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Sustainable Investing Research Initiative

SUMMARY

Columbia University Sustainable Finance Seminar

SFS7: How to Catalyze more Private Capital through Blended Financing Structures to Finance Innovative Solutions

Oct 6, 2025

OVERVIEW

This seminar brought together academics and practitioners to examine the conceptual foundations, practical applications, and persistent challenges of blended finance. Blended finance is a structuring approach that uses catalytic capital from public or philanthropic sources to de-risk investments and mobilize private capital for sustainable development.

Key themes included the important role of catalytic capital, the misalignment of the current development finance system with mobilization goals, as well as the importance of using blended finance to create demonstration effects (that correct private sector risk perceptions) and to create new markets. Participants explored the strategic use of guarantees, the need for better alignment between public and private sector stakeholders, and more. The seminar concluded by identifying clear priorities for making blended finance a more powerful tool, emphasizing the need for improved education, rigorous research, and greater collaboration across the entire spectrum of capital providers.

I. A Conceptual Framework for Blended Finance

The first keynote outlined a conceptual framework for blended finance, establishing its core principles and purpose. The speaker began by emphasizing that blended finance is not an asset class or a new form of investing, but rather an approach to structuring transactions. Its primary role is to solve large-scale global problems, such as climate change, humanitarian needs, and infrastructure gaps. This is accomplished by recalibrating how risk and return are shared, thereby enabling private capital to enter markets and projects it would otherwise avoid.

To illustrate the concept, a thought experiment was presented: a mayor of a small town lacking electricity receives a grant. Instead of using it for a short-term solution like a diesel generator, the mayor could use the funds to de-risk a more substantive proposal from a clean energy company that had previously deemed the investment too risky. With the grant absorbing some of the initial risk, the project becomes bankable and attractive as an investment opportunity. This "win-win" scenario, where concessional (charitable or below-market return) capital helps improve the risk-return profile of investment opportunities for private (commercial) capital is the essence of blended finance.

The presentation outlined three core factors for a blended finance transaction to serve as catalyst and finance sustainable development:

1. Leverage: The use of catalytic capital from public or philanthropic sources must mobilize additional private sector capital. The speaker noted a distinction here, contrasting a stricter definition requiring private capital mobilization with the OECD's broader definition of mobilizing any "additional" capital. The former was argued to be closer to the spirit of blended finance, as private capital is what needs to be mobilized.
2. Impact: The transaction must contribute positively to the Sustainable Development Goals (SDGs) in a developing country. While not all parties in the deal need to have a sustainable development intent, the transaction as a whole must generate a measurable positive impact.
3. Return: The transaction must be structured to offer a positive financial return, making it viable for commercial investors.

A central theme was the role of “catalytic capital,” the concessional funding that activates a transaction. However, the speaker identified substantial barriers to scaling its use.

- First, risk perceptions of investment opportunities in emerging markets are often exaggerated (i.e. perceived risks are greater than actual risks), deterring private investors.
- Second, transactions are frequently bespoke and complex, making them difficult to replicate.
- Most importantly, the amount of available catalytic capital is far too small and has been stagnant for years.

The last point prompted an in-depth analysis of the broader development finance system, particularly Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs). The speaker argued that this system is outdated. MDBs and DFIs were originally designed for public grant-making, not for mobilizing the private sector. This has created a stark misalignment where public and private capital are often at odds, competing for a limited set of deals rather than collaborating. A rethinking of the role of these institutions is needed to ensure they use their capital more effectively to catalyze, rather than compete with, private investment.

II. A Practitioner's Perspective on Impact and Systems Change

The second keynote speaker, drawing on extensive public sector experience in blended finance, provided a practitioner's view on applying blended finance, particularly in Least Developed Countries (LDCs). This presentation shifted the focus from pure definition to strategic implementation, emphasizing an impact-first approach aimed at achieving systemic change.

The speaker began by contextualizing their work in LDCs, which are markets that receive less than a double-digit percentage of MDB and DFI capital due to low credit ratings and high perceived risk. In this environment, the principal goal of blended finance is not just to close a single deal but to use catalytic capital to pilot transactions that create a demonstration effect and create new markets. By proving that the actual risk of an investment is lower than the perceived risk, these pilot projects can crowd in other investors over time, fundamentally altering market dynamics. Given the small pool of available catalytic capital relative to private capital, this focus on demonstration was presented as its most efficient and effective use.

A key argument offered by the speaker was that blended finance should be approached with the end goal of systems change. Rather than creating countless small, disparate structures that dilute

the limited concessional capital, efforts should focus on designing vehicles that address major market failures. An example provided was the Global Fund for Coral Reefs, a blended finance vehicle created to address the lack of institutional investment in SDG 14 (Life Below Water). The fund was not designed to solve the entire problem but to create a mechanism that proves the viability of such investments and attracts other entities into the space.

The presentation also highlighted two notable challenges observed in practice:

1. Public Capital Crowding in Public Capital:

A common pitfall is that concessional public funds end up mobilizing capital from other DFIs or MDBs rather than genuinely private sources. This often happens because the private sector is not engaged at the outset during the design of the financial structure. Their return expectations and risk perceptions are not adequately incorporated, leading to structures that are only attractive to other public-minded actors.

2. Lack of a Standardized Return Expectation:

Return on capital is not a fixed number; it is a function of the market, the type of capital (pension fund, venture capital, etc.), and risk perception. The role of blended finance should be to create structures that help reduce the gap between the return expectations associated with the perceived risk and the actual returns generated once the risk is properly managed.

Finally, the speaker framed blended finance as a modern, refined iteration of older concepts like public-private partnerships. Its ultimate objective should be seen as problem-solving for difficult challenges, such as climate adaptation or financing SMEs in new sectors, where the private sector cannot or will not act alone initially. The existence of Green Banks in North America and Europe was cited as a domestic example of institutions using concessional capital to mobilize private investment for a specific public good, illustrating the versatility and power of the blended finance approach.

The open discussion tackled the practical challenges and strategic imperatives of blended finance. Participants discussed the structural roles of development institutions, the effectiveness of different de-risking tools, and the fundamental tensions in blending public and private objectives.

Rethinking the Role of MDBs and DFIs

Reforming the operational strategy of Multilateral Development Banks (MDBs) emerged as a central theme. Participants noted that these institutions often position themselves in the mid-level, or "mezzanine," risk layer of a capital stack rather than absorbing the initial, "first-loss" risk. This practice can inadvertently crowd out private investors, as the DFI uses concessional funds to de-risk its own position instead of acting as the primary catalyst for mobilizing new private capital. This dynamic runs counter the core idea of blended finance serving as catalyst to mobilize private capital and close the financing gaps. The discussion concluded that if MDBs and DFIs shifted their strategy to exclusively focus their investments in market-failure areas with potential for new market creation, they could greatly expand catalytic capital and unlock greater sums of private capital. Achieving this shift would require a comprehensive reassessment of their governance structures and institutional mandates.

Guarantees as a Powerful Catalytic Tool

Participants highlighted the often understated importance of guarantees and insurance products as powerful and effective de-risking tools. Unlike direct equity or debt investments, guarantees fundamentally change a project's risk-return profile for private investors without requiring a large upfront outlay of concessional capital. Instruments like political risk insurance were identified as particularly important catalysts for encouraging investment. Guarantees are especially effective for mobilizing domestic capital in emerging markets; for example, a guarantee can encourage a local bank to begin lending to a new or unfamiliar sector like agribusiness SMEs. As the bank builds a track record and gains experience in the sector, the need for the guarantee diminishes, helping to create a sustainable local market. Furthermore, these tools can be crucial for helping investors look past broad sovereign credit ratings to assess a project on its own financial and operational merits.

The Dual Need for Mobilization and Direction

Participants explored the dual need for mobilizing large amounts of private capital and the need to direct that capital to ensure it achieves specific social or environmental impacts. The conversation cautioned against focusing solely on mobilization without clear guardrails. Balancing these two needs is more of an "art than a science," requiring a nuanced, sector-specific approach to avoid market distortions.

The Context-Dependent Nature of Blended Finance

The discussion emphasized that blended finance is not a one-size-fits-all solution but a highly context-dependent practice. The appropriate level of subsidy and the right structuring approach must be carefully tailored to the specific market, region, and, critically, the maturity of the sector in question. Because there is no perfect price discovery process for these types of investments, the structuring involves navigating misperceptions of risk and balancing multiple goals. Participants agreed that mature sectors with established private investment, such as clean energy, likely require very little concessional support. Conversely, nascent fields like nature-based solutions or climate adaptation, which do not yet have as strong of a commercial track record, require catalytic intervention to spur market activity and prove their viability to private investors, creating a necessary demonstration effect.

Lack of In-House Expertise as a Primary Barrier

A key barrier to scaling blended finance, as highlighted in the discussion, is not the financial risk-return profile of the deals themselves, but a significant lack of in-house expertise among potential investors. Survey data presented during the session revealed that for many institutions not yet engaged in blended finance, the primary deterrent was the absence of internal knowledge required to navigate the complexity of these structures. This points to a deep-seated knowledge gap in the market. Investors lack the specific skills to source, structure, and conduct due diligence on blended finance transactions. This finding points to an urgent need for targeted education, professional training, and capacity building initiatives to equip asset managers and institutional investors with the necessary tools to confidently enter this space and contribute to mobilizing capital for sustainable development.

The Challenge of Valuation and Price Discovery

The discussion also examined the underlying challenge of valuation and "price discovery" in blended finance. Participants noted that these transactions occur in nascent markets or markets with failure contexts where price signals are distorted or incomplete. This transforms the process of determining the appropriate level of subsidy or concessionality into more of an "art than a science." The valuation is heavily influenced by subjective risk perceptions, the negotiating power of the involved parties, and the unique "small p" politics of each deal, rather than being based on objective, market-driven data. This ambiguity creates significant hurdles, as it makes it difficult to show that public funds are being used efficiently and are not creating unintended market distortions. It also presents a barrier for institutional investors who rely on standardized models and clear benchmarks for making capital allocation decisions, further complicating efforts to scale the market.

PART III – CONCLUSION AND ACTION-ORIENTED PRIORITIES

The seminar concluded by identifying several action-oriented priorities to advance the field of blended finance:

Establish a Common Vocabulary and Shared Intentionality

Establishing a common vocabulary and an agreement on key terms is a foundational priority. The lack of a universally accepted lexicon for concepts like "blended finance," "catalytic capital," and "mobilization" hinders progress, as stakeholders often operate with different assumptions. Before solutions can be designed, a common language is essential.

Building on this, participants stressed the importance of shared intentionality. The use and intent of blended finance as a structuring tool to mobilize private capital must be explicit and unified. If the imperative is shared, subsequent conversations about data transparency, credit ratings, and stakeholder engagement can proceed from a common foundation.

Reform the Mandates of Development Finance Institutions

A recurring and crucial priority is to rethink the role and operational mandates of Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs) to ensure their primary function is mobilization of private capital, not competition.

Bridge the Knowledge Gap Through Education and Research

The discussion revealed a pressing need for education and research. There is a significant cultural and knowledge gap between public and private sector actors. Development professionals often lack a deep understanding of private capital markets, while private investors may not grasp the nuances of impact measurement and development priorities. Initiatives that provide "Finance 101" for the public sector, and "Impact 101" for the private sector can create the shared understanding necessary for effective partnerships. Furthermore, survey data revealed that a primary barrier for investors is an absence of in-house expertise in blended finance, highlighting a clear need for academic and professional education.

Focus on Specific Sectors to Overcome Complexity

The immense heterogeneity of projects and geopolitical contexts makes a one-size-fits-all approach to blended finance impossible. A participant suggested that to make tangible progress one could focus on a narrow set of project types. For example, by concentrating efforts on specific sectors—such as smallholder agriculture, water infrastructure, or forestry—it may be possible to develop replicable models and generate data that can correct risk misperceptions, creating pathways that can then be adapted for other areas.

Broaden the Scope of Sustainable Finance

The discussion concluded with a call to broaden the conventional view of sustainable finance. Much of the current discourse, research, and capital flow is concentrated on publicly listed assets in developed markets. To address the SDGs effectively, the focus must shift towards emerging and frontier markets, and encompass the full spectrum of capital providers, including philanthropies, MDBs, DFIs, family offices, VCs, asset managers, and large institutional investors. Better understanding the preferences, restrictions, and potential for partnership among these diverse actors is crucial for unlocking the capital needed for sustainable development.

Leverage Technology and Artificial Intelligence

Looking ahead, participants identified Artificial Intelligence (AI) as a potentially transformative force capable of addressing fundamental barriers in blended finance. By applying technology, the field can move beyond its "art form" status toward greater efficiency, rigor, and transparency.

AI, combined with tools like remote sensing, can analyze vast datasets to provide dynamic, real-time verification of a project's environmental and social impact, offering investors credible assessments. Furthermore, AI models can generate more accurate, project-specific risk profiles, helping to correct broad misperceptions tied to sovereign ratings and improving price discovery. Finally, AI can automate complex due diligence processes, reducing transaction costs and increasing transparency. These advancements are essential for building trust, lowering the barrier to entry for institutional investors and other investors, and for effectively scaling investments in sustainable solutions.

Note: Blended Finance is a key focus area of the Sustainable Investing Research Initiative (SIRI). Please visit the dedicated [SIRI Blended Finance](#) webpage for more information about its latest research publications, case studies, summary reports of key insights from past events, and upcoming activities.