

## Private Sector Development Synthesis Note

### Private sector partnerships to promote economic development - An overview of donor funds and facilities

January 2017

#### 1. Introduction

**Most bilateral donors aim to engage the private sector as a strategic partner across their work.** This includes an ambition to build longer-term and more equal relationships with the private sector. While donor agencies are beginning to explore new approaches that focus on co-developing a variety of collaborations and partnerships jointly with business (see also section 3 of this Note)<sup>1</sup>, a declining but significant sub-set of business engagement work is implemented through application-based funds and facilities. The majority of such funds are centrally-managed and aim to facilitate investments of donor country companies in developing countries to achieve commercial and development benefits.

**In such funds and facilities, donor support is typically awarded to winning proposals which are selected based on pre-defined criteria.** Support may consist in

- **Financial support for private investments or pre-investment activities (e.g. feasibility studies) in developing countries**, including through matching grants and/or loans or equity;
- **Technical advice** to businesses (either directly through programme staff or via grant support); and/or
- **Matchmaking services** that link companies with donor-funded programmes, implementing partners or business partners.

This note gives an overview of major business partnership funds and facilities that are publicised on donor agency websites, and that include economic or private sector development among their objectives. To allow for more focus and clarity, the note does *not* review facilities offering finance for infrastructure development or other forms for public-private collaboration, such as dialogue, advocacy or knowledge sharing.

Specifically, this note is based on the experiences of more than 20 funds and facilities supported by donor agencies. Section 2 provides an overview of their key characteristics as well as current trends; Section 3 summarises major issues and debates regarding donor partnership facilities. The Annex briefly summarises individual facilities of each donor agency.<sup>2</sup> Information on major funds and facilities that recently closed is also provided, to facilitate access to resources on lessons learnt. An up-to-date mapping table of active partnership funds and facilities is available on the DCED website.

#### 2. A brief summary of donor-funded business partnership programmes

- ❖ All partnership funds and facilities share the fundamental **objectives** of encouraging private investments that will stimulate local economies and ultimately benefit poor populations, including through access to better jobs, incomes, goods or services. A few programmes emphasize enterprise-level objectives such as

<sup>1</sup> For more information, see the DCED's 2017 briefing note on donor's transition to strategic private sector engagement.

<sup>2</sup> Note that a **detailed discussion of set-ups and experience of donor-funded partnership mechanisms** (excluding those providing financial support other than grants) is available in [DCED \(2013\): 'Donor partnerships with business for Private Sector Development. What can we learn from experience?'](#)

increased competitiveness, or transfer of technology and know-how, while others have a stronger focus on pro-poor business models and the social impact of a company's investment and practices. Even in the latter case, however, a common condition for donor support is that the project is of commercial interest to the company.

- ❖ **More than half of the programmes reviewed do not have any thematic focus** and are hence open to supporting businesses in any sector. Several others specify a range of possible sectors. Among the most popular sectors are agriculture or rural areas, manufacturing and renewable energy.
- ❖ **The most common form of financial support is matching grants.** The share of grant support in investments is usually up to 50%, although in some programmes it can be more, reaching up to 90%. Maximum support ranges from small grants of about US\$20,000 up to about \$1.5 mio, but in most cases it is higher than \$250,000. Almost all programmes specify a required private contribution. In some cases, the amount or share of support depends on the phase of the investment project supported (e.g. feasibility study or project implementation), size of the partner company, or the target country of investment. For example, Finnpartnership covers a higher share of project costs in low-income countries and Finnish SMEs than for upper-middle income country investments or large companies.
- ❖ **While most partnership mechanisms offer either grant support or loans and other forms of finance, a few have more recently opted for a flexible approach to the type(s) of finance they provide.**
  - The multi-donor funded Africa Enterprise Challenge Fund primarily offers matching grants, but can also provide interest-free, non-recourse loans (between US\$250,000 and US\$1.5m).
  - The multi-donor funded Global Innovation Fund offers grants, loans (including convertible debt), and equity investments ranging from US\$34,000 to \$15.3 mio (£30,000 to £10 mio), depending on the needs and capacities of the innovating company.
- ❖ **In another recent trend, a growing number of centrally managed funds and facilities are working exclusively through 'innovative' finance, including loans, loan guarantees as well as equity.** Most such initiatives can be described as impact investment, which refers to the practice of providing loans or equity into companies, organisations or funds with the aim to achieve development impact while generating less than a market rate of return.<sup>3</sup> However, only a few donor programmes, such as the new Dutch Good Growth Fund, currently award returnable capital directly to business.

A more common emerging practice is to fund intermediary institutions to increase financial access for inclusive businesses. Such initiatives are often still presented as part of agencies' business partnership portfolios. For example, the Good Growth Fund also invests in intermediary funds providing finance to developing country SMEs. Another major example is DFID's Impact Programme, which provides capital to investment vehicles that reach poor producers or consumers. Sida's Innovative Finance Programme offers loans and guarantees to institutions lending to businesses that invest in risky projects or regions. **All of these initiatives complement other, more traditional development finance vehicles in donor countries** which provide long-term risk capital for private projects in developing countries;<sup>4</sup> however, given that they do not directly support projects proposed by businesses, they are not reviewed here in more detail.

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<sup>3</sup> See for example [DFID](#), [Mulago Foundation](#) and [GIIN](#).

<sup>4</sup> For a full list of European Development Finance Institutions <http://www.edfi.be/members.html>

- ❖ **Cash grants to businesses are typically focused on supporting one or more of the following types of early stage activities:** Market research and feasibility studies; prototype development and testing; partner identification and visits; supply chain and distribution network development and trialling; and/or purchase of capital goods such as new machinery or other equipment that is critical for the implementation of the project. **Technical advice** is another major area of support; donor-funded facilities may either co-finance the costs of external consultancy services or offer advice in-kind. Frequent areas of advisory support include the pro-poor design of a company's business model, staff or out-grower training, improving financial management, sector- or country specific advice, or compliance with industry standards. Some facilities also assist businesses in identifying additional sources of financial or technical support, or in engaging in dialogue with government.
- ❖ A few donors fund **separate match-making mechanisms** to help companies identify business partners or implementing organisations before making an investment. For example, the Netherlands' Matchmaking Facility is exclusively dedicated to linking up companies from developed countries with potential partner companies in developing countries. Other initiatives help companies find implementing partners for development projects (e.g. Australia's Business Partnerships Platform).
- ❖ **Most business partnership programmes award support directly to a company; a few programmes, however, formally require the participation of a non-profit organisation** which receives matched contributions from both a donor and a company to implement a project, typically relating to the company's supply chain. Examples include USAID's Global Development Alliance; Danida's Market Development Partnerships, or Sida's Public Private Development Partnership Programme. In the case of GIZ's Integrated Partnerships, companies contribute technologies or other resources to existing development cooperation projects in a way that also benefits them commercially.
- ❖ **Several programmes require a certain size and annual turnover for potential partner businesses;** they also typically require a few years of operations on the market and exclude new start-ups from support. A few programmes specifically offer **different support windows** for SMEs and larger applicant companies, such as Finnpartnership.
- ❖ **Five centrally-funded programmes** (including matchmaking facilities) **are currently tied**, i.e. only open to domestic companies in the donor country (e.g. Finnpartnership), **while others seem to be open to businesses from any country** (e.g. Global Innovation Fund), and **or a regional sub-set, such as European or African businesses** (e.g. Germany's DeveloPPP programme and Africa facility).
- ❖ **The majority of programmes are centrally-managed mechanisms that support business projects in any developing partner country of the donor government.** In addition, **5 major facilities have been identified which operate at the national or regional level.** Moreover, many PSD programmes now integrate challenge funds as one of the programme components; such funds are not included here as they tend not to be widely publicised.
- ❖ **Eight major donor-funded partnership mechanisms have recently terminated or temporarily closed.<sup>5</sup>** The Three rationales for closure are typically proposed:

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<sup>5</sup> These include, with closing years indicated in brackets: The former AusAID Enterprise Challenge Fund (2013); Danida's Business Partnership Programme (2014); The Business Innovation Facility Pilot (2013); Sida's Innovation against Poverty

- **The planned programme duration has come to an end.** In some cases, donors are planning to review experiences and are considering launching new funding rounds in the future.
- **The partnership mechanism has been replaced by a new type of programme or approach to working with the private sector.** This is the case for the Business Innovation Facility pilot, which provided technical support to innovative business models on a competitive basis. It has been redesigned as market systems development programmes in five countries, with a greater focus on market analysis, flexible collaborations with businesses and no centrally-managed business proposal competitions. The Netherlands' Private Sector Investment Programme, a matching grant facility, which has been superseded by the Dutch Good Growth Fund (a returnable capital facility). In the case of Australian DFAT, its Enterprise Challenge Fund has been replaced by the Business Partnerships Platform; the platform is also an application-based fund but has been designed in consultation with the Australian private sector and stresses DFAT's non-financial offer (e.g. knowledge of local business environments and partner governments), in addition to financial support.
- **The programme was not considered effective in achieving the desired economic development objectives.** For example, Danida's Business Partnerships Programme has been suspended in 2014 following an independent [evaluation](#). A note on the website explains that "this decision follows an evaluation (...) which concluded that the effect on job creation and sustainable growth in developing countries has not been sufficient. Furthermore, there has been unclarity with regard to EU rules."

### 3. Key issues and debates in the context donor partnerships with business

Current discussions on the effectiveness of funds and facilities for partnering with business can be grouped into two categories, which will be further explored below:

1. The first category is about lessons and debates regarding the design and implementation of funds and facilities that invite proposals from business. In other words, if donors choose a challenge fund or similar approach to working with business, what are key issues to consider?
2. The second category is about looking at partnership funds and facilities in the broader context of approaches to working with business and their effectiveness in achieving 'shared value' – i.e. lasting commercial and development benefits.

#### 3.1 Lessons and debates for funders and implementers of partnership funds and facilities

**Eligible companies: It is important to align eligibility criteria for companies with the funds' objectives, as well as managerial and financial capacity**

- While **smaller businesses** may be in greater need of grants to progress, smaller grants tend to be as expensive to manage as larger grants, and smaller businesses may require stronger involvement of project staff to provide technical advice and management support to succeed. **Larger businesses** may have more human and financial resources to ensure effective project implementation and achieve large-scale or systemic development impacts; the additionality of support may however be harder to demonstrate. Assessments of three partnership programmes concluded that grant funding level

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challenge fund (temporarily closed in 2013); DFID's Responsible and Accountable Garment Sector Challenge Fund (2013), Food Retail Industry Challenge Fund, and Trade in Global Value Chains fund (2016); the Netherlands Ministry's of Foreign Affairs Private Sector Investment Programme (2014) and PPP Facility for Sustainable Entrepreneurship and Food Security (temporarily closed in 2016).

should not be too small (e.g. not less than around \$26,000) due to lower administrative effectiveness and the difficulty to demonstrate development impacts.<sup>6</sup>

- **International companies** tend to be more experienced and their background can be more easily checked before partnerships are being established. **Developing country companies**, however, may have greater knowledge of the local context and market but may involve more risks in terms of financial robustness and it may be more difficult to check for reputational risks (e.g. linked to past behaviour).
- **The practice of tied aid** may trigger market distortions by promoting businesses that might not otherwise be the best ones to work with to achieve development results in the target country.<sup>7</sup> The OECD's 2016 peer learning report on private sector engagement further points out that "a focus on domestic commercial interests undermines co-ordination with other DAC members that continue to uphold the commitment to untied aid. If DAC members focus on their own commercial interests, it is more difficult for them to harmonise efforts, co-ordinate, pool resources and pursue joint initiatives."<sup>8</sup> On the other hand, practitioners sometimes stress that communication with domestic businesses can be easier and more efficient from a linguistic and geographic point of view. More recently, however, there seems to have been a decline in tied facilities in favour of more open mechanisms to identifying partners.

**Matching grants versus other types of financial support: Many open questions remain regarding the effectiveness of different kinds of financial support.**

- **Donor agencies are increasingly complementing grant support with other forms of finance, such as loans, loan guarantees or equity, or setting up new mechanisms that only provide returnable capital to inclusive businesses.** In the UK, for example, the International Development Committee notes that more bilateral support to the private sector provided as returnable capital "could potentially play a greater role in a future strategy, and repayments received from investments in successful private sector enterprises could be recycled to fund further ventures."<sup>9</sup>
- **While these approaches may cater to the financing needs of diverse grantees in flexible ways, various questions remain.** They include whether returnable capital is more effective than other approaches in achieving development impacts; how it affects the working and accountability relationships between donors and recipients; whether it can legitimately qualify as development aid; how it relates to development finance and commercial banks; and if donor agencies have the capacity to manage such finance. Brain, Gulrajani and Mitchell (2014) note that administering grants is much easier and cheaper than loan, equity or quasi-equity financial instruments. Further, "if adopted, donor organisations will need to develop longer time horizons and a more nuanced range of criteria by which to assess the results of challenge funds, to accommodate these financing options."<sup>10</sup>

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<sup>6</sup> Triple Line Consulting (2011): Enterprise Challenge Fund for the Pacific and South-East Asia. Independent Progress Report, for AusAID; KPMG (2012): Evaluation of the Finnpartnership Programme, 2006-2011, p.5; Kindornay, Higgins and Olender (2012): Models for Trade-Related Private Sector Partnerships for Development, North-South Institute, p. 33.

<sup>7</sup> Alberto Lemma and Karen Ellis (2014): Centrally managed donor funds and facilities to promote business engagement, ODI.

<sup>8</sup> Private Sector Engagement for Sustainable Development: Lessons from the DAC, OECD, 2016.

<sup>9</sup> International Development Committee (2014), The future of UK Development Cooperation. Phase 1, Development Finance.

<sup>10</sup> Adam Brain, Nilima Gulrajani and Jonathan Mitchell (2014): Meeting the challenge: How can challenge funds be made to work better. A similar remark has been made in a [recent review of the Africa Enterprise Challenge Fund](#).

**Central versus country-level fund management: There are clear trade-offs between a narrow or wide geographical focus of partnership facilities.**

- **Country and regional level mechanisms** typically have a shorter management chain, probably resulting in a more cost-effectiveness; closer proximity to bidders, resulting in better evaluation of applicants' capacity and financial condition; easier problem-solving assistance for implementation difficulties; greater context-specific knowledge to assess the relevance of the proposed project; and easier integration of partnerships with other donor projects and initiatives.<sup>11</sup> The ability to assess the applicants' financial capacities as well as alternative sources of finance in the target market also mean that country-level mechanisms may find it easier to assess the additionality of donor support.<sup>12</sup>
- On the other hand, **advantages of centrally-managed funding mechanisms** may include: greater knowledge sharing and world-wide cross-learning among bidders, donor staff, and other donors based on the compilation of results and emerging lessons from the funded projects; the ability to attract a wider range of potential business partners or amount of good quality proposals; as well as a better ability to create linkages between companies from donor countries with developing country businesses.<sup>13</sup>

**Two key bottlenecks for enhancing effectiveness and learning from experience: Additionality assessments and measurement of results**

The DCED review of experience in donor partnerships with business ([DCED, 2013](#)) identified two key areas that partnership funds and facilities could improve:

- First, they typically had no internal guidelines for assessing additionality ex-ante, i.e. whether the business could and would implement the project without donor support. Existing assessment criteria were often limited or vague, and assessments relied too heavily on information provided by applicant businesses.
- Secondly, it found that the increasing interest in partnership mechanisms has not been matched by a growth in the evidence base regarding their impact. Few results were publicly available, and if so, they were generally anecdotal without credibly examining the impact. Reasons include limited resources made available for results measurement, and a mismatch between expectations on businesses to provide data on results, and their ability and incentives to measure them.
- A growing amount of research and evaluations, as well as new DCED good practice documents<sup>14</sup> have been instrumental in bringing attention to these issues, and that donors and practitioners are showing increasing interest in addressing them.

**'Hands-on' versus 'light touch' project management approaches: Partnership facilities with very small management budgets are no longer perceived as an effective development approach.**

- In the pursuit of cost-effectiveness, donor funds and facilities for partnering with business have traditionally been designed as **'light-touch' mechanisms**: management capacity and interaction with businesses were kept to the necessary minimum.

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<sup>11</sup> Ebony Consulting International (2003): Mid-term review of the Financial Deepening Challenge Fund, Sec.] 4, p.3.

<sup>12</sup> DCED (2014): Demonstrating Additionality in Private Sector Development Initiatives. An exploration of good practice for challenge funds and other cost-sharing mechanisms.

<sup>13</sup> Ebony Consulting International (2003): Mid-term review of the Financial Deepening Challenge Fund, Sec. 4, p.3.

<sup>14</sup> See DCED (2014): [Demonstrating Additionality in Private Sector Development Initiatives. An Exploration of Good Practice for Challenge Funds and other Cost-Sharing Mechanisms](#); and DCED (2013): [Measuring Results in Challenge Funds. Practical Guidelines for Implementing the DCED Standard](#).

- However, it has been increasingly recognised that a light touch approach may be a false economy as it **undermines the effective use of aid funds**. For example, Brain, Gulrajani and Mitchell (2014) note that *“allowing insufficient funding to conduct robust design and sufficient market system and sector-specific research to understand how projects could have a catalytic effect, without disadvantaging other businesses in the sector, is poor development practice.”*<sup>15</sup> Similarly, interviews with practitioners for DCED good practice guidelines have demonstrated that sufficient management capacities are required to enable an adequate assessment of **additionality** before awarding support to business, and to facilitate credible **results measurement** during project implementation.<sup>16</sup>

To read more about these and other lessons learnt and debates, please refer to the evaluations and reviews of recent and ongoing partnership funds and facilities on the [DCED’s knowledge page on the theme](#).

**3.2 Application-based funds and facilities in context: Moving beyond transactional mechanisms to achieve ‘real’ partnership?**

**Current discussions on private sector engagement indicate that many traditional funds and facilities for working with business are no longer considered as ‘fit for purpose’ to develop strategic and genuine partnerships with business.** This is documented in more detail in the DCED’s consultative briefing note on **How donor agencies can make the transition to strategic private sector engagement (2017)**:

- **In traditional donor funds and facilities, the process for entering collaborations has been top-down:** The overall companies are invited to submit proposal in light of criteria pre-defined by donors (e.g. with support being tied to certain types of businesses, activities, sectors and/or development objectives). Gaining an understanding of companies’ needs and priorities has tended to be an afterthought, rather than the starting point of collaborations.
- **In traditional models, working with business also tends to be transactional and one-off in nature:** Donors typically cost-share two-to-four year projects with companies, whereas NGOs may be contracted by governments or companies as implementers. These roles don’t always maximise partners’ strengths and resources or are able to cater to diverse company needs and development objectives. Further, common measures of success, such as the amount of finance leveraged or number of joint projects supported, don’t reflect the quality and outcomes of engagement.

**As a result, donor and other development agencies are looking for ways to engage the private sector on more equal terms (e.g. by taking several months or even years to jointly develop shared value partnerships from scratch) and to build longer-term relationships with strategic business partners.** Some agencies also maintain application-based funds and facilities but have changed their design significantly to be aligned with strategic private sector engagement objectives. For example, they may be much more flexible in terms of eligible applicants; projects to support and types and amounts of financial support to provide (e.g. innovation funds); or they may allow staff to access funds if they have identified promising partners outside of existing programming frameworks (e.g. DFID’s planned Business Partnership Programme). Agencies are also changing their internal structure, roles and responsibilities, and staff capacity to facilitate such changes in engagement practices. (see DCED, 2017 for more details).

<sup>15</sup> Adam Brain, Nilima Gulrajani and Jonathan Mitchell (2014), p.24.

<sup>16</sup> See footnote 14.

**By opting for more flexible and business-driven approaches in engaging the private sector, donor agencies also seem to be incorporating lessons from in-country market development programmes.** These also aim to facilitate scalable pro-poor business models, but differ from application-based funds in their strategies to achieve this (see the [DCED Synthesis Note](#) on this topic).<sup>17</sup> Similar to the emerging private sector engagement approaches of some donor agency headquarters, market development programmes emphasise the importance of starting out with an analysis of markets and business incentives, and co-develop partnership activities jointly with business partners.

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<sup>17</sup> See also *DCED (2013): [Matching Grant Schemes and Systemic Approaches for Private Sector Development - Are they complementary? DCED Synthesis Note.](#)*