43 Private Sector & Development

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EUROPEAN DEVELOPMENT FINANCE INSTITUTIONS

STRATEGIC PLAYERS IN CHANGING TIMES

EDFI European Development Finance Institutions

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SUMMARY

This issue of Private Sector & Development magazine was prepared in collaboration with the association of European Development Finance Institutions (EDFI).

EDFI European Development Finance Institutions

Françoise Lombard
CEO Proparco and member of AFD Group Executive Committee

Luuk Zonneveld
Chairman of EDFI

In a world dominated by economic uncertainty, climate challenges and serious geopolitical tensions, European development finance institutions (DFIs) need to adapt. They are facing an uncertain geostrategic context that challenges their priorities, activity and *modus operandi*.

Since 2015 and the 3rd International Conference on Financing for Development in Addis Ababa, European DFIs have demonstrated their relevance and have become a strategic pillar for European development strategy. They have stepped up their cooperation and firmly anchored their operations within the framework of the Sustainable Development Goals (SDGs). These financial institutions currently invest more than €12 billion a year in the private sector in emerging and developing countries. By targeting sectors with a high social and environmental impact, these investments help to create jobs and preserve global public goods and greater social and economic stability, especially in the most fragile regions. By mobilising European resources and expertise effectively, the investments of European DFIs ultimately generate positive benefits both for local populations and European citizens.

With the 4th International Conference on Financing for Development (FfD4) due to be held in Seville in a few weeks' time – which should serve as a reminder of the growing role that the private sector needs to play in achieving the SDGs - European DFIs need to adapt their business model to combine solutions to global challenges, outreach initiatives and support for European priorities more effectively. To do this, they have a number of serious advantages. By capitalising on their local presence, network, expertise and the diversity of their instruments, they can mobilise – both locally and internationally – private investors in the service of development. With the support of their partners – public stakeholders, businesses, financial institutions, investors and philanthropists – they help with the structuring of ecosystems, drive the ecological transition and foster innovation. By using blended finance when needed, they invest in more fragile contexts or in new impact-focused sectors. Lastly, by acting collectively, they encourage uniform practices and standards by capitalising on European expertise.

With the European Development Finance Institutions (EDFI) association, which brings together 15 bilateral DFIs representing a combined portfolio of €53 billion, Europe has incomparable strategic leverage for harnessing European development and competition policy for the benefit of all.

Samantha Attridge
Principal Research Fellow, ODI Global

Samantha Attridge is a Principal Research Fellow who leads ODI Global's research programme on the mobilisation of private capital and she co-chairs the FIC Global Research Network on private capital mobilisation. She is a development finance expert specialising in blended finance, public development bank's (PDB's) and development finance institutions (DFI's), whose work is widely referenced, and whose expertise is regularly sought after by donors, DFIs, PDBs, international organisations and other external stakeholders.

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Head of Development Economics, BII

Paddy Carter is the Head of Development Economics at BII, responsible for internal and external thought-leadership on development economics and finance. Before joining BII, in 2019, he was a Research Fellow at the Centre for Global Development (CGD), and before that, at the Overseas Development Institute (ODI). He has a PhD in economics, on the topic of foreign aid, from the University of Bristol, where he was also a British Academy Post-Doctoral Fellow. His research has been published in leading economic journals.

William Paul Forster
Researcher, writer and editor focused on international development

William Paul Forster is a researcher, writer and editor focused on international development. With an academic background in the politics of knowledge, his interdisciplinary activities centre on the design, delivery and evaluation of strategies and products for advocacy, public diplomacy, reporting and knowledge management. Before academia and development consulting, Paul managed a digital communications consultancy and worked worldwide as a journalist.

Homi Kharas
Senior Fellow, Center for Sustainable Development, Brookings Institution

Homi Kharas is a senior fellow in the Center for Sustainable Development, housed in the Global Economy and Development program at Brookings. In that capacity, he studies policies and trends influencing developing countries, including aid to poor countries, the emergence of the middle class, and global governance and the G20. Prior to joining Brookings, Homi spent 26 years at the World Bank, serving for seven years as Chief Economist for the World Bank's East Asia and Pacific region and Director for Poverty Reduction and Economic Management, Finance and Private Sector Development.

Jérémie Ceyrac
Director of Investments, Proparco

Jérémie Ceyrac is Director of Proparco's Investment Department, which covers both fund-of-funds and direct equity and corporate investment activities. Jérémie has headed up the department since 2018 and was previously a Senior Investment Manager at Proparco. He has worked on numerous transactions in Africa and Asia. Jérémie is a graduate of London School of Economics and Paris Dauphine University and has also worked in financial consulting and acquisition finance in Europe.

Olivier Charnoz
Deputy team leader of the Knowledge Hub Digital, European Commission

Olivier Charnoz currently serves as Deputy team leader of the Knowledge Hub Digital at the European Commission, where he advises on EU digital initiatives across the Global South. His work spans digital infrastructure, innovation and startups, artificial intelligence, private sector engagement, investor mobilisation, and more. He has previously worked with various donors, including German, Australian, and French cooperation agencies. He spent 12 years at the French Development Agency Group and holds a Ph.D. from the London School of Economics.

David Kuijper
CEO, Association of European Development Finance Institutions (EDFI)

David Kuijper has been the CEO of the Association of European Development Finance Institutions (EDFI) since September 2023. Previously, he served as the Manager of Public Investment and Blended Finance at FMO (the Dutch Development Bank). He joined the Netherlands Foreign Service in 1998, where he held various positions. He is an alumnus of the Free University Amsterdam, the Netherlands, and University College Dublin, Ireland.

Jean-Baptiste Sabatié
Deputy CEO, Proparco

Jean-Baptiste Sabatié has been Proparco's Deputy CEO since July 2024. He has close to 25 years of experience in the field of public and private sector impact finance. In the summer of 2020, he left his functions as regional director for Mexico, Cuba and Central America, as well as country director for Mexico of the French Development Agency (AFD), to join AFD's headquarters. Until taking up his current position, he was AFD's Director of Transformation, responsible in particular for steering and implementing the AFD Group's transformation program.

EDFI members

EDFI (the association of European Development Finance Institutions) was established in 1992 to support and promote the work of bilateral Development Finance Institutions (DFIs). With a combined portfolio of €53 billion, including over €15 billion of climate finance, EDFI's 15 member institutions share a vision of a world where the private sector offers people in low- and middle-income countries opportunities for decent work and improved lives; also, where private investment flows are aligned with the Sustainable Development Goals and the Paris Climate Agreement. EDFI's mission is to promote the joint interests of its members, inform policy, and drive innovation in industry standards.

BIO Investing in a Sustainable Future
British International Investment
COFIDES We invest in development
cdp
finnfund
FMO Entrepreneurial Development Bank
INVESTMENT FUND FOR DEVELOPING COUNTRIES
KFW DEG
Norfund
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SIFEM
simest gruppo cdp
SOFID Financiamos a Internacionalização
Swedfund

OVERVIEW

Assessment and outlook for DFI initiatives: towards greater efficiency?

Jérémie Ceyrac, Director of Investments, Proparco

Over the past decade, health, climate and geopolitical challenges have increased exponentially. In response, Europe's development finance institutions (DFIs) have stepped up their cooperation and anchored their activities firmly within the framework of the SDGs. While the overall assessment of this decade is a positive one, it also highlights the need for adjustments, which should enable European DFIs to step up their action as part of a more partnership-based approach – notably with players from the private financing sector – while continuing to fulfil their counter-cyclical role and financing the challenges of tomorrow.

AN ARTICLE BY
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Over the past ten years, the world has been confronted with major crises of an exceptional intensity. The Covid-19 pandemic compounded the climate crisis, in an especially conflict-ridden geopolitical context, reflected notably in the war in Ukraine and a fresh outbreak of conflict in the Middle East. The arrival of the new Trump administration in the United States has weakened multilateralism from the get-go and had a very direct impact on development aid – you only need to look at the recent upheavals at the United States Agency for International Development (USAID). The mindset whereby aid and solidarity should be replaced by "deals" – which would enable donor nations to justify a return on investment for their constituents – has taken hold in certain countries. European DFIs are not entirely immune to these semantics, which are putting their model under strain.

The context is rendered all the more unusual by the fact that the Fourth International Conference on Financing for Development (FfD4) will be held in Seville between June 30 and July 3, 2025 - and the Sustainable Development Goals (SDGs) and Paris Climate Agreement are celebrating their 10th birthdays. It therefore seems especially appropriate to examine the role of development finance institutions (DFIs) during this eventful decade and to consider any adjustments that would enable us to amplify their action, convey it more clearly to the public and measure the impact "per euro invested" more effectively.

STRONGER COOPERATION IN PURSUIT OF THE SDGS

During this tumultuous decade, European DFIs have clearly grasped the need to forge closer ties, reassess collective priorities and scale up their objectives. Since the adoption of the SDGs in 2015, intense cooperation has been developed between DFIs, facilitated by the need for a common framework approach. The new strategic guidelines for Agence Française de Développement (AFD) and its subsidiary Proparco also acknowledge this shift, promoting a 100% SDG project management approach (so that allocating funding to one SDG does not indirectly harm the others), and showcasing partnerships.

This enhanced coordination between DFIs covers several aspects. It can, for example, take the form of shared financial support for pivotal economic players, in a context of urgency and conflict. In 2024, Proparco, along with other institutional donors such as IFC and EBRD, provided support to the Bank of Palestine (BOP). Similarly, just a few months after the Russian invasion of Ukraine, 13 DFIs teamed up to support a new round of financing for Horizon Capital, a long-standing player in financing Ukrainian tech SMEs. DFIs contributed 86% of the $350 million raised by Horizon (**see also page 8 concerning the work of IFU**, the Danish development finance institution, in emergency situations, particularly in Ukraine).

Cooperation between DFIs can also take the form of a joint initiative, decided and implemented jointly on the basis of an observation or the identification of a need. This is the case of the Africa Resilience Investment Accelerator (ARIA), which aims to unlock investment in Africa's most fragile markets[1] by providing a local presence, origination support, technical support services, and promoting closer ties between DFIs and their partners. From the outset, ARIA was set up as an integrated initiative within British International Investment (BII) and Netherlands Development Finance Company (FMO). It mobilizes other DFIs, including Proparco, Swedfund and Norfund (**see also page 10 for an article on FMO's work in fragile contexts**).

This cooperation between DFIs towards faster, more robust action is also embodied in sometimes more formal governance structures. In 2016, EDFI, which comprises 15 European DFIs (including Proparco), created EDFI Management Company. This structure has the capacity to apply directly to European grant and guarantee programs, and to manage and coordinate facilities backed by such funding, based on priorities defined by the DFIs. It strengthens the position of European DFIs as EU partners in key areas such as climate finance (and the provision of associated European expertise), mobilizing the private sector, and development financing in fragile and war-torn countries. EDFI Carbon Sinks, a joint European guarantee program benefiting DFIs and supported by EDFI Management Company, is a good illustration of how this mechanism actually works. With more than €360 million mobilized from the European Commission thanks to EDFI Management Company, DFIs will be able to finance ecosystem service activities underpinned by carbon finance, or support the transition of agricultural and forestry practices, which require a long timeframe and sometimes a deferred financial return. Thanks to this EU package, Proparco can aim to finance natural capital, a theme in which European – and particularly French – expertise is flourishing, and which Proparco could leverage to finance projects in Southern countries. This modus operandi for mobilizing European funds makes it possible to raise more substantial resources at a lower cost through pooling – and therefore to finance part of DFIs' initiatives with financial resources obtained collectively outside of national budgets. It is also a more efficient method as it takes the form of guarantees (which may never be called, or may even be profitable for the Commission if the funded projects are economically sustainable). It is also a way of achieving the SDGs and their application points (such as the financing of carbon sinks) which have hitherto been neglected by DFIs due to still untested economic models.

FOCUS
PROPARCO

Proparco is a subsidiary of the AFD Group focused on private sector development. It has been promoting sustainable economic, social and environmental development for over 45 years. Proparco provides funding and support to both businesses and financial institutions in Africa, Asia, Latin America and the Middle East. Its action focuses on the key development sectors: infrastructure (mainly for renewable energies), agribusiness, financial institutions, health and education. Its operations aim to strengthen the contribution of private players to the achievement of the Sustainable Development Goals (SDGs) adopted by the international community in 2015.

1 › See *Acting in fragile contexts»: the 41st issue of Private Sector & Development magazine*. In 2023, Proparco's commitments in the most fragile countries amounted to over €1.7 billion.

AN ARTICLE BY
OLEKSII PARKHOMCHUK

Oleksii Parkhomchuk joined IFU in 2007, bringing prior experience from PwC and IFC in Ukraine. As an Investment Director, he now plays a key role in managing IFU's portfolio and pipeline in Ukraine—one of IFU's largest markets—working closely with two new colleagues in the Kyiv office. Oleksii remained in Kyiv after the outbreak of the war, providing reassurance to portfolio companies. The continued operation of the office was instrumental in deploying the Ukraine Facility funded by the Danish government in March 2023.

FOCUS
IFU

The Investment Fund for Developing Countries is a Danish (IFU) impact investor contributing to green, just and inclusive societies as well as supporting the Sustainable Development Goals. IFU provides risk capital to companies operating in developing countries across Africa, Asia, Latin America and parts of Europe. Investments are made on commercial terms in the form of equity, loans and guarantees. Capital under management is expected to grow from EUR 2.1 billion to EUR 5.0 billion over the next few years.

How IFU continues to invest in Ukraine despite war and high risk

Oleksii Parkhomchuk, Investment director, IFU representative Ukraine

The Danish Investment Fund for Developing Countries (IFU) is working tirelessly alongside the Ukrainian government and society to support the country's businesses and people. It follows a rigorous funding process, while upholding sustainability principles.

Russia's invasion of Ukraine has dramatically changed the financial and business landscape. Yet, IFU has not withdrawn from its significant portfolio in Ukraine. On the contrary, the fund continues to make new investments, helping the Ukrainian economy to withstand and build back better. In 2023 and 2024, IFU financed six new projects in Ukraine. These included loans to Bank Lviv focusing on SMEs, a mid-sized food producer and three manufacturing companies, as well as an investment in the Horizon Capital PE fund. Even before the war, such an investment volume in a single country would have been considered an outstanding achievement. The risk capital provided by IFU is allocated from an eight billion euros fund for Ukraine established by the Danish government. Most of this is for military support. But a portion is also allocated to civilian activities and private sector investments.

Businesses demonstrate remarkable resilience

IFU has more than 25 years of experience investing in Ukraine and had 15 active investments in the country when Russia invaded. All – except one have remained operational throughout 2022-2024, and demonstrated enormous resilience and strong performance with both Ukrainian as well as Danish personnel working under exceptionally challenging conditions.

The role of IFU is - despite the war - to continue to provide risk capital that enables the investees to restore revenues, maintain tax contributions, retain jobs and create new opportunities for vulnerable groups such as women and veterans – while upholding sustainability principles. If Ukraine's economy collapses, the cost of reviving it will be far greater than supporting it now.

While conditions have changed, IFU continues to follow a rigorous project assessment process, carefully analysing each potential investee's business plan and financial model. It disregards Ukraine's country risk, to keep interest rates viable for borrowers. Yet it continues to perform strict due diligence on business models, financial projections and risk factors. IFU assumes that borrowers will be able to repay their loans despite the wartime uncertainties.

Focus on commercially viable companies

In that regard, IFU's mandate remains unchanged, and the fund continues to provide structured, redeemable financing to commercially viable companies that form the backbone of Ukraine's economy, ensuring they remain healthy and bankable. One of the most surprising lessons since the war began has been Ukraine's resilience. Key business infrastructure remains functional, including connectivity, electricity, banking systems, and logistics, all performing better than initially forecast. But numerous challenges stills exist, including labour shortages due to mobilization, Russian attacks on energy infrastructure, with risks of blackouts, as well as corruption concerns. These issues must be addressed and will require continued, dedicated "efforts" from the Ukrainian government, local society and Ukraine's allies.

Looking ahead, IFU is actively building its investment pipeline and leveraging European financing and guarantee instruments alongside its own funding. And the Fund's Kyiv office is working tirelessly to support existing clients, process new investments swiftly, and ensure that Ukraine emerges from this crisis strong and independent.

The efforts made over the past 10 years, both quantitatively and qualitatively, should therefore be welcomed: increased cooperation between institutions has significantly enhanced the efficiency and impact of European DFIs' initiatives.[2] Other developments – notably in the regulatory sphere – have also emerged in the last decade: for example, since 2021, the European climate taxonomy framework and the EU's Sustainable finance disclosure regulation[3] have harmonized the terms used to refer to impact investing, climate finance and so on. All of this work to define, label and standardize regulations helps to objectify the action of sovereign or private economic players in pursuit of the SDGs. These changes and regulatory incentives, combined with the work of development agencies over many years, have created a framework that is more conducive to investment, particularly in combating climate change. In 2022, for the first time, the commitments of "developed" countries (€116 billion per year, according to the OECD[4]) to developing countries to compensate for damage suffered or to contribute to mitigation and adaptation efforts have actually been met (**see also page 13 on climate finance by BII, the British development finance institution**).

> ***"During this tumultuous decade, European DFIs have clearly grasped the need to forge closer ties, reassess collective priorities and scale up their objectives."***

ADJUSTMENTS THAT ARE STILL NECESSARY TO ACHIEVE THE OBJECTIVES

While the reasons for celebration are very real, they should not mask the fact that only 16% of SDG targets[5] are on track to be achieved by 2030. Ten years after the Addis Ababa Conference on Financing for Development (FfD3), the Seville FfD4 represents a milestone that must be seized upon to make the essential adjustments that will accelerate the achievement of SDG objectives. Certain specific objectives are still less well funded by DFIs than others – such as SDG 14, despite the fact that it lies at the heart of the United Nations conference on oceans, to be hosted in Nice in June 2025.

> ***"While the reasons for celebration are very real, they should not mask the fact that only 16% of SDG targets are on track to be achieved by 2030."***

2 ▸ These gains in efficiency and impact can be measured in a number of ways, especially by the evolution of the projects financed. In 2024, European DFIs committed €12.35 billion (for 708 projects), compared with €6 billion (for 534 projects) in 2015. Source: EDFI.
3 ▸ See https://finance.ec.europa.eu/regulation-and-supervision/financial-services-legislation/implementing-and-delegated-acts/sustainable-finance-disclosures-regulation_en
4 ▸ See https://www.lemonde.fr/planete/article/2024/05/29/climat-l-objectif-de-100-milliards-de-dollars-pour-les-pays-du-sud-a-enfin-ete-atteint-et-largement-depasse_6236192_3244.html
5 ▸ See https://www.unsdsn.org/resources/the-sustainable-development-report-2024/

AN ARTICLE BY
ANDREW SHAW

Andrew Shaw leads FMO's Programmatic Technical Assistance team, which is spearheading the organization's Market Creation initiatives. He has over twenty years of experience supporting sustainable private sector development in emerging markets. He is specialised in sourcing and developing partnerships and projects that foster sustainable and inclusive growth and gets excited by creative and innovative solutions. It is this inclusive and entrepreneurial approach to development that makes him tick.

FOCUS
FMO

FMO is the Dutch Entrepreneurial Development Bank. As a leading impact investor, FMO supports sustainable private sector growth in developing countries and emerging markets by investing in ambitious projetcts and entrepreneurs. FMO is working (providing technical assistance) and investing in frontier markets to develop opportunities into financeable projects. It develops both businesses and ecosystems.

Developing and investing in frontier markets to achieve the SDGs

Andrew Shaw, Programmatic Technical Assistance team leader, FMO

How FMO is working (providing technical assistance) and investing in frontier markets to develop opportunities into financeable projects.

With just five years to reach the UN's Sustainable Development Goals (SDGs), it is undeniable that progress towards achieving them is lagging worldwide. FMO is working towards a world in which by 2050, > 9 billion people live well within planetary boundaries. Through its '2030 Strategy: Pioneer, Develop, Scale', FMO is maximizing its impact towards achieving the SDGs. Accelerating action to this end will require doing more of what is already being done – such as, mobilizing investor capital[1] and leading syndications[2] that support financial inclusion. Stepping up in other areas to address the lack of investible opportunities will also be required. FMO is acting resolutely with its market creation approach, a new and bold flywheel for investing. The aim is to develop unbankable opportunities into bankable projects, thus bridging the broader development ecosystem to address pipeline shortfall and an ever-widening SDG financing gap. This entails developing both businesses and ecosystems: the former makes individual opportunities bankable; the latter addresses systemic challenges that hinder investments, which must be solved over a longer-term horizon.

For example, through Invest for Impact Nepal – which FMO established as a sector initiative together with BII and SDC – it focuses on addressing ecosystem constraints to proactively create investment opportunities and support local financial institutions and private equity funds. Investing in frontier markets is also critical to insuring the impact of DFI's. Over half of the world's poor live in fragile contexts, and while such markets represent a higher-risk environment FMO must fulfil its mandate. This in line with SDG 10: Reducing Inequalities – for example, with its NASIRA[3] program (set up with the European Commission and powered by Team Europe). NASIRA gives portfolio guarantees to financial institutions, making possible lending to groups that were previously overlooked, like young and women entrepreneurs.

Increasing investment flows in frontier markets

FMO's latest and most ambitious approach focuses on frontier markets; for example, as with the Africa Resilience Investment Accelerator (ARIA), a joint initiative between, FMO, BII and Proparco. ARIA supports the long-term economic growth of underinvested frontier markets across Africa; together, the initiative has unlocked USD 45 m in DFI investment since 2021 and has provided more than 40 companies with technical assistance.
An example of a pioneering deal recently closed consisted of a loan of USD 20 m to Ethiopia's Dashen Bank to support agricultural development, making FMO the first foreign institution to offer long-term funding to Ethiopia's financial services sector. The aim was to catalyze the market and foster confidence among investors to mobilize more private capital, for example, by helping to improve Dashen's ESG standards.

While the priority is to redirect and increase investment flows in frontier markets, meaningful change will require strong partnerships. So join FMO in collective action – together with other DFIs and Team Europe actors – to provide an aligned, coordinated approach to addressing the dearth of investment projects.

1 ‣ https://www.fmo.nl/news-detail/6fb79fab-ec10-4e7e-9fe8-d908dda30b06/sdg-loan-fund-mobilizes-usd-1.1-billion-of-investor-capital
2 ‣ https://www.fmo.nl/news-detail/e966f9ab-abd9-415f-b08e-b4470704d21d/fmo-arranges-usd-200-mln-syndicated-facility-for-khan-bank-to-support-green-financing-msme-financial-inclusion
3 ‣ https://www.fmo.nl/nasira

ASSESSMENT AND OUTLOOK
FOR DFI INITIATIVES: TOWARDS
GREATER EFFICIENCY?

To help achieve the SDGs and accelerate the transition, DFIs must meet the dual challenges of building a more partnership-based and systematic approach with private finance players, while also being in a position to take on the necessary risk to finance new solutions. A partnership-based mindset between private actors and DFIs is absolutely crucial if we are to achieve the objectives in emerging and developing countries. Private finance players manage the resources essential to financing the transition, while DFIs have expertise in the field and decades of experience in these countries. While the idea is not new, scaling up, the systematisation of reflexes and their operational deployment are slow to materialise. Moreover, while most European DFIs now aim to mobilise the private sector[6], their effectiveness is still too often measured in terms of the volume of financing on their balance sheet. To engage in dialogue with the major private financiers and work together to redirect financial flows, DFIs must strive for simplification and pragmatism. Without renouncing their ambitions or their exemplarity, development banks need to have a right to make mistakes, otherwise DFIs will just remain in familiar territory and target projects which, in certain cases, should be financed by the private sector. Lastly, regulators can do more to unlock energies by adapting the banking regulation framework and recognising the specific nature of DFIs' activities, particularly to take more account of the specific features of development mandates and the benefit of blended finance.[7]

Public opinion and governments also expect DFIs to finance the challenges of tomorrow and support for innovation is therefore becoming a key metric. It is particularly important to invest in innovative projects from the earliest stage, in sectors such as climate technologies, carbon finance, electric mobility and hydrogen. DFIs are not always sufficiently present in these sectors, sometimes due to banking-related constraints and economic models ill-suited to this objective – and the absence of the right to make mistakes, which is accorded to private actors. Their capacity to invest massively in innovation and in the adoption of new technologies implicitly raises the question of their added value, their role and their expertise.

WHAT IS THE FUTURE FOR THE ACTION OF DFIS?

This expectation on the part of the public and governments can therefore also be an opportunity to finance challenges outside of traditional arrangements and to rethink the role of DFIs – in particular by focusing on the earliest stages of innovative projects.

DFIs must assume the role of anchor investor and facilitator for transactions located well upstream of the deployment phase, and their guiding principle should not be to compete with the private sector, even if this means leaving the field to commercial banks and fund managers. However, DFIs are expected to focus on non-traditional climate finance issues requiring substantial investment; this is how emerging sectors such as carbon markets, climate technologies, the circular economy and financing adaptation to climate change can be consolidated.

With regard to fragile and war-torn countries, it is even more obvious that only a collaborative approach will work. It is futile to think that each DIF can single-handedly solve the problems of fragile countries. DFIs must use their respective programmes and leverage multilateral donors with greater resources.

6 ‣ Since 2025, Proparco has been testing a '1:1 ratio', reflecting the aim that for every euro carried on the balance sheet, another euro is raised from the private sector.
7 ‣ Blended finance refers to the strategic use of development finance and philanthropic funds to channel private capital flows into emerging markets. See also the article on blended finance on page 14.

The sheer number of crises (political, climate and territorial) reveals the scale of the initiatives that still need to be deployed to achieve the SDGs. The fragmentation of geopolitical blocs will require working with new players who are less sensitive to political cycles, as is the case with private philanthropy, which is often faster and more innovative. The challenge for DFIs in this constantly changing world will be to maintain their role as the cornerstone of development finance. They must remain agile enough to work with public actors, philanthropists and private financiers so that as many resources as possible are invested in the SDGs. All of this is highly ambitious but realistic – DFIs often have an untapped wealth of ideas, talent, experience and networks.

DFIs therefore need to transform to increase their mobilisation capacity. They could possibly do this by focusing on new technologies to free up their currently constrained resources, particularly with a view to achieving efficiency for every euro invested and mobilised (whether with governments or private actors). By financing innovation on a larger scale – even if this means insisting upon more rights to make mistakes. We must also remove obstacles to action, which are often due to the accumulation of standards and regulations. To successfully make these adjustments in an increasingly complex world, it is essential to strengthen the partnership approach, a proof of collective intelligence, provided it does not hinder the speed of implementation, particularly with private actors in the North and South – and more specifically with those who finance the local and regional economy, such as local insurance funds, provident funds and pension funds.

It is by drawing up this largely positive assessment of the actions of European DFIs, but also by pointing out some of the necessary adjustments, that their role and added value for the future can be estimated. At a time when public budgets earmarked for development funding are being cut, the geopolitical context is becoming more complex and multilateralism is in crisis, it is essential to continue the changes initiated as part of a collective approach and to consolidate the effectiveness of European DFIs. ■

> ***“To help achieve the SDGs and accelerate the transition, DFIs must meet the dual challenges of building a more partnership-based and systematic approach with private finance players, while also being in a position to take on the necessary risk to finance new solutions.”***

DFIs’ key role in climate-change resilience

Chiara Trabacchi, Climate change manager, British International Investment (BII)

The climate challenge is daunting but technological progress and cost reductions are opening new investment opportunities all the time. We can look forward to a golden decade of climate investing.

It is easy to fall prey to pessimism. The consequences of global warming are increasingly evident; greenhouse emissions continue to rise; and as demonstrated at COP29 (2024), the global coalition for action is teetering. To counter this, the 2025 Fourth International Conference on Financing for Development (FfD4) must aim for consensus and make real action commitments. On finance and looking to solutions, there are abundant opportunities ahead to mitigate and adapt to climate change. Development Finance institutions (DFIs) are playing a big role in catalysing climate investing, with new opportunities emerging constantly. The underlying reasons for optimism are technological innovations and cost reductions, making investments to decarbonise economies and adapt to the changing climate increasingly commercially attractive. The first job of DFIs is to help markets in the early stages – supporting pioneering climate technologies and business models – and to invest in more established technologies (e.g. wind and solar) in countries where private markets are relatively immature. Such investments are set to dominate climate finance in the near term: renewable energy generation, transmission and storage in the largest and most emissive middle-income economies. Examples are the Suez wind project in Egypt (financed by a consortium of DFIs) and South Africa’s Red Sands standalone battery project (by Globeleq, co-owned by BII and Norfund). The second job of DFIs is to facilitate private investment in projects such as these and their respective markets. Here, blended finance tools can bring opportunities in line with institutional investors’ risk-return requirements. Investments in energy systems are the most visible, but they are just the beginning of what DFIs can deliver. Climate investing needs to permeate every aspect of economies. Four areas stand out however: innovation, the financial sector, nature-based solutions, and adaptation and resilience.

DFIs as launchpads for private investment

Because DFIs exist to take risk for development they are ideal supporters of venture capital funds and other early-stage investment vehicles. These, in turn, back the entrepreneurs pioneering new climate technologies and business models. DFIs can also help green local financial sectors by supporting banks and other financial actors to introduce and grow new climate lending lines, by offering both technical assistance and capital for on-lending, on terms that share the risks and incentivise climate investments. Another important challenge is biodiversity protection and restoration. Already, DFIs are the most significant supporters of sustainable forestry in many countries, and are well-placed to support new enterprises to seize opportunities for nature-based solutions, created by the voluntary carbon credit trading framework, agreed at last year’s COP. Finally, there is the enormous opportunity of “adaptation and resilience” (A&R). While many investments needed to help society and ecosystems to adapt to climate change fall within the public sector, A&R is also a commercial proposition. Businesses must protect their activities against climate-related risks, and these investments offer high returns – the Global Commission on Adaptation estimates that cost-benefit ratios are between 2:1 and 10:1.[1] There is an estimated $2trillion market opportunity to meet that demand, which private investors cannot ignore.[2] Not adapting will impact food, water and energy security and economic growth. DFIs are already investing to decarbonise economies and help communities deal with the impacts of climate change. In the coming decade, they must scale up operations to seize additional opportunities.

1 › Adapt now: a global call for leadership on Climate Resilience (Global Commission on Adaptation)
2 › World Economic Forum (2022)

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FOCUS
BII

BII is the UK’s development finance institution and impact investor, with a mission to help solve the biggest global development challenges by investing patient, flexible capital to support private sector growth and innovation. BII invests to create more productive, sustainable and inclusive economies in Africa, Asia and the Caribbean, enabling people in these countries to build better lives for themselves and their communities.

SPOTLIGHT

Blended finance should be seen as a success

Paddy Carter, Head of Development Economics, BII
Jean-Baptiste Sabatié, Deputy CEO, Proparco

The FFD4 conference in Seville should avoid both unrealistic optimism and unwarranted negativity about blended finance. It is not a magic wand, it is a tool that enables DFIs to make more high impact investments, and to attract private capital at scale to markets that lack it. DFIs have made real progress over the last decade, evolving their business models and creating structures to deploy blended finance effectively.

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PROPARCO

Proparco is a subsidiary of Agence française de développement (AFD), focused on private sector development. It has been promoting sustainable economic, social and environmental development practices for over 45 years. Proparco provides funding and support to both businesses and financial institutions across Africa, Asia, Latin America and the Middle-East. Its actions focus on key development sectors including infrastructure (with a specific focus on renewable energies), agribusiness, financial institutions, healthcare and education. It aims to boost the contribution of the private sector to achieving the Sustainable Development Goals, adopted by the international community in 2015.

The consulting firm Gartner coined the idea of a "hype cycle" for new technologies. Early proof-of-concept stories and media interest lead to a "peak of inflated expectations", only to be followed by a "trough of disillusionment" after reality falls short of the hype. But then, as benefits start to crystalise and products mature, comes the "slope of enlightenment", followed by "the plateau of productivity".

In February 2025 the OECD held its Private Finance for Sustainable Development conference, and, from panel to roundtable, conversations about blended finance and mobilizing private finance started with the same question: why are we failing?[1] Such despondency is unwarranted. It is time for the conversation around blended finance to escape the trough of disillusionment and turn towards enlightenment.

Blended finance is already helping development finance institutions (DFIs) have an impact on an ever-greater scale. DFIs exist to increase the quantity and quality of investment in private enterprises in low- and middle-income countries. That is because economic and social development, the eradication of poverty in all its forms, and the transition to environmental sustainability all need private investment (among other many things). Blended finance succeeds whenever it is used to deliver additional private investments with positive social impacts efficiently. The most recently available data (from MDBs and DFIs), showed a 12 per cent annual increase in mobilized private long-term finance in 2022, to $63bn.[2] Under the headline numbers will be numerous examples of blended finance being used successfully to achieve impact.

LAYING THE GROUNDWORK

But blended finance aspires to something more than co-investment between DFIs and private investors. When DFIs support an infrastructure project in a frontier market that includes some long-term lending from local banks, the hope is that those banks will take something positive from the experience and want to take on similar projects. The anticipated result should be an increased supply of long-term capital from the local financial sector. When DFIs create financial structures tailored to the needs of regulated institutional investors from OECD countries, the hope is also that those structures will be replicated and scaled, increasing the supply of capital in markets where it is lacking. DFI's want to push back the frontiers of where global capital will go.

It is here that progress has been slower. There are successful examples, but these efforts generally have not scaled as rapidly as might have been hoped for. The optimistic view, however, is that the groundwork has now been done, and we have begun to climb the slope towards the "plateau of productivity". Building on pioneering efforts such as the IFC's managed co-lending portfolio platform, the Emerging Africa & Asia Infrastructure Fund, and the Danish SDG fund, DFIs have created several structures that should now start to deploy private capital at increasing scale. Examples include the Asian Development Bank's "Innovative Finance Facility for Climate in Asia and the Pacific", a multi-donor financing partnership with the ambition of mobilising over $12bn, the $1.1bn SDG Loan Fund created by FMO, Allianz, and Skandia, and the "Scaling4Impact" $1bn securitisation of IDB Invest's portfolio, involving Newmarket, Axis and AXA. The ILX Fund, a private debt fund that offers B-loan participation in investments originated by DFIs – which launched its first fund in 2022 with the backing of Europe's largest pensions fund manager, APG – launched its second fund in 2024. BII has recently launched a competition for asset managers to bring forward their best ideas to leverage concessional capital from a new Mobilisation Facility, for scalability and impact.

DEMAND-SIDE CONSTRAINTS

This is a story of what Hans Peter Lankes, Managing Director of the think tank ODI Global, calls "micro success amid macro failure". The big picture, as seen in data on cross-border capital flows, does not show investment volumes rising rapidly, as accelerated progress towards the SDGs requires. Blended finance can push against macroeconomic forces, such as global monetary tightening and the "polycrisis", which have done such damage to emerging and frontier economies, but it cannot overpower them. The idea that supply-side interventions, such as blended finance, could simply "redirect" the trillions of assets under management in rich countries towards the developing world was always misconceived. Private finance needs businesses that want to raise capital to finance investments. It is the demand side that ultimately constrains how much investment blended finance can facilitate. That is why we need more resources for "upstream" policy work and project development. At the same time as some are lamenting the failure of blended finance to scale, at the FFD4 conference in Seville, we will hear concerns that too much attention is being paid to scale and not enough to impact. Those concerns are misplaced. It is hard to think of investments that have a greater impact on mitigating global heating than those which decarbonise the big emissive economies of middle-income countries. This is where blended finance is mainly being deployed at scale today. But mobilising private finance in markets where a shortage of suitable capital is holding back development is not the only function of blended finance. DFIs also use concessional capital to make high impact investments that they otherwise could not have made. Most DFIs are required by their shareholders to stay within agreed financial parameters. Some have credit ratings to protect and must comply with regulations. By blending their main balance sheet with more concessional pools of capital, DFIs can push further into frontier markets. Those investments are often smaller, and they do not always involve private investors in the initial transaction, so they are less evident in reported mobilization statistics. But they bring firms and markets closer to the point where they can attract private investment. Mobilization at scale, and capital market development more broadly, is an important objective. But there is no question about what comes first – it is impact.

AN ARTICLE BY
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JEAN-BAPTISTE SABATIÉ

Jean-Baptiste Sabatié has been Proparco's Deputy CEO since July 2024. He has close to 25 years of experience in the field of public and private sector impact finance. He joined Proparco's commitments department in 2009 before taking up the position of Chief Risk Officer from 2012 to 2014. He was then Deputy Secretary General of the institution until his move towards the international network of the French Development Agency (AFD) in summer 2016. In the summer of 2020, he left his functions as regional director for Mexico, Cuba and Central America, as well as country director for Mexico, to join AFD's headquarters. Until taking up his current position, he was AFD's Director of Transformation, responsible in particular for steering and implementing the AFD Group's transformation program. Jean-Baptiste Sabatié is a graduate of ESCP Europe.

1 ‣ https://www.oecd-events.org/cop-pf4sd-2025conf
2 ‣ https://www.eib.org/attachments/press/mdb-joint-report-mobilization-of-private-finance-2022.pdf

Private sector finance for development - pitfalls and opportunities

Homi Kharas, Senior Fellow, Center for Sustainable Development, Brookings Institution

Ambitious countries are putting in place platforms for attracting finance and developing projects. Aided by blended finance, the results are encouraging: losses on long-term investments in publicly-supported infrastructure in developing countries are smaller than those in many advanced economies.

Private finance contributes to development by financing new investments, enabling entrepreneurship and innovation, and creating jobs. It is driven by markets, profit, and risk. Most private finance in developing countries is via foreign direct investment (FDI). However, FDI may not be aligned with national economic development priorities. Hence, in this paper, the term "private finance for development" refers to privately-sourced finance that is used for publicly approved development projects.

The largest component of private finance for development is net transfers of privately-sourced public sector or publicly-guaranteed debt. Net transfers show how privately sourced bonds and bank credit contribute to new investments. They comprise gross disbursements of loans less interest and principal repayments.

Some features stand out from the data on net transfers reported by the World Bank's International Debt Statistics. First, private capital flows were relatively small in most regions for the period 1990-2000. Recently, they have increased, notably to sub-Saharan African countries. Second, private capital flows have been highly volatile in every region. Third, the most recent cycle, the post-COVID-19 period, produced large negative transfers for all regions. These had turned around by 2023, except in Africa and Latin America, suggesting that private financing may be experiencing an upswing.

To feature more prominently in sustainable development, private finance must be enlarged and become more stable. This can happen only if the cost of capital comes down, and if risk and the perception thereof is lowered.

> **"To feature more prominently in sustainable development, private finance must be enlarged and become more stable. This can happen only if the cost of capital comes down, and if risk and the perception thereof is lowered."**

WHY IS PRIVATE FINANCE SO STUCK?

Limited information on developing countries. Private finance flows most easily where there is reliable and accessible information on risks and returns. The conventional view is that investments in emerging markets are high risk, yet asset managers do not have access to sufficiently disaggregated data to incorporate risk metrics into their asset allocation models. The credit risk information architecture in developing countries is very underdeveloped.

This is starting to change. The Global Emerging Markets Risk (GEMs) database consortium has released new reports on the credit performance of lending to private and public entities in developing countries[1]. It suggests that lending to private companies in emerging markets is equivalent to lending to non-investment grade firms in advanced economies – with annual default risk of 3.56% and loss-given-default of 27.8%.

However, experience with lending to projects that are carried out by the public sector or that have a public guarantee has been far better. The annual default rate here has been 1.06%, and the loss-given-default rate, 5.1%. Yet, awareness of this data is poor. A survey conducted on behalf of the International Finance Corporation (IFC) showed that almost two-thirds of respondents were unaware of GEMs.[2] Confidentiality concerns continue to limit the expansion and dissemination of such databases, which is regrettable considering their potential role in private finance for development.

Regulatory constraints. Good credit information is institutionalized in financial regulations, specifically Basel III (for banks) and Solvency 2 (for insurance companies). Under Basel III, capital cover for each loan depends on the assessed risk. Without detailed credit registries – unavailable in many EMDEs – the risk weighting depends on generic values, which tend to be conservative. Basel III also incorporates the liquidity requirements of a Net Stable Funding Ratio, which encourages banks to use the cost of long-term liabilities as the basis for their long-term loans, raising the cost of lending.[3] Long-term loans for infrastructure in developing countries have a trifecta of risks under Basel III that raise the cost of capital for such projects. Hence, since Basel III's adoption, banks have cut back lending to these infrastructure projects.

While this has happened everywhere, it has had a disproportionate impact in developing countries. In advanced economies, bond finance has substituted for bank loans – which has not been possible in most developing countries.

Similarly, Solvency 2 makes long-term financing for development from insurers and reinsurers more expensive by highlighting political and regulatory uncertainty, construction risk, and low levels of liquidity. With both Basel III and Solvency 2, data-driven risk assessments by sector and location would permit investment allocations to be based on actual risks and returns, rather than on perceptions and anecdotes.

The pipeline development quandary. An oft-cited bottleneck for private finance is the lack of "bankable" projects. Already in 2015, the Addis Ababa Action Agenda highlighted potential difficulties in implementing the Sustainable Development Goals: "insufficient investment is due, in part, to … an insufficient number of well-prepared investment projects."[4] Without bankable projects and structures for private capital to flow, no one will incur the up-front cost of developing these projects (estimated at 5%+ of project costs). →

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1 ▸ https://www.eib.org/en/press/all/2024-373-new-publications-by-gems-consortium-offer-further-insights-into-emerging-market-credit-risk
2 ▸ https://www.gemsriskdatabase.org/wp-content/uploads/2024/11/IFC-GEMs-Report.pdf
3 ▸ https://www.brookings.edu/wp-content/uploads/2024/12/For-The-Worlds-Profit-07-Ch07.pdf
4 ▸ https://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

PRIVATE SECTOR FINANCE
FOR DEVELOPMENT - PITFALLS
AND OPPORTUNITIES

FOCUS
CENTER FOR SUSTAINABLE DEVELOPMENT

Launched in 2020 by the Global Economy and Development program at Brookings, the Center for Sustainable Development (CSD) generates leading research and insights to advance global sustainable development and implement the Sustainable Development Goals (SDGs) within and across all countries.

Efforts have been made to scale up project development. A Global Infrastructure Facility was created in 2014, with the support of the G20. In its first ten years of operation, it mobilized around $71 billion in private finance across 67 countries ($7 billion per year).[5] Yet, 40-80 such facilities would be needed to reach the scale required.[6]

While there are benefits from global and regional project development facilities, a more efficient future path would be to locate these in developing countries. The World Bank reports that 13 developing countries now have government-sponsored and -funded project development facilities to attract private finance for infrastructure. However, they do not fully recover their costs and are thus constrained from scaling up. They also face specific challenges with small-scale projects and with cross-subsidizing project preparation where projects fail to advance to financial close.[7] Work is needed to develop bankable projects. The IFC has had some success by reorienting 30% of its analytical support to upstream activities – work designed to advance projects to private investment within five years.[8] Similar activities throughout the private finance ecosystem are needed.

Absence of scalable risk mitigation instruments. Several project risks are outside the control of private investors – for example, political, regulatory, construction/land/permit-related and foreign exchange risks. Transferring these risks to insurers and guarantee agencies can be expensive and time-consuming. An alternative is to transfer risks to governments through blended finance. The historical experience with structuring blended finance deals has been summarized in Convergence's State of Blended Finance 2024 report.[9] It cites annual average investment totaling $15 billion over the last decade but recognizes difficulties with discerning time trends due to discrete changes in country situations.

Blended finance requires concessional resources. Deployment of these has varied. Convergence identifies four typical structures: provision of loans and equity; guarantees and insurance; grants for project preparation and design; and technical assistance grants for policy and regulatory reform and strengthening. Noted by Convergence is the limited expansion in official development assistance (ODA) for blending since 2018, with a drop-off of 45% due to reduced activities in Ukraine. Blended finance helps mobilize private and official finance. To date, $1 of concessional finance has mobilized $1.8 dollars of private finance and $2.3 of official non-concessional finance,[10] which in blended finance transactions, mostly comes from multilateral lenders. Bilateral lenders increased their exposure to developing countries by just 3% during 2015-2023. During this period, it was reduced in upper-middle-income countries and increased in lower-middle-income countries.

Underdeveloped domestic financial markets. Currency risk poses a particular challenge. Private financiers must address credit risk with revenue in local currency but with liabilities in foreign currency. This is minimized where projects can access domestic finance, which is becoming increasingly available from public development banks. About 530 of these now account for 10% of global investment.[11] Under the umbrella of Finance in Common, these (many in the Global South) provide solutions and partnerships that reflect domestic conditions. Their support includes participation and leadership platforms, dialogue with government counterparts on policy and regulatory reform, and mobilization and prioritization of concessional aid to overcome investment bottlenecks.

With local financiers as trusted partners, foreign private finance becomes easier to mobilize.

5 ‣ https://www.globalinfrafacility.org/
6 ‣ https://icrier.org/g20-ieg/pdf/The_Triple_Agenda_G20-IEG_Report_Volume2_2023.pdf
7 ‣ https://documents1.worldbank.org/curated/en/099053124132550754/pdf/P1792711a64e3000c192d81d6c646824c90.pdf
8 ‣ https://www.ifc.org/en/what-we-do/sector-expertise/creating-business-creating-opportunities#faqs
9 ‣ Convergence – State of blended finance (2024)
10 ‣ Ibid.
11 ‣ https://www.e3g.org/news/finance-in-common-2025-a-springboard-to-delivery-on-climate-and-development-goals-e3g-media-advisory/

A WAY FORWARD

Notwithstanding the headwinds limiting private finance for development, there is considerable potential. New initiatives exemplify mobilizing private finance at the project level. These include entities like the Green Guarantee Company[12] and the Investment Mobilization Collaboration Agreement.[13] The need is to shift from individual transactions to partnerships on priority development programs. In partnerships, investors can scale their activities and reduce their risks so that finance flows in larger volumes, making it cheaper and less volatile.

Two innovations for scaling are promising:

1. New-style country platforms. Ambitious countries are putting in place platforms for prioritizing investment. These develop projects and organize dialogues on policy and institutional bottlenecks in executing projects. They scale projects into programmatic solutions. While still to be tested for providing the institutional backbone for systemic change over long periods, they offer a way of programming and executing at scale. They will provide opportunities for learning.

2. Better mobilization and private finance cost reduction. Blended pools of capital have proven attractive for projects. There is now a risk history of actual default and loss-given-default in specific geographies and sectors on which to base asset allocation models. The experience is encouraging: losses on long-term investments in publicly-supported infrastructure in developing countries are smaller than those in many advanced economies. Granular data on this remains to be made more available to the public. These data, and their inclusion in risk models and regulations, are necessary for institutional capital to be deployed in developing countries. The pooling of multiple sources of capital can then create suitable portfolios of finance for sustainable development at scale.

> ***“Already in 2015, the Addis Ababa Action Agenda highlighted potential difficulties in implementing the Sustainable Development Goals (...). Without bankable projects and structures for private capital to flow, no one will incur the up-front cost of developing these projects (estimated at 5%+ of project costs).”***

12 ‣ https://greenguarantee.co/green-guarantee-climate-finance/
13 ‣ https://openaid.um.dk/project/XM-DAC-3-1-288717?appBasePath=projects

Sustainable investment in emerging markets and developing economies: mobilising institutional capital

Samantha Attridge, Principal Research Fellow, ODI Global

Sustainable investment is crucial for aligning financial returns with positive social and environmental impacts, especially in emerging markets and developing economies (EMDEs). Despite their strong financial performance and critical role in global growth and climate action, institutional investors remain underexposed to these markets due to liquidity concerns, regulatory barriers, and risk perceptions. Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs) help bridge this gap by providing market insights and mitigating risks. Unlocking EMDE investment at scale requires regulatory reform, investor leadership, and behavioural change.

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Sustainable investment is gaining momentum worldwide, driven by the need to align financial returns with positive outcomes for people and the planet. This shift is not just a trend – it is an essential path forward. The world faces pressing challenges that demand urgent action, from climate change to poverty alleviation and social inequality. Emerging markets and developing economies (EMDEs) must be at the centre of these efforts. These regions are not just financial frontiers offering institutional investors such as pension funds and insurance companies growth and diversification benefits; they are the battlegrounds for climate action, poverty alleviation, and social progress. The potential to leverage growing investor interest in sustainability for the benefit of both people and the planet is immense.

EMDEs: A STRONG INVESTMENT CASE

There is a compelling investment case for allocating more capital to EMDEs. Research by ODI Global[1] has found that since 2010, emerging market bonds have consistently outperformed their developed market counterparts. Furthermore, over the past two decades, emerging market equities have delivered returns on a par with, or in some cases exceeding, those of developed markets – excluding the United States. Despite these strong performance indicators, institutional investors continue to under allocate capital to EMDEs, thereby missing out on significant diversification benefits and long-term growth opportunities.

The typical allocation from insurance companies ranges from 0% to 5%, while pension funds allocate between 5% and 15% of their portfolios. One of the key challenges is that EMDE investments are often illiquid, making them less attractive to institutional investors, who prefer liquid, easy-to-exit positions. Additionally, many EMDEs lack well-developed capital markets, which limits the ability of investors to trade securities freely. As a result, most investment in EMDEs is channelled into a handful of more-developed, large emerging markets like China, India, and Brazil, while smaller-, middle- and lower-income economies – where capital could drive the most impact – are largely overlooked.

A recent analysis by Morgan Stanley[2] highlights this underinvestment, revealing that traditional allocation strategies significantly underweight emerging markets. Their models indicate that typical emerging market exposure is just one-sixth of what would be recommended by an optimal allocation strategy. This under allocation means that investors are foregoing substantial potential gains, particularly as EMDEs are projected to drive global growth in the coming decades. These markets currently contribute over 60%[3] of global GDP and represent a rising share of global market capitalisation.

As Europe grapples with an ageing workforce and stagnant productivity growth, institutional investors seeking to meet future pension obligations must look beyond the region's limited economic prospects. Projections suggest that Europe's GDP growth will average only 1.45%[4] annually through 2029, compared to 2.29% in the United States and an even more robust 5-6% in EMDEs. The global economic landscape is shifting, and investors who fail to embrace the opportunities presented by EMDEs risk being left behind in an era of rapid transformation.

MDBs AND DFIs PLAY A CRITICAL ROLE

Institutional investors face a number of EMDE investment hurdles and they can rely on MDBs and DFIs to navigate these. The key role of MDBs and DFIs in enabling access to high-return, transformative investment opportunities is briefly outlined below:

Providing market insights and risk mitigation

Institutional investors often hesitate to enter EMDE markets due to unfamiliarity and an exaggerated perception of risk. But the experience of MDBs and DFIs tells a different story. These institutions have a proven track record in private asset investment across EMDEs. Their deep expertise translates into invaluable credit risk insights, captured in the GEMS[5] dataset - a repository of default and recovery data from 21 MDBs and DFIs.

The latest GEMS release (October 2024) challenges common risk misconceptions. It reveals that MDB/DFI private debt loss rates in EMDEs are lower than widely assumed, with an average annual default rate of 3.56% over the past decade – comparable to non-investment-grade firms in advanced economies. Even more compelling, recovery rates stand at a solid 72.2%, outperforming many global benchmarks.

MDBs and DFIs don't just provide data – they actively de-risk EMDE investments. With unmatched market knowledge, on-the-ground presence, and a suite of risk-mitigation tools – including guarantees, political risk insurance, and blended finance structures – they pave the way for institutional investors to confidently step into EMDEs.

It is time to rethink EMDE risk – backed by data, not perception. MDBs and DFIs must intensify their efforts on data. Investing in robust, transparent and standardised data systems is key to bridging this gap. Two game-changing areas for MDB and DFI improvement include: (1) granular GEMS risk data – essential for accurate risk modelling and pricing; and (2) harmonised ESG and impact metrics – aligning with regulations and investor expectations. →

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ODI GLOBAL

ODI Global is an independent, global think tank. It leads thinking and agendas to deliver transformational change and bring about a global sense of resilient, just and equitable prosperity. The mission of ODI is to inspire and inform policy and practice which lead to the reduction of poverty, the alleviation of suffering and the achievement of sustainable livelihoods in developing countries. ODI Global works with partners in the public and private sectors, in both developing and developed countries.

1 ‣ https://odi.org/en/publications/trillions-or-billions-reassessing-the-potential-for-european-institutional-investment-in-emerging-markets-and-developing-economies/

2 ‣ See: https://www.morganstanley.com/im/publication/insights/articles/article_howmuchtoown_us.pdf
3 ‣ https://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/ADVEC/WEOWORLD
4 ‣ https://www.ft.com/content/a16868a8-44cc-4fe8-a51c-c079fb20ccda?sharetype=gift
5 ‣ See: https://www.gemsriskdatabase.org/#Default and recovery statistics- Private and public lending

Structuring products to meet the needs of institutional investors
Institutional investors seek competitive, risk-adjusted returns when making allocation decisions. To attract capital, EMDE investments must align with these expectations - offering competitive returns while addressing perceived risks. The key? Large-scale, investment-grade products backed by diversified asset pools with robust ESG and impact reporting. MDBs and DFIs play a crucial role in making this happen. By originating and structuring assets—often through collaboration—they create pooled investment vehicles that meet institutional standards, unlocking new opportunities in EMDEs.

> *One of the key challenges is that EMDE investments are often illiquid, making them less attractive to institutional investors, who prefer liquid, easy-to-exit positions.*

Reducing costs and expanding opportunities
Investing in EMDEs is often costly due to higher transaction costs in private markets and limited opportunities in public markets, leading to an over-reliance on private investments. MDBs and DFIs can help lower costs by originating lower cost investment opportunities, pooling assets, and syndicating deals with private asset managers.

Strong ESG and Impact Frameworks
Institutional investors face growing pressure to integrate sustainability into their decision-making. Yet, reliable ESG and impact data in EMDEs remains a major hurdle. This is where MDBs and DFIs step in. With their well-established ESG and impact frameworks, they help ensure that investment opportunities align with global sustainability standards – bridging the data gap and enabling smarter, more responsible capital allocation.

RETHINKING REGULATION AND ADDRESSING BEHAVIOURAL BIAS

However, to truly unlock investment in EMDEs at scale, we must look beyond MDBs and DFIs and dismantle the systemic barriers – both regulatory and cultural – that are holding capital back. Europe's regulatory framework unintentionally penalises EMDE investments. Take Solvency II – its capital charges for non-OECD infrastructure debt are misaligned with actual credit risk. Due to data limitations during its 2016 calibration, a blanket 13% charge was applied to unrated 10-year non-OECD infrastructure project loans. Yet, newer Moody's data suggests that loss rates in Lower- and Middle-Income Countries (LMICs) are comparable to, or even lower than, those in High-Income Countries (HICs). A 2020 recalibration study[6] found that African MICs and HICs warrant a charge as low as 4% – a stark contrast to the outdated 13%. It's time to revisit these capital requirements.

Another issue is Solvency II's 'matching adjustment', which helps insurers manage liquidity risk but applies only to investment-grade assets. With most EMDE sovereigns rated below BBB, hovering around BB- , this creates an artificial cliff, reinforcing a bias toward Developed markets. EU regulators must reassess this threshold.

On sustainability, new EU finance regulations also tilt the playing field. The Green Asset Ratio (GAR) excludes non-EU green investments from its numerator but includes them in its denominator. This means European DFIs like FMO and others who issue debt but who invest outside the EU – despite extensive sustainable EMDE investments – could register a 0% GAR. Both FMO[7] and EIB[8] have recently raised concerns about the reputational risks associated with this new regulation.

6 ‣ See: https://cdn.gihub.org/umbraco/media/3466/infrastructure-debt-capital-charges-for-insurers.pdf
7 ‣ See: https://www.ft.com/content/8c1657fb-2024-4a3b-bb82-1562fddcdc51
8 ‣ See: https://www.ft.com/content/12399810-a782-465b-8378-5099252306a5

Regulation is not always the issue. In major European pension markets, the bigger challenge is behavioural investor bias and ingrained conservatism. UK pension funds, for example, allocate a mere 0.5% of assets under management to EMDEs, despite no regulatory restrictions. Home-market familiarity and fiduciary caution often lead to a preference for domestic or nearby markets[9], where investors have easier access to information.

CHARTING THE WAY FORWARD

Change requires political and investor leadership. The Netherlands provides a blueprint – strong government direction and proactive regulatory support have transformed its financial system into a leader in EMDE and impact investing. The UK is now taking steps in that direction, with the Institutional Investor Group on Climate Change new report[10] setting out concrete actions in three key areas:

- Political and Industry Leadership – UK Chancellor, Foreign Secretary, and top asset owners/CEOs must set a clear investment agenda.
- Industry-led steering committee – A dedicated body to drive initiatives, including capacity-building and regulatory assessment.
- Data transparency and standardisation – Regulators and industry players must collaborate to bridge information gaps and facilitate informed investment.

These initiatives set a powerful example. They should spur action worldwide and inspire the preparatory process of the United Nations Fourth International Conference on Financing for Development, which will be held in Seville (June/July 2025). It is important to be pragmatic about what is achievable – but even more so, the agreement must lay the foundation to inspire and drive systemic and behavioural change. Securing broad buy-in from key stakeholders beyond the development finance community will be essential to making real progress.

Mobilising greater investment in EMDEs is essential for achieving the Sustainable Development Goals and fostering global economic resilience. Addressing regulatory barriers, enhancing investor engagement, improving data availability, and leveraging the expertise of MDBs and DFIs will be key to unlocking this potential. With strong leadership and a commitment to innovation, institutional investors can play a transformative role in financing the future of EMDEs, while securing long-term, sustainable returns.

> *To truly unlock investment in EMDEs at scale, we must look beyond MDBs and DFIs and dismantle the systemic barriers – both regulatory and cultural – that are holding capital back. Europe's regulatory framework unintentionally penalises EMDE investments.*

9 ‣ See: https://symbioticsgroup.com/publications/misperception-risk-emerging-markets/
10 ‣ See: https://www.iigcc.org/resources/report-uk-climate-finance-hub-2025

ANALYSIS

Development finance institutions: new directions for the future

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DFIs have grown in scale and influence, blending public and private finance to drive development impact. They support ESG integration and foster innovation through blended tools, but face limits in risk appetite, mandate overload, and coordination. As global needs shift, DFIs must evolve: focusing on SDG transitions, ecosystem building, and inclusive digital and green transformation—backed by agile governance, strategic partnerships, and adaptive risk models.

Development Finance Institutions (DFIs) stand at a critical crossroads, balancing public interest and private capital amid escalating global crises—climate change, inequality, geopolitical instability, and financial volatility. Over the past two decades, they have expanded in scale and ambition, but now may risk stagnating in a model that favours optimisation over transformation. The familiar pillars of additionality, risk, mobilisation, and impact, once drivers of innovation, increasingly serve to justify incrementalism and maintain the status quo. As tensions grow between financial discipline and developmental ambition, the sector faces a defining choice: refine existing models or embrace a catalytic role in reshaping development finance. Meeting this moment requires more than new instruments—it demands a redefinition of DFIs' institutional purpose. This analysis offers a strategic framework to guide that shift, grounded in field realities and aimed at repositioning DFIs as agents of systemic change.

> *DFIs are recognised as essential actors by governments, the private sector, and civil society alike, yet doubts are intensifying over their capacity to live up to the demands of the current era.*

1 • https://www.afd.fr/en/ressources/development-finance-institutions-new-directions-future

FIT FOR THE FUTURE?

The rapid expansion of DFIs over the past twenty years reflects a growing consensus around the value of development-oriented finance. More than 500 DFIs now exist globally, including bilateral institutions and public development banks. With mandates to mobilise private investment in underserved sectors and geographies, these institutions have deployed an expanding toolkit—loans, equity, guarantees, and technical assistance—to catalyse activity where commercial actors hesitate. Their counter-cyclical role has made them reliable partners during crises, capable of sustaining flows in volatile contexts. Between 2002 and 2014, DFI commitments rose sevenfold, reaching USD 70 billion annually. By 2021, that figure exceeded USD 90 billion. The emergence of new players, such as FinDev Canada and the US International Development Finance Corporation, signals a widening appetite for public-private financial leverage.

Yet this trajectory masks deeper tensions. While the volume of activity has increased, many question whether DFIs are structurally equipped to respond to the complexity of today's development challenges. Climate change, digital transformation, migration, and fragile statehood demand flexible, system-aware interventions. However, DFIs often operate within risk-averse investment committees and accountability frameworks more attuned to financial performance than developmental disruption. Interviews conducted across the sector highlight a persistent confidence gap: institutions are unsure how far they can deviate from traditional norms without losing credibility, capital, or political support.

The result is a paradox. Institutions designed to act where markets fail increasingly resemble the very markets they were meant to complement. Financial prudence often trumps strategic boldness. This structural drift toward incrementalism threatens to limit DFIs' transformative potential. The imperative now is to shift not only the volume of investment but its nature—towards a purpose-driven, transition-oriented finance that shapes markets rather than just enters them.

This study focuses on international DFIs with cross-border mandates, including Proparco, BII, BIO, DEG, IFC, and EBRD, while excluding domestic or export-focused institutions and Chinese policy banks (except for contrast). Insights were drawn from 25 interviews with senior professionals across DFIs, private funds, and civil society. Using the "Three Box Strategy" framework—managing the present, letting go of outdated habits, and creating future practices—the analysis explores what constrains and enables DFI evolution, reflecting a shared sense that institutional renewal is both necessary and overdue.

VOICES OF RECORD

The interviews conducted for this study reveal a development finance landscape rich in capability but troubled by growing internal unease. DFIs are recognised as essential actors by governments, the private sector, and civil society alike, yet doubts are intensifying over their capacity to live up to the demands of the current era. What emerges is a set of overlapping narratives: pride in institutional strengths, concern over operational rigidity, frustration with proliferating mandates, and convergence around unresolved contradictions. These voices expose the tension between ambition and structure, between public mission and institutional behaviour. →

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> *“DFIs are widely appreciated for their ability to sustain investment in volatile contexts. Their counter-cyclical function—stepping in when private actors withdraw—gives them a stabilising role that few institutions can match.”*

What works well: the strengths of DFIs

DFIs are widely appreciated for their ability to sustain investment in volatile contexts. Their counter-cyclical function—stepping in when private actors withdraw—gives them a stabilising role that few institutions can match. This credibility has been earned through long-term engagement in difficult environments, often underpinned by political mandates that prioritise resilience over rapid returns.

They are also recognised as pioneers of financial innovation. Blended finance, risk-sharing instruments, early-stage equity, and performance-linked guarantees were often developed or scaled with DFI involvement. Their long time horizon allows them to structure deals that support systemic change, rather than chase short-term yields. DFIs act as market signalers, validating sectors or regions previously considered too risky or opaque, and encouraging others to follow. In doing so, they bridge the often-separate worlds of public mandate and private capital.

Beyond financing, DFIs contribute to setting the rules of the game. Their ESG standards, safeguards, and approaches to impact measurement have become benchmarks across the field. Interviewees repeatedly noted the positive influence DFIs exert through non-financial dimensions: coaching entrepreneurs, strengthening institutions, and funding ecosystem infrastructure. Their role in enabling local capacities—through business development services, intermediaries, and accelerators—was cited as particularly valuable, albeit under-recognised in public narratives. Their credibility is not just technical but relational: over time, DFIs have earned a reputation as reliable, long-term partners in fragile and uncertain contexts. This status as "patient capital" providers gives them unique influence and trust across both public and private actors in the development space.

Concerns and disappointments : institutional limitations

Alongside their strengths, DFIs face growing criticism from within and beyond their walls. Foremost among the concerns is a structural aversion to risk. While DFIs are mandated to operate in difficult environments, internal processes increasingly mirror those of commercial banks. Investment committees often reject proposals with high developmental potential if they fall outside narrow financial thresholds. This conservatism reflects both internal cultures and external expectations, especially from shareholders focused on capital preservation and financial sustainability.

The bureaucratisation of operations was another recurring theme. As DFIs grow, they tend to become more hierarchical, rules-based, and compliance-driven. Decision-making slows, innovation stalls, and frontline staff lose autonomy. Multiple interviewees described a shift from purpose-driven initiative to process-bound inertia. Rather than creating space for calculated experimentation, institutional systems default to control, risk minimisation, and regulatory shielding.

This institutional rigidity has direct consequences on portfolio composition. DFIs often underinvest in fragile, low-income, or conflict-affected contexts—not due to lack of mandate or need, but because internal mechanisms are ill-adapted to volatility and uncertainty. Instead, they concentrate on middle-income countries and commercially viable sectors where other investors are already active. The aspiration to be catalytic risks giving way to competition with commercial finance, raising questions about whether DFIs are truly operating in the spaces that need them most.

Fragmentation was also cited as a limiting factor. DFIs often act independently, even when addressing similar challenges in the same countries. Coordination with other development actors, including multilateral banks and national agencies, remains limited. The result is duplication, inefficiency, and a dilution of systemic impact. Some interviewees expressed disappointment at missed opportunities for collective action and learning across the ecosystem.

Rising expectations: missions that are multiplaying

The scope of DFI mandates has expanded dramatically in recent years. In addition to private sector development and economic growth, DFIs are now expected to deliver on climate action, gender equity, SME support, job creation, digital inclusion, and human rights due diligence. Each of these goals is legitimate and urgent. Yet their accumulation has created internal overload.

Interviewees described growing difficulty in reconciling ambitious mandates with operational capacity. Resources—financial, human, and organisational—have not kept pace with the proliferation of goals. Institutions are stretched across too many fronts, with insufficient clarity about prioritisation or trade-offs. Rather than fundamentally revising strategy, DFIs tend to layer new missions atop existing frameworks, generating complexity without alignment. This has led to internal fatigue, inconsistent delivery, and reduced clarity of purpose. Even highly motivated teams struggle to balance strategic coherence with donor-driven expectations. The result is often a gap between intention and execution. Institutions may adopt the language of inclusion, transition, and sustainability, but without the internal reconfiguration needed to deliver on those promises. As one interviewee put it, “the strategy sounds bold, but the engine hasn’t changed.” Without recalibrating internal systems, missions risk becoming symbolic rather than transformational.

Cross-Institutional convergences

Despite differences in size, geography, or governance, a high degree of discursive convergence is now visible across DFIs. Most institutions anchor their identity around the same core principles: additionality, impact, mobilisation, and ESG integration. These elements dominate strategic frameworks, annual reports, and donor communications. A common vocabulary has emerged that facilitates coordination, comparison, and legitimacy.

Yet behind this alignment lie unresolved tensions. One central ambiguity concerns institutional identity: are DFIs financial institutions with development goals, or development agencies with financial tools? This lack of clarity affects decision-making, investment strategy, and the interpretation of performance. A second tension lies in balancing portfolio quality with transformational ambition. Risk-averse behaviours persist even in institutions that espouse bold missions. Efforts to harmonise impact metrics and ESG practices have made progress, but translation into practice remains uneven. Many interviewees acknowledged that while systems exist, they are not always used as strategic levers. The pressure to meet financial benchmarks often overrides learning-oriented approaches. Greater collaboration across DFIs could foster not just efficiency, but a redefinition of what development finance can and should be. →

> *“The scope of DFI mandates has expanded dramatically in recent years. In addition to private sector development and economic growth, DFIs are now expected to deliver on climate action, gender equity, SME support, job creation, digital inclusion, and human rights due diligence. Each of these goals is legitimate and urgent.”*

FOUR DISCURSIVE TENSIONS

DFIs operate within a set of dominant discourses that shape what is considered legitimate, strategic, or even possible. Among these, four interconnected tensions—risk, mobilisation, impact, and additionality—play an outsized role. Originally intended as guiding principles, they have in many cases become limiting frames. Rather than supporting adaptive strategies, they risk locking institutions into cycles of optimisation and defensive compliance. These tensions do not simply reflect operational challenges; they embody the unresolved contradictions at the heart of development finance.

Risk appetite vs development imperative

DFIs are tasked with operating where commercial finance cannot or will not go. Their role is to assume risk on behalf of development outcomes. Yet in practice, risk management often eclipses development ambition. Investment committees frequently apply financial criteria that mirror those of commercial banks, using benchmarks designed to protect capital rather than unlock transformation. As a result, high-impact but unconventional investments are routinely filtered out before serious consideration.

Several DFIs have attempted to create mechanisms to break this pattern—concessional windows, first-loss tranches, technical assistance—but these tools are often deployed within rigid procedural frameworks that blunt their transformative potential. Institutional cultures remain shaped by caution, accountability pressures, and legacy performance metrics. Even when risk-tolerant tools exist on paper, the appetite to use them decisively is lacking.

> *Mobilisation has become a central metric of success for DFIs. The ability to crowd in private capital is often framed as evidence of efficiency, scale, and market relevance.*

This disjuncture reveals a deeper challenge: the internalisation of a financial logic that treats deviation from market norms as a threat rather than a necessity. In a world of cascading crises and structural inequalities, development finance will require institutions that do not simply absorb risk but redefine what forms of risk are worth taking. Without a deliberate recalibration of risk frameworks to reflect mission-based priorities, DFIs will remain confined to the safer margins of the development landscape.

Mobilisation vs Transformation

Mobilisation has become a central metric of success for DFIs. The ability to crowd in private capital is often framed as evidence of efficiency, scale, and market relevance. However, an excessive focus on mobilisation has led to a strategic drift toward large, low-risk projects—especially in renewable energy and infrastructure sectors in middle-income countries—where private investors are already active. The emphasis has shifted from additionality to volume, from structural change to financial leverage.

Transformative investments—those that restructure sectors, incubate local innovation, or tackle underserved markets—tend to be smaller, riskier, and harder to quantify. These projects often fall outside the mobilisation paradigm, yet they are precisely the kind that can redefine development trajectories. Mobilisation metrics rarely capture the quality, context relevance, or long-term developmental value of capital flows.

This tension is more than methodological; it is ideological. Mobilisation as currently practiced reflects a worldview in which private capital is the ultimate validator of impact. That framing risks marginalising development pathways that do not align with investor expectations. If DFIs are to play a genuine transformational role, they must move beyond measuring how much private capital they attract, and focus instead on how they shape markets, shift norms, and open space for inclusive economic models.

Impact vs institutional complexity

The past decade has seen a proliferation of frameworks, indicators, and rating systems to assess impact. DFIs have developed sophisticated approaches to ex-ante evaluation, monitoring, and post-investment review. However, these systems often operate parallel to the actual investment process. Impact assessments are frequently undertaken as compliance exercises, disconnected from strategic decision-making or deal origination.

This disconnection has consequences. Impact data does not consistently feed into portfolio strategy, resource allocation, or learning loops. Staff responsible for financial structuring and those managing impact evaluation often work in silos, with limited integration. The result is a situation in which institutions talk about impact constantly but act on it selectively.

The challenge is not one of intent, but of institutional design. As long as impact remains an external layer—rather than a core driver—DFIs will struggle to align operations with mission. Simplifying and embedding impact thinking across teams and stages of investment, and linking it to incentives and governance, would transform these systems from reporting tools into engines of institutional learning and adaptability.

Additionality vs. market presence

Additionality is a foundational concept in development finance: DFIs should intervene only when their involvement adds value that the market cannot provide. Yet in practice, proving additionality has become an administrative hurdle rather than a strategic inquiry. Institutions expend considerable effort documenting counterfactuals, often using proxies that are imprecise or overly narrow.

> *A strategic compass is needed to guide DFIs beyond portfolio management and into a space of intentional transformation. This compass is not a rigid blueprint, but a navigational tool grounded in field realities, informed by institutional introspection, and oriented toward long-term developmental impact.*

This formalism creates distortions. DFIs may avoid promising deals out of fear of appearing to displace private actors, even when public interest would be served. Conversely, they may stretch the definition of additionality to justify marginal contributions. The lack of a shared, flexible framework leads to inconsistent applications and, at times, reputational risk.

The real issue is conceptual: additionality should not be a static condition to be proven ex-ante, but a dynamic role to be designed and adapted across project lifecycles. It must reflect not just market absence but developmental need. By reimagining additionality as a context-sensitive, relational concept, DFIs can reposition themselves as active contributors to development ecosystems rather than mere gap-fillers. This requires new forms of evidence, new narratives of value, and a shift from defensive justification to strategic intent.

A STRATEGIC COMPASS

Development Finance Institutions stand at a crossroads. Incremental adaptation is no longer sufficient to meet the magnitude of global challenges. The moment demands a redefinition of purpose, tools, and institutional behaviour. A strategic compass is needed to guide DFIs beyond portfolio management and into a space of intentional transformation. This compass is not a rigid blueprint, but a navigational tool grounded in field realities, informed by institutional introspection, and oriented toward long-term developmental impact. →

> *DFIs must operate not only as individual entities, but as a coordinated community. Stronger alignment through common platforms, shared instruments, and unified policy dialogues—such as EFSD+ and global multilateral forums—can amplify collective influence and create coherence across institutions.*

Enabling sustainable transitions
DFIs must reposition themselves as enablers of large-scale sustainable transitions. This entails supporting shifts in business models, financial structures, and institutional logics to accelerate progress on climate resilience, digital equity, and inclusive economies. Isolated project financing is no longer sufficient. DFIs should instead invest in the enabling conditions that allow entire sectors to evolve—through instruments like sustainability-linked loans, outcome-based financing, and blended models that reward ambition and long-term value. Alignment with the SDGs must move beyond rhetoric to guide investment decisions, shape risk appetite, and frame partnerships.

Backing pioneers and frontier innovation
Transformative solutions often come from outside traditional channels. DFIs must engage directly with frontier actors—entrepreneurs in fragile states, local intermediaries, and civil society innovators. Rather than waiting for mature investment opportunities, they should take proactive roles in venture development, offering first-loss support and tailored instruments like equity, quasi-equity, or concessional funding. The goal is not to pick winners, but to create the space and support systems for diverse, locally embedded innovations to emerge and grow.

Building enabling ecosystems
Systemic change depends on robust ecosystems, not isolated transactions. DFIs must invest in the institutional infrastructure that underpins sustainable private sector growth—domestic capital markets, inclusive financial intermediaries, digital infrastructure, and enabling policy environments. This requires upstream engagement and long-term partnerships with public actors, as well as a commitment to capacity-building. In fragile or low-income countries, this ecosystem-building role may be more critical than immediate disbursements and should be prioritised accordingly.

Mainstreaming digital and environmental transitions with sovereignty
DFIs must fully integrate the twin transitions—digital and environmental—into their core strategies, while safeguarding local agency. Digital infrastructure and data governance are not merely technical—they determine who controls, benefits from, and is protected within evolving digital economies. DFIs must ensure these transitions are inclusive and sovereignty-enhancing. Likewise, environmental finance must support context-specific, just transitions, avoiding extractive models and prioritising circular economies, green industrial policy, and biodiversity protection. These themes should no longer sit in isolated thematic units—they must become central to all operations.

Together, these four orientations redefine DFIs' role—from cautious financiers to strategic architects of development pathways. This shift calls for bold coalitions, broader use of instruments, and a willingness to take calculated risks in service of systemic impact.

DEVELOPMENT FINANCE
INSTITUTIONS: NEW DIRECTIONS
FOR THE FUTURE

ENABLING REQUIREMENTS

For the strategic compass to move from theory to practice, DFIs must address the institutional constraints that currently limit their ability to act. Ambition alone is not enough—real transformation requires updated governance, incentives, and operating models aligned with mission-driven finance. Without these enabling conditions, even the most compelling strategy will struggle to gain traction.

Rethinking governance and mandates
The foundation lies in aligning governance structures with developmental intent. Board-level directives must explicitly prioritise long-term impact over short-term financial returns. This may require adjusting return expectations, accepting greater performance variability, and reassessing capital adequacy frameworks. Shareholders must redefine success—not solely as the protection of capital, but as its catalytic deployment for systemic, lasting development gains.

Building adaptive operational models
DFIs must evolve their operational systems to support calculated risk-taking and innovation. Risk management frameworks should distinguish between recklessness and strategic boldness, and empower staff with more autonomy. Approvals should be streamlined, and incentive systems must reward collaboration, learning, and developmental impact—not just disbursement speed or financial ratios. To support this shift, DFIs could establish dedicated innovation units—semi-autonomous hubs with the freedom to test new tools, deploy capital differently, and learn from failure. Regulatory sandboxes and innovation budgets, backed by shareholder support, can create safe zones for experimentation and growth.

Strengthening coordination and interoperability
Greater coordination across DFIs and with other development actors is critical. Fragmentation reduces efficiency and limits collective influence. DFIs should work toward shared standards, pooled financing vehicles, and co-investment platforms to foster scale and reduce duplication. Institutional interoperability should be treated as a strategic goal—allowing multiple actors to collaborate on transitions rather than compete on individual transactions.

Investing in foresight and institutional intelligence
To lead rather than follow, DFIs must enhance their anticipatory capacities. This means investing in horizon scanning, data analysis, and scenario planning to stay ahead of geopolitical, technological, and policy shifts. Institutional foresight allows DFIs to spot opportunities, mitigate emerging risks, and guide their strategies proactively rather than reactively.

Acting as a global community
Finally, DFIs must operate not only as individual entities, but as a coordinated community. Stronger alignment through common platforms, shared instruments, and unified policy dialogues—such as EFSD+ and global multilateral forums—can amplify collective influence and create coherence across institutions. This global collaboration is key to turning fragmented efforts into system-wide impact. Without these enabling requirements, the strategic compass risks remaining a symbolic gesture. With them, it becomes a powerful lever for the reinvention of DFIs as drivers of transformation. ■

> *Ambition alone is not enough—real transformation requires updated governance, incentives, and operating models aligned with mission-driven finance.*

Journey without Maps

David Kuijper, CEO, Association of European Development Finance Institutions (EDFI)

Radical uncertainty in geopolitics and geoeconomics is set to increase, along with risks of crises – and the global community's mitigating capacity is diminished. In a world without a global balance of power, a 'G-zero world', Development Finance Institutions (DFIs) are well positioned to buttress Europe's ability to act cohesively on the global stage to safeguard European values, which overlap with the Sustainable Development Goals.

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When British Prime Minister Harold MacMillan[1] was asked what the biggest challenge was for a Prime Minister, he responded: **'Events, my dear, events'**.

When radical uncertainty hits, unexpected global and regional events disrupt carefully crafted strategies, slash the value of risk models, and disturb focus. Difficult times await the 'planners', while the 'searchers' may turn out to be better equipped[2].

Recently many unforeseen events have unfolded for which politicians felt unprepared, causing unease in organisations. Who could have thought last autumn that a lightning-fast rebel offensive would capture Damascus, ending the Assad regime in Syria and greatly reshuffling the Middle East card deck once again. Meanwhile, an EU historic first: an annulled democratic election amid allegations of Russian interference[3]; a newly elected U.S. Vice-President calling Europe 'undemocratic', and the world's richest person, 'First Buddy' to President Trump, openly backing Germany's radical-right party; North Korea sending troops to Europe; and South Korea surviving an autocoup. Meantime, the US President has threatened Denmark with invading Greenland.

In the coming years, this radical uncertainty in geopolitics and geoeconomics will increase. The global community's capacity to deal with **downside monetary and geopolitical risks** has decreased. Hence, societies are more vulnerable to financial and economic crises.

> *"Increasingly, we are at risk of moving to what Ian Bremmer calls the 'G-zero world' –one where no single country or alliance of countries holds the political or economic dominance to coordinate an international agenda and a world order no longer aligned with the global balance of power."*

1 › Prime Minister of the United Kingdom from 1957 to 1963.
2 › Reference to Bill Easterly's categorization of development professionals into 'planners' and 'searchers in 'The White Man's Burden', 2006
3 › Romania's cancelled presidential election

GLOBAL REALIGNMENT SCENARIOS

There are multiple reasons for this vulnerability. First, DFIs global collective ability to act has been weakened by **a decline in government capacity**. Governments in the three largest global markets United States, China and the European Union – have shown a **lack of effective** action to mitigate downside risks. This has added to economic uncertainty in the mid to long term and the possibility of a sudden jump in financial market volatility. In all three leading economies, debt has swelled, while productivity lags. This malaise has gone hand in hand with political decline. US and European democracies have been weakened by populism, influencing operations by autocratic powers, and divisiveness in the social media. Popular calls for strong leadership worldwide are a preoccupying sign of institutional weakness. In China also, demographic challenges, economic decoupling/technology bans and over-centralisation have put pressure on the Communist Party governance model, compromising the capacity of government to pursue effective economic policy and reforms.

Concerning too is the **'beggar-thy-world'** strategy conducted by the two leading economies (US and China): instead of exporting stability, they are exporting disruption. China is exporting overcapacity, and the U.S. under Trump will likely export higher interest rates. In response, other countries will raise protectionist barriers, and financial conditions will tighten. Governments are, to varying degrees, retracting to **'country-first'** policies, threatening future global output and further contributing to geopolitical and trade tensions.

The **EU Global Gateway strategy** is leaving its start-up phase, with the ambition to mitigate the consequences of global disruption for Europe and secure vital value chains. While Global Gateway is geostrategic, rather than protectionist, protectionist elements – such as the preference for EU standards and companies – are emerging.

> *"How can DFIs best cope with radical uncertainty? There is no need to drastically change forecasting tools, but rather for greater awareness of the geopolitical contexts in which DFIs operate. Also, resilience and levels of preparedness within DFIs need to be boosted."*

Previously, effective global governance would have mitigated the effects of such emerging trends in the leading economies. However, **the multilateral system is showing worrying signs of breaking up,** especially concerning economic and climate policy coordination. Waning US leadership, the basis of the multilateral system, is providing space for alternative structures. BRICS is an attempt at this.

Increasingly, we are at risk of moving to what Ian Bremmer calls the **'G-zero world'** –one where no single country or alliance of countries holds the political or economic dominance to coordinate an international agenda and a world order no longer aligned with the global balance of power.

To realign the world order with emerging global powers, three possible scenarios are possible: **reform the current system** and ensure its governance corresponds to geopolitical reality; **design new structures; allow for disintegration**, and factor in more conflicts and wars. We seem to be on track for the third scenario.

We are in the unique situation where the leader of the dominant global power is advocating for dismantling the very system that it built up to exercise its global power. Large countries such as Mexico, Indonesia, and South Africa do not yet have the ways and means to set up alternative multilateral systems that bring stability.

ENTERING A PERIOD OF TRANSITION

FOCUS
EDFI

EDFI (the Association of European Development Finance Institutions) was established in 1992 to support and promote the work of bilateral Development Finance Institutions. With a combined portfolio of €53 billion, including over €15 billion of climate finance, EDFI's 15 member institutions share a vision of a world where the private sector offers people in low- and middle-income countries opportunities for decent work and improved lives; also, where private investment flows are aligned with the Sustainable Development Goals and the Paris Climate Agreement. EDFI's mission is to promote the joint interests of its members, inform policy, and drive innovation in industry standards.

How can DFIs best cope with radical uncertainty? There is no need to drastically change forecasting tools, but rather for greater awareness of the geopolitical contexts in which DFIs operate. Also, resilience and levels of preparedness within DFIs need to be boosted.

DFIs find themselves in a central and visible forward position, vulnerable to crises but also highly relevant for crisis responses, as the war in Ukraine has shown. This frontline position is akin to the position DFIs were in during the Cold War, but with some stark differences: they were in a relatively quiet niche within a stable multilateral system, anchored by the World Bank, IMF, and regional development banks; they were smaller, less pioneering, and therefore less vulnerable to 'events' and criticism, as well as being less regulated and therefore less complex organisations.

In 2025, the multilateral system is crumbling, and DFIs are much larger and spread over a wider geography. They are in more sectors than before, and are under scrutiny in this age of social media, affecting their agility and risk appetites. Regulatory frameworks require deep expertise and additional capacity, and there are mounting costs and unprecedented levels of complexity within the organisation and in the investment process. As after the end of the Cold War, **DFIs are entering a transition period**. Despite the complexity described, European DFIs are arguably in a good base position to navigate this transition. They stand a good chance of achieving sustained growth, based on their performance over the last decade; their investment network in key emerging economies; their robust impact measurement and data systems – which help DFIs respond to transparency demands – and the unique expertise of more than 3500 staff. Making use of this base will require close coordination within and among DFIs. It will also require engagement with shareholders on the capacity of DFIs to be flexible, creative, and pioneering.

DFIs are embarking on **a journey without maps**. As Forster and Charnoz[4] mention in their November 2023 paper [5], "the urgency for DFIs to innovate, adapt, and deliver is intensifying". They argue that, to respond to a rapidly "evolving development landscape", DFI strategies will need to shift focus. While these currently emphasise optimising operations, a shift is needed to reflect on 'core purpose, essence, and direction'. DFIs have always functioned against the backdrop of the post-war multilateral system, which is now crumbling. Henceforth, they and their shareholders need to define their role in a 'G-zero' scenario. Consequences and measures can be identified at two levels: those in the medium- to long-term for DFIs' respective markets and for their clients, and those for DFIs' immediate business continuity.

MEDIUM- TO LONG-TERM CONSEQUENCES

Falling government capacity and a G-zero world would create a more fragmented and inequitable future landscape for development finance. In this scenario, several consequences are possible:

Overall, a G-zero world will lead **to heightened political risk and unpredictable policy environments**. This will be compounded by shareholders shifting their focus to national or regional priorities. In addition, complex prudential and financial regulations and reticent investment partners may make it more difficult for DFIs to invest and take risk. Possible DFI responses include:

Localisation will be required due to increased unpredictability and risk. This will involve more engagement with local partners and better local intelligence gathering through local presence and liaising within the local policy and investment arena, as well as with multilateral and diplomatic actors.

4 ▸ See also page 24 to 31: "Development finance institutions: New directions for the future"
5 ▸ https://www.afd.fr/en/ressources/development-finance-institutions-new-directions-future

Data harmonisation, standardisation and transparency will have an even higher priority, requiring acceleration. This is because perceptions of increased risk and less appetite for the extra costs of impact management can be countered by quality data and transparency.

Availability of **concessional finance** may decrease over time. Government budgets will realign to new global realities, with a rapid increase in defence spending and domestic industry subsidies, to the detriment of international aid budgets. In this scenario, pools of concessional finance may be available only for geostrategic sectors, such as critical raw materials, food security, harbour and transport infrastructure, and digital transformation. To access these funds, many DFIs may need a costly refocus. Possible DFI responses include:

A need to actively advocate for a broader vision on geostrategy among policymakers and politicians. This will include emphasising the geostrategic importance of maintaining and scaling-up concessionality in climate finance, renewable energy and the financial sector.

Syndication and mobilisation platforms will be needed, with more deep and structured cooperation with institutional investors and existing platforms (e.g. ILX) that are not dependent on concessional finance.

Non-public sources of concessional finance/grant funding – philanthropic foundations, private funds and family offices – will need to be accessed through more deep and structured cooperation.

Over time, a drop in multilateral effectiveness could **stall the evolution of global standards**, leading to more splintering and divergence of standards and therefore rising compliance costs. Possible DFI responses include:

Active **engagement with global standard-setting bodies** (e.g. IFC, IFRS, and OECD) will be required for the evolution of standards and to ensure their relevance and alignment with DFIs' investment practices.

The **principle of interoperability** – intensification of DFIs' plea for embedding within EU regulatory frameworks with national and international ESG standards, in particular, IFC standards – will be required. This will ensure that global standards are well anchored in national frameworks.

Rising compliance costs will be countered by bundling DFI compliance operations, for instance, through joint KYC teams.

CONSEQUENCES FOR DFIs' IMMEDIATE BUSINESS CONTINUITY

DFIs are experienced in dealing with uncertainty. Nevertheless, the increase in the 'quantum of uncertainty', and the increased likelihood of disrupting events, necessitates thought on whether DFI practices and systems can deliver. Are the DFI business strategies 'sufficiently robust to alternative futures and resilient to unpredictable events'[6]?

A G-zero world with growing radical uncertainty may **weaken DFIs' strategy execution and risk management practices**. Conventional risk management relies on historical data to estimate probabilities for the future. Risks in a G-zero world, however, are often novel. How can DFIs prepare for these? The possibilities are:

Recalibrating existing strategies to ensure these are sufficient to deal with radical uncertainty.

Adaptive, scenario-based strategic planning should be introduced. It should allow for rapid action after unexpected events.

A '**prepared searchers**' and continuous learning culture should be fostered, with the emphasis placed on preparing for any number of possible futures.

Building resilience in IT infrastructures and operational guidelines: as DFIs are increasingly involved in geostrategic policy (e.g. Ukraine), the risk of cyber incidents is mounting. In addition, IT infrastructures should be capable of promoting rather than deterring cooperation among DFIs.

6 ▸ Mervyn King, John Kay, Radical Uncertainty – Decision-making beyond the numbers. See also this FT-review: Radical Uncertainty: Decision-Making Beyond the Numbers, by John Kay and Mervyn King

STRENGTHS AND PARTNERSHIPS, KEYS TO DFI RESILIENCE

As 'events' and more uncertainty will dominate DFI operations more prominently in the years ahead, they will need to be prepared to manage the risks. DFIs will also need to keep sight of the opportunities that uncertainty brings, building on their past strengths and expertise. As business owners know, uncertainty brings new horizons for entrepreneurship and growth. This is no different at the geopolitical level – and no different for DFIs.

At a time of multilateral uncoupling and political decline, DFIs need to rely on their strengths and partnerships more than ever. DFIs are uniquely placed to mitigate the effects of such disintegration and to step into the void that may open up. Their tradition of cooperation needs to be treasured as well as their close links to policymakers through shareholders. Stronger cooperation in the development of joint narratives, mutual support in risk management and the boosting and bundling of resources to fight further cost inefficiencies may be prerequisites for the successful and steady navigation of a world where unexpected events are ubiquitous.

DFIs also play a role in buttressing Europe's ability to act cohesively on the global stage to forge meaningful partnerships with EMDEs and to safeguard European values, which overlap with the Sustainable Development Goals. DFI prominence as an operational channel also presents a rare opportunity to assist in strengthening Europe's geostrategic role and to help prevent a protectionist relapse.

Finally, as the world order is realigning its balance, DFIs can **also play a role in thwarting a meltdown of the transatlantic alliance**. There is a common interest among societies on both sides of the North Atlantic to build on efforts to defend multilateralism, democracy, and free market values. EDFI's recent affiliate partnerships with FinDev Canada and U.S. DFC could prove to be an asset in these efforts.

> *"As 'events' and more uncertainty will dominate DFI operations more prominently in the years ahead, they will need to be prepared to manage the risks. DFIs will also need to keep sight of the opportunities that uncertainty brings, building on their past strengths and expertise."*

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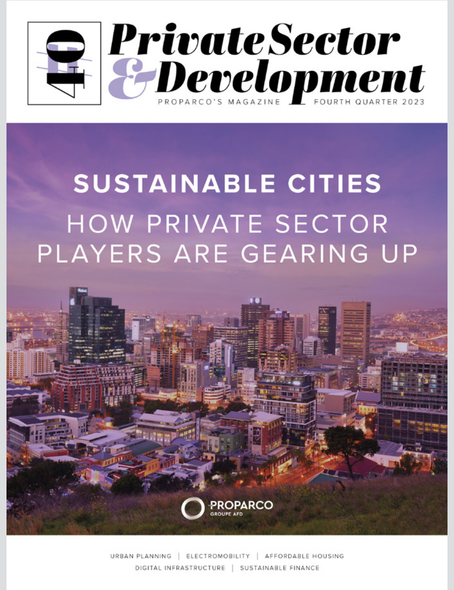

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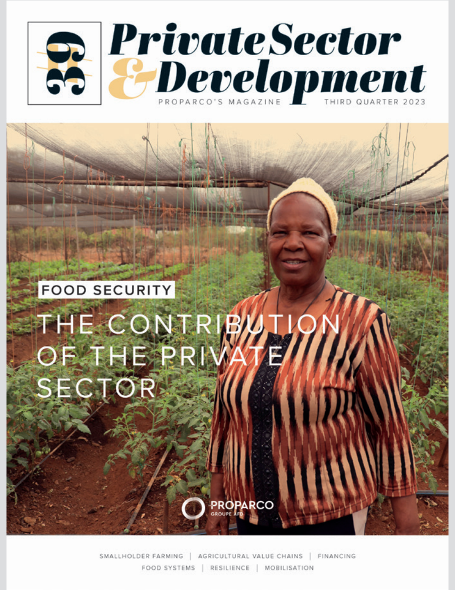

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Private Sector & Development (PS&D) is a half-yearly publication that provides analyses of the mechanisms through which the private sector can support the development of southern countries. Each issue compares the views of experts in different fields, from academia to the private sector, development institutions and civil society.

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