

## Private Sector Roundtable

# DFI Guidance for Using Investment Concessional Finance in Private Sector Operations<sup>1</sup>

April 15<sup>th</sup>, 2013

### 1. Background

Multilateral and bilateral development institutions (together, Development Finance Institutions, or “DFIs”) have been increasing their investments into the private sector. The private sector is an important engine of growth and sustainable employment, and therefore a critical part of the development mandate for many DFIs. At the same time it has been recognised that channelling public resources to private entities to further development objectives raises important operational questions and calls for different approaches than are used to support sovereigns. To this end, international and bilateral DFIs have undertaken two major projects to clarify what they do to further development through the private sector and to identify the key principles that guide such operations.

First, the Private Sector Development Institutions Roundtable, which is an annual meeting of the heads of DFIs focusing on private sector development, published a report, *International Finance Institutions and Development Through the Private Sector*, in September 2011. It documented both the value of the private sector in development and the role of DFIs in supporting development through the private sector. The report sought to provide answers to the underlying question of why public resources of DFIs should be used to support private firms, both directly and indirectly.<sup>2</sup> The report highlighted the importance of the private sector in supporting inclusive growth, poverty reduction, job creation, and access to critical goods and basic services and by providing tax revenues. DFIs support the private sector to help close gaps in finance, knowledge, and standards, through high-impact, sustainable development projects and programmes. Governments that fund DFIs are increasingly looking for approaches that deliver high development impact while efficiently using the limited taxpayer resources. Working with the private sector is an attractive option for a DFI because this can leverage the limited funds entrusted to the DFI by catalysing the resources and talent of private actors.

Second, and in parallel with the work on this report, the Heads of Multilateral Development Banks (“MDBs”) decided to identify the set of general principles that MDBs can use to support the private sector in a way that is sustainable and ensures additionality of their operations. At their April 2012 meeting, the Heads of MDBs endorsed the resulting report, *MDB Principles to Support Sustainable Private Sector Operations*. This confirmed five core Principles that guide MDBs’ engagement with, and support of, the private sector, so as to achieve development goals consistent with their mandates. These Principles are:

- Additionality
- Crowding-in
- Commercial sustainability
- Reinforcing markets; and
- Promoting high standards.

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<sup>1</sup> This note is prepared by a working group comprising representatives of from the Private Sector Roundtable. It has not been formally approved by respective Managements of the participating institutions.

<sup>2</sup>[http://www.developmentandtheprivatesector.org/report/files/assets/downloads/IFI\\_and\\_Development\\_Trough\\_the\\_Private\\_Sector.pdf](http://www.developmentandtheprivatesector.org/report/files/assets/downloads/IFI_and_Development_Trough_the_Private_Sector.pdf)

Taken together, these principles affirm MDBs commitment to provide market-consistent support for commercially sustainable projects in situations where private investment is not forthcoming, or requires supplementing.

Both reports underlined the major principle of providing finance to the private sector on market-based, non-concessional and sustainable terms. This is because it was acknowledged that subsidised financing to the private sector risks distorting the market and possibly undermining the demonstration impact of any DFI private sector operations. It is for this reason that providing finance to the private sector at concessional terms is not permitted according to the mandates of many IFIs and bilateral agencies, or only permitted in specific cases as an exception to the general rule, which underscores the principle of creating sustainable markets.

Nonetheless, there are instances where subsidies or concessionality may be justified to foster projects with a high development impact through private sector operations. As defined and discussed below, concessional finance for a private sector project may come into play where there are market and/or institutional failures, such as un-priced externalities. In these instances, concessional finance can bridge the immediate gap and support a transition to a sustainable solution. Concessional finance can also address selected distributional concerns by enhancing the equality of opportunity for specific vulnerable groups.

The above Principles for engagement with the private sector, however, are equally applicable to these cases, and must be taken into consideration, in part because of the inherent risks in deploying concessional support to the private sector, including the possibility that this could undermine long-term private sector development objectives. It is all the more important in these situations to ensure that DFI interventions are carefully designed to reinforce markets and promote the eventual commercial sustainability of the private sector.

As a result, the leaders of the Private Sector Development Institutions Roundtable a year ago commissioned a Working Group, led by the EBRD and the IFC and comprising representatives of MDBs<sup>3</sup> and bilateral agencies, to provide guidance on the use of concessional finance in the private sector.

## **2. Approach**

### *Objective*

This note discusses *what* concessional finance is, *why* it may be justified, and *how* to deploy it in private sector projects in a manner that mitigates its risks, maximises development outcomes, and is consistent with the broader MDB Principles for working with the private sector. It draws on the previous reports cited above and current internal policies and guidelines of DFIs, as well as the practical experience that is accumulating among these institutions. Specifically, it aims to identify common ground among DFIs and to elaborate on the applicability of the principles for DFI involvement in the private sector to cases of concessional finance, while recognising that there are differences among institutions with respect to mandates, institutional constraints, and experience in deploying concessional finance.

### *Scope*

Recognising different institutional mandates of DFIs, the focus here is *on non-sovereign guaranteed private sector financial operations (i.e. loans, guarantees, and equity investments) with majority privately-owned companies*. This note does not consider non-sovereign guaranteed operations with

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<sup>3</sup> The African Development Bank, Asian Development Bank, Inter-American Development Bank and European Investment Bank (for the latter, in the context of its operations with Neighbourhood and Partner countries).

municipalities or state-owned enterprises, or sovereign or sovereign-guaranteed operations even where private sector firms are among the ultimate beneficiaries, such as operations with state-owned financial institutions intended to benefit private sector companies.

The principles discussed here apply to the overall financing of a project, irrespective of whether the concessional financing is being provided by the DFI itself or a third party, including when the concessional finance is part of the wider project's financial structure outside of the immediate control of the DFI. Its approach and core tenets would also be applicable, for example, to the non-sovereign guaranteed portion of a public-private-partnership ("PPP") project, where the project's concessional finance portion is mobilized and availed through a sovereign entity. Technical assistance (advisory services) delivered free or at reduced cost, is also considered a form of concessional finance, but is not covered in this paper.

#### *Definition of concessional finance*

In its broadest meaning, concessional finance comprises financial products, including loans, guarantees, and equity investments, provided on terms that are clearly more favourable than those explicitly<sup>4</sup> available from the market. According to the OECD/IMF definition concessional loans are loans extended on terms substantially more generous than market loans. Concessionalism is achieved either through interest rates below those available on the market, the impact of which can be further enhanced through a favourable, tenor or repayment profile<sup>5</sup>. Other aspects of structure may also make a loan concessional. For example, unless it is reflected in the pricing, lower seniority or a weaker security package of a loan would be considered concessional if commercial financial institutions would normally not accept it for a particular client in a particular market environment.

The most common element of concessionalism is the price, if it set at a level significantly (and demonstrably) below what is available in the market. Benchmarks for market terms of a loan are bank interest rates and fees of loans available in the market. Typical tenors and grace periods available can also serve as a benchmark, to the extent that unreasonably long tenors or grace periods can be seen as concessional, particularly when combined with below-market pricing<sup>6</sup>. In the case of equity investments, the typical benchmark would be the return required by a commercial equity investor for an investment with similar risk profile.

It is acknowledged that concretely assessing, in practice, the level of "the" market rate is often challenging, particularly in less developed economies, where local capital markets are typically underdeveloped or non-existent and borrowers may only have limited and sporadic access to international capital markets or commercial bank lending, if at all. More generally, when competition is limited and markets are illiquid, price signals may not provide a reliable benchmark, making it more difficult to assess the extent to which concessionalism is built into a given product. On the other hand, the presence of a concessional element is easiest to identify when it results from explicit blending.

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<sup>4</sup> When finance is provided where there is otherwise no access to market (i.e. the market rate is infinite), one could argue that such finance is implicitly concessional. However, we take a more narrow interpretation here.

<sup>5</sup> (OECD, *Glossary of Statistical Terms after: IMF, 2003, External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary, IMF, Washington DC*).

<sup>6</sup> In itself, the provision by a DFI of a longer tenor than available in the market represents a genuinely different service and is often seen as true additionality rather than concessionalism. An excessively long tenor (e.g. longer than the economic life of the underlying investment) can however be seen as a form of concessionalism.

### 3. Rationale for concessional finance in the private sector

The application of public funds to provide concessional finance to the private sector must be justified on the basis that it clearly addresses an identified market and/or institutional failure. While concessional finance can be justified as long as such a failure exists, the pursuit of a sustainable outcome would require that the underlying, systemic problem would also be addressed rather than relying on a permanent injection of concessional funds. In this context, it may, for example, be appropriate to use concessional finance in order to improve economic opportunities for targeted vulnerable groups, such as through the provision of certain services at an affordable price.

The starting point for the use of concessional finance by DFIs is the existence of *a gap between private and social returns, reflecting the presence of a market failure resulting from such phenomena as (un-priced) externalities.*<sup>7</sup> Relevant externalities are usually “public goods”, such as emissions reductions, enhancing biological diversity, providing open access to recreational areas, research and development and deployment of innovative technologies, or affordable provision of basic infrastructure services. The fact that these benefits cannot immediately be fully monetized by investors makes the private financial internal rate of return lower than the true economic rate of return for society. An element of concessionality (explicit or implicit in the financial terms) can then bridge the gap between private and social returns and make the project happen.

For concessional finance directed at the private sector to result in a *sustainable outcome*, there should be an expectation that similar private sector projects will in the future become viable without requiring concessionality. This implies some underlying structural change in markets, behaviours (e.g. the adoption of new technologies), or regulation (for example an appropriate system for pricing the externality) that will remove the need for concessionality. A focus on commercial sustainability in DFI concessional finance operations with the private sector implies therefore that concessionality in a particular sector would not continue to be provided for an indefinite period, in other words, concessionality would be time-bound.

An example of private sector projects that fulfil these expectations would be early investors (or first-movers) in a nascent market, such as firms introducing new energy-efficient technologies and business practices, or a farmer introducing sustainable agricultural practices, where these activities would not be undertaken because of their relative novelty, high perceived risk, or high initial cost of an undemonstrated market behaviour, currently adverse or as of yet still untested regulatory framework, or untested technology. Entry may be induced by concessionality that is temporary at the sector level, which demonstrates the long term viability of a commercial solution. Concessional finance that helps to “de-risk” individual projects in a market where the demonstration effect has the potential to be significant, or where cost or risk barriers are prohibitive, but are expected to decline over time, alter the incentives or the market structures, leading to commercial sustainability for later entrants.

Thus a gap between private and social return is usually considered to be the driving factor to justify concessional finance, but the argument does not stop there. Bridging this gap may not be sufficient to address the concerns that are further discussed in section 5 below regarding commercial sustainability and the reinforcement of markets. Achieving a commercially sustainable outcome may require parallel interventions, such as policy dialogue and technical assistance, to address the root causes of

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<sup>7</sup> Other market failures, such as asymmetric information, which leads to irrational risk aversion can also result in the under-provision of certain goods or services (e.g. lending to SMEs or to projects involving new technologies). Such market failures are usually addressed with technical assistance targeted at raising awareness and transferring knowledge and skills to affected audience. The use of concessional finance could also serve to overcome barriers related to behavioural inertia prevailing in a sector and demonstrate the potential for commercial replicability of actions undertaken by first movers.

underlying market failure(s). Concessional finance may nevertheless remain necessary if such interventions are not sufficient or possible at least in the short run.

Moreover, concessional financing only makes sense, indeed, if the project would not happen without it<sup>8</sup>, as a reasonable investor would decide not to proceed with a particular activity without the benefits of concessional finance.

Ideally the host country where the DFI support is intended would undertake activities on the regulatory or institutional fronts on their own, supported, as appropriate and when within mandate, by DFI policy dialogue or advisory services regarding regulatory change, or other activities that promote sustainability by increasing the probability of market transformation taking hold.

At the same time, it is recognised that there are differences between DFIs with respect to mandates, budgets, policies, strategies, priorities and capacities. Depending on the nature of their institutional objectives and the rationale for their interventions, some DFIs may place more or less emphasis on policy reforms and sustainable market transformation.

#### 4. Forms of concessional finance

Concessional finance can take different forms and each form can be deployed through specific financial products.

- **A grant** (a transfer of resources with no obligation and expectation of return) is perhaps the most transparent form of concessional finance since the subsidy component is equal to the grant's face value. Grants can be disbursed as capex or operational subsidies, for example as interest rate subsidies, or periodical payments for achieved and verified results (i.e. results based payments or performance-based financing products).
- **Debt instruments.** Debt finance can be concessional based on price (including interest rates and/or fees), tenor, subordination, repayment profile, and/or security. For example, concessional debt may involve interest rates that are below commercially available market rates for the given risk profile, and/or below-market interest rates combined with longer grace periods or tenors than available on the market.
- **Risk mitigation** products can be concessional in that they are not priced commensurate for the risk they cover. These products can help catalyse commercial providers of funding to support activities that may be perceived as too risky by commercial investors or lenders, and risk cover provided by commercial insurers may not be available or affordable. Risk mitigation instruments may also include partial credit guarantees, risk-sharing facilities (pari-passu or first-loss covers), structured debt funds, and securitizations.
- **Equity** can be concessional if the provider of the concessional equity agrees to accept a lower return for the risk undertaken, or buys the equity at a less favourable price than commercial investors. Equity – because of its lower rank of security for the investor – can also leverage additional debt finance, by improving the equity-to-debt ratio for the project. Equity is concessional only to the extent that the investor requires a lower risk-adjusted rate of return, thus facilitating the sponsor to invest in projects that are riskier than commercial investors would normally consider for such an expected return.

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<sup>8</sup> In other words, DFIs' standard market-based financial products must be insufficient to catalyse the investment.

Different forms of concessional finance may have the same level of concessionality measured in grant equivalents. There is no a priori universal advantage of using one form of concessional finance product over another in private sector projects, although transaction costs for each may vary. Each form of concessionality aims to address different underlying problems, whether these are related to access, cost, risk, or the cash-flow profile of the project. For example, if the main financing barrier is the high up-front cost of finance for certain projects/borrower types, then a structured concessional debt may be more appropriate than a risk sharing/guarantee product. If liquidity is available in the commercial market but high perceived risk is a barrier, then risk sharing may be more appropriate.

Each instrument of concessional finance can be *blended*. Blending takes place when non-concessional DFI resources are mixed with concessional funding provided by public agencies, it may be provided from donor funds alone with the DFI acting as an implementing agent, or, in the case of some DFIs, it may be provided directly on the balance sheet of a DFI from its own resources. Blending is just one way of delivering concessional finance, but it is increasingly being used because most DFIs are not allowed to offer funding from their own resources below their cost of funds and because it is perceived as a more transparent way of providing a grant element. It may also be more efficient to implement than parallel financings, because it provides recipients with a one-stop shop, reducing administrative costs and coordination issues.

## 5. Designing concessional finance products

With a robust rationale, concessional finance has the potential to catalyse private investments that deliver social benefits and that would not otherwise have happened with commercial financing or standard DFI financial products alone. However selecting *when* it is appropriate to use concessional finance is just the first step in its successful application. *How* it is used is equally important.

Careful structuring of individual concessional finance products enhances the catalytic effect while helping to mitigate risks that accompany the use of concessionality. Concessional activities carry significant risks of distorting the market, delaying the introduction of necessary policy reform, and undermining the development of sustainable markets (see the Box below). Understanding these risks is a necessary condition for effective application of mitigating measures through adequate design of concessional finance products. In all instances, it will be important to consider these risks by assessing the project's costs and benefits as a whole, beyond the concessional financing element.

Selecting and designing a concessional finance product and its structure should always follow an in-depth market assessment and be targeted and tailored to the specific context and the nature of the externality or financing barriers.

The following section discusses a set of principles that DFIs can employ with regards to design of concessional finance products for the private sector. These principles for structuring concessional funds are based on the *MDB Principles to Support Sustainable Private Sector Operations*. In order to provide context, the *MDB Principles to Support Sustainable Private Sector Operations* are highlighted in italics below.

**Box: Risks potentially associated with concessional finance**

Unless properly designed and executed, concessional finance may:

- (i) Undermine the formation of sustainable markets;
- (ii) Provide low value for money (waste of public funds);
- (iii) Misallocate resources in the economy (distortions), when concessional finance diverts scarce investment resources towards excessively risky, unviable or otherwise weak projects. Some specific risks are associated with concessional risk management products, such as “moral hazard” (encouraging imprudent, excessive borrowing) or “adverse selection” (allocating the lowest quality debt to the guarantee facility);
- (iv) Reduce overall funding available for targeted areas through crowding-out larger volumes of existing or potential private and development finance;
- (v) Discourage or delay commercial replication of underlying projects by entrenching expectations that they are not commercially viable (because subsidies are needed);
- (vi) Delay market transformation if concessional finance is seen as a substitute for the policy reforms that address the root cause of market and/or institutional failures and barriers;
- (vii) Encourage entrepreneurs to engage in activities that may not be productive from the perspective of their core business (e.g. writing grant applications rather than improving efficiency and competitiveness of products);
- (viii) Create conflict of interest for DFIs themselves;
- (ix) Cause negative distributional consequences if rich rather than poor households and regions capture the benefits.

- **Additionality**

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

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

- **Crowding-in**

*MDB support to the private sector should, to the extent possible, catalyse market development and the mobilization of private sector resources.*

**Application to concessional finance:** Concessional finance crowds-in sustainable private investments if it is structured to provide the missing element in the overall financing that makes private projects commercially financeable and if it successfully creates a demonstration effect of commercial replicability. The concessional finance embedded in a financing package should not be greater

than necessary to induce the intended investment (“minimum concessionality” principle) and maximise the leverage of private funding.

- **Commercial sustainability**

*IFI/MDBs support of the private sector and the impact achieved by each operation should be sustainable, both during and after their involvement. MDB support must therefore be expected to contribute to the commercial viability of their clients.*

**Application to concessional finance:** Operations supported with concessional funds should be designed to contribute to the commercial sustainability of the relevant activity or sector, avoid creating permanent dependency on long-term subsidies and prevent rent-seeking behaviour among private beneficiaries. To encourage commercial replication of individual operations supported by concessional finance on market terms and manage the expectations of subsidies among potential private sector beneficiaries, concessional programmes (at the sectoral level) should be *time-bound*, with credible expectations that they will be phased-out over time. When possible at the programmatic level, sunset clauses should be announced *ex-ante* to shape such expectations. When considering concessional support to specific projects, there should be an expectation that future investments in similar projects in a given sector will gradually require fewer subsidies and eventually no subsidies. However, depending on initial circumstances, commercial sustainability and independent commercial replication may only be achievable over time, possibly after several rounds of legitimate DFI interventions, that may or may not involve some and declining concessional element.

- **Reinforcing markets**

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

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

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

- **Promoting high standards**

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

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

When confidentiality permits, DFIs should aim to report on their concessional programmes, including quantification of subsidy levels and the results of these programmes, including, if possible, on the incremental impact of concessional finance.

- **Other Issues**

Consistent with many international conventions including the Paris Declaration and Accra Agenda for action, IFI support to the private sector using concessional resources will continue to be guided by country priorities and will continue to focus on results.

Where feasible and appropriate, concessional finance products supporting the private sector should be accompanied by targeted technical assistance and/or policy dialogue with the government to address the policy and institutional barriers to the commercial viability of projects in the sector. Such complementary activities can increase the probability of market transformation overall.

## **6. Governance and management**

When they pursue concessional finance projects DFIs have an interest in paying particular attention to governance to ensure transparency and accountability, keeping in mind that different DFIs have different structures and that they may only have limited experience in managing concessional finance products for the private sector. As noted in previous sections, there are significant market distortion and reputational risks inherent in providing concessional finance to private enterprises.

### *Transparency*

Transparency in internal decision-making with regards to the structure of (e.g. product, amount, tenor, price, fees, subordination, repayment, etc.) and justification for the application of concessional finance products to the private sector is very important. To the extent possible, internal transparency around the subsidy element should allow comparison with other financial products available on the market.<sup>9</sup>

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<sup>9</sup> A number of mechanisms have been successfully used to tune concessionality to the minimum required for the project to be financed. For example, for PPPs where there are a number of players in the market, the choice of partner can be based in part on a process of bidding down the subsidy element.

Externally, DFIs should seek to signal to the market the rationale for a given concessionality and the expected diminishing subsidy intensity trajectories, which are key to managing market expectations. There may be limits to transparency, in particular related to confidentiality or the need to prevent strategic gaming and rent-seeking behaviour of potential beneficiaries.

#### *Managing conflicts of interest*

Internally, DFIs should aim to avoid linking staff incentives or business targets to the volume of concessional finance to be mobilized and disbursed. Rather, incentives around the deployment of concessional finance should aim at encouraging efficient and innovative concessional finance products, enhancing results, leveraging private funds, and supporting the graduation of projects and sectors from the use of concessional finance.

Concessional funds by their nature will have a different risk/return appetite from DFI's own funds. When the concessional funding is deployed alongside or blended with DFI funds, internal conflicts of interests can arise. Governance and management structures may be designed to ensure clear lines of accountability for the use of concessional funds and of the DFI's own funds, due to the different incentives of each, and the moral hazards inherent in co-mingling management and governance, including the possibility that volume incentives disproportionately promote the use of concessional finance. DFIs may also choose to separate internal accounting and segregate funds in different accounts. Effective segregation of funds can improve transparency to both donors and clients.

#### *DFI Coordination*

Due to the increasing supply of concessional finance from donors, coordination among DFIs working in the same countries, regions or sectors is often encouraged. Where DFIs overlap in their geographic and sector focus, there is the potential for concessional finance from one institution to undermine a market-oriented structure from another institution. To the extent possible, DFIs should strive to coordinate their activities and underlying market assessment, including the appropriate use of concessional finance. DFIs could also engage in a dialogue with donors about coordinating levels of concessionality and design of facilities when operating in the same markets.

## **7. Summary**

It is recognised that in some situations concessional financing to the private sector is required to catalyse a project that will ultimately achieve commercial sustainability and contribute socially and environmentally responsible private sector initiatives.

- Channelling concessional public funds to the private sector may be justified when private returns deviate from social returns in the context of an under-priced externality and when such financing can eventually generate a sustainable solution through supporting some underlying structural change, for example to enhance equality of opportunity for explicitly targeted excluded groups. Other market failures, such as information asymmetries resulting in excessive risk aversion are best addressed by technical assistance or policy reforms. It is recognised, however, that there may be differences between the policies and practices of DFIs, reflecting differences with respect to mandates, budgets, policies, strategies, priorities and capacities. DFIs may place more or less emphasis on policy reforms and sustainable market transformation.
- The agreed *MDB Principles to Support Sustainable Private Sector Operations*, which are additionality, crowding in, commercial sustainability, reinforcing markets, and

promoting high standards, are an important consideration when applying and designing concessional finance. This points to the need to consider projects in their entirety, and, in particular, to pay close attention to these principles in structuring concessional finance projects.

- The particular application of *MDB Principles to Support Sustainable Private Sector Operations* to concessional finance for private companies implies careful targeting and calibration of concessional finance to reach sustainable outcomes, with a focus on ensuring also, when possible, that complementary activities help foster the conditions for further replication and avoiding long-term subsidy-dependence in a given sector.
- Commercial sustainability in DFI operations with the private sector would imply that subsidies to a given sector be time-bound and be phased-out over time. While long-term subsidisation of private companies is counter to the goal of sustainability, the required timeframe for subsidisation can only be assessed case-by-case, depending on the circumstances of any given intervention.
- A range of instruments, including grants, loans, equity, and risk sharing products, may be used as vehicles for concessional finance to the private sector.
- Good governance and management that provide for transparency and accountability for results are particularly important in this area.
- Business and staff incentives should not create a bias towards the use of concessional instruments. Instead, incentives should be aligned with the achievement of relevant, market compatible objectives through sustainable private sector activity.

This note aims to support DFIs when developing and reviewing internal policies, guidelines and/or procedures for using concessional financial products for the private sector. The guidance is meant to be used taking into account the respective mandates of the broad range of DFIs currently active in the private sector space.