

# Private Sector Development Strategy

## Prosperity for all: making markets work







# Private Sector Development Strategy

## Ministerial Forward

Creating the right conditions for businesses to expand and grow is essential if we are serious about achieving the MDGs. If we want people in developing countries to have the chance to get a job and earn a decent living, if we want parents to be able to provide for their children, if we want families to have access to affordable goods and services, and if we want to make poverty history for millions of people around the world – we need to put the private sector at the heart of the way we work. This strategy sets out how we will do that.

The Millennium Development Goals (MDGs) are about helping people to realise those simple ambitions. And the UK is committed to providing the support they need to do that.

Governments don't have all the answers. The World Bank estimates that 80% of poverty reduction is due to economic growth. It is the private sector that drives the economic growth developing countries need. It is companies that offer people the chance to get a job and earn a living. It is the private sector that creates wealth and helps individuals and nations lift themselves out of poverty.

The private sector does not just mean multinational companies. Small firms and enterprising individuals matter just as much.

If we want to achieve the MDGs and make a difference to the lives of the poorest we need to work with businesses – small and large – to create jobs, drive growth, and raise the incomes of the poorest.

This strategy will prioritise three things: firstly, it will help businesses – from multinational companies to individual entrepreneurs to provide jobs and deliver goods and services. Secondly, it will improve market access by rewarding investment and private enterprise and giving poor people the opportunity to make better use of local and international markets. And thirdly, it will enhance competition by helping governments to tackle constraints such as corruption, excessive regulation and weak transport links.



**Mike Foster MP**  
Parliamentary Under-Secretary of State  
for International Development










# Table of contents

	<b>Executive Summary</b>	<b>4</b>
	<b>List of Figures</b>	<b>7</b>
	<b>List of Tables</b>	<b>7</b>
	<b>Text Boxes</b>	<b>7</b>
	<b>List of Acronyms</b>	<b>8</b>
<b>1</b>	<b>Putting wealth creation at the heart of development</b>	<b>9</b>
	▶ 1.1 Private companies – the route to prosperity for all	10
	▶ 1.2 Where's the evidence?	12
<b>2</b>	<b>The case for intervention</b>	<b>15</b>
	▶ 2.1 Overcoming market failures and inefficiencies	15
	▶ 2.2 Avoiding state failure	17
	▶ 2.3 The political economy of PSD	17
	▶ 2.4 Global trends and local influences	19
	▶ 2.5 The donor response	20
	▶ 2.6 An agenda for PSD donors	21
<b>3</b>	<b>DFID's private sector development strategy</b>	<b>22</b>
	▶ 3.1 DFID's core PSD competencies	23
	▶ 3.2 Access, Competition & Engagement (ACE)	24
<b>4</b>	<b>Working with business for sustainable development</b>	<b>26</b>
	▶ 4.1 New approaches to business: pushing the boundaries	27
	▶ 4.2 Growth and the investment climate	32
	▶ 4.3 Successful and responsible: managing social and environmental risk	33
<b>5</b>	<b>Making markets work in partner countries</b>	<b>34</b>
	▶ 5.1 Making markets work better for the poor	35
	▶ 5.2 Supporting inclusive market development	38
	▶ 5.3 Improving the performance of international agencies	40
	5.3.1 Multilateralism with 'edge'	40
	5.3.2 Development finance institutions	41
	5.3.3 Infrastructure development facilities	42
<b>6</b>	<b>Research, innovation and knowledge management</b>	<b>43</b>
<b>7</b>	<b>Priorities and risks</b>	<b>46</b>
	▶ 7.1 Sharpening the focus	46
	▶ 7.2 Key risks and mitigation	47



# Executive Summary

About 2.6 billion people live on less than \$2 a day. Everyday, roughly half of the world's population struggle to earn enough income through employment and selling products from their farm and households. Poor men and women participate in markets to meet their needs for food, housing and services such as transportation. But these markets are often difficult or costly to access for poor people. They may be informal, uncompetitive and may not meet the needs of the poor effectively. The world's poor are not well integrated into the global economy and do not get access to its benefits. Amartya Sen has described participation in economic interchange as a basic part of social living and argues that economic freedoms are closely tied to political and social freedoms.



The core of the DFID Private Sector Development (PSD) Strategy is to make markets function better and with greater fairness. More accessible and competitive markets enable poor people to find their own way out of poverty by providing more real choices and opportunities. Markets that function well have wider economic benefits too. They encourage firms to innovate, reduce costs and provide better quality jobs, goods and services to more people. Wealth creation is at the heart of development. The evidence is clear – increasing incomes amongst the poor leads to better educated and healthier poor people. The involvement of poor people in economic growth is the best way to get people out of poverty and represents the exit strategy for aid. Sustained economic growth in developing countries is essential if we are to reach the Millennium Development Goals (MDGs). Growth lies behind about 80% of the poverty reduction that has been achieved so far and is needed to finance the achievement of the other MDGs as well. *Growth: a step change in DFID engagement* sets out our vision for sustainable development. DFID's PSD Strategy describes how that vision can be achieved.

The private sector is the engine of innovation, investment and growth. Vibrant, competitive markets populated by dynamic private companies offer the most effective way to create wealth, jobs and prosperity for all on a sustained basis. Nine out of ten jobs in the developing world are in the private sector.

DFID will help maximise the private sector impact on the MDGs in three ways:

1. Working with international and domestic private companies to boost the positive impact of their core business.
2. Working with developing country governments and international agencies to create an environment that supports the growth of business. Specifically, this means reforms that allow markets to work with greater efficiency and fairness.
3. Investing in research and knowledge management that supports private sector development.

## ► 1. **Working with business to support sustainable development.**

DFID's objective is to leverage the maximum impact from the private sector on the MDGs. This means responsible businesses operating in a healthy investment climate, producing not only growth and jobs, but also innovative solutions to development challenges.

DFID expects companies to be responsible for the social, environmental and economic risks in their areas of operation, and will work with them to achieve this. This is particularly true in sectors such as mining and construction where companies have a large social and environmental 'footprint'. DFID will work to ensure that business concerns on the investment climate are reflected in the national plans of developing countries. We will encourage companies that are developing new approaches and extending 'core business', to engage the poor and have transformative impacts. This includes assisting business to invest in new supply chains that make their goods and services accessible, available and affordable to poor people. A good example is the Health Product Development Partnerships to accelerate the development and use of new drugs and vaccines for significant but neglected diseases in developing countries. DFID will look to new partnerships under initiatives such as the Environmental Transformation Fund to harness the resources of private companies to meet the challenges of climate change.

## ► 2. Working with governments and international agencies to promote inclusive market development.

DFID will use its decentralised in-country presence, technical expertise and untied flexible aid in a limited number of low-income countries. The core of the Strategy is to make markets accessible, competitive and work in a way that involves and benefits the poor. This type of inclusive market development will encourage private companies to invest more, create more jobs, and widen the access of poor people to markets, goods and services.

DFID will use its shareholding and co-financier roles to improve the private sector development performance of international development agencies. DFID will work with other aid agencies to refine and promote inclusive market development as a way to support private sector led growth. DFID will also challenge international financial institutions to raise the proportion of their investments in low income countries and 'frontier markets'.

## ► 3. Improving research, and knowledge management on PSD issues.

Better knowledge of the most effective ways to support PSD will improve DFID's work with companies, as well as with governments and aid agencies. Consensus has emerged around the conditions necessary to stimulate bursts of private sector growth in low income countries. However, we know less about how to generate private investment that produces and sustains jobs, higher incomes and tax revenues in the longer term. To improve PSD programmes, we need to know more about the impacts of private sector development programmes. To obtain and spread this knowledge, DFID will establish a major new global resource centre to deliver world class research and support on growth to developing countries. The International Growth Centre will provide high-quality, practical, analytical and policy support to developing countries on PSD, drawing on a network of growth experts.

To make the biggest possible impact, DFID will focus its PSD activities in technical areas where we are recognised to be a lead development partner. DFID will focus geographically on Public Service Agreement (PSA) countries and frontier economies. DFID is not well placed to be a large scale 'retailer' of private sector development programmes and will instead work with the international community to deliver such programmes.

In 2006 the UK Parliament's International Development Committee tasked DFID to develop a Strategy which clearly articulated how the Department will support private sector development as part of its growth agenda. The Strategy is targeted at DFID's development partners – in government, the private sector, civil society and other developing agencies – who are interested in working with the Department on private sector led growth.





## List of Figures

1. What the private sector offers
2. Paths out of poverty
3. Poverty reduction is closely associated with growth
4. Growth and private investment
5. Private investment and poverty reduction
6. The rising importance of non-ODA flows
7. Three elements of the DFID PSD Strategy
8. DFID's approach to working with companies
9. New bank accounts in South Africa

## List of Tables

1. Main types of market failure and their consequences
2. Different country contexts and their implications
3. The Access Competition Engagement Framework

## List of Boxes

1. Informality and PSD
2. Women face greater barriers in business
3. Food subsidies in India
4. Business Call to Action
5. The Food Retail Industry Challenge Fund
6. Health Product Development Partnerships
7. The Multi Fibre Arrangement forum
8. International Institute on Business and Human Rights
9. DFID's new Competition Assessment Framework
10. Send Money Home
11. Crowding in private sector players in Bangladesh
12. One million Kenyans bank by phone

# List of acronyms

ACE	Access Competition Engagement
AFT	Aid For Trade
BDF	Business Development Facility
BERR	(Department for) Business Enterprise and Regulatory Reform
BRICs	Brazil, Russia, India, China
CAF	Competition Assessment Framework
CDC	CDC group plc (formerly Commonwealth Development Corporation)
CoST	Construction Sector Transparency Initiative
DFI	Development Finance Institution
DFID	Department for International Development
EITI	Extractive Industries Transparency Initiative
ETF	Environmental Transformation Fund
FRICH	Food Retail Industry Challenge Fund
GAVI	Global Alliance for Vaccines and Immunisation
GDP	Gross Domestic Product
GPOBA	Global Partnership for Output Based Aid
IFC	International Finance Corporation (part of World Bank Group)
IFI	International Financial Institution
IFFIm	International Finance Facility for Immunisation
ILO	International Labour Organisation

M4P	Making Markets Work Better for the Poor
MDG	Millennium Development Goal
MeTA	Medicines Transparency Alliance
MFA	Multi-Fibre Arrangement
MNE	Multinational Enterprise
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PDP	Product Development Partnerships
PEAP	Poverty Eradication Action Plan (Uganda)
PIDG	Private Infrastructure Development Group
PPP	Public Private Partnership
PRBS	Poverty Reduction Budget Support
PSA	Public Service Agreement
PSD	Private Sector Development
RDB	Regional Development Bank
SME	Small (and) Medium Enterprise
TPDS	Targeted Public Distribution System
UN	United Nations
WBG	World Bank Group
WHO	World Health Organisation





# 1

## Putting wealth creation at the heart of development

**“...perhaps for too long we have talked the language of development without defining its starting point in wealth creation – the dignity of individuals empowered to trade and be economically self-sufficient”**

Gordon Brown, UN, July 2007

Billions of people remain in poverty. And this is despite concerted efforts to meet the MDGs – especially the goal of halving the number of people in poverty by 2015. The underlying reason for this is that poor countries have not been able to grow fast enough, or sustain the type of broad-based growth which generates the jobs and incomes which get people out of poverty. Poverty reduction depends on sustained economic growth. It will not be enough to simply redistribute existing resources. The best way to pull people out of poverty, the real exit strategy from dependency on aid, is inclusive growth. Economic growth is driven by private investments and improved productivity. A vibrant private sector depends on a business environment that is conducive to private investment. The business environment is better where there is: effective government, efficient markets, and strong human development.

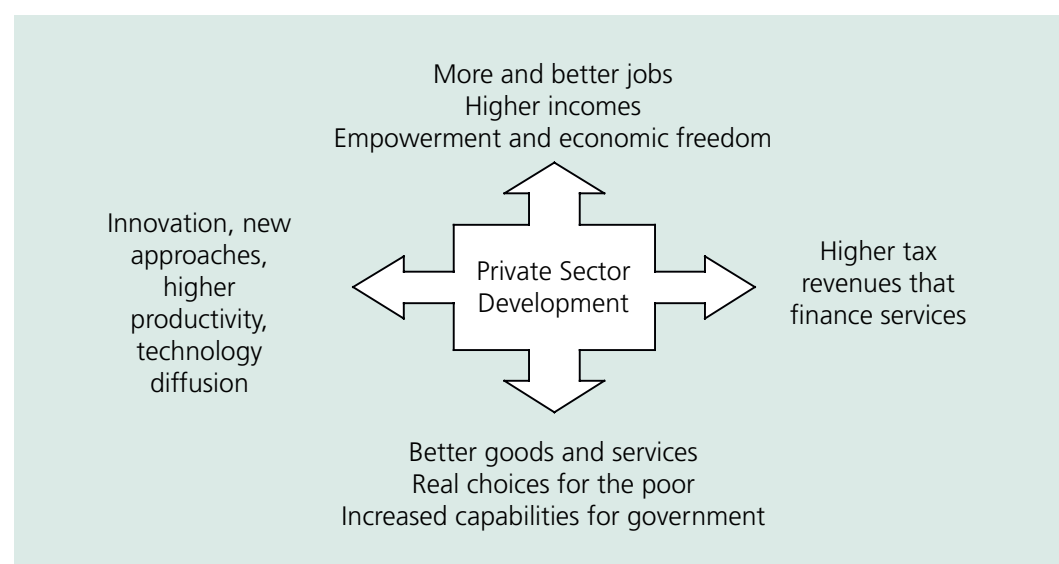
Governments in developing countries are under urgent political pressure to find employment opportunities for the 400 million young people between the ages of 15 and 24 that are seeking work. Many of these are in countries affected by conflict. Governments also need to find sustainable ways to finance their operations. Private companies who drive growth and create jobs are the major source of tax, but revenue collection in many African countries is only 10% of GDP. Without a sustained source of domestically generated revenue, governments are in no position to provide essential public services such as health and education to their citizens.

If they are to generate jobs, raise tax revenues and deliver poverty reduction, poor countries need stronger private sector development. A bigger private sector role in development can accelerate wealth creation among the poor. DFID can play a key role here by focusing attention on private sector development, and by moving wealth creation to the top of the development agenda. DFID can scale up successful partnerships already established with the private sector, and continue to devise new ways of working with private companies.

## ► 1.1 Private companies – A key component of prosperity for all

There are many participants in the private sector, from small-scale farmers and traders right through to large international companies. Because successful private companies are the engine of growth, and the main long term source of jobs and incomes it is vital for the wellbeing of a society that there is a vibrant private sector. The contribution private companies can make to development and prosperity is dependent on their success. Successful companies are usually investing, improving productivity, employing people, paying salaries, providing goods and services, generating profits and paying taxes. Figure 1 shows the main areas where private sector development makes a positive contribution to development.

**Figure 1: What private sector development offers**



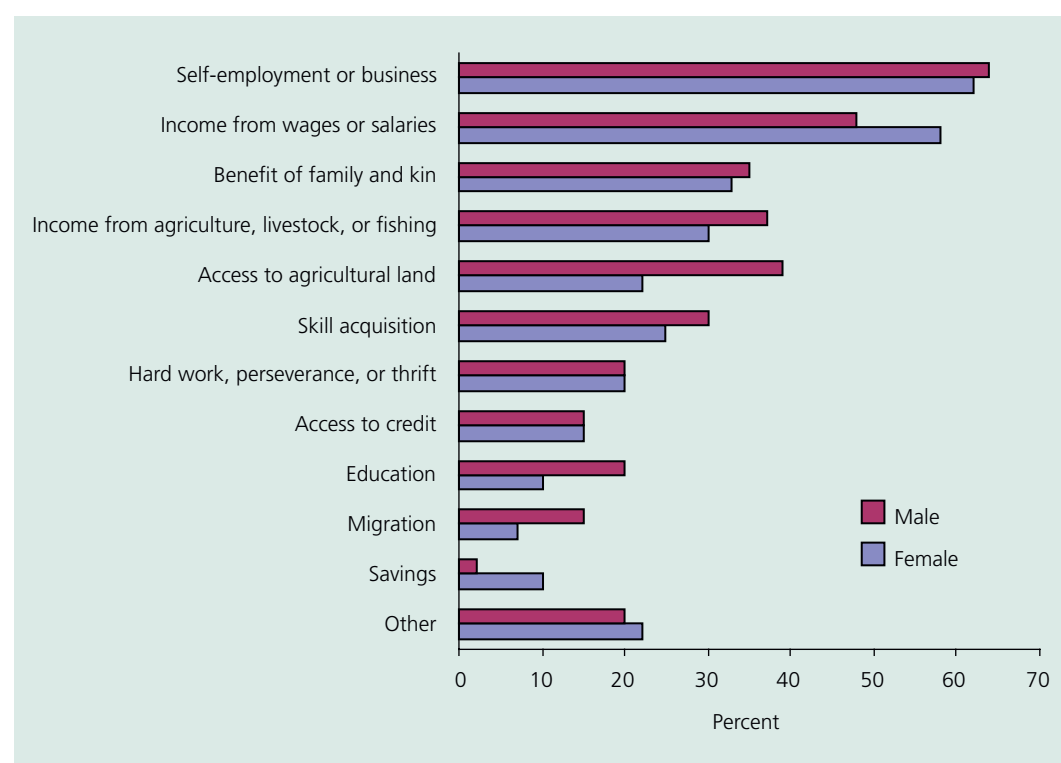
Central to the private sector contribution is its role as the ‘engine of growth’. Productivity improvements and investment drive growth, and improvements in productivity result from private sector innovation. Competitive pressures in markets increase efficiency (the best use of resources) and provide incentives for continued innovation and investment.



In many developing countries, the Government is the main provider of formal employment. However, the public sector can only offer a limited number of jobs, and as more young people enter the labour market, private companies become the primary source of *future* employment opportunities. For many poor men and women, getting a job is the way out of poverty. The World Bank's report, *Voices of the Poor*, surveyed around 60,000 poor people and asked them what they saw as their best escape route from poverty. The answer was unequivocal: wages or self-employment. But despite these aspirations, youth unemployment remains a major development challenge. According to the 2005 World Development Report, youths in developing countries are twice as likely to be unemployed as the average adult.

**Figure 2: Paths out of poverty**

**How 60,000 poor people thought they might escape poverty**



The taxes that private companies and individuals pay fund core government functions such as delivering health and education services. Effective tax collection from companies and individuals builds capacity and accountability on the revenue side of public finance, as well as providing resources for public expenditure. A recent DFID study conducted for the *Growth: a step change* paper found that across low income countries, a 10% increase in per capita income saw a 12.7% increase in tax revenue and 11% increases in education and health expenditure.

For poor men and women, the private sector offers empowerment. In developing countries, much of the private sector is made up of small household or informal enterprises. The poor live in the private sector – they buy and sell labour, goods and services in private informal markets. When poor people create or join an enterprise they gain voice and dignity. When they earn higher incomes they increase their ability to exercise choices and reduce their vulnerability. Creating wealth and achieving economic independence for the poor is at the heart of what we mean by 'development'. Amartya Sen has described participation in 'economic interchange' as a basic part of social living, noting that economic freedoms are closely linked with political and social freedoms. Consequently, when markets do not function in a fair and efficient way, it is the poor who suffer.

## Informal employment on the rise



A high proportion of informal freelance employment in an economy normally goes alongside low levels of development and high levels of market regulation. So why with positive growth and market-oriented reforms in many developing countries, is informality still *rising*?

One part of the answer is that market reforms need to go further, to tackle the micro-economic environment in which small businesses operate. Another is to understand that informal business in the developing world is different than elsewhere. Traditionally, informal employment has been understood to be involuntary: a form of survival by 'surplus' workers 'queuing' for the scarcer, more desirable formal sector jobs. However, the informal freelance sector in developing countries – especially those experiencing growth – can also be vigorous and entrepreneurial. Informality in this case is often an intentional response by small companies driven by competition to reduce the impact of regressive taxes and high labour costs

It is also important to appreciate how individuals and social groups experience regulation differently. One of the features of informality in many developing countries is that specific social groups and castes are often more highly represented. In many countries women dominate the informal economy.

Grasping these distinctions points towards distinct types of policy solutions. Where informality is involuntary, broad growth strategies, including the provision of infrastructure,

access to credit and Markets for the Poor programmes are likely to be appropriate. Where businesses choose to stay informal, a closer look at the design of tax regimes, social security systems and deregulation is recommended.

The private sector is not a 'sector' in the way we refer to transport or education. Private companies are part of the fabric of society and operate in all the areas important to the lives of the poor. Also, private companies can have a different performance culture to government agencies. They are often subject to competitive pressures in markets, and their owners, management and staff are rewarded according to their ability to generate profit. As profit is an easily measured indicator of performance, it can be used to make rapid adjustments to the deployment of resources in relation to achievements. And, inevitably, companies that do not make profits go out of business. This simple feedback process is the reason why private companies are generally more efficient and innovative than their local counterparts in government service. Nevertheless, private sector approaches can be harnessed to traditional domains of government services such as infrastructure, health and education which can help to make them more effective and oriented to the needs of consumers.

### ► 1.2 Where's the evidence?

*Growth: a step change in DFID engagement* outlines the compelling evidence that shows how a vibrant private sector is a driving force for growth and development, and how growth leads to poverty reduction. It states that economic growth requires that the productivity of existing activities is increased and that new economic activities are developed. This requires investment by the private sector. Whilst there is no elixir for growth, the private sector is most likely to invest in countries where: there is an open trade regime and an attractive investment climate; fair, efficient and contestable markets; and where they can access financial services, appropriate skills, technology and connectivity through good infrastructure and IT.



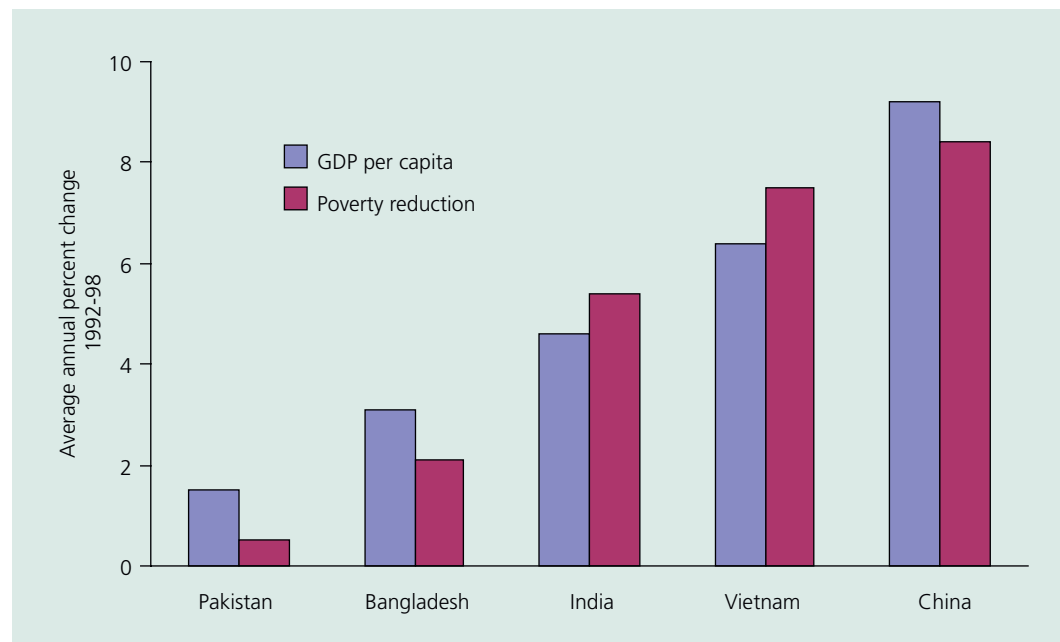
**“Over the years we have been reminded of what we have always known – that a job is the surest route out of personal poverty. In the same way, we have also affirmed that economic growth is the surest route out of poverty for nations”**

Douglas Alexander, Institute of Directors, March 2008

## Growth and poverty reduction

Growth accounts for more than 80% of poverty reduction, and has lifted 500 million people above the poverty line since 1980, while less than 20% came as a result of changes in inequality. In East Asia, where growth has averaged 9% a year over the last 15 years, 300 million people are no longer poor – see figure 3.

Figure 3: Poverty reduction links to growth



## Private investment and growth

Data from the World Bank over the period 2002-2006 show a positive relationship between the share of private investment as a proportion of total investment and the rate of GDP growth (see figure 4). In other words, the higher the level of private investment, the higher the rate of growth. Similarly the same measure of private investment is inversely related to poverty levels (see figure 5). So, if private investment is higher, poverty incidence is lower.

Figure 4: Growth and Private Investment

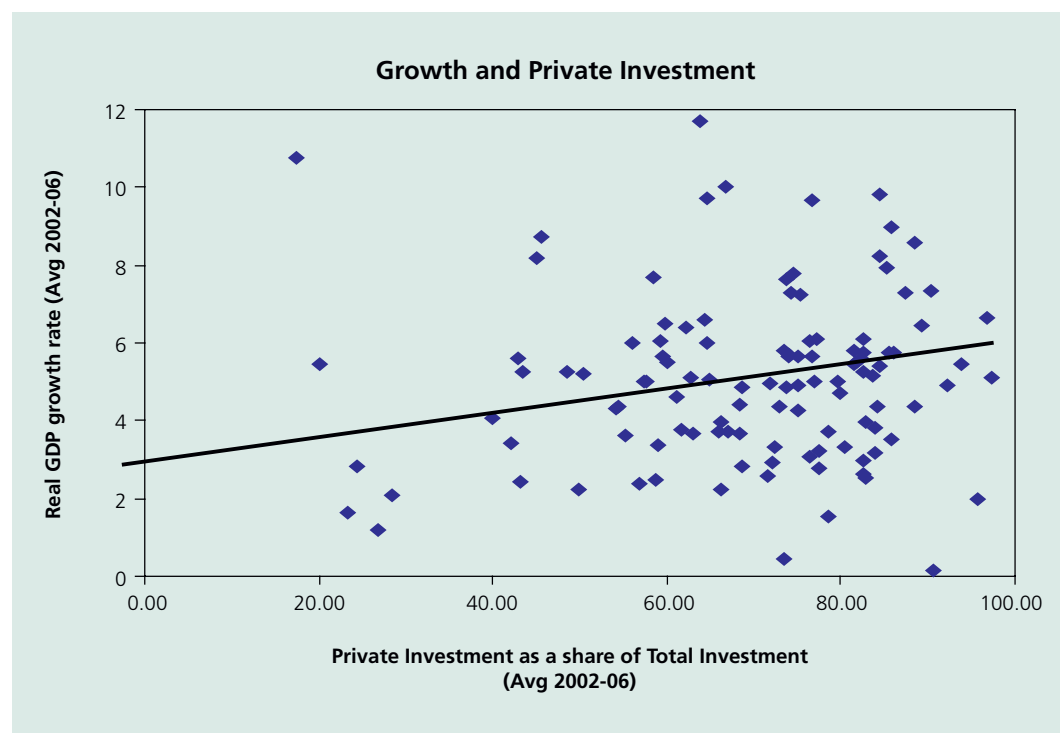
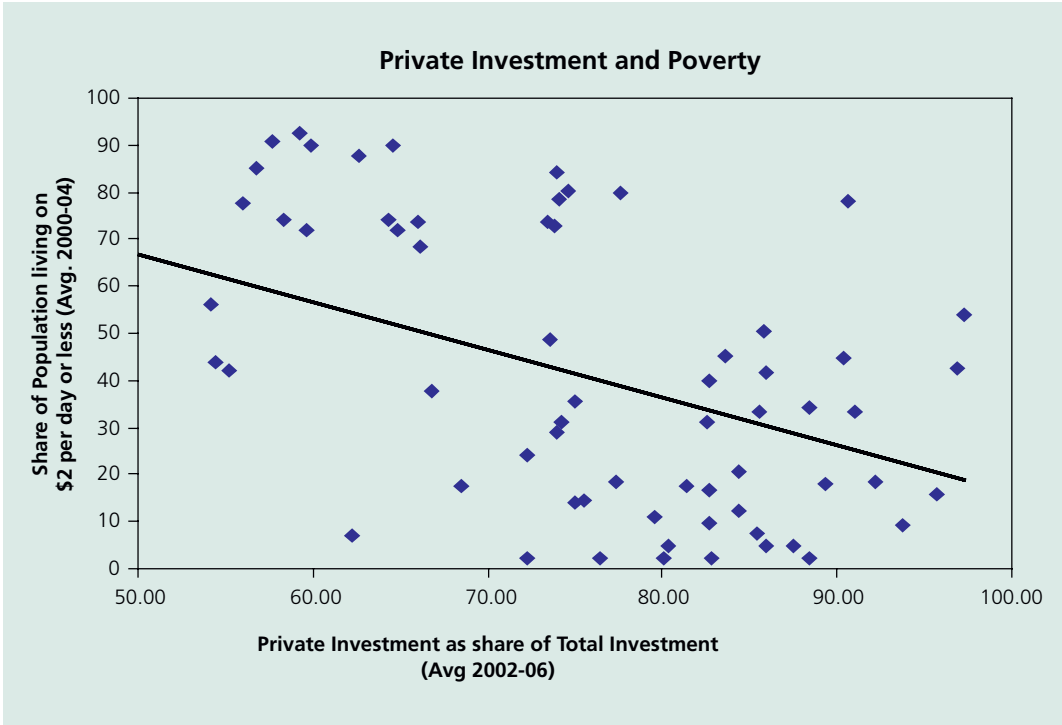


Figure 5: Private Investment and Poverty







# 2

## The case for intervention

**Just because private sector development is successful, it does not necessarily follow that poor people benefit. Private markets can exclude the poor, especially those who have nothing to buy or sell. Social or economic barriers can exclude groups such as ethnic minorities, migrants, or women.**

We cannot assume that conventional economic policies such as market liberalisation will automatically reduce poverty through a 'trickle-down' process. On the contrary, it is now widely accepted that specific measures are needed to ensure that the poor participate. Growth needs to be made available to all in order to address rising inequality, and provide opportunities and the capability to participate in markets. As Paul Collier argues in *The Bottom Billion* (Oxford University Press, 2007), the main problem of countries in the bottom billion is not that they have had the wrong type of growth but that their "growth rate has been negative in absolute terms and in relative terms massively below that of the rest of the developing world".

### ► 2.1 Overcoming market failures and inefficiencies

It is justifiable for donors to support government interventions in markets where there are significant failures and inefficiencies which limit private sector growth and prevent the participation of poor men and women. The intelligent use of public resources, such as those highlighted in Table 1, can help overcome the most important of these failures.

## Women face business barriers



PHOTOGRAPHER © SVEN TORFINN, PANOS

A recent study on Kenya found that, even though women entrepreneurs make up nearly half of micro, small and medium business owners (MSMEs), they hold less than 10% of the available credit. Kenya does not have a credit bureau that could capture women's excellent repayment histories; and products like leasing and factoring are not widely available. Women-owned MSMEs are less likely to register their businesses, and women see tax rates, tax administration, and customs as greater constraints to business growth than do men. (IFC/DFID 2004)

**Table 1: Market failures and their consequences**

Type of market failure	Issues & consequences
Market power though monopoly or imperfect competition	If a few producers gain sufficient market power, they can exclude potential competitors, restrict supply and charge higher prices. This is the case in many developing country markets, especially where investment costs are high. Where competition is limited or distorted, it is usually the weak and poor who lose out.
Uneven access to information, or lack of information generation	Instead of all buyers and sellers having access to the same knowledge, some producers or consumers may lack information, allowing others to exploit their ignorance. Poor information may prevent producers meeting the needs of consumers, and be partly to blame for the failure of financial markets to lend to the poor, and for suppliers of consumer goods failing to meet the needs of the poor.
Social exclusion	Markets where specific social groups such as women, ethnic minorities or castes face specific discriminatory barriers that prevent or discourage market participation.
Incomplete or 'missing' markets	Markets in some developing countries can be either non-existent or too 'thin' to function properly. Because of problems such as high risks, high transaction costs, high transport costs and short time horizons of investors, markets only provide for the needs of the wealthier few. Consequently, the reach of the market is limited.
Co-ordination failures	For markets to work, they often need complementary markets and functions to develop with them (for instance, rice and the supply of rice processing machinery). Where price signals fail to cause the complementary market to develop, a co-ordination failure occurs, preventing the growth of the market or causing it to be incomplete.
Externalities & public goods.	Some activities produce positive or negative effects that are not reflected in the market price. For example, the costs of pollution (such as CO <sub>2</sub> emissions) are not reflected in the costs of the producer. This means that the market over or under supplies some products. Some 'public goods' such as transport networks and basic health and education services are usually supplied by government (although this has been changing with new models of public-private partnerships).





## Food subsidies in India

**I**n India food subsidies are provided through the Targeted Public Distribution System (TPDS). The TPDS aims to reduce chronic poverty by providing essential commodities including rice, wheat, sugar, kerosene and fertilizer at highly subsidised prices. Projections for 2007/08 put food subsidies at 1% of GDP.

The government of India recognises that the TPDS is highly inefficient. For every one rupee transferred to the poor, the government spends 3.65 rupees. There are also large targeting errors, with many poor families failing to benefit from the scheme while some of those that receive the benefits are well off.

### ► 2.2 Avoiding state failure

Governments have long sought to ensure that market outcomes benefit the poor. However, the effects of 'state failure' can be worse than those of market failure. Governments can impede the functioning of markets and the development of the private sector through inaction as well as poorly conceived actions. A typical response to poorly performing markets is for governments to try to provide goods and services themselves. Often, this distorts markets and crowds out the private sector. And because government and donor resources are limited, these direct interventions either fail to meet the needs of the poor, or generate temporary and unsustainable supply. In the worst cases, the supply of the good or service becomes a form of patronage. As well as excluding private participants, governments also create and operate a range of institutions that operate in markets. These might cover roles such as: management and supervision of security, providing public infrastructure, procuring goods and services, and providing health and education services. In many developing countries, the government has limited capacity in terms of (a) knowing how best to harness the private sector, and (b) negotiating and agreeing terms with private operators. The main emerging lesson from this experience is the importance of an effective relationship between the state and private sector to identify appropriate solutions to address 'market failure'.

### ► 2.3 The political economy of private sector development

An effective relationship between the state and private organisations provides a sound foundation for successful private sector development. The capability of a state underpins political and economic stability and helps ensure that human rights, personal safety and the security of property are respected. And the state is generally primarily responsible for the provision and regulation of infrastructure, health and education.

The state also plays a critical role in providing the institutions required for private companies to grow. It sets the climate for investment and commerce through trade policy, competition policy, regulation of utilities, commercial justice systems, taxation, land reforms, labour codes and environmental management. Markets themselves can be seen as a type of institution with their own 'rules of the game' that are set by historical, political and cultural factors. In theory, it is the role of the state to arbitrate between competing claims on resources and to maintain stability. But within many of DFID's partner countries, we cannot assume the state is a neutral and rational arbiter. Its legitimacy is often underpinned by entrenched interest groups, and there is tension between the need to continue to satisfy these interest groups and making rational choices which will be of wider benefit to all. This is particularly the case within more fragile environments (where nearly half of poor people live) where the sense of 'social contract' between the government and the governed is often weak.



In promoting PSD we must understand the political economy of the state and the political economy of business interests. We also need to appreciate the extent to which they coincide; and the incentives for more rational policy implementation. Private sector development – and the economic growth that results – must be made politically and socially workable. To deliver growth, resources must be shifted to more productive uses, and surpluses must be re-invested productively – for instance in order to acquire modern technology. A sound financial system is essential in order to match surpluses to investment needs. And it is critical that the state can execute politically sensitive tasks such as collecting taxes from large companies and powerful individuals.

Studies of the high growth countries of East Asia show how a strong state with economic competence has been able to successfully develop a ‘common interest’ between the state and the business sector. State and business alliances have been used to maintain stability while managing change, to acquire modern technologies and to invest economic rents productively. A key feature of this relationship is that even favoured companies were subjected to the external discipline of competing in international markets – regardless of the fact that they were protected within domestic markets. In contrast, weaker states risk being captured by commercial interests, and may see economic rents looted or frittered away on non-productive uses. States which lack economic competence may be unaware of the developmental benefits of business activity.

The state needs to develop credible systems for making policy. These systems must show that policy making has predictability, that corruption is being controlled and that the state cannot be hijacked by specific interest groups. Growth itself generates pressures as new sources of wealth emerge. The state has a key redistribution role in order to make sure those who are otherwise unable to participate in economic growth are included. There is no blueprint for addressing these issues. The success of any action will depend on the local political context, the strength of local ownership and the credibility of government agencies. PSD interventions need to take in to consideration strong political pressures to create jobs and involve the poor in large numbers in a growing economy.



## ► 2.4 Global trends and local influences

In most developing countries, political and 'state failure' issues are compounded by large and fast moving trends driven by globalisation, climate change, technology and conflict. These trends have a strong influence over options for successful PSD. Examples include:

- **Urbanisation and migration.** Across the world people move in search of better opportunities. More than half the world's population now live in cities, as people move from rural areas to urban centres. Every year more than 190 million people migrate internationally. If these migrants were a country it would be the fifth largest in the world. Migration is closely linked to the development of labour markets, and migrants have made remittances one of the main flows of finance both internationally and within countries.
- **Climate change** is described by the Stern report as "the greatest and widest ranging market failure ever seen". To overcome this failure, we need to devise better ways to set the price for carbon, and to enable carbon trading on a large scale. The private sector is the most likely source of technical solutions to low carbon development. But the right incentives are needed to change behaviour, promote innovation and spread technology on a global scale. Without urgent action, the more carbon that is released into the atmosphere, the greater the potential for millions of poor people to suffer from famine, disease and water shortage through increased temperatures and rising sea levels.
- **The global flow of trade** has more than doubled since 1990. More open economies lower the cost of goods and services. More countries are relying on export-led growth. While the purchases from developed economies remain important, new trade patterns reflect regional and global supply chains and increasing 'south-south' trade.
- **The 'new rules of trade'** such as international standards for products, labour and the environment – as well as the growing influence of global procurement systems and consumer activism – are transforming supply chains for products and services that are increasingly spread across countries.



- **Transformational technologies** such as mobile telephones and wireless internet are dramatically lowering the cost and increasing the availability of market-related information. Better, cheaper, ubiquitous information will make it easier to 'cut out the middle man' and speed the 'flattening' of production, distribution and retailing systems in goods and services.
- **Instability** resulting from political, ethnic and religious conflict deters investment and limits the potential for growth and PSD to pull people out of poverty. Paul Collier writes in *The Bottom Billion* that 73% of those one thousand million people who are the world's poorest live in countries that have endured civil wars.

There are implications for private sector development in all of these areas. The scale and significance of such global trends requires that governments, companies, development agencies and their partners understand their direction and potential impact.

In addition to these global influences, the effectiveness of PSD activity will depend on the local country context and on state capability. Table 2 presents a simple picture of different countries and the types of state and market issues that are important. The main implication is that the type of private sector and market development activities that are most effective will vary greatly in different local contexts.

**Table 2: Country contexts and market issues**

Stage	State capacity and market status
<b>Post conflict states.</b>	<ul style="list-style-type: none"> <li>• Unstable and insecure environment.</li> <li>• High demand for essential goods and services.</li> <li>• Relief efforts can undermine market development.</li> <li>• Limited market infrastructure.</li> <li>• Weak state capacity.</li> </ul>
<b>Fragile state – establishing the basics.</b>	<ul style="list-style-type: none"> <li>• Thin or missing markets often dominated by powerful interests.</li> <li>• Poor market infrastructure.</li> <li>• Limited basic services.</li> <li>• Suspicion of private sector.</li> <li>• Rent-seeking and risks of expropriation deter investment.</li> <li>• Weak government with questionable legitimacy.</li> </ul>
<b>Low Income Country: unleashing growth, ensuring it is robust and broad-based.</b>	<ul style="list-style-type: none"> <li>• Key role for developmental state in economic co-ordination, risk mitigation and 'rent management'.</li> <li>• External trade pressures may drive internal reform.</li> <li>• Limited but growing state capacity.</li> <li>• Challenges in ODA and public finance management.</li> <li>• Growing and more reliable markets.</li> <li>• Increasing private investment and decentralization of production decision making.</li> </ul>
<b>Middle Income Country: sustaining growth and competitive advantage.</b> <b>Dealing with inequality.</b>	<ul style="list-style-type: none"> <li>• Maturing state with economic competence and enforceable 'rules of the game'.</li> <li>• Redistributive mechanisms for poor people/regions.</li> <li>• Checks and balances to maintain transparency and predictability.</li> <li>• Investment in public goods.</li> <li>• Global integration.</li> <li>• Deepening private markets and increasing private investment.</li> <li>• Bigger and more diverse types of enterprise.</li> <li>• Wider multipliers and growth linkages.</li> </ul>

For some nations, particularly poor landlocked countries and small islands, PSD initiatives will need to increase access to regional and international markets. Such nations might for instance, need regional trade infrastructure and transport corridors, and these will require cost and revenue sharing agreements between participating countries. As Paul Collier notes in *The Bottom Billion*, many landlocked African countries are not really participating in global integration because of poor regional integration.

## ► 2.5 The donor response

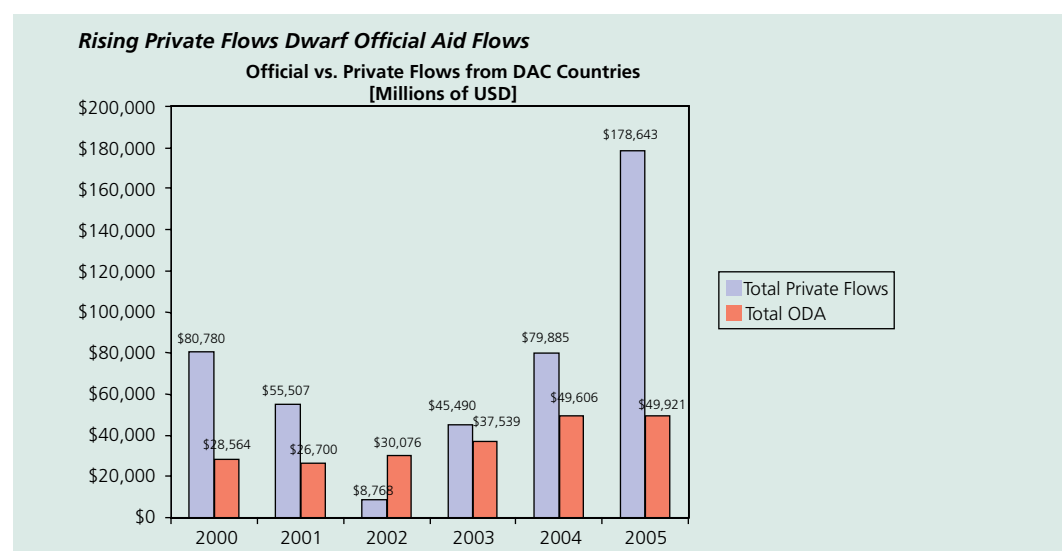
Development agencies have a long history of engaging in private sector development. The reasons for this range from bilateral trade promotion initiatives through to poverty reduction. PSD approaches have evolved over the years. Earlier programmes in the 1980s focused on providing finance and support services to individual businesses – often with an implicit or explicit subsidy. Aid was commonly tied to goods and services from companies in the donor countries. While this enabled some businesses to grow, it did little to promote wider market development in either financial services, or in business support services. In the 1990s, as concerns about the importance of poverty reduction increased, the attention of PSD programmes shifted towards small and medium enterprises and microfinance. On top of this, the collapse of the Soviet Union in 1991 increased the demand for programmes covering state enterprise reform and privatisation.



More recent PSD thinking has focused on the market system as a whole and on the overall environment for business. This has led to programmes which support the improvement of the business climate, regulatory reform and enhancing market development. But despite these trends, donor support for PSD remains fragmented. There is plenty of innovation but few mechanisms that enable co-ordination and learning. Furthermore, incentives facing different donors vary widely. Bilateral donors are influenced by political priorities, while multilateral lending agencies face the need to develop and expand their loan portfolios. Multilateral Development Banks' (MDBs) loan portfolios are predominantly in Middle Income Country (MIC) markets where returns may be higher.

At the same time, as commercial interest in 'emerging markets' has grown, there has been a significant rise in private financial flows to developing countries in the form of remittances and investment. These are now far bigger than official Overseas Development Assistance (ODA), as figure 6 demonstrates. However, these aggregate figures hide a very high concentration of private flows to a select few countries, where there are extractive industries or a strongly growing manufacturing export sector. In addition the domestic capital markets of some countries have seen substantial growth.

**Figure 6 The rise of private financial flows**



The rise of the 'BRICs' (Brazil, Russia, India and China) reveals a shifting world order in which former recipients of aid become donors themselves. New donors, including China and Korea, take very different approaches. Other new entrants include private 'philanthro-capitalists' such as the Gates and Google Foundations and the vertical 'single issue' global funds.

## ► 2.6 An agenda for PSD donors

Within this environment, development partners need to address a number of key issues if they are to effectively support private sector development. These include:

- Making the best use of an emerging common interest in sustainable development between private companies and development agencies.
- Attracting more private sector participation in both the financing and provision of key development-related services such as infrastructure and some health services.
- Ensuring that the rapidly evolving and integrating global trade and financial systems work for the benefit of people and companies in developing countries.
- Tailoring PSD programmes to the very different contexts and circumstances of partner countries ranging from fragile states through to MICs.
- Increasing the private sector development performance of international agencies.
- Engaging with new and emerging donors such as China who are making significant trade-related PSD investments in Africa or the vertical funds.
- Improving knowledge management of private sector development impacts to disseminate best practice more effectively.



# 3

## DFID's Private Sector Development Strategy

DFID's strategy for PSD is based on making the best fit between the opportunities for achieving change and DFID's main competencies. It has been developed in response to the International Development Committee's request, in 2006, that DFID develop a strategy which clearly articulates how the Department will support private sector development as part of its growth agenda. The Strategy is aimed at the whole of DFID – not just specialised private sector development advisers. It is also targeted at DFID's development partners – in government, the private sector, civil society and other developing agencies – who are interested in working with the Department on private sector led growth.



A significant positive shift in DFID's approach to supporting PSD could lead to a substantial positive impact on development results for all the reasons that have been set out. But this will require that DFID staff begin to think about how to incorporate PSD in all the appropriate areas of their work. For example, livelihoods advisers already look at markets and links with the livelihood opportunities for the poor. Infrastructure advisers are expanding their work on private sector participation in the financing and delivery of infrastructure services. Other advisers could explore how markets and innovative public-private mixes could improve the delivery of other core services to the poor – including health, education and environment. Governance advisers could further examine how the state operates to improve the performance and behaviour of business.

### ► 3.1 DFID's core PSD competencies

DFID's main strengths in relation to PSD are:

- Substantial and growing untied grant resources that can be deployed to address development problems in a flexible way.
- Knowledge and experience of working with companies and a proven set of private sector-oriented aid instruments, including: challenge funds, infrastructure facilities (under the Private Infrastructure Development Group (PIDG)) and multi-stakeholder programmes (such as the Extractive Industries Transparency Initiative).
- A highly decentralised and devolved structure with a strong technical private sector development capacity in some developing countries allowing entrepreneurial approaches well suited to local circumstances.
- An established 'activist shareholder' role on the boards of the World Bank, Regional Development Banks and Development Finance Institutions such as the IFC.
- 100% ownership of CDC – an effective and successful development finance company which in 2006 had annual investments of £257 million.
- A large research and policy development capacity, and close links to an extensive independent network of development research capability – including universities, institutes and thinktanks.

These capabilities place DFID in a strong position to contribute effectively to the key PSD issues. DFID is credibly placed to work in partnership with key players in private sector development. DFID's support for innovation – such as challenge funds, financing facilities, Poverty Reduction Budget Support (PRBS) and multistakeholder initiatives – demonstrates DFID's ability to take on higher levels of risk than other players in the private sector development 'industry'. DFID's entrepreneurial approach has underpinned many of its PSD successes, as endorsed in the UK's *International Development Committee 2006 Inquiry on Private Sector Development*.

DFID's decentralised structure encourages innovation, since decision makers are closer to clients, have access to flexible funding, and are more aware of client needs. DFID has experience of channelling resources through multilateral organisations and other donor groupings. Based on its own expertise in a number of technical areas, and drawing on its extended research and policy capability, DFID is well placed to be a knowledge contributor and manager in private sector development. The DFID Strategy builds on areas where we have proven success in PSD, such as improving access to the financial sector, market development, infrastructure financing and investment climate reform. But the Strategy also foresees continued innovation and experimentation. We are exploring new approaches and instruments that are experimental in nature and have not had years of implementation experience. These include the expanded use of challenge funds, advance market commitments, transparency initiatives and other facilities for developing partnerships with private firms and foundations.

## ► 3.2 Access, Competition & Engagement (ACE)

The DFID approach to private sector development can be understood in terms of the three themes of 'Access, Competition, and Engagement' (ACE):

- Working to improve **access** to economic opportunities by the poor – making markets work for the poor.
- Working to develop **competitive** markets – to encourage private sector development.
- **Engaging** with private sector companies – to help achieve the MDGs.

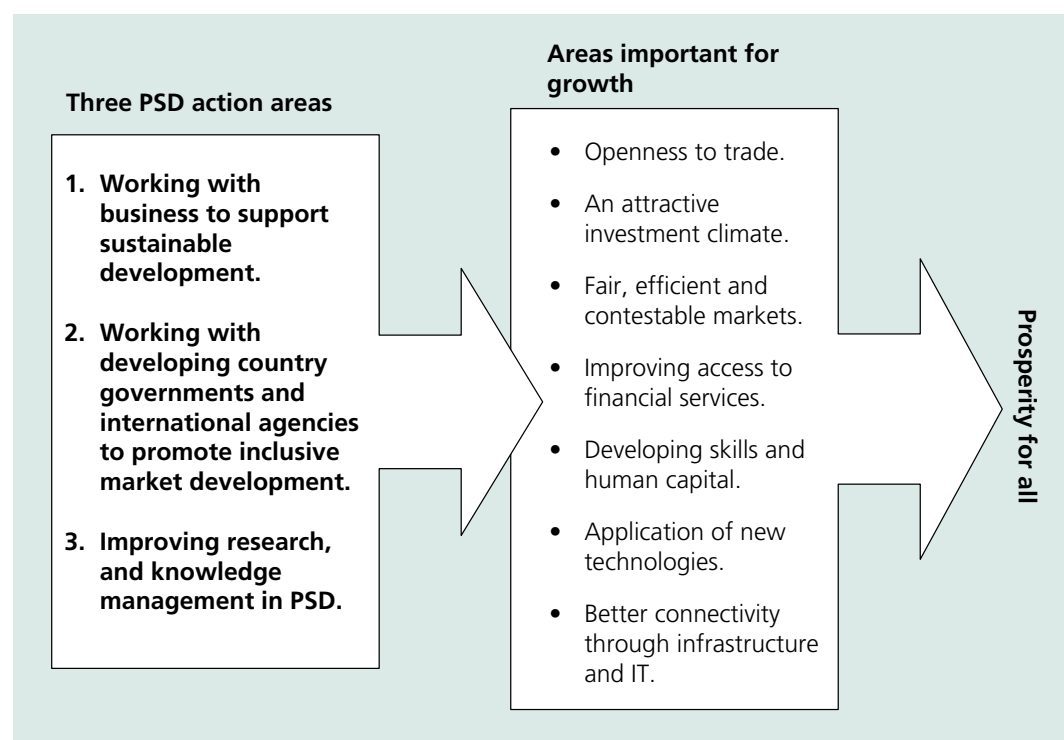
**Table 3: The ACE framework**

	Access	Competition	Engagement with private companies
Change results from:	Increased market participation by poor men and women.	Sharper market based incentives for change.	Increased capacity of market players.
Key outcomes:	Greater economic freedoms. Improved capabilities of the poor.	Innovation. Lasting systemic change – beyond scope of a single firm or agency. Reduced costs and increased supply of better quality goods and services. Reduced 'rent-seeking' and corruption. Increased investment.	Emergence of businesses that are: Pushing the boundaries in achieving development impact. Consolidating 'core business' and contributing to growth. Managing social and environmental risks.
Main indicators:	Jobs, incomes, access to goods and services by income group.	Competition measures. Market indices (structure, conduct, performance).	Jobs/Incomes. Economic Growth.

The three themes cut across specific intervention areas which are:

1. Working with international and domestic private companies to make the most of the positive impact of their core business.
2. Working with developing country governments and international agencies to create an environment that supports the growth of private business. Specifically, this means support for reforms that allow markets to work with greater efficiency and fairness.
3. Investing in research and knowledge management to measure results better and to inform our work with companies, governments and international agencies.

Figure 7: Three intervention areas of the DFID PSD Strategy





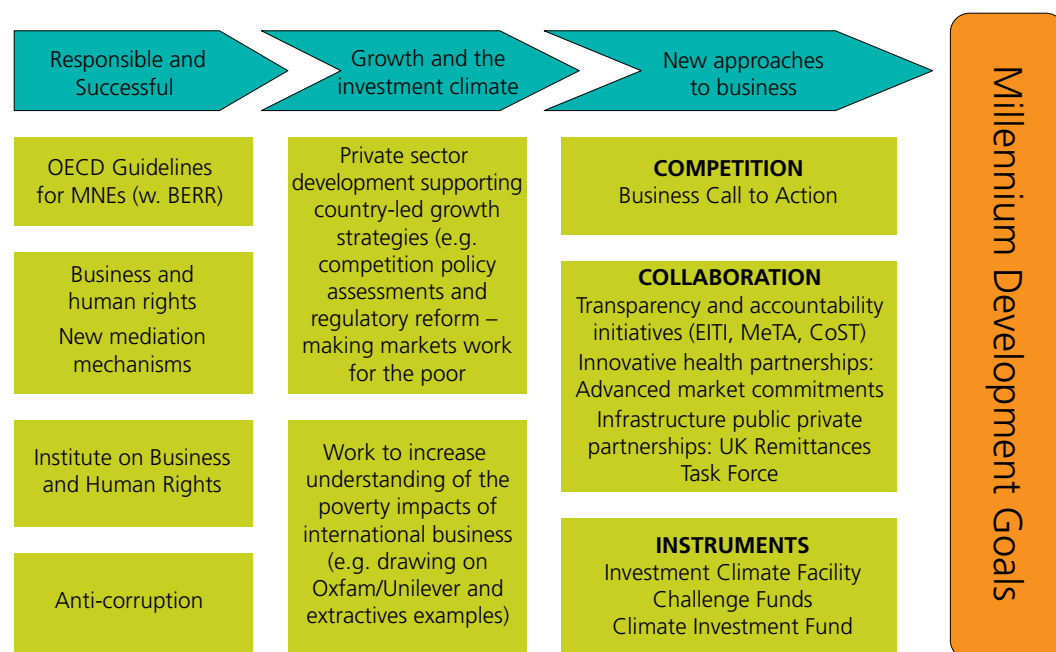


# 4

## Working with business for sustainable development

The innovation, energy and resources of international and domestic companies in developing countries can transform both the communities in which they operate and the prospects for overall growth and sustainable development. The UK sees business as a key partner in achieving development objectives. Different ways of working with three types of businesses are shown in figure 8.

Figure 8: DFID's approach to working with companies



Most companies are in the middle, where “doing business” contributes to **growth** and development. Successful businesses will generate wealth and employment as well as commercial linkages with other firms. DFID will work with companies to ensure that business concerns are reflected in the national plans of developing countries.

We also want to work with companies at the forefront of corporate activity. These are companies that are developing new approaches to business by **pushing the boundaries** of business models to both generate profits but also to have strong positive developmental impact. DFID will work with businesses to extend their ‘core business’ to have a transformative impact – for instance by taking risks to invest in new supply chains or finding new ways of making their goods and services available to poor people.

We also expect companies to be **successful and responsible** in regard to the social, environmental and economic risks present in their areas of operation. This is particularly true of companies with a large social and environmental ‘footprint’ such as the extractive and construction sectors. Most of the positive developmental impact of business will be through **growth**.

#### ► 4.1 New approaches to business: pushing the boundaries

Much of DFID’s work with business is focused on encouraging companies to make sure their core business (profitably producing and selling goods and services) delivers better development outcomes. The underlying concept is to exploit opportunities where commercial objectives align with development objectives. For instance, DFID is working with the companies that signed the Prime Minister’s Business Call to Action to develop new ways of doing business in sectors as varied as food and beverages, technology and finance. Appealing to the commercial incentive and doing what business does best, companies have successfully developed new initiatives that can transform the lives of poor people.

## Business Call to Action



**P**rime Minister Gordon Brown, in his speech to the United Nations on 31 July 2007, stated that “trade, wealth creation and job creation are the only routes to long term prosperity”, and that business has a key role to play, in partnership with others, in meeting the MDGs. On 6 May, 2008 the Prime Minister launched the Business Call to Action. The Business Call to Action outlines how DFID will work with companies to develop new business models, based on their core business, that can be scaled up to have a transformative economic impact on the communities affected – in terms of jobs, investment, goods and services.

There are many ways in which new business models can support growth and development, including through investment, significant job creation and providing new government revenues through taxes. As well as this, international and local businesses can help to improve productivity and quality in international supply chains. One of the biggest effects will be increased access to goods and services. For example:

- Banks and insurance companies can make financial services available to poor people, or provide the full range of products and services needed by businesses. This is especially the case for traditionally under-reached sections of the population such as women.
- Telecoms firms can bring access to information to poor and remote areas.
- Energy firms can provide power in diverse ways to meet differing needs of different populations.
- Supermarkets and agribusiness companies can work to improve the development impacts of supply chains.
- Pharmaceutical companies can improve access to medicines.
- R&D firms can generate technologies appropriate to people and firms in developing countries.

**T**he **Food Retail Industry Challenge Fund (FRICH)** is designed to bring together retailers and African farmers to increase the market for sustainably produced food in the UK. The purpose of this £2 million fund is to improve market access for food exports produced by poor and small scale farmers in Africa. This is in line with UK commitments to substantially improve market access for developing country exports.



## The Food Retail Industry Challenge Fund

FRICH will help design business models with the potential to bring millions of farmers in to fairer and more profitable trading relationships with UK shoppers. The fund's intention is to encourage new thinking. It aims to develop and test new ways of adding value to African food exports to the UK and increase the market for food that has been sustainably produced by small-scale farmers and farm workers in some of the poorest countries in Africa. The fund will make £2 million available for grants to partnerships that bring retailers and African farmers together to test new ideas. The partnerships will be expected to match fund the value of these grants.





DFID will develop new capacity to help broker innovative business models which help meet the needs of poor people and support growth. One way of doing this is through a new Business for Development Facility (BDF). This will combine expertise in bringing together partnerships between the private, public and non-governmental sectors in a variety of areas. It will foster specialist knowledge and advice on new business models to meet the needs of poor people – including ‘bottom of the pyramid’ approaches – and develop a knowledge centre that will disseminate good practice in this area.

DFID has considerable experience working directly with the private sector, through initiatives such as challenge funds. These are designed to stimulate business activities that benefit the poor, where the private sector has previously under-invested due to perceived risks, lack of information or other barriers. Challenge funds provide ‘matching grants’ of up to 49% of the costs of commercial proposals

that are selected on a competitive basis by an independent expert panel. Applicants are invited to submit innovative and potentially transformational business plans that achieve development objectives. These objectives might include better access to products and services by the poor or increased employment and growth in target areas.

DFID has been a leader in the development of the challenge fund approach. It is committed to the recently launched \$50 million, multi-donor, Africa Enterprise Challenge Fund (AECF), which builds on the successes and lessons of DFID’s Business Linkages Challenge Fund (2000 – 2005), Financial Deepening Challenge Fund (2000 – 2008), and a number of smaller, sector-specific and country-specific challenge funds. Long-term success will be measured by the commercial replication and scaling up of innovative schemes that were initially supported by challenge fund investments. The Financial Deepening and Business Linkages funds have successfully engaged the private sector in transformational and innovative investments. The success of such initiatives has spawned a new wave of second generation challenge funds covering: African Enterprise, Remittance Partnerships, Financial Inclusion and the development effects of Supermarkets (Food Retail Industry). The approach has also been adopted by AusAID in their East Asia and Pacific Enterprise Challenge Fund. We are also seeing the start of challenge funds at the country level in Bangladesh and Vietnam.

Besides developing new business models, companies can also push the boundaries by working in new ways with other stakeholders to help create sustainable businesses. Many sectors face challenges that limit the development of markets and do harm to poor people. Corruption in oil, gas and mining leads to increased poverty and conflict. It also multiplies risks for extractive companies. Inefficient health markets mean poor people cannot access quality drugs. Corruption also raises reputation risks for pharmaceutical companies. Misspent public money in the construction sector leads to poor quality houses, schools and hospitals. Corruption acts as a deterrent too, preventing construction companies from operating in developing countries. DFID has pioneered work with the companies in the extractive, construction, health and other sectors. We bring stakeholders together to work in new ways to reform corrupt and inefficient markets and increase transparency and accountability.

## Transparency initiatives

Under the **Extractive Industries Transparency Initiative (EITI)**, 24 resource-rich countries, and the majority of major multinational oil, gas and mining companies, have voluntarily agreed to open their books and work with a wide range of stakeholders – including civil society – to increase transparency over the revenues generated from oil, gas and mineral exploitation. The initiative has achieved a wholesale change in the way that extractive revenues are viewed, with transparency becoming an international norm. This is helping to make extractive industries an engine of economic growth by reducing the scope for corruption and improving the investment climate. The *2006 International Development White Paper* committed the UK Government to apply the lessons of EITI to other sectors. Following extensive consultation and development, the Medicines Transparency Alliance (MeTA) and the Construction Sector Transparency (CoST) initiative were launched in spring 2008.

**MeTA** In many countries, weak governance and a lack of transparency in medicines supply chains contribute to high levels of inefficiency, corruption and fraud. This can mean that medicines prices are too high, quality assured medicines are not available, and there are counterfeit and substandard medicines in the market. DFID has been working with developing country governments, pharmaceutical companies, civil society, the World Health Organisation (WHO) and the World Bank to develop MeTA. MeTA is a new multi-stakeholder approach towards increasing transparency and accountability in the selection, regulation, procurement, sale and distribution of medicines in developing countries. This will strengthen governance, improve efficiency, encourage innovative and responsible business practices, and ultimately increase access to medicines.

## Health product development partnerships (PDPs)



**P**DPs are public private partnerships bringing together expertise from both the public and private sectors, to accelerate the discovery and development of new drugs, vaccines and other health technologies (such as microbicides and diagnostics) for neglected diseases.

DFID has been a significant investor in PDPs, including the International AIDS Vaccine Initiative and the International Partnership for Microbicides. We work closely with other funders including foundations such as the Gates Foundation and Wellcome Trust and other government donors. PDPs bridge the gap between the urgent need for new health technologies and the private and public sector's expertise.

PDPs work as virtual pharmaceutical companies, with the central staff managing a portfolio of potential drugs, vaccines etc, in partnership with others. PDPs have a variety of partners, including large pharmaceutical companies (Merck, GSK and Novartis, for instance); pharmaceutical companies in Middle Income Countries; biotechnology companies; contract research organisations; developing country stakeholders in disease programmes; users and advocacy groups. In 2007 the UK pledged \$485 million towards the advanced market commitment for the pneumococcal vaccine, and is exploring areas such as malaria and tuberculosis too. It is also a major funder of the GAVI Alliance and recently helped create the International Finance Facility for Immunisation (IFFIm) which will provide up to \$4 billion in new funding for vaccines.

PHOTOGRAPHER © ROB HUIBERS, PANOS

**The Construction Sector Transparency Initiative (CoST)** The construction sector is vital to economic growth and development in poor countries. Many countries, unfortunately report corrupt practices. The World Bank estimates global losses to corruption of hundreds of billions of dollars per year. Where corruption occurs, public sector money is wasted and taxpayers fail to get value for money. Decisions about which construction projects to spend taxpayers' money can be skewed by corruption, rather than made in the public interest. The use of poor quality materials and inappropriate cost-saving measures can lead to shoddy and dangerous buildings. DFID is working with construction companies, civil society, developing country governments and multilateral partners to bring greater transparency and accountability to the construction sector. CoST is a multi-stakeholder partnership that aims to make government funded construction projects deliver on time, to high quality, producing safe infrastructure at reasonable prices.

Other new types of partnerships include health related public private partnerships, and new partnerships to tackle climate change.

## **Business and climate change**

Business has a pivotal role in meeting the challenge of climate change. Private companies are a critical source of technical and financial solutions to low carbon development. But the right incentives and prices are needed to stimulate innovation, to change behaviour and to encourage the spread of technology on a global scale. Private firms have responded positively to opportunities arising from agreements to reduce greenhouse gas emissions (such as the Kyoto Protocol), by designing, investing in and implementing projects with reduced carbon footprints. And there is strong private interest in markets for tradable emission reduction credits. Further development of the global carbon market will be the key to mobilising private finance at scale.

Driven by the need to manage their own risks from climate effects, as well as business opportunities, the private sector has an important part to play as developing countries adapt to climate change. The new Schroders Climate Change Fund, for instance, will increase incentives for adaptation innovations by opting for investments based on their resilience to climate change. And private and public-private sector initiatives are already being established to help people in developing countries manage the risks and effects of extreme weather events and climate change. BASIX (a microfinance institution), ICICI Lombard and SwissRe have piloted rainfall insurance in India, together with the World Bank. Also, SwissRe have developed a Climate Adaptation Development Programme to develop a commercial market in risk transfer solutions. And more than 40 companies have signed up to the Climatewise initiative – this will consider (among other things) how their activities can support developing countries in understanding and responding to the risks of climate change.

The UK is supporting a multi-donor initiative to support climate change. The Climate Investment Funds, to be capitalised by up to £800 million from the International Window of the UK's Environmental Transformation Fund, aim to provide urgently needed finance for mitigation and adaptation, and to pilot mechanisms ahead of post-Kyoto negotiations in 2012. The Funds aim to give working examples of ways to assist developing countries with low carbon and climate resilient development in advance of decisions on longer term financing mechanisms. We strongly support ensuring the CIFs are country-led, with funding in support of developing country investment plans that build on existing strategies, with a strong role for private sector activity in support of these country-led plans.

The role of private companies is recognised in the recent Bali Action Plan, which calls for consideration of private sector funding and investment to support action on mitigation, adaptation and technology cooperation. Effective collaboration between the public and private sectors will be essential to meet the challenges of climate change.





## The MFA Forum

**D** FID supports the Multi-Fibre Arrangement Forum. This brings garment industry exporters, trade unions, government agencies, non-governmental organisations, and international buyers together to promote greater international competitiveness through improved productivity and increased social responsibility via compliance with health and labour standards.

The Forum was established to support MFA countries to manage the threats and benefit from the changes following the dismantling of old trade agreements under WTO rules.

The Forum uses convening power to bring established initiatives (including the Ethical Trading Initiative), international organisations (donors, trade unions, ministries of national government) and the private sector (multi-national corporations and domestic industries) together to address common challenges. In Bangladesh, the Forum has facilitated the establishment of a government-led National Social Compliance Forum and worked with major international brands and retailers to propose a unified code of compliance. It has also assisted in creating a local multi-stakeholder group responsible for meeting the challenges of compliance and increasing competitiveness.

## ► 4.2 Growth and the investment climate

The greatest developmental contribution that companies can make is through the investment, jobs, revenues, goods and services they produce. The private sector is powerful in driving growth and market development. DFID works through various international initiatives and partnerships with developing country governments to help develop better business environments which enable entrepreneurship to flourish. DFID will engage with international business to encourage their constructive participation in the dialogue on regulatory reform, investment in public goods, public–private partnerships and other measures to support growth.

Alongside this DFID works with organisations like the Ethical Trading Initiative, International Labour Organisation and the MFA Forum, seeking a better understanding of how responsibility and competitiveness are mutually supportive, and how developing country suppliers can benefit from international trade (see box on the MFA Forum). DFID works with others in developing tools which measure the economic impact of company activities, including in the extractive industries sector.

### ► 4.3 Successful and responsible: managing social and environmental risk

Private companies sometimes operate in ways that harm workers and the environment – ultimately damaging the development of the countries they operate within. It is primarily the responsibility of host governments to address poor performance, for example through regulation and monitoring. But the capacity of governments to do this in many developing countries is low, and needs to be strengthened.

International initiatives can play an important role here. The OECD Guidelines for Multinational Enterprises are a set of corporate responsibility standards for companies, covering labour laws, taxation, competition and the environment. The UK Government supports the guidelines and promotes them widely. In addition, allegations of poor conduct can be investigated through the UK's National Contact Point (of which DFID is one part). Since the *2006 White Paper* DFID is committed to strengthening the guidelines, particularly in relation to doing business in places where there is weak governance. There is also significant work being done on business and human rights, including the work of the UN Secretary General's Special Representative on Business and Human Rights, and the Business Leaders Initiative on Human Rights (BLIHR), both of which are helping to provide better company guidance. DFID is involved with these activities and will continue to look at new ways of supporting business-led activities to improve practice in human rights.

Corruption is a major impediment to development. The OECD Guidelines cover this, as do various other business codes like the Transparency International code of conduct. Under the OECD Anti-Bribery Convention it is now a criminal offence for UK companies to bribe foreign officials in developing countries.

#### International Institute on Business and Human Rights



DFID is providing seed funding to support the development of an International Institute on Business and Human Rights. The Institute is supported by a wide range of international stakeholders, including governments, businesses, the UN Global Compact and NGOs. It will, in practical ways, build on the work of the UN Special Rapporteur on Business and Human Rights. The purpose of the institute is to provide a source of global expertise in the area of business and human rights. The Institute will build a unique body of knowledge to help define the responsibilities of different duty bearers, and provide services to help build the capacity of stakeholders to uphold human rights in practice. It will also provide an independent mediation service to explore alleged abuses of human rights.





# 5

## Making markets work in partner countries

**“..we need to fully acknowledge the critical importance of the private sector in driving development – focusing our attention.... on enterprise, on free and fair trade and open markets.... the building blocks of growth”.**

Gordon Brown, Business Call to Action, May 2008

Competitive markets are critical for economic growth. This requires investment by the private sector – small farmers through to large firms. *Growth: a step change in DFID engagement* states that the private sector will not invest in markets that are not contestable, where entry and exit are not enabled and where there are no opportunities for business to innovate.

The core of the DFID PSD Strategy is to make markets work better, and to make them work in a way that involves and benefits the poor. Such inclusive market development will encourage the private sector to invest more, create more jobs, and increase poor people's access to markets, goods and services.



## ► 5.1 Making markets work better for the poor

By making markets work better, DFID's work will have a positive effect on the overall economic performance and growth of its partner countries. The market development approach will consist of the following steps:

1. **Diagnostics:** Researching and analysing economic sectors that are of particular importance to growth and which may have strong direct and indirect effects on the welfare of poor men and women. This is a rigorous process, undertaken at the country level, which provides a basis for setting priorities.
2. **Identifying problems:** Setting out a 'vision' of how key markets could develop, and identifying specific hindrances standing in the way of market development and access to economic opportunities by the poor. For example, particular social groups such as women, ethnic minorities or castes may face discriminatory barriers in markets.
3. **Action:** Defining and supporting interventions to overcome these hindrances and achieve sustained large scale change (change beyond the scope of a single firm or entity).

DFID's PSD work using the market development approach will typically encompass: growth analytics; business and investment climate reform; trade policy; factor market development (finance, land and labour); service market development (infrastructure and information); development of the sector; and product markets that are of key importance for a particular country or region.

### Growth analytics

DFID will capitalise on its decentralised structure and strong in-country presence to support the use of growth analytics in developing countries, including analysing the role of the private sector. Growth analytics is the process of identifying the 'binding constraints' to growth, and ensuring that overcoming these obstacles is a priority within country-led and owned growth strategies. DFID will work with developing country partners and other donors to ensure that growth strategies build on – rather than duplicate – the same country-led processes that generated poverty reduction strategies. Strong political economy analysis will be an integral part of the work, as results are more likely to be influenced by local political factors than by the content of the strategies themselves. DFID has worked with the World Bank to undertake growth analytics in a number of countries, including Rwanda, Nigeria, Tanzania and Ghana. The findings are being used to develop reform programmes.

### Business and the investment climate:

DFID has provided support to a number of countries to help improve the investment climate for business. Examples include:

- **Nigeria** reduced the number of days to register property from 274 days in 2005 to 80 days in 2006.
- **Rwanda** dramatically increased domestic taxation revenue to 14% of GDP in 2005 – double what it was in 2002.
- **Mozambique** has reformed customs procedures so that goods now clear customs 40 times faster, and customs revenues have increased from 2.9% of GDP in 1996 to 5.8% in 2005.
- **India** and **Tanzania** have developed and implemented effective competition policies – estimated to have increased growth by up to 2.5% a year.
- **Ghana** reduced the number of days to register a business from 81 to 42 between 2006 and 2007.

## DFID's new Competition Assessment Framework (CAF)



DFID recently developed the CAF as a diagnostic tool to help policy makers easily assess the state of competition in important sectors of their economy, and to identify and address areas of weak competition. It takes a holistic approach that recognises competition can be harmed by inappropriate government policies and legislation, as well as by anti-competitive practices by private companies.

### Trade – the catalyst

Trade has a huge potential as a catalyst in the evolution of the private sector and for the achievement of significant development. No country in recent times has grown on a sustained basis without successfully integrating with global and regional markets. Economies which are more open lower the costs of goods and services. Since 2000, developing country exports have been growing at 10% a year, twice as fast as exports from high-income countries. Developing countries' share of world trade has increased from 25% in 2000 to 35% in 2006. There are huge opportunities for private companies in developing countries to benefit from global economic integration. However, trade systems and policies often work against them.

DFID will continue to support trade policy development at three levels:

#### *Beyond the Border*

We will support policy analysis to influence EU positions in international trade negotiations which achieve outcomes that promote development. The conclusion of the 'Doha Development Agenda' offers the best way to secure development oriented reforms. Should negotiations fail, DFID will continue to work for a package of measures to benefit poor countries.

#### *At the Border*

DFID will help countries with trade facilitation and the development of private and public standards for goods and services. Effective trade facilitation promotes trade by reducing costs and delays in the movement of goods and services across borders, and contributes to government revenue by increasing tax collection at border posts. DFID will continue to work with the private and public sectors to ensure that international trading standards and regulations – particularly those in agricultural health, safety, environmental and social standards – do not act as unfair barriers to trade or as bottlenecks in the supply chain.

#### *Behind the Border*

Trade liberalisation does not automatically result in more trade and greater prosperity in poorer countries. Equally important is the capacity to trade. DFID will provide increased Aid For Trade (AFT) to help overcome obstacles which prevent developing country companies from taking advantage of the increased market access offered by trade liberalisation.

## Sending money home



DFID has developed Remittance Country Partnerships in Bangladesh, Nigeria and Ghana. These address ineffective policies and regulations that prevent the market for remittances from working efficiently. DFID also established the [www.sendmoneyhome.org](http://www.sendmoneyhome.org) website to provide comparable information on remittance prices to consumers. The aim is to increase transparency and stimulate competition, leading to lower prices and a better service for migrants in the UK. Since the beginning of the project the average cost of sending £100 has fallen by 5.6% across 11 countries and by as much as 28% to India.

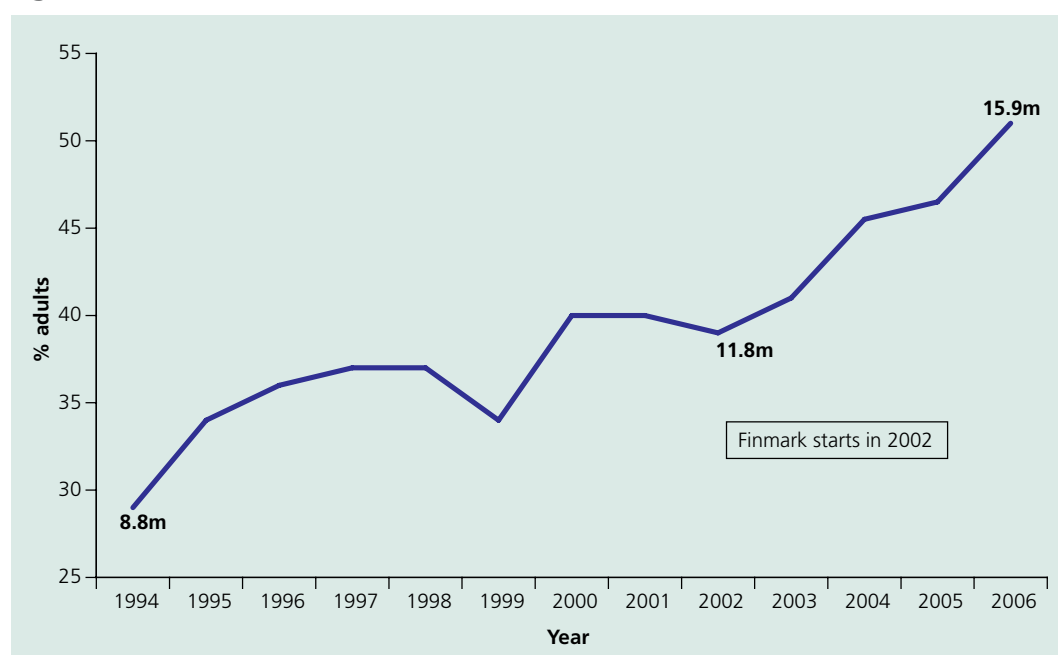
## Financial sector development

DFID is recognised as a leading development partner in financial sector development. DFID will use its expertise in this area to assist developing countries to:

- Improve the legal and regulatory environment in the financial sector.
- Increase the provision of financial markets data and analysis on access (FinScope).
- Widen the outreach of financial services to poor people.
- Harness and stimulate financial sector innovations (such as smart cards and mobile phone banking).
- Make the most of the development effect of remittances by reducing costs, increasing transmission speeds, and providing other support such as 'Send Money Home' programmes.

These initiatives will help countries enhance financial inclusion, strengthen the role of the financial sector to deliver development outcomes, and innovate. In South Africa, DFID set up the FinMark Trust, with the aim of making financial markets work for the poor. The Trust has now carried out FinScope surveys to measure household access to, and perceptions of, financial services in 12 countries. The surveys show the size of the potential market and help stimulate product innovation aimed at poor people. Since the first survey was carried out in South Africa in 2004, over two million people have opened 'Mzansi' basic bank accounts – 60% of whom had never had a bank account before.

**Figure 9 Users of new bank accounts in South Africa**





**Land market development.** DFID has initiated work on developing markets in land (Nigeria, Ghana and Tanzania) and labour (Vietnam, Bolivia and South Africa). DFID will build on this work by in-depth analysis to assess the most effective way to support land and labour market development in a number of countries.

**Product and service market development.** Linking the rural poor to global value chains is a common theme in market development programmes being implemented in Bangladesh, Nicaragua, Nigeria, Vietnam and South Africa.



### The Katalyst programme in Bangladesh

The 'Katalyst' programme in Bangladesh uses a market development approach. First, key sectors of particular relevance to poor people are researched and analysed. Once specific hindrances are identified, Katalyst works with a varied combination of NGO facilitators, consultants, and private companies to overcome the constraints that have been identified. Examples of Katalyst interventions include:

- Working with rural information centres to provide services, including internet access to farmers and other businesses, where market information is poor or absent.
- Promoting innovations and skills improvements in fish farming, where productivity and incomes are low, leading to major increases in productivity of fish farmers as well as fish sellers and nursery producers.
- Bringing together media and marketing businesses, which then combine to provide training in skills and approaches in marketing.
- Supporting public/private dialogue where business membership organisations are weak.

Conservative estimates show that the first five-year phase of Katalyst had affected 453,000 SMEs and farmers. By 2009, using more than 50 different private companies and other organisations that have been attracted or 'crowded-in' to the approach, Katalyst will have generated 183,000 jobs and \$729 million in additional income from its Phase One activities. Other development partners including Canada and the Netherlands are joining the UK and Switzerland in supporting Katalyst's market development approach.

## ► 5.2 Supporting inclusive market development

Half of UK aid is spent bilaterally. DFID's decentralised country programmes, untied flexible funding and budget support instruments such as Poverty Reduction Budget Support (PRBS) are distinctive strengths. DFID will use these instruments to support inclusive market development in Public Service Agreement (PSA) and frontier countries. PRBS has been an effective tool for engaging in policy dialogue on private sector reform in a number of countries. In Uganda, Ghana, Pakistan and Tanzania DFID has used the PRBS as the main means to encourage government to undertake PSD reform. In Pakistan, regular discussion with government has led to market-based reforms, such as improving procurement procedures for private contractors and setting up regulatory systems. This has also resulted in a focus on structural issues like fiscal policy, higher budgetary allocations for skills development, and approval of the competition law. DFID will build on these successes in developing public sector development programmes in PSA countries where there is a PRBS programme.

In countries where PRBS is not an option, specific market development programmes may be developed. Building on experience in Nigeria, Bangladesh and South Africa, DFID has implemented market development approaches under the label of 'Making Markets Work Better for the Poor' (M4P). There are nine DFID-financed M4P-branded programmes in six countries. M4P forms the basis of DFID's approaches to financial sector development and agriculture. The success of the approach has attracted the interest of other donors, including the International Finance Corporation (IFC), the International Fund for Agricultural Development (IFAD), the Asian Development Bank (AsDB), Inter American Development Bank and bilateral programmes from Australia, Canada, Germany, the Netherlands and Switzerland. Total DFID investment in these programmes is approximately £50 million. Although a common analytical framework is used to assess market development potential in different countries, the specific interventions will depend on the country and political context.

### PRBS in Tanzania



In 2007 the Government of Tanzania allocated 46% of its national budget spending on poverty reduction to support economic growth. This included spending on infrastructure, agriculture and other essential economic services. £90 million of general budget support from DFID contributed directly to this. DFID is engaged in policy dialogue with government to improve the quality of public policy and spending in these and other growth related areas, as well as improving the quality of public-private dialogue. DFID Tanzania is actively leading on the growth components of the PRBS, focusing on improving the business climate and infrastructure provision, supporting customs reform, improving the quality of public spending, and financial sector reform. DFID Tanzania's programme supports Tanzania's poverty reduction strategy by providing additional technical assistance support for more reforms, and by working directly with the private sector. For example DFID has provided technical assistance to improve infrastructure planning and implementation to ensure that one of Tanzania's obstacles to growth is alleviated. Infrastructure investment receives a high PRBS allocation.

## ► 5.3 Improving the performance of international agencies

DFID has extensive experience of working with and through other development partners – especially international development agencies such as the multilateral development banks and the UN. DFID is both a shareholder and a co-financier of many World Bank and Regional Development Banks programmes. These contributions can be substantial. For example, the recent UK contribution of £2.13 billion to the latest round of IDA replenishments means that the UK is the largest IDA donor accounting for 14% of total commitments. Besides making financial contributions, DFID is a leading member of the CGAP consortium on microfinance, the International Donor Committee on Enterprise Development, and is a major bilateral partner in the World Bank Group's technical assistance activities around the world. For example, DFID-supported work on improving the environment for business in Africa helped to develop the World Bank's own approach. Similarly, the DFID-supported FinScope approach to generating data on financial inclusion is now being used by the World Bank. These international institutions are important vehicles for the implementation of the private sector development Strategy. Even though DFID's budget is growing rapidly, the operations and effectiveness of the overall aid industry – and the big players within it – will have a far larger impact on PSD and developing country prosperity than DFID's bilateral activities.

### 5.3.1 Multilateralism with 'edge'

Up to half of DFID's budget goes through multilateral development organisations, including one-fifth through the European community. This proportion will be higher in the future. It is vital that DFID works with the multilaterals more effectively. This goes beyond the role of multilaterals as deliverers of co-funded programmes. It is about how multilaterals behave and perform overall. If DFID could achieve even a small improvement in effectiveness in the PSD performance of the World Bank and other Multilateral Development Banks (MDBs), this would arguably have a greater impact on developing country prosperity than a large improvement in DFID's own private sector development performance.

DFID has two main channels to influence the performance of multilaterals. These are (a) through our shareholder function, and our influence via the board in support of a wider reform agenda; and (b) through co-financing and other arrangements – such as joint-financing facilities. Each channel could be better used to make the multilaterals more effective at supporting PSD and growth.

Specific DFID actions, in alliance with other shareholders in the multilaterals, include:

- Allocating appropriate resources so that multilaterals – especially the World Bank Group – are able to continue to formulate and implement best practice in PSD policies and programmes.
- Ensuring that MDBs assign appropriate resources in areas where DFID is moving out. For instance, infrastructure service provision, microfinance, and areas in investment climate and business environment.
- Encouraging multilaterals to work in a responsible way in developing countries – building local capacity and ensuring that approaches to growth are in line with growth diagnostics and national plans – rather than being driven by sector investment interests.
- Improving the capacity of multilaterals to address political economy issues within their support for PSD.
- Working with the multilaterals to strengthen their assessment of the development impact of their PSD work
- Working with the IFC and WB on improving the way they are addressing the barriers to women's economic empowerment and entrepreneurship.
- Ensuring that UN agencies and other multilaterals take appropriate care to rebuild inclusive markets and PSD in planning and implementing humanitarian assistance.



DFID and other shareholders do not yet have a good set of indicators to compare the relative development impacts of the different multilaterals in relation to their investments to enhance private sector development. The Multilateral Effectiveness Framework is a good start but shareholders need more specific information on operations that are directed at private sector development

### **5.3.2 Development finance institutions**

The Development Finance Institution (DFI) sector comprises official agencies that invest in the private sector in developing countries. International DFIs include the IFC, the European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB). Bilateral DFIs include CDC (UK), FMO (The Netherlands) and Proparco (France). With annual investments of approximately \$25 billion, 70% of which go to Middle Income Countries, the DFIs have been relatively neglected by DFID and other shareholders, and present a strong opportunity for future work. The main issues are to encourage more pioneering investments in the frontier markets – such as poorer developing countries and the poorer regions of Middle Income Countries – and to ensure DFI investments have a greater impact on the poor. The main aim of EBRD is to encourage investment in the least reformed transition economies and to promote market economies in the former USSR.

With the IFC, DFID has pioneered the use of gender and growth assessments which focus on analysing hindrances to women's economic activities as entrepreneurs, producers and in the labour market. As a result a number of participating countries have undertaken specific measures to improve the investment climate for businesswomen, and removed barriers to women's employment. These changes have included reform of requirements for security on loans, and alterations to the practice of land titling.

CDC, a development finance institution 100% owned by DFID, seeks to promote and generate evidence of the commercial viability of investment in private businesses in developing countries. Following a major reorganisation in 2004, CDC now operates as a fund of funds, committing capital to investments in poorer countries' markets. CDC provides fund managers with overarching investment criteria based on sound business principles and permits them to manage their investments using CDC (and others') capital. Attracting private capital to frontier markets is a key tenet of CDC's investment policy. The objective is to combine profitability with a catalysing effect on private sector investments in frontier markets.

This multiplier – or market development – approach has been effective. By 2008, CDC had developed relationships with over 50 fund managers in some of the poorest regions of the world. Investing in sectors including agribusiness, power and real estate, the effect has been significant. For example, agribusiness employed substantial numbers of poor people; power had a major impact on their lives; and real estate opened up new sector development opportunities in poorer countries. Besides this, local financial markets, and the investment regulations that govern them, are affected by the skills, products and foreign investors that CDC can bring to bear. Since 2003, the average annual return to CDC's investor, DFID, has been nearly 20%. Fund value has risen by £1.3 billion, or over 135% of opening net assets; the total net worth of the company stands at over £2 billion; and third party capital attracted a total of nearly £0.5 billion. A priority for DFID is to encourage other DFIs to adopt the market development approach.

### 5.3.3 Infrastructure development facilities

DFID tries to act as a catalyst for private participation in financing and delivery of infrastructure services to help to mitigate risks. DFID has been instrumental in establishing a range of multi-donor international partnerships designed to overcome the barriers that deter private investors in essential infrastructure. Over 80% of DFID's funding in this sector has been channelled through the Private Infrastructure Development Group (PIDG), comprising the World Bank Group, Austria, Ireland, the Netherlands, Sweden, Switzerland and UK – and its associated programmes managed in the World Bank and IFC. Between 2000 and 2006, DFID spent \$120 million in private sector infrastructure, paving the way for some \$2.6 billion of private investment in the infrastructure of poorer developing countries. These innovations have been among the most effective in DFID's portfolio in terms of encouraging external private resources and achieving the greatest financial impact.

In the area of private sector participation in infrastructure, DFID will aim for:

- *Sustainability for privately managed facilities.* A step change is needed to involve more private financial institutions in infrastructure in poorer developing countries. DFID plan to support InfraCo and GuarantCo, to attract additional private partners to expand their size and impact, with a view to placing the facilities on a financially sustainable footing. Financial sustainability has already been achieved by the Emerging Africa Infrastructure Fund (EAIF).
- *Expanding technical assistance and advisory services.* Weak public capacity and lack of appropriate legislation and regulation remain major challenges. DFID plans to continue supporting advisory and technical assistance facilities, such as DevCo, the Technical Assistance Fund (TAF) and the Public-Private Infrastructure Advisory Facility (PPIAF).
- *Mainstreaming of output based aid approaches.* The Global Partnership for Output-Based Aid (GPOBA) could transform the way aid is delivered. By shifting payments and incentives towards the results achieved, GPOBA may lead to markedly improved outcomes, as well as building a vibrant market for private local suppliers. DFID plans to expand support to GPOBA.
- *Scaling up community access to finance.* This is needed for housing, water and sanitation, perhaps through a global scale up of the Community Led Infrastructure Financing Facility (CLIFF).
- *More innovation in renewables.* More stimulus is needed for greater private sector participation in providing low carbon and renewable energy technologies, rural water and sanitation, low-cost housing and other municipal infrastructure services.
- *Building capacity of developing country governments.* Governments need to know how (a) when and where to use the private sector to provide infrastructure, (b) to negotiate with private firms effectively, and (c) how to monitor their performance once contracted or in a Public Private Partnership (PPP). The UK has a competitive advantage in providing advice in this area, having had significant experience. Partnerships UK brings this together, providing advice to UK public bodies at all levels in undertaking PPPs and increasingly to developing country governments as well.



# 6

## Research, innovation and knowledge management

**“Beyond ... immediate action, research will play an important part of our longer-term response. We will need knowledge and research to ..... increase prosperity among the poorest people in the world.”**

Douglas Alexander, launch of DFID Research Strategy, April 2008



## Research and knowledge management

DFID and other agencies need to learn more about the most effective ways that PSD can be supported in order to achieve prosperity for everyone. This knowledge needs to be well managed in order to accelerate the spread and uptake of innovation, and to improve the effectiveness of private sector development interventions. There are two priority areas:

- Impact assessment. Development agencies are not rigorous enough in assessing the effectiveness of aid. There is too much focus on inputs and not enough on results. DFID will support more work on cost-effective and practical ways to measure the effectiveness of PSD work. This evidence will be essential for demonstrating the case for public sector development and market based approaches to financiers and implementation partners.
- Devising and supporting ways to employ the substantial capacity of the private sector to conduct research and to adopt and scale-up innovations.

DFID will establish a major global resource centre to deliver world class research and analysis to developing countries on growth. The International Growth Centre will provide this support.

## New Approaches

Development agencies need to combine more effectively with companies and researchers to support 'leading edge' thinking in PSD activity. These tasks will involve a mixture of internal and outsourced activities. They could be summarised as:

- Scoping and developing new aid instruments that motivate private companies. DFID can build on successful innovations that generate compelling incentives for greater private sector investment to help achieve development objectives. These include challenge funds, advance market commitments and output-based aid.
- Political economy analysis focused on working with the private sector and the implementation of market development approaches.
- More work on market development approaches including: (a) deeper understanding of market interactions in the informal sector and what lies behind the process of formalising businesses, and (b) new measurable indicators for markets and market development – especially among the poor.
- Better knowledge of the workings of land and labour markets, including the failure of markets for skills development.
- Making public–private partnerships operational, especially in areas such as the provision of public services. The UK has unparalleled experience of PPPs including the Private Finance Initiative (PFI) which can be harnessed to assist developing countries.

## Innovation

DFID will provide sharper incentives for innovation and for scaling up that innovation. The private sector, with its resources, technologies and management capability, is often best placed to develop and rapidly spread innovative solutions to development problems. But how can these resources be deployed in the service of development? We have successfully experimented with innovative ways to harness private sector skills, and resources in research and development, to develop medical and agricultural technologies relevant to developing countries. DFID will expand its work in this area. Examples from existing DFID work include:

- Mobile phone banking in Africa.
- Development of vaccines suited to developing countries.
- Forest backed bonds for mitigating climate change.

DFID will work to significantly upgrade and sharpen the incentives for development innovation in the private sector, using means such as challenge funds and other competitive matching grant schemes.

New challenges and potential innovation areas include:

- Linking developing country producers to carbon markets, and spreading low carbon technology through market-based mechanisms.
- Harnessing the advances in cell phone banking for more ambitious uses including (a) international remittances and (b) direct government cash transfers to the poor (G2P).
- Financial innovations to make future payments secure in areas that may have significant positive development effects. Possibilities include (a) output based payments for service delivery to the poor (b) seasonal agricultural production in a range of sectors (c) returns from investments in specific developing countries that would be attractive to their diaspora.



**One million  
Kenyans to  
bank by phone**

**V**odafone has signed up 150,000 customers in Kenya for its mobile phone banking service, M-PESA, and expected to reach 1 million by the end of 2008.

M-PESA (which in Swahili means 'mobile money') is a fast, safe and affordable way to send and receive money through mobile phones without the need for a bank account. DFID helped set up the pioneering service by matching Vodafone's investment of £1million, through the Financial Deepening Challenge Fund, to pilot M-PESA in Kenya. Nick Hughes, Global Head of International Mobile Payment Solutions at Vodafone, explained that without DFID support he would not have been able to convince Vodafone to invest in this venture. The service has now become so popular that 2,500 people are signing up every day to be able to send and receive money.

M-PESA targets poor customers who, until now, have been excluded from formal bank networks, due to their remote location and small volumes of transactions. With more than 46% of the population living below the poverty line the introduction of M-PESA may have huge developmental benefits for poor people in Kenya. Vodafone have recently joined with CitiGroup to allow international remittances to be sent from people in the UK to friends and relatives in Kenya by mobile phone. They are also working with DFID Kenya to see if M-PESA could be used to distribute social payments to poor families in remote areas.



# 7

## Priorities and risks

### ► 7.1 Sharpening the focus

A key challenge to PSD has been weak focus and prioritisation within the development community. To enhance its impact, DFID will be highly selective in focusing its direct efforts on PSD and will encourage other development partners to do likewise. DFID will sharpen its focus in the following ways:

- Direct PSD support will be focused on a limited number of key Public Service Agreement (PSA) and frontier countries. All other DFID support for PSD will be provided through development partners such as the World Bank and Regional Development Banks. Where there are weaknesses in a country's capacity, DFID will explore the potential for short-term secondments to compensate.
- DFID will not directly provide bulk funding for infrastructure development – even though infrastructure financing has been identified in numerous growth diagnostic exercises as a key obstacle to growth and PSD. This is because the IFIs (World Bank and RDBs) are better placed than DFID to do this. DFID is already a shareholder and financier of the IFIs. Also, we support several autonomous multi-donor facilities under the PIDG that aim to leverage in private finance and introduce other innovations to improve infrastructure project cycles in developing countries.
- DFID will do less direct work on microfinance – as this sub sector is maturing and becoming part of the mainstream of commercialised financial sector development. As in infrastructure, we will continue to financially support a number of multi-donor and IFI initiatives that promote microfinance.



- DFID will do less direct work on state enterprise reform. Since the major demand for this work in Eastern Europe and the former Soviet Union is now past and – given the national government leads on this in states such as India and Bangladesh – DFID’s front-line involvement is no longer so vital.
- DFID will do less direct work in support of small and medium enterprises (SMEs) and business development services – as many bilateral donors are now active in this area. Higher returns may be achieved through further development of market development approaches in a number of markets and sectors. This more systemic approach looks at the role of business in general – and not just SMEs or business services.

## ► 7.2 Key risks and mitigation

The impact of the Strategy and DFID’s activities could be undermined by two key risks:

- An inability to effectively influence other development partners to adopt market development approach.
- Potential risks to reputation from working directly with the private sector.

DFID will be selective about where to focus its direct private sector development efforts. Direct PSD support will be focused in key PSA and frontier countries. All other support will be provided through other development partners, such as the World Bank and regional development banks. Where there are capacity weaknesses, we will explore the potential of short-term secondments. Furthermore, key areas such as infrastructure financing, microfinance and state enterprise reform will be left to other development partners. DFID will provide financial support and will second people (where necessary), but will not lead in these areas. Over the past 15 years, we have succeeded in influencing other development partners to adopt robust guidelines for these sectors. In finance, the focus should now move to making financial markets work for the majority, especially the poor. In infrastructure, we should focus on strengthening our role as a shareholder and financier of key IFIs and multi-donor facilities that aim to leverage private finance as opposed to delivering infrastructure services directly.

DFID is recognised as the lead donor in PSD. We will use this position to work with other donors to develop smart responses to the challenges hindering the development of competitive markets. This will include influencing other development partners to switch from the current practice of direct delivery towards a market development approach. To facilitate this process, DFID will undertake a realistic assessment of the impact of existing M4P programmes and disseminate the findings to development partners. This will also help to enhance both the viability of the approach and its role within key PSD forums such as the Donor Committee for Enterprise Development. In addition, DFID will assess ways in which it can better enhance its influence as a strategic board member on a number of key IFIs. To improve its capacity to do this, DFID will explore the potential of increasing the number of advisers in policy roles at headquarters and in key regional offices.

As in many areas of government activity there is always a potential risk. Working with the private sector is no different. The DFID label could be exploited for commercial gain or we could engage in partnerships that have limited added value for poverty reduction. DFID will minimise these risks by using corporate risk management tools, supplemented by clear and updated policies and guidelines for working with the private sector.









# What is Development?

## **International development is about helping people fight poverty.**

This means people in rich and poor countries working together to settle conflicts, increase opportunities for trade, tackle climate change, improve people's health and their chance to get an education.

It means helping governments in developing countries put their own plans into action. It means agreeing debt relief, working with international institutions that co-ordinate support, and working with non-government organisations and charities to give communities a chance to find their own ways out of poverty.

## **Why is the UK Government involved?**

### **Getting rid of poverty will make for a better world for everybody.**

Nearly a billion people, one in six of the world's population, live in extreme poverty. This means they live on less than \$1 a day. Ten million children die before their fifth birthday, most of them from preventable diseases. More than 113 million children in developing countries do not go to school.

In a world of growing wealth, such levels of human suffering and wasted potential are not only morally wrong, they are also against our own interests. We are closer to people in developing countries than ever before. We trade more and more with people in poor countries, and many of the problems which affect us – conflict, international crime, refugees, the trade in illegal drugs and the spread of diseases – are caused or made worse by poverty in developing countries.

In the last 10 years, Britain has more than doubled its spending on aid to over £5 billion a year. We are now the fourth largest donor in the world.

## **What is DFID?**

DFID, the Department for International Development, is the part of the UK Government that manages Britain's aid to poor countries and works to get rid of extreme poverty.

We are working to achieve the Millennium Development Goals - a set of targets agreed by the United Nations to halve global poverty by 2015.

With 64 offices overseas, DFID staff work in some of the most difficult places in the world to protect the vulnerable and help countries recover from conflict. We work with organisations like the United Nations, European Union and the World Bank to find international solutions to international problems. We give money and other help to governments in developing countries to support their own action plans to reduce the number of people living in poverty. And we fund charities, including the British Red Cross, VSO and Oxfam, to work directly with communities.

1 Palace Street  
London SW1E 5HE,  
UK

and at:  
Abercrombie House  
Eaglesham Road  
East Kilbride  
Glasgow G75 8EA,  
UK

Tel: +44 (0) 20 7023 0000  
Fax: +44 (0) 20 7023 0016  
Website: [www.dfid.gov.uk](http://www.dfid.gov.uk)  
E-mail: [enquiry@dfid.gov.uk](mailto:enquiry@dfid.gov.uk)  
Public enquiry point: 0845 3004100  
or +44 1355 84 3132 (if you are calling from abroad)

© Crown copyright 2008

Copyright in the typographical arrangement and design rests with the Crown. This publication (excluding the logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright with the title and source of the publication specified.

Published by the Department for International Development. Printed in the UK, 2008, on recycled paper containing 80% recycled fibre and 20% totally chlorine free virgin pulp.

Product reference: PRD135

ISBN: 1 86192 986 2