh has entered the 'blend country category' of the World Bank lending policy.**

Also, it would result in the loss of preferential market access and preferential treatment

6 Blend country is the term used to describe one of the operational lending categories of the World Bank. Blend countries are eligible for International Development Assistance (IDA) loans but are also eligible for International Bank for Reconstruction and Development (IBRD) loans because they are financially creditworthy (World Bank, n.d.).

7 The World Bank lending policy classifies economies into IDA, IBRD, and Blend country categories based on their own operational policies, and per capita income and borrowing capacity of the recipient countries. IDA countries are those with low per capita incomes that lack the financial ability to borrow from the IBRD, whereas IBRD countries are mostly middle-income countries (MICs) and credit-worthy LICs. MICs represent more than 60% of IBRD's portfolio (World Bank, n.d.).

8 The IDA is the part of the World Bank that helps the world's poorest countries by providing loans (called "credits") and grants for programs that boost economic growth, reduce inequalities, and improve people's living conditions (World Bank, 2018). IDA complements the World Bank's original lending arm—IBRD, and mainly focuses on providing concessional finance to poor or low-income countries (LICs). According to World Bank (2018), this means that IDA credits have a zero or very low-interest charge and repayments are stretched over 30 to 38 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress.

9 IBRD is the original lending arm of the World Bank, which was established to function as a self-sustaining business and provides loans and advice to MICs and credit-worthy LICs (World Bank, 2018). The IBRD supports the World Bank Group's mission by providing loans, guarantees, risk management products, and advisory services to the recipient countries (World Bank, n.d.).

which Bangladesh enjoyed as an LDC. All these make the quest for alternative sources of funding a matter of urgency, particularly for implementing the SDGs, which would demand USD 928.5 billion from 2017 to 2030, according to the SDGs Financing Strategy (GED, 2017). Generating additional resources through public finance is becoming a highly significant challenge for Bangladesh. Accordingly, accessing development finance from diverse sources and using it to leverage private funds for projects with high development impact, with some level of concessionality embedded in it, is urgent. Blended finance is becoming increasingly important considering both, the rising cost of the ODA and a greater reliance on private funding.

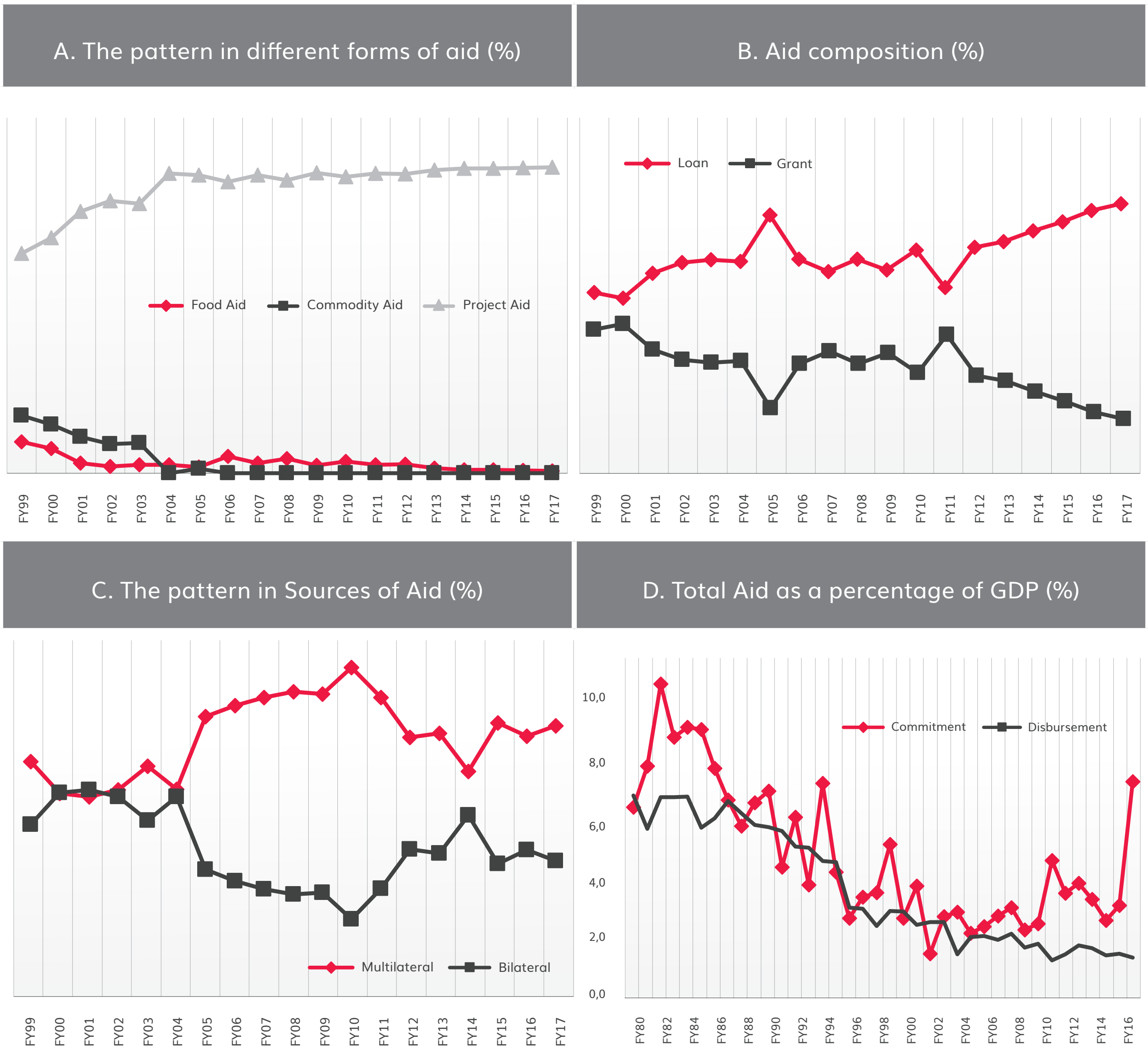
> **Bangladesh has gradually transformed itself from an aid-dependent to trade-dependent economy.**

A brief overview of financial flows in Bangladesh

Foreign aid

To have a better understanding of sectoral focus, the balance of payments' impacts and other implications of blended finance, it is necessary to understand the overall aid and financial flows of blended finance in Bangladesh. This section provides some facts in this regard. Bangladesh was highly dependent on foreign aid during the years that immediately followed its independence in 1971. This trend continued in the 1970s and the 1980s. Even though Bangladesh had been receiving an increasing amount of foreign aid historically, the country had gradually transformed itself from an aid-dependent to trade-dependent economy (Sobhan, 2002). There have been significant changes in the loan-grant composition of foreign financial flow (Figure 1B), the sourcing of aid (Figure 1C), and in the share of total aid in GDP (Figure 1D).

Figure 1. Major trends in financial flow into Bangladesh.



Note. In figure A, B and C the vertical axis presents 100 percentage points representing total ODA
Source: Authors elaboration with data from ERD (2018).

During the early years of independence (in 1971), Bangladesh received a significant share of the aid flow on food and commodity aid, mostly from bilateral sources (Figure 1A and 1C). In the fiscal year 2016-2017, Bangladesh received USD 3.65 billion in the form of project aid. Of the total aid disbursed (USD 3.67 billion), USD 2.50 billion came from multilateral sources (68.1%) and USD 1.17 billion came from bilateral sources (31.9%) (ERD, 2018).

As can be seen in Figure 1B, following the country's independence in 1971, grants were the conventional type of funding in Bangladesh from the fiscal year 1971-1972 to the fiscal year 1976-1977. In the fiscal year 1976-1977 to the fiscal year 1996-1997, the share of grant and loan was similar. Since the fiscal year 1996-1997, ODA has been primarily formed by loans (Figure 1B). From the fiscal year 2011-2012 to the fiscal year 2015-2016, the average share of loan disbursement compared to the planned expenditure was 83%; for grants, this share was 82% (AIMS database, ERD, n.d.). In the fiscal year 2015-2016, the top five sectors receiving the highest allocation of project aid were power, transport, infrastructure, health and education. The top ten sectors receiving maximum project aid (five-year average) for the fiscal year 2011-2015, as seen in Table 1.

Table 1. Major sectors receiving project assistance (5 year average) (in million USD)

Economic sector	1976-1980	1981-1985	1986-1990	1991-1995	1996-2000	2001-2005	2006-2010	2011-2015
Public administration	0	1	3	17	26	163	612	530
Power	43	98	213	196	126	180	236	472
Education and religion	9	15	46	76	98	119	275	334
Transport	59	77	107	192	248	220	107	234
Health, population, and family welfare	8	11	25	26	82	96	193	229
Physical planning, water supply, and housing	6	13	33	52	110	146	102	194
Industries	63	61	128	51	12	30	21	127
Agriculture	21	66	59	73	61	56	54	105
Water resources	17	51	102	132	120	55	71	76
Communication	7	11	23	26	17	67	5	73

Source: Authors' calculation from data available in ERD (2018)

Since the fiscal year 1975-1976, the World Bank's International Development Assistance (IDA) has been the most crucial source of project aid (Table 2). Japan has been the most important bilateral development partner for Bangladesh in terms of aid. More recently, Bangladesh has opted for significant loans from non-traditional providers from the global south. The major South-South Cooperation (SSC) type of flows include lines of credit offered by India (three lines of credit until now, worth USD 8.0 billion) and China (an offer, through the signing of bilateral memorandums of understanding (MoUs), of USD 25.0 billion on government to government basis and 15 billion under business to business basis).

Table 2. Major multilateral and bilateral sources of disbursed aid (in million USD)

Agency	1996-2000	2001-2005	2006-2010	2011-2015	FY 2016	Country	1996-2000	2001-2005	2006-2010	2011-2015	FY 2016
IDA	340	421	611	772	1158	Japan	111	738	292	282	553
ADB	255	201	552	576	814	China	0	72	6	4	116
UN	68	37	140	156	129	UK	53	221	44	52	65
IDB	15	27	20	53	101	India	12	21	8	0	85
UNICEF	30	38	48	47	39	South Korea	0	0	0	0	33
EU	51	32	59	33	4	Germany	47	267	53	69	61
IFAD	11	14	16	28	52	Denmark	8	97	35	27	24
OPEC	11	8	3	11	26	Russia	11	82	29	3	203

Note. In this table, five fiscal year averages for the period 1995-1996 to the fiscal year 2014-2015; and the yearly figure for the fiscal year 2015-2016 have been used.
Source: Authors' calculations from data available in ERD (2018).

Three conclusions may be drawn from the above discussion in the context of Bangladesh. First, as has been mentioned above, on a relative scale, ODA has been on a declining trend. Second, as has been argued, the country's cost of borrowing is set to rise shortly, given the dual transition to LMIC (of World Bank category) and from LDC group (of the United Nations). Third, the demand for investible resources will rise significantly in the short and medium-term future, and the –dominant share of this will have to come from the private sector (GED, 2017).

Private investment

Private investment in Bangladesh (as a share of GDP) has remained stagnant in recent years. In the fiscal year 2017-2018, private investment as a share of GDP was estimated at 23.3%. The target set for the fiscal year 2018-2019 is 25.1% of GDP, which would require an increase of 1.9% compared to the fiscal year 2017-2018. This implies that in the fiscal year 2018-2019, approximately USD 14 billion will be additionally needed to meet the target for private investment (i.e. a 22.7% year-on-year increase in nominal terms). This is indeed a challenging task. However, the growth of credit to the private sector from the banking system, which is the single largest source of private sector financing, generally tends to be lower.[10] For example, it has increased by about 17.6% in the fiscal year 2017-2018.

Because private investors face several barriers, private investment has remained stagnant in recent years in Bangladesh.

Private investors face several barriers in Bangladesh. The country was ranked 177th among 190 economies across the world in 2017 on ease of doing business by the World Bank (2018). Bangladesh has been particularly struggling in the areas of

10 It needs to be noted that in Bangladesh about 74% of the total investment financing is through loans form commercial banks.

accessing electricity, registering property and enforcing contracts. According to the Global Competitiveness Report 2017-2018 by the World Economic Forum (2017), leading private investors in Bangladesh reported corruption, inadequate infrastructure, inefficient government bureaucracy, inadequately educated workforce, poor work ethic and limited access to financing as the top six problematic factors affecting doing business in the country (WEF, 2017). Indeed, it is critically important that these challenges are adequately addressed to boost private investment in Bangladesh. Much will depend on how the attendant obstacles, identified by the previous global reports, are tackled to encourage investment flows, being of blended finance type or otherwise.

It is vital that factors affecting doing business in the country are adequately addressed to boost private investment.

Private borrowing from external sources

An analysis of the trends in foreign loans availed by the local private companies for the period 2011-2017 reveals that the total number of foreign loans has increased sharply over the years (from 24 loans in 2011 to 134 loans in 2017)[11]. The number of loans extended by the Offshore Banking Units (OBUs) has increased gradually over the past years; its share in a total number of foreign loans rose from 29.2% in 2011 to 61.5% in 2016 (Table 3).

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11 The corresponding monetary value of foreign loans also increased from a total of USD 909.3 million to USD 1,494.3 million, a growth of almost 63% over the timeframe mentioned above.

Table 3. Analysis of foreign loans taken by the local companies (2011-2017)

Year	Total No. of loans	The share of loans from OBUs	No. of hard loans	No. of soft loans	Average maturity period (years)	Average interest rate (%)	Total amount of foreign loans (USD million)
2011	24	29.2	7	14	5.2	4.6	909.3
2012	62	32.3	5	50	5.1	4.2	1466.2
2013	103	49.5	1	100	5.2	4.2	1182.3
2014	129	52.7	6	99	4.5	4.7	1771.1
2015	129	52.7	3	98	5.0	3.1	1930.2
2016	148	61.5	11	108	5.0	3.3	1386.5
2017	134	59.0	40	67	5.5	3.6	1494.3

Source: CPD calculations from Bangladesh Investment Development Authority (BIDA) data[12] as presented in CPD (2018)

Furthermore, as CPD's analysis revealed, the number of hard-term loans[13] has been on the rise in recent years, i.e. loans are becoming less concessional. Understandably, the terms and conditions of the loans received by Bangladesh are likely to be more stringent as Bangladesh moves forward in its middle-income country and prepares for its LDC-

12 A number of assumptions were made while carrying out this exercise: discount rate was considered to be 5 per cent; when grace period was not mentioned it was assumed to be 0; when payment per annum was not mentioned it was assumed to be 1; other fees and maintenance cost were excluded due to lack of uniformity and complexity of the involved issues, which if considered, would likely lead to underestimation of the cost of borrowing to some extent; in case of multiple interest rates for different periods of loans, the weighted average interest rate was used; foreign financing directed to the borrower in the form of deferred payment, repaid in instalments, was not counted as loans while calculating weighted average interest rate.

13 Hard-term loans are provided on terms and conditions which are equally or more stringent than those available for loans commercially available in the market.

graduated future. Bangladesh's current debt-GDP ratio is at a comfortable state (Table 4). However, this may change in the near-future (CPD, 2018). Hence, it is likely that the country will need to forge a renewed foreign financing strategy which considers blended finance as an essential option.

Table 4. External debt balance for the last ten fiscal years

Fiscal year	Total debt service liability (DSL)	Debt outstanding at the end of each FY	Debt outstanding as % of GDP	Total DSL as % of export	Total DSL as % of remittances
2007	722	19,355	24.3	5.9	12.1
2008	770	20,266	22.1	5.5	9.7
2009	855	20,859	20.4	5.5	8.8
2010	876	20,336	17.6	5.4	8.0
2011	929	22,086	17.2	4.1	8.0
2012	967	22,095	16.6	4.0	7.5
2013	1,091	22,381	14.9	4.0	7.5
2014	1,294	24,388	14.0	3.9	9.1
2015	1,097	23,901	12.3	3.5	7.2
2016	1,051	26,306	11.8	3.1	7.0

Source: Authors' calculation from data available in ERD (2018)

Policies and practices in the context of blended finance

Policy mapping undertaken for this study reveals that while there have been significant changes in the aid regime over the years, in terms of actors, modalities of aid flow, target areas, and aid conditionalities, the concept of blended finance has not received due attention in the policy circles of Bangladesh. The Seventh Five Year Plan (7FYP) of Bangladesh does emphasise the role of the private sector in the development of Bangladesh (GED, 2015). The plan stresses the need for using PPPs as an effective mechanism to finance development including infrastructure. The "SDGs Financing Strategy: Bangladesh Perspective", formulated by the GoB indicates that about 42% of total finance for meeting the SDGs in Bangladesh will have to come from the private sector, another 6% will need to be covered by public-private partnerships (PPPs) (GED, 2017). However, none of these policy documents mentions blended finance as a possible option for financing the SDGs. One of the government policy documents, the National Policy on Development Cooperation (NPDC), drafted in early 2016, also mentioned the importance of blended finance. The NPDC defines blended finance as the use of public funds to unlock private and philanthropic capital for development. This includes PPPs, technology transfers, aid for generation of a higher amount of remittance and its better utilisation, assistance in capital market development, and support to strengthen revenue collection (ERD, 2016). The document further stipulates that the private sector, for both profit and non-profit, would be eligible to receive funds from external sources to implement development programs and projects that are aligned with national development priorities.

> **Blended finance is the use of public funds to unlock private and philanthropic capital for development.**

A significant development in Bangladesh from the perspective of catalysing private fund has been the enactment of the Public-Private Partnership Act, 2015 (PPP Act) in September 2015. The PPP Act intends to encourage investment in infrastructure and to establish a functional regulatory framework for the private sector investors.

The PPP Act created the PPP Authority (PPPA) for expedited dealings with financial and administrative formalities concerning the PPP projects, and the Cabinet Committee on Economic Affairs (CCEA) for speedy approval of the concerned plans. Currently, 47 PPP projects are in the pipeline with approval on principle. Indeed, to meet the development targets, Bangladesh must increase investment in infrastructure from the current USD 3.5 billion annually to USD 12.5 billion per year (Jamal, 2017).

The private sector, which is incorporated under the Companies Act 1994 and registered with Bangladesh Investment Development Authority (BIDA), is eligible to obtain credit from recognised lenders. The loan agreements are negotiated at competitive rates and in line with the current borrowing costs in the international market. The range of loans covers commercial loans including financial loans, bank loans, and buyer's credit as well as supplier's credit from institutions or individuals. These loans are used for investment in the industrial sector including small and medium-sized enterprises (SMEs), infrastructure, and priority sectors as defined in the Industrial Policy (Ministry of Industries, 2015). However, these are not to be used for working capital purposes or purposes of investment in the capital market.

To obtain loans from foreign sources, a private company in Bangladesh requires approval from the Scrutiny Committee of the BIDA which is chaired by the Governor of the Bangladesh Bank (the Central Bank). In practice, the committee does not approve loan applications which have an interest rate of more than 5% (all inclusive, six-month average of LIBOR[14] is considered in most cases). This is applicable for loans by IFIs and OBUs. There is no regulation or specific guidelines regarding any ceiling; however, it is the general practice to encourage deals with lower rates of interest. While this is intended to discourage illicit financial flow to assist investors with good track records as regards repayment of loan and business prospect and facilitate access to financing for them,

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14 LIBOR or ICE LIBOR (previously BBA LIBOR) is a benchmark rate that some of the world's leading banks charge each other for short-term loans. It stands for Intercontinental Exchange London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world (Choudhry, 2011).

there is a need for a more transparent process in this regard. The possible rate should be updated following a methodology which considers the volatility of the LIBOR and risks of currency swap to provide predictability for the prospective investors and curb ad hoc decision-making process. In addition, a consolidated approach to examine blended finance initiatives from the perspective of meeting national development priorities is yet to be developed[15].

Blended finance initiatives in Bangladesh

A literature review and interviews with relevant actors revealed five types of operational blended finance modalities (e.g. instruments or process of blending) in Bangladesh:

a. debt (when the financial flow is coming as debt);
b. equity investment (when the financial flow is in the form of equity investment in a venture with the state-owned or privately-owned entity);
c. debt-equity mix (when the financial flow is a combination of debt and equity)
d. Syndicated financing (when financial streams originate from syndication of several sources with the same or a diverse range of participation modality); and
e. Credit lines (when the fund is created to finance 'special schemes').

In addition to the modalities mentioned above, in a few instances, 'guarantee' was found to be one of the components of the financing arrangement[16]. However, the guarantee is not very common as a particular instrument of blended finance initiatives in Bangladesh. One of the possible reasons for the low prevalence of guarantees in countries such as Bangladesh is the high-risk perception of the country.

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15 ERD has expressed interest in working on this issue in the near future.

16 For example, the Shirajganj Power project by Sembcorp Northwest Power Company (Case 4 in this study) is benefitting from political risk guarantee provided by the Multilateral Investment Guarantee Agency (MIGA). Another example is the Teknaf Solar Power Plant by Guarrantco, where there will be 90% credit guaranteeing. This project is in discussion stage for now, as mentioned at one of the interview sessions.

In the course of the study, it was observed that several instances are not formally labelled as blended finance initiatives but satisfy the necessary conditions to qualify as one[17]. Two observations follow. First, blended finance, in practice, has existed in Bangladesh for quite some time. Moreover, there is a need for mainstreaming the concept of blended finance in Bangladesh so that it is possible to make appropriate use of the opportunity in a well-informed manner.

Blended finance, in practice, has existed in Bangladesh for quite some time.

Under the present study, the following four projects have been selected as examples of blended finance facilities in Bangladesh based on several key informant interviews (KIIs)[18]. Three of the four blended finance projects are related to infrastructure development while the other one is related to financial services. These blended financed projects are being implemented by private, state-owned entities or through public-private partnerships (PPPs). These projects are likely to have high development impact in Bangladesh[19].

17 To cite a possible case, syndicated financing has been there since 2000. For example, ADB financed the first private power plant in 2000 where it provided a direct loan, guarantees to collect fund from international private sector lenders and also delivered a channel to other international DFIs that wanted to invest but did not have a physical presence in Bangladesh.

18 Participants of the KIIs included chief executive officers (CEOs) and chief economists of banks, experts from multilateral development organisations, representatives of domestic and international financial institutions, investment officers, concerned government officials, professionals from development partner organisations, private sector professionals and corporate officials.

19 The selected projects include key sectors such as infrastructure and financial inclusion. Both of these issues are considered necessary for the country according to the 7FYP.

Case 1

Name: bKash

Modality: Equity

Major partners and structure of financing

bKash was established in 2010 as a joint venture between Money in Motion LLC (an American company that invests in start-ups that promote financial inclusion) and BRAC Bank (a commercial bank in Bangladesh focused on small and medium enterprise). bKash, the mobile financial services entity, operates as a BRAC Bank subsidiary. Money in Motion came up with USD 5 million as seed capital. Bill and Melinda Gates foundation subsequently came up with an additional grant USD 10 million in 2010 (to consulting firm Shore Bank International to support bKash's development). Besides, IFC made an equity investment of USD 10 million in 2013. IFC and the Bill and Melinda Gates Foundation are minority shareholders in this blended finance deal that had both commercial financing as well as equity participation. BRAC Bank owns a 51% stake in the company. Money in Motion and IFC have 36.5% and 12.5% stake in bKash, respectively.

Description

bKash has played a significant role in developing Bangladesh's mobile financial services industry from scratch and is the country's leading player, accounting for 75% of the market. It has contributed significantly to improve financial inclusion in the country. Following bKash's footsteps, other commercial banks initiated other similar services. As of March 2018, 18 companies had about 60 million registered clients of which 40% are with bKash. Very recently, Alibaba Group (Alipay) has bought 20%of bKash's stake (16% share in the first phase and the rest 4% later), at an undisclosed valuation. According to a recent deal, Alipay Singapore E-commerce Private Limited will purchase 20% of the equity of bKash, including preference share which will be calculated based on post-dilution. Alipay will buy 10% of the bKash stock from Money in Motion, IFC and Bill and Melinda Gates Foundation. The deal entitles Alipay to subscribe for a further 10% share of bKash.

The following three cases are based on power generation projects. Financing for power and energy is a significant challenge for Bangladesh, and the government has been encouraging the participation of the private sector in the sector. The projects are likely to have direct and indirect development impact on the private sector and at the household levels. Lenders involved in this type of projects (such as the ADB, IFC and others) generally tend to consider development impact in the financing objectives.

Case 2
Name: Bibiyana II Gas Power project by Summit Bibiyana II Power Company Limited (SBIIPCL)
Modality: Direct Financing (Debt) by International Financial Institutions (IFIs) and equity between private investors

Major partners and structure of financing
The Asian Development Bank (ADB), the International Finance Corporation (IFC), and the Islamic Development Bank (IDB) have provided financing support (parallel loan) of USD 210 million for the

project company SBIIPCL[20] (of which 75 million by IFC, 75 million by ADB and 60 million by IDB) at the interest rate of 6-month LIBOR plus 4.4%, with an interest rate swap of 2.45 per cent. SBIIPCL has been set up on an equity basis by Summit Industrial and Mercantile Corporation (Pvt.) Limited[21] with 80% ownership (USD 72 million), and General Electric Energy, LLC (GE) having 20% share (USD 18 million). The project is now fully operational[22]. The project stipulates loan repayment period of 13.5 years and a grace period of 1 year.

Description

The objective of the project is to provide reliable, affordable and efficient electricity with the target of 341 MW power generation. The project has to comply with environmental and social guidelines adopted by the IFC, the ADB, and the Department of Environment (DoE) of Bangladesh. The China Northeast Electric Power Engineering & Service Co. Ltd. will operate the plant while BRAC Bank will oversee accounting issues and security aspects. This is a pioneering venture for a local banking institution. The company entered a 22-year power purchase agreement (PPA) to sell all electricity generated from the project exclusively to the Bangladesh Power Development Board (BPDB), the country's state-owned electricity company. According to an interview with a relevant party, the Bibiyana II project is producing the lowest cost of electricity in the country and thus contributing significantly to Bangladesh's energy security.

20 The direct loan amount is the largest given to a Bangladeshi private sector project by any of the three development agencies.

21 Summit Group is a major player in Bangladesh power sector landscape.

22 The project has achieved Simple Cycle Commercial Operation Date on the 06 June 2015, and Combined Cycle Operation Date on the 28th December 2015.

Case 3

Name: Moheshkhali Floating LNG (MLNG) terminal by Excelerate Energy

Modality: Debt-Equity

Major partners and structure of financing

This is a USD 179.6 million project which originates from the collaboration between Excelerate Energy, IFC, and Petrobangla. The former two had been mandated to provide and arrange the required financing for the terminal. IFC played the role of a coordinator and extended support to mobilise a debt financing package equivalent to USD 125.7 million for the project. The debt financing package included USD 32.8 million from IFC with the rest coming from the CDC Group, DEG, FMO and JICA (Excelerate Energy, 2017). IFC and Excelerate also have an equity arrangement with IFC's share being USD 10.8 million and that of Excelerate's share being USD 43.1 million. Excelerate Energy will build, own, and operate the terminal for 15 years, after which the company will transfer ownership to Petrobangla.

Description

This is Bangladesh's first liquefied natural gas (LNG) import terminal, an important infrastructure project from the perspective of energy security of Bangladesh given the country's declining reserve of natural gas, the major source of primary energy in Bangladesh. The project will provide access to natural gas from global markets. With up to 500 million standard cubic feet of gas per day (MMscf/d) of regasification capacity, Moheshkhali Floating LNG will make energy available for industrial development and help generate jobs. The public sector entity, Petrobangla, will also be able to access natural gas from the project. MLNG will be a fully integrated turnkey floating LNG terminal.

Case 4

Name: Shirajganj Power Project by Sembcorp North-West Power Company

Modality: Mobilisation (similar to Syndication Financing)

Major partners and structure of financing

Sembcorp North-West Power Company is a joint venture (public-private partnership) between Sembcorp Utilities and Bangladesh's state-owned North-West Power Generation Company. North-West Company has a share of 29%. Within the sector, this project represents the most substantial direct foreign investment in Bangladesh in recent years and is expected to attract additional capital for the industry. According to Sembcorp (2016), IFC has directly financed USD 73 million and has helped mobilise funds from the Singapore-based infrastructure project financing firm. The Clifford Capital and JICA gave a loan of USD 103 million and USD 30 million respectively. In addition to this, the CDC has contributed USD 41.25 million and USD 60 million through IFC's blended finance channel. The total project finance by these three financiers is USD 300 million. The USD 41.25 million component of CDC tranche will benefit from political risk cover provided by the Multilateral Investment Guarantee Agency (MIGA). A part of Clifford Capital's MIGA will also provide a political risk guarantee to Sembcorp for its equity investment in the project[23]. Repayment period of these loans is 14 years with a grace period of 2.5 years (usually the construction period).

The direct loans were taken at a commercial rate of LIBOR plus 4%; for the IFC part quarterly LIBOR has been hedged at 2.35%. Clifford Capital and CDC

23 This marks IFC's first investment with Sembcorp and IFC-MIGA's first joint project in Bangladesh.

have also used the 3-month LIBOR; for JICA the semi-annual rate is 2.5%. The political risk guaranteed by MIGA requires a 0.75% per year premium payment to cover the risk.

Description

The project will be the second largest independent power plant with a capacity of 414 MW. It will cover the increasing demand for electricity in Bangladesh. The government considers that the project will have a crucial development impact in the country.

For the three power generation projects listed above, several agreements were necessary to initiate the projects: a power purchase agreement (PPA), letter of interest (LOI) issued by the government, implementation agreement, a fuel supply agreement, and a land lease agreement (if applicable). The PPA[24] serves as a security statement from the government's side, i.e. the Bangladesh Power Development Board (BPDB)[25]. The quasi-sovereign guarantee provided by the state-owned enterprise, BPDB (GoB) in buying the electricity produced in the power plants at commercial rates and in USD, helps these companies mitigate both the market risk and the exchange rate risk. The revenue of the power plants and the loan repayment both are in USD; thus, the exchange rate risk for the private investor is not a relevant issue. This enhances credibility and makes the project financially viable for investment – therefore, obtaining the PPA is an essential requirement for financier application. The PPA with the government has been helpful in this context.

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24 The PPA offers high security under the 'take or pay' arrangement. This type of arrangement ensures the payment by the government for the capacity component (includes the debt, equity payments) and the energy component.

25 Electricity is sold at an administered price by the state-owned enterprises. It is a *de facto* monopoly.

We conclude from the case studies that the lenders or financial collaborators have strict regulations and criteria for the environment and social standards. This requires the Bangladeshi private investors to upgrade their operations in compliance with international standards. In case of equity-based arrangements (such as bKash), international players have relatively more influence on organisational policies as equity shareholders compared to other modalities of blended finance (e.g. debt, syndicated financing, etc.). Local partners have to comply with more stringent international standards. Adherence to a consolidated compliance policy framework raises the capacity of investor companies to face the international market on a sound footing.

Power plants fuelled by gas are generally cleaner compared to plants which use coal. The latter have higher risks of environmental pollution. For this reason, the lenders and implementing agencies of the project incorporated strict technological parameters that promote an environmentally friendly production (low-carbon technology). This also helps to minimise social and environmental costs. Thus, blended finance initiatives in the power sector have indeed supported the cause of clean energy in Bangladesh. This will contribute to attaining SDG 7 in the Bangladesh context (increased reliance on clean energy).

Summary of observations

Major actors in the blended finance field of Bangladesh

Blended finance has been in operation in Bangladesh for several years now. However, it is now evident that with the private sector growing in scale and scope, this particular financing instrument is becoming increasingly popular. Expert interviews conducted for the study indicate that among the significant international financiers, IFC has the largest blended finance operation in Bangladesh. Other IFIs including ADB, IDB, AFD, KFW and CDC, which are seeking opportunities to expand their services in Bangladesh, are also either getting into or exploring these windows. Indeed, if the conducive regulatory regime is ensured, blended finance may emerge as one of the dominant and popular financing modalities in the next years.

Several domestic financial institutions including the Infrastructure Development Company Limited (IDCOL), Bangladesh Infrastructure Finance Fund Limited (BIFFL), and Investment Promotion and Financing Facility II (IPFF II) Project have the potential to be major players in terms of promoting private sector investment in Bangladesh, particularly in infrastructure related sectors. For now, their operations are limited, and they are yet to attract blended finance initiatives.

Potential sectors for blended finance initiatives

The findings of the study suggest that the infrastructure sector holds most of the existing or completed blended finance initiatives in Bangladesh. There is no doubt that Bangladesh needs to mobilise a formidable amount of financial resources for developing its transport and communications, energy and power sectors, ports etc. Besides the infrastructure, areas with the high potential to receive and utilise blended finance include high-tech parks, logistics industry (warehousing facilities) and export-oriented thrust sectors (leather and footwear, pharmaceuticals, ICT, plastic, light engineering). Also, Bangladesh needs to look for financing in renewable energy to address the challenges induced by climate change. These sectors have high potentials to attract blended finance. At the discussion meetings, some stakeholders also felt that industries such as waste treatment plants (plants that convert waste to energy) have high development impact in the context of Bangladesh and could also potentially be attractive blended finance opportunities. The health sector was also perceived to have high prospects in this connection, according to some interviewees.

A significant factor which drives the success of blended finance ventures is the financial viability of the projects. Interviews with potential financiers in the field of blended finance indicate that innovative projects with high development impact are the most prospective from the perspective of their investment decision. For example, bKash is Bangladesh's first mobile financing service which significantly enhanced access to financing services at the grassroots level and boosted financial inclusivity. Also, the power and energy sector were found to be less risky for IFIs. Indeed, IFIs were perhaps encouraged to go for blended finance arrangements in this sector for this reason. One key factor that prompted the IFIs is that the 'purchase power agreement' between the government (being the monopsony) and private investors provided a guaranteed financial return on investment.

Compatible instruments for blended finance initiatives

According to major stakeholders in the blended finance arena in Bangladesh, the following two instruments were reported to be relatively more effective - 'long-term loan' and 'convertible debt'. Long term financing, particularly for the infrastructure sector, is limited in Bangladesh. Besides, convertible debt, where the creditor can convert loan arrangement to equity-based arrangement, subject to the good performance of the debtor, could further enhance investment prospects.

Major financiers of blended finance initiatives often opt for interest rate swaps with their commercial bonds.

Concessionalities offered by IFIs involved in blended finance initiatives

Major financiers of blended finance initiatives often opt for interest rate swaps with their commercial bonds in international markets to reduce risk premiums for private sector debtors. IFC's swap arrangement in Sri Lanka is an example. Some IFIs have specific organisational terms of reference which may not allow awarding loans to private sectors at interest rates lower than the market rate (prevailing in Bangladesh) as this may harm the interests of the private sector (commercial banking) by distorting markets. Long-term financing is the most common type of concessionality offered by the financiers in blended finance initiatives; i.e. in terms of the longer repayment period and grace period (in most cases the repayment period ranges from 13-20 years in contrast to the prevailing market terms that allow repayment period of 5-7 years).

Two issues may be noted in this connection. First, the foreign loans availed from OBUs have interest rate within 5% (according to a recent CPD analysis using data for the 2011-2017 period) but have shorter repayment period (ranging between 5.2 and 5.5 years) compared to the loans under the blended finance initiatives. Second, since the interest rate of foreign loans is capped around 5% (notional, not mandatory), the interest rate of blended finance initiatives is lower than the prevailing interest rate on commercial bank loans, which ranges between 9-13%. However, the cost of currency swap and the lack of exchange rate hedging facilities in Bangladesh must consider the effective interest cost and the extent of actual concession in case of blended finance.

Added benefits for private investors involved in blended finance initiatives

In addition to the usual longer tenure and relatively low-interest rate, the blended finance initiatives in Bangladesh also offer additional facilities. Several interviewees reported that in some cases the IFIs (such as IFC) provided technical support to the project to raise compliance assurance capacity and to ensure adherence to the provisions in the deal. Also, if a project is approved for blended finance, it is usually considered to be socially and environmentally credible as the requirements are stringently followed and works as leverage to mobilise additional funding. This raises the project's reputation in the market and enhances the confidence of the associated parties. Enhanced capacity of the parties involved helps the entrepreneurs to mobilise more funds from the market. This is important since assembling collateral-free loans for a longer-term period is practically impossible in Bangladesh in the absence of necessary institutions. The interviews conducted under this study suggest that private sector entrepreneurs who were part of blended finance deals were able to leverage their track record to mobilise additional finances. In some cases, the IFIs (such as IFC) in Bangladesh had helped the private sector to build corporate governance structure within the company (going beyond the blended finance component), and this has helped the companies to negotiate deals for other projects.

Prospects for future blended finance initiatives

It was noted by some interviewees that interested potential financiers look for collaboration opportunities with major financiers (or DFIs, IFIs) present in the Bangladesh market. In such instances, the financial institution which has experience of operating in Bangladesh facilitates the ventures of the interested potential financiers. The physical presence and market knowledge of the IFIs play a decisive role in capturing the interest and confidence of financiers looking for business opportunities in Bangladesh. For example, interviewees from well-established IFIs have shared that their involvement in a project boosts the investors' or lenders' confidence. This also helps to anchor a substantial amount of financing which may lead to syndicated funding for a project. Even if there is no formal collaboration, they exchange knowledge and insights about the market which helps operators to do business in a more informed way.

IFIs are interested in exploring more initiatives in other sectors besides the currently prevalent ones such as power and infrastructure. According to the interviews, IFIs have evinced keen interest to invest more in blended finance type of projects if they find suitable opportunities. Similarly, some interviewees indicated that chances of attracting foreign investment or foreign financing for a project are higher when domestic players are involved (e.g. through equity participation). This condition is not mandatory under the current regulatory regime; however, it could be a prudent approach to design an appealing project to foreign financiers. The domestic player can be either from the public or private sector (preferably private given the lack of successes from the public sector). The share or involvement in the project could be in the form of debt, equity, mezzanine equity (preferential equities) or convertibles. Such arrangements could further strengthen the viability of blended finance projects.

Blended finance tends to be more accessible to larger private investors in Bangladesh

An excellent track record of the private investors (partners) in blended finance ventures is a prerequisite for attracting finance. The capacity of businesses and entrepreneurs to deliver the expected outcomes, complete the project on time and meet repayment obligations is essential from the decision-making perspective of potential lenders. Therefore, blended financing tends to be more accessible to the well-established large businesses that have a credible balance sheet. As a result, finding potential foreign lenders who would be interested in partnering with small-scale private actors in developing countries remains a challenge, and this needs to be addressed.

The "missing middle": SMEs can be reached with dedicated blended finance funds

Blended financing tends to be more accessible to the well-established large businesses that have a credible balance sheet.

Modalities need to be identified to attract blended finance to SMEs through appropriate incentives and policy support. Almost all the interviewees recommended this. Besides, they suggested that the "missing middle" or small and medium enterprises would have better access to blended financing if a consolidated and dedicated fund were set up to cater to their needs. Specialised funds can be created in which domestic or foreign development partners and DFIs can participate in the form of equity. The fund could be regulated by the GoB and disbursed through the commercial banks. For IFIs, reaching individual SMEs is difficult due to higher transaction cost. For example, WTO-EIF has initiated a project to provide financial support to the SME Foundation, women entrepreneurs' association (WEA), and Joyeeta Foundation in Bangladesh. The idea is to give loans to small and medium entrepreneurs at a reduced rate, with smaller collaterals and longer tenure.

Dedicated funds and credit lines as blended finance instruments are found to be more appropriate for SMEs. A cap can be put on lending to ensure that only small and medium entrepreneurs get the funds. For example, regarding the apparel sector retrofitting project, the AfD has introduced a credit line where the lending limit is capped at EUR 1 million. The objective of this fund is to help the small and medium apparel companies to improve the working conditions, upgrade technology to reduce pollution and to provide them with investment security. Although commercial banks are in charge of loan disbursement, any loan from EUR 1 million to EUR 3 million must be approved by the AfD itself. The objective of this condition is to prevent investments from being solely directed to big players in the market.

> **A rigorous assessment of the development impact is essential for all blended financed projects.**

Development impact needs to be the core criterion of success for a blended finance initiative

A rigorous assessment of the development impact is essential for all blended financed projects. Most often this is not considered during the planning stage of the projects. Regularly IFIs do not assess the project's development impact after completion of a project, although it is mandatory to mention the intended development impact while preparing a proposal for the blended financed project. It is too early to assess the development impact of blended finance in Bangladesh as the projects that have been supported are still in the process of implementation. However, the success or failure of blended finance projects ought to be measured in terms of attaining the intended development impact and not merely on the ground of payments of interest and appropriate amortisation.

More financial instruments need to be brought into play

Bangladesh's capital market lacks the sophistication to attract and cater to the specificities of blended finance initiatives while a secondary bond market is virtually absent. There is no well-established bond market in Bangladesh which impedes the lending process of prospective financiers. There are no operational private equity or debt funds either. At present, there is no hedging facility for the entrepreneurs in Bangladesh although this is particularly important to help avoid currency mismatch and other risks (interest rate volatility, inflation rate risk etc.) associated with projects financed by the blended finance.

Available instruments and funds are not being utilised prudently to increase and attract additional blended finance to Bangladesh. For example, the massive amount of life insurance funds (about USD 4 billion) are invested in various short-term deposits with commercial banks. Ideally, such funds should have been invested in long-term projects (in sectors which require long-tenured financing such as infrastructure). This is a major weakness of the capital market. Unless a robust corporate bond market is developed, insurance companies or financiers will not have the necessary vehicle to invest.

Regulatory reforms need to be considered at the earliest

Several regulatory bottlenecks need to be addressed regarding blended finance. At the moment, it is not clear which institution is in charge of blended finance initiatives in Bangladesh. Interviewees indicated that whenever there is any new initiative or project which requires innovative or non-conventional terms of financing, it takes a long time to get the necessary approval from the designated authorities. Government officials do not want to take the risk of approving something that is out of the ordinary practice. Fitting novel projects into the existing framework is causing significant delays. Additionally, since there is no regulation or guidelines in place, officials tend to avoid approving new projects.

Some government agencies that play critical roles in dealing with blended finance in Bangladesh may include the External Resources Division (ERD) in the Ministry of Planning, Public Private Partnership Authority (PPPA), the Bangladesh Investment Development Authority (BIDA), the Bangladesh Bank, and the Finance Division in the Ministry of Finance. Indeed, coordination among these agencies will be a significant challenge in the context of promoting and regulating blended finance in Bangladesh. A legal and regulatory framework for blended finance is pertinent. A regulatory framework can support the adoption and implementation of blended finance initiatives and will make the Bangladesh market lucrative for such investments.

To address regulatory bottlenecks, blended finance initiatives can be categorised into three types:

a. Transaction-based financing refers to the projects where private sector investors bring in financing at commercial rates, and it is supported by concessional financing from the government, DFIs, or IFIs. The PPPA can be the leading agency here since this fit into their working modality. The PPPA can then negotiate and discuss the overall deal structure with the government bodies, development partners, and other financial institutions.
b. Product based financing refers to the involvement of financial instruments in the deal structure and the specific instruments and mechanisms needed to be designed and developed to bridge the financing gap (for example, interest rate hedging, credit council, refinancing, and modalities to address inflation-rate risk, interest rate risk, exchange rate risks). This is a difficult case and would require the involvement of the multi-stakeholder group including Bangladesh Bank, Stock

Exchange regulators.

c. Specific development need-based financing refers to the financing of projects primarily aligned with national development priorities. For example, long term low-interest rate funds are directed to renewable energy and solar-based projects. These should be part of mainstream arrangements sanctioned by a government entity, preferably the ERD.

Bangladeshi stakeholders, from both the public and private sector, felt that there is a heightened need for a permanent institutional framework for blended finance. BIDA, in this case, can play the leading role in terms of spearheading this initiative while other relevant government agencies including the Central Bank should be part of this. On the IFIs side, Local Consultative Group (LCG) is the platform of development partners in Bangladesh and plays an essential role in coordinating various initiatives. On their part, they may consider constituting a particular working group on blended finance. Such a group would include major interested parties, including both the IFIs and the private entities which are emerging as key players in the blended finance scenario.

Blended finance has great potential in Bangladesh

Addressing the challenges mentioned above can enhance the prospects of the promising blended finance initiatives in Bangladesh. The financing needs of the private sector in developing countries such as Bangladesh are significant, and access to concessional financing as injection of equity funding remains an area of keen interest. Thus, the potential for expanded involvement of blended finance type partnerships in Bangladesh is quite significant. Indeed, since there is a lack of venture capital in countries such as Bangladesh, blended finance could be a particularly vital instrument to finance innovative ventures with elements of relatively higher risk[26]. Blended finance leads to the promotion of higher social and environmental standards, better production and

26 bKash can be such an example.

management practices and improved corporate governance. All these contribute to raising the operational efficiency of the private sector players.

In the end, blended finance can support Bangladesh's private sector to earn credibility, raise its creditworthiness, and enhance its reputation in the global financial market. Greater involvement of the private sector in large scale infrastructure type investments, facilitated by blended finance, also helps the public sector by reducing the financial burden which it would otherwise have to bear.

Concluding remarks

The flow of blended finance may create new payment obligations on the part of domestic companies and also in some cases on the part of the GoB. For example, the payments for electricity to power sector projects–under blended finance initiatives–are financed with foreign currencies (in this case, USD). Hence, this will result in higher foreign exchange obligations for the government of Bangladesh. This will likely generate additional pressure on the country's balance of payments. Consequently, policymakers should be aware of the balance of payment implications arising from a significant inflow of blended financing to the country. Thus, due diligence is needed in approving the projects that are implemented with blended finance. Some stakeholders have also cautioned that encouraging blended finance initiatives may impose the risk of substituting domestic financing with subsidised or concessional foreign financing if proper safeguards are not put in place. This will likely have negative implications for the development of the local financial market. However, other stakeholders thought that if properly regulated, blended finance could enhance the efficiency of Bangladesh's domestic financial market by stimulating competition.

As the preceding discussion testify, companies financed with blended finance tend to be in a more advantageous position compared to companies without such financing, thanks to access to concessional finance and injection of equity. However, it was also pointed out that because of the nature of blended finance, these additional benefits could also lead to market distortion. For example, bKash among all the providers of mobile financial services in Bangladesh enjoys the single largest market share. At least in part, this has happened because of the positive contribution of blended finance. To create a level playing field and address market distortion related anomalies, the regulatory regime may need to calibrate to maintain a competitive level playing field in the market.

From a policy perspective, blended finance interventions are set to gain increasing relevance and importance. Evidence suggests that development financing institutions are looking for new opportunities to invest in low-income countries. To a large extent, attracting blended finance opportunities to Bangladesh will hinge on good corporate governance. However, what also needs to be stressed is that blended finance is an additional source of finance which could play an important role in implementing the SDGs and should not be seen as a substitute for ODA, neither as a justification for the low levels of ODA flow.

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