The Donor Committee for Enterprise Development

# Private Sector Development Synthesis Note

## DCED Member Agency Policies for PSD: The State of the Art

*March 2017*

**Working with and through the private sector in development is now a priority across donor and development agencies in order to achieve lasting and scalable development results** – including jobs, incomes and better, more affordable products and services for the poor. Indeed, a central message of the 2030 Agenda for Sustainable Development is that development goals cannot be achieved without the private sector. One of the core functions of the DCED is to respond dynamically to emerging knowledge needs of its member agencies as they expand private sector development and engagement portfolios – by sharing experience and evidence and by launching new research and action agendas with members.

**This Synthesis Note reviews some of the most common elements in current agency policies[1], and points to practical ways in which the DCED assists in policy formulation and implementation.** Specifically, it

- outlines trends in *how* agencies plan to engage with and support the private sector, and *what* sectors, geographies and types of outcomes they focus on;
- highlights critical issues and evidence for consideration as new policies are being developed; and
- illustrates how the DCED assists its member agencies in policy development and implementation, including through examples of knowledge products and initiatives that respond to member agency priorities. Unless indicated otherwise, all hyperlinks below point to DCED webpages or publications.

**More details on the policies of each agency can be found on the individual agency pages.** For an overview of how PSD policies can be designed to tackle extreme poverty, see also Getting to Zero: Tackling Extreme Poverty through Private Sector Development Policy Guide (Chronic Poverty Advisory Network, 2015).

### Private sector development approaches

1. **All governmental donor agencies now cite direct engagement with the private sector, in particular with domestic or international business, as a central approach to promoting economic development.** Private sector engagement can be implemented through a variety of instruments, including financial support, technical assistance and sharing of knowledge and networks, e.g. via public-private platforms.

[1] The Note is primarily based on publicly available policy documents and other material on the websites of DCED member agencies, including fifteen – mainly governmental – donor agencies as well as six UN organisations.

1.1 **While most donor agencies still maintain dedicated centrally or regionally managed funds and facilities inviting project proposals by business, private sector engagement is increasingly seen as a way of operating *across* the organisation, and an approach that involves co-developing partnerships jointly with business (see also DCED, 2017).** For example, Australia DFAT notes that "all new [aid] investments will explore innovative ways to promote private sector growth or engage the private sector" (DFAT, 2014), while Sida "no longer has a specific strategy for private sector engagement" and "considers [it]… to be a cross-cutting approach" (OECD, 2016).

> **Note: The DCED has published a briefing note which describes in more detail how pioneering agencies are implementing this transition, pointing to key areas of institutional and programming changes that are being made for strategic private sector engagement** (see also section 16 below). An action agenda is currently being developed to focus on those aspects of change that DCED member agencies require the most support in.

1.2 **A growing number of agency policies mention plans to offer a wider range of financial products to business to cater to diverse support needs – including loans, equity and guarantees, in addition to grants.** For example, DFID and Norway are committed to strengthening their domestic Development Finance Institutions to support businesses this way. The Swiss government, Sida, DFID and others are also supporting dedicated programmes or impact investment facilities investing directly into business or investment funds. Others, like the Netherlands Ministry of Foreign Affairs, are directly managing funds that provide returnable capital to business.

> **Note: Various questions remain regarding non-grant financial support to business.** They include whether returnable capital is more effective than other approaches; how it would affect the working and accountability relationships with recipients; and whether it can qualify as development aid; how it relates to development finance and commercial banks (see also section 17 below); and if donor agencies have the capabilities to manage such finance. For example Brain, Gulrajani and Mitchell (2014) note that it is easier and cheaper to administer grants than loan, equity or quasi-equity financial instruments. Further, "if adopted, donor organisations will need to develop longer time horizons and a more nuanced range of criteria by which to assess results…". The DCED's 2016 review of results measurement in impact investing highlights key issues that warrant additional attention by donor agencies in this regard. The DCED has also launched follow-up research projects, including on how to attribute results to investors and what types of results information investee businesses value the most.

1.3 **Most agency policies explicitly or implicitly point to the importance of promoting responsible business practices** – such as through engaging in the ILO Decent Work agenda and the UN Global Compact with business, or by setting exclusion criteria for partnerships with business. Examples of issues discussed in policies include restrictive labour practices, human rights abuse, corruption, health and safety issues, and environmental damage. A more detailed DCED synthesis note on practices for screening private sector partners summarises key criteria and processes in use (see also NSI, 2014). Some agencies aim to work with social enterprises in particular.

> **Note**: **The DCED has joined forces with Oxfam to review the role of businesses' legal form and structure for social impact (see this 2016 briefing note);** to date, there is however no strong evidence base to suggest that the social impact of such companies is better than that of 'standard' companies.

2. **The second area of work mentioned in the majority of agency policies is creating Enabling Environments for business and economies to thrive and grow, in particular through legal/ regulatory and governance reform.** About half of the member agencies also cite skills development as an intervention area to create better conditions for private investment and employment.

2.1 **In a new development, evidence on the lack of results of standardised governance reform packages is now leading to actual changes in agency strategies:** As for example pointed out by ODI and The World Bank (2017) standardised reform packages have typically failed, while context-specific and adaptive approaches to identifying and implementing 'good-fit' solutions have been more successful. In response, DFID's 2017 economic development strategy argues in favour of 'politically smart' approaches to economic development based on robust analysis of local politics, and more flexible programmes that learn, adapt and seize new opportunities in the course of their implementation. Similarly, USAID's 2017 programme cycle operational policy encourages adaptive management in all development programmes.

**Note: To help programmes implement adaptive, context-specific approaches to policy reform, the DCED has published An introduction to political economy analysis for practitioners.**

**Separately, a 2016 DCED working paper offers an extensive review of emerging evidence and experience on approaches for** creating enabling conditions for inclusive business **in particular.** While many regulatory reforms and government policies to stimulate private investment in general are likely to benefit inclusive business as well, the market entry and scaling up of innovative inclusive business models will often require tailor-made government responses, based on an assessment of the target sector and the needs of individual businesses (see also section 3 below).

3. **Half of the members also note that economic growth does not always lead to more and better jobs and incomes for the poor and marginalised.** They stress that other policies and programmes must be in place to ensure benefits for underprivileged sections of the population. Making markets work for the poor, or market systems approaches, is one popular approach. Another group of agencies focuses on promoting Inclusive Business models – although several of them now stress the importance of encouraging inclusive market systems, too.

**Note: The DCED's knowledge page on Market Systems and the Poor has for many years been the most frequently visited DCED webpage.** It offers hand-picked strategy documents, practical guidelines for designing and implementing market systems approaches – including in basic service delivery - as well as programme case studies. The Inclusive Business page is the fourth most popular thematic page in the DCED's knowledge portal on Implementing PSD.

4. **Small and Medium Enterprise development remains an element of about two-thirds of DCED member agencies' PSD work.**

**Note**: **The most common objective of small and medium enterprise (SME) development articulated by donor and development agencies is to create employment for the poor**. As however pointed out by the World Bank (2016), evidence suggests that "much of entrepreneurship policy to encourage broad-based entrepreneurship and firm start-up has little implications for employment, growth, innovation and structural transformation". The report argues that donor policies should therefore distinguish between support to high-growth and innovative entrepreneurs, which have the potential to generate new jobs and structural change, and support to subsistence entrepreneurs, to improve their livelihoods.

5. **Some agencies follow ambitious strategies that explicitly seek to help support economic transformation in their partner countries** – for example through industrial policy support, including the development of light-manufacturing industries, as well as increasing agricultural productivity. Improving the involvement of developing countries in trade and export remains a related key priority for the majority of members – supporting governments and private sector companies to expand their business and integrate into regional and global value chains.

   **Note**: **Based on the DCED's website statistics, governments have a much more active interest in implementing effective industrial policies than suggested by agency strategy papers alone:** The Industrial policy webpage is the second most frequently visited page on the DCED website, and industrial policy is among the top google search terms that leads people to the site.

## Impact-level objectives

6. A majority of agencies consider **employment creation** **as the ultimate objective of PSD.**

   **Note: Views on whether job creation is the most appropriate priority, and the best ways to achieve and measure it vary, as outlined in a DCED working paper and a DCED synthesis on Employment Creation.** In fact, setting developing programmes the overarching goal of creating jobs (while apparently a political imperative) can be a problem from a technical point of view. One dilemma relates to a mismatch between development and commercial priorities. Most jobs are created by business, yet business itself rarely prioritises job creation per se. In practice, most PSD programmes focus on promoting competitiveness and/or productivity. While it is expected that this will lead in the medium term to more sustainable, higher-income or more numerous jobs, the exact link to employment is very context-specific and often not clearly articulated by programmes. It may also take longer than the project duration, for higher productivity to lead to job creation. In addition, defining, measuring and attributing job creation – including for example informal, indirect or seasonal jobs – involves various technical challenges. As an alternative to job creation, achieving and measuring changes in income is often more feasible. (see Tanburn, 2014 for more details)

7. **Women's economic empowerment (WEE) is now prominently listed as a programming priority in the majority of member policies.** Some agencies provide targeted support to women through business training, advice and information services. Increasingly through, DCED members encourage all programmes to integrate gender sensitivity and empowerment considerations, as applicable.

   **Note: The DCED's Business Environment Working Group has published a working paper and guidance on integrating gender considerations into Business Environment Reform.** Work is ongoing in the DCED Women's Economic Empowerment Working group on how to integrate gender and WEE across the project cycle in market development programmes.

8. **A third of member agency policies name youth as an important target group of initiatives to generate additional employment and income**.

**Note: While employment creation is the most common objective of agencies' work with young people, research suggests that young people often already engage in mixed, complex livelihoods, earning income from multiple sources, in particular in fragile states - so 'job creation' would not be a binary process (Maclay and Skelton in ECDPM, 2017).** Employment interventions following a linear trajectory from training to formal employment may therefore be ineffective. Instead, young people may require flexible and varied support options to broaden and upgrade their existing portfolio of income-generating activities. Indeed, a recent systematic review of youth employment programmes (IZA, 2016) found that programmes which integrate multiple interventions are more likely to have a positive impact.

9. **In about half of donor agency private sector policies, private-sector driven solutions to mitigating, and adapting to, climate change are a priority objective of support.** The other half of donor agencies consider economic growth that is environmentally sustainable as an important cross-cutting objective.

10. **Almost a third of DCED member agencies have published plans to harness new technologies for economic development in low-income countries.** These include, for example, e-commerce, information and communication technologies, and/ or peer-to-peer finance.

11. **Several agencies have become more outspoken about their ambition to pursue domestic interests alongside poverty reduction abroad**. This includes:

    11.1 **Being explicit about the combination of aid and trade objectives** (e.g. The Netherlands and UK). This trend is also witnessed in the integration of foreign aid portfolios into a joint foreign affairs and trade department in several countries. Further, the business partnership facilities of several donor agencies are currently officially tied to domestic companies (OECD, 2016).

    11.2 **An increased focus on tackling the root causes and consequences of migration, in particular through support to income opportunities for the rural poor and those living in fragile environments** (see also below). In addition, ECDPM (2017) states that OECD-DAC donors including Sweden, The Netherlands, Denmark and Germany are using aid funds to address short-term needs of refugees at home, ranging from 15% to 34% of ODA in those four countries.

## Geographies of interest

12. **About half of DCED member agency policies stress the importance of promoting economic opportunities in fragile and conflict-affected environments** – in some cases with a specific focus on the Middle East and North Africa region.

13. **In addition to a focus on low-income and least developed countries, two economic development policies include plans to increase trade and economic cooperation with middle income countries.** In addition to domestic interests (see above), this is partly based on the recognition that many of the world's poorest now live in emerging economies.

14. **Much of the work summarised in agency policies focuses on agricultural development in rural areas, but a few now highlight the importance of urban development and poverty reduction (**e.g. DFID, 2017**).**

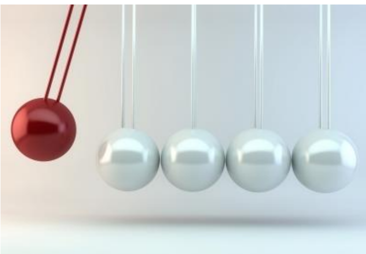
> **Note: Future policies are likely to articulate more clearly how the agencies will address the impacts of growing urbanisation and assist the urban poor**. A growing body of research is now available to inform programming (see for example, The World Banks' Knowledge Portal on the theme, the 2016 EPS PEAKS (2016), and Evidence on Demand (2014).) How to best balance and sequence support to agricultural and industrial development is a related key issue (see also DCED (2017): Synthesis note on Employment Creation).

## Institutional arrangements

15. **As noted above, a number of governments have shifted the organisational responsibilities for development aid by integrating their foreign affairs and trade department and/or by spreading development initiatives across multiple Ministries:** An overview of different donor governance models, including the pros and cons of integrating foreign affairs and trade functions, can be found here (starting from p.27). Regardless of the institutional leadership on development cooperation, several governments now seek cross-governmental collaboration or whole-of-government approaches to economic development abroad. For example, the UK has launched a cross-departmental Prosperity Fund, which will be used to improve the competitiveness and operation of developing markets; others, like The Netherlands, Finland or Germany are seeking to develop a unified government support offer to businesses investing in developing countries.

16. **Engaging the private sector strategically and on an equal footing (see section 1) requires a fundamental shift in how donor agencies are organised and operate**. Institutionally, they are still largely set up as bilateral agencies – focused on providing conditional funding or technical assistance to governments in particular. This is also reflected in traditional mechanisms for working with business, which tended to be transactional and top-down, with donor procedures dictating the shape of support. As summarised in the DCED's 2017 briefing note on strategic private sector engagement, several agencies have however begun to make institutional changes in order to be better equipped for working with business – including through the development of more flexible funding and programming frameworks; changes in staff responsibilities and team structures; and systematic efforts to build staff skills and experience.


17. **As donor agencies are increasingly interested in providing loans, equity and guarantees to the private sector (see section 1.2), reflecting on the most appropriate division of labour between donor programmes, bilateral and international DFIs is growing in importance, too.** OECD (2016) notes that "the management of private sector engagement mechanisms should be determined by institutions' existing networks, expertise and experience" and the comparative advantages of institutions should inform the development of strategies and activities to avoid duplication of efforts.



## Measuring and communicating results

**18. There is interest across many member agencies to demonstrate transparency, effectiveness, accountability, based on appropriate measurement and communication of development results**. In line with donors' prioritisation of private sector engagement, they see a particular need to demonstrate that they add value to what businesses would otherwise do; and to pro-actively communicate the achievements of their work with large multinational or domestic business.

**Note: Agency policies can encourage good practice in their programmes by pointing to the DCED's multi-donor guidance and resources**.

The **DCED Standard on Result Measurement** is a key tool for helping to improve PSD policies and programmes and to demonstrate real results. It is currently used by more than 100 programmes in over 50 countries. An extensive and growing set of supporting resources and case studies is available on the DCED website.


The DCED has also summarised key criteria and principles for assessing additionality of support to business, and signposts a range of other practical resources. Robust evidence on results and practical examples of large-scale development impact can also be found on the DCED website. Communication with the public could also be enhanced if PSD policies outlined more clearly the values behind PSD, such as enabling an exit from charity and hand-outs, the dignity of having a sustainable income, and the benefit of increasing tax revenues that can be spent on health, education etc.

**In a nutshell: How the DCED supports policy and programme development**

- The DCED is a centre for peer learning and helps agencies to agree on common approaches to PSD. It the space for member agencies to come together to discuss ongoing trends and to develop fit-for-purpose and innovative approaches. A key feature of the DCED to respond to members' knowledge needs in nimble ways and take forward new research and action agendas to address members' most pressing concerns.
- The DCED follows an empirical approach, learning from evidence and experience on the ground in providing guidance, research summaries, and programme examples. It also offers  extensive knowledge pages on on all major PSD approaches as well as insights into debates, comparisons of effectiveness, and lessons learnt.
- For more targeted support to individual agencies, the DCED Secretariat provides a 'helpline' service for members when they are formulating PSD policies and strategies, helping member agencies gather the right information, facilitating advice from other members and highlighting best practices. The DCED Secretariat can also present on different themes and lessons learnt to member agency staff on request.

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