The Donor Committee for Enterprise Development

Private Sector Development Synthesis Note

Mega-Trends in Private Sector Development

The 2015 DCED Annual Meeting focused on the theme of 'Mega-Trends' in Private Sector Development (PSD). PSD compromises interventions that aim to stimulate economic opportunities for the poor, by enhancing market dynamics. This synthesis note provides a few of the more surprising insights into some of the key trends which are predicted to affect PSD as we currently know it. It draws together inputs from speakers on the day and from recent literature. Suggestions for how PSD professionals can best respond to these trends are presented.

There are hyperlinks to the presentations, and to other sources, in the body of the text.

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1. Emerging Economies

In 2015, McKinsey Global Institute (MGI) published the book "No Ordinary Disruption: The Four Global Forces Breaking All the Trends". These are the mega-trends which MGI believes will shape the global economy of the future; Jan Mischke of MGI introduced these at the 2015 DCED Annual Meeting. In "No Ordinary Disruption" MGI turns first to the shifting of the 'centre of economic gravity' eastwards, to emerging markets like China and India.

In and beyond Asia, emerging markets are not only becoming powerful actors in the global economy; they are also assuming a more active role in the sphere of international development. Bilateral activities are typically framed as 'cooperation', avoiding the implicit hierarchy of the term 'aid'. There is also some logic to this term: emerging economies are more similar economically to the developing economies they cooperate with, and this cooperation may prioritise mutual benefits through trade over charitable considerations. At the DCED Annual Meeting 2015, Tom de Bruyn presented the results of a survey which showed that Malawian government officials find the Food and Agriculture Organisation of the United Nations (FAO), China and Brazil to have the most useful expertise for Malawian agricultural challenges. This is in contrast to the perceptions of traditional donor agency employees, who felt that the World Bank and the International Finance Corporation (IFC) offered the most useful advice. Technologies developed in countries such as China and Brazil may also be a better fit for developing countries. In her presentation at the Annual Meeting, Lídia Cabral emphasised that Brazil's agricultural 'tropical technologies' could easily be applied in many African countries.

If emerging economies are important players in PSD, how can traditional donors better cooperate with them for development impact? Sophie Mottram represented the trilateral cooperation programme AgriTT at the Annual Meeting. AgriTT is one of the first trilateral development programmes focusing on

agricultural technology transfer to improve food security in two African countries. Its partners are the United Kingdom Department for International Development (DFID), the Chinese Ministries of Agriculture and Commerce, the Malawian Ministry of Agriculture, Irrigation and Water Development, the Uganda Ministry of Agriculture, Animal Industry and Fisheries, and the Forum for Agricultural Research in Africa. AgriTT takes a value chain approach, linking producers, markets and consumers, and encouraging added-value services around new technologies. It has been challenging for the programme to achieve strategic and operational consensus amongst partners, and to harmonise the rules under which DFID and the Chinese Ministries operate. However, in the programme's experience there are many benefits to trilateral cooperation, including utilising the comparative advantages of different partners. For example, UK management and finance expertise complements Chinese experience in using agricultural technology for poverty reduction.

Zhenbo Hou, in a recent ODI paper, similarly stressed the value to China of learning from traditional donors' expertise. In particular, lessons in efficient organisation of development ministries and effective collaboration with international think-tanks and NGOs could be usefully shared. However, the experience of AgriTT shows that this new trilateral approach may take time to achieve impact. Not every early initiative will be successful, and each should be used as part of a learning process.

2. Urbanisation

In "No Ordinary Disruption" MGI argues that cities are powerful engines of growth in emerging markets such as China and India. As explored in an recent paper by Howard Miller for EPS PEAKS, 'What are the features of urbanisation and cities that promote productivity, employment and salaries' there is a well-developed literature on why cities lend themselves to high productivity growth, based on two fundamental principles of economics: division of labour and economies of scale. MGI predict that nearly half of global GDP growth between 2010 and 2025 will come from 440 cities in emerging markets – 95 percent of them small- and medium-sized cities which many of us are not aware of yet.

However, whilst the development experience of countries and their urban areas around the world (and the lack of advanced rural societies) indicates urbanisation may be a necessary component of growth, Miller argues that it is not sufficient. Indeed, with 5 million people moving to cities every month but often not finding work, urban poverty is on the rise. In Sub-Saharan Africa, according to UN Habitat, 200 million people were living in slums in 2010, nearly 62 percent of the region's urban population.[1]

One hypothesis for this is that many cities, in Africa in particular, have been formed not by the presence of agglomeration economies but as a result of resource rents. Where urbanisation results from the income effect of natural resource endowments rather than structural change in the economy, resource rents are spent disproportionately on consumption rather than investment and demand for labour is focussed in non-tradable services[2]. It has been shown to be possible to follow resource-led growth followed by diversification and industrialisation for more sustainable development, for example in Malaysia, Chile and (to a lesser extent) South Africa.[3] However, a new paper by Professor Dani Rodrik shows that countries are running out of industrialisation opportunities sooner and at much lower levels of income than early industrialisers, with Latin America and Sub Saharan Africa particularly badly affected. He proposes a focus on services instead of manufacturing, such as information technology and finance, which are highly productive and tradable, and also benefit from the agglomeration effects of cities. The service sector could play the same escalator role that manufacturing has traditionally played, and donors should be considering how best to support its development in partner countries.

[1] http://www.worldbank.org/en/news/feature/2014/01/30/beyond-bricks-mortar-inclusive-cities
[2] Gollin, Douglas, Jedwab, Remi, and Vollrath, Dietrich, 2013, "Urbanization with and without Industrialization"
[3] Ibid.

Donors may also want to promote a range of services. Miller stresses that cities which focus on one or two activities, usually within manufacturing, heavy industry or technology, can be particularly useful to harness the benefits of agglomeration and localisation within the narrow bounds of a specific industry. However, whilst such cities tend to be very good at creating jobs they are less good at innovating, and are also highly exposed to the fortunes of an industry.

Another important question is in which cities should donors concentrate their efforts? Dan Dowling, from the Urbanisation and Climate Change department of PricewaterhouseCoopers, gave a presentation at the Annual Meeting which explored the economic and social benefits of having multiple, economically specialised and interconnected cities, as opposed to one dominant 'capital' city – based on a paper reporting the results of spatial and economic modelling in Ethiopia. Cities with over 5 million inhabitants appear to become less efficient, and demand more expensive infrastructure, for example because of the pressure on transport links. Indeed, growth rates in cities like Rio de Janeiro and Mexico city have been slower than the national averages[4]. However, in practice little is typically invested in planning to prevent this. As such, donors may wish to help new cities develop, to prevent overcrowding of existing cities. Supporting the initial infrastructure development necessary in new cities is a potential way to do this. Whilst this is typically considered to be very capital intensive, the ILO has argued that promoting labour intensive road construction will generate twice the number of jobs compared to capital intensive road construction and irrigation.[5]

If multiple, decentralised urban centres do emerge, donors will need to be able to work effectively with local as well as national government and find ways to maximise efficient links between cities. This can be done by exploiting natural corridors. In Ethiopia, for instance, a strategic geographic focus on the East African Rift Valley corridor helps to link Ethiopia to international markets through port cities to the East, and with the growing regional economies of Uganda, Rwanda, Kenya and South Executive summary to the West.

Finally, there are specific problems associated with urbanisation which donors should not ignore. Informality tends to be higher than average in cities, with some evidence that this affects women disproportionately to men[6]. Urban poverty is often associated with conflict, organised crime and gangs. Slum housing can pose health and environmental risks, and interventions which help entrepreneurs to generate income through recycling of waste can thus offer multiple benefits.

3. Growing Youth Bulge and Aging Populations

Significant demographic changes are underway in many of the countries in which donors are working. The 'youth bulge' is a well-recognised phenomenon, whereby falling infant mortality followed, with a lag, by falling fertility leads to significant decreases in the ratio of the non-working age population to the working age population. This phenomenon has been particularly marked in the MENA and Sub-Sahara Africa regions amongst others to significant decreases in the ratio of the non-working age population to the working age population. Economists such as Justin Yifu Lin, Ragui Assaad and Farzaneh Roudi-Fahimi and Deborah Levison have argued that the 'youth bulge' can be a positive influence on developing countries: if the increase in the number of working age individuals can be fully employed in productive activities, other things being equal, the level of average income per capita should increase as a result. This is not a given, however. Justin Yifu Lin points to the structural transformation which took place in China whilst the country's 'youth bulge' was at its peak as the reason that high youth unemployment

[4] Cadena, Andres, Remes, Jaana, and Resrepo, Alejandra, 2011, "Fulfilling the promise of Latin America's cities" McKinsey Insights

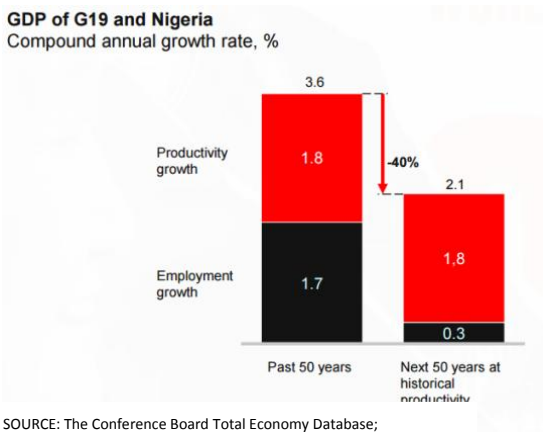
[5] IFC, 2013, "Poverty Literature Review Summary: Infrastructure and Poverty Reduction"

[6] Ghani, Kanbur and O'Connell, 2014, "Urbanization, Gender and Business Creation in the Informal Sector in India", World Bank Economic Premise

was avoided[7]. This underlines the importance of generating structural transformation, potentially through services rather than manufacturing – as argued by Dani Rodrik and others. There are significant risks to social and political instability if a large cohort of young people are unable to find employment.

Conversely, other partner countries are now facing an aging population, which presents a significant risk to economic growth. According to MGI, if global productivity continues to grow at its current rate, GDP growth in the G19 countries and Nigeria will slow down by approximately 40%. In the past 50 years, employment growth has contributed the remaining 1.8%. In the next 50 years, employment growth is predicted to deliver only 0.3%, suggesting a total annual growth rate of 2.1%. At the same time, pressure on welfare states will increase.

Even in emerging economies, the proportion of individuals over 65 in the population is increasing rapidly – and predicted to rise from 5% in 2000 to 8% in 2025 and 14% in 2050. In India, a country better known for its youth bulge, there are already over one hundred million people over the age of sixty; this is expected to grow to over three hundred million by 2050, according to estimates by the Population Division of the United Nations Department of Economic and Social Affairs. In countries where state healthcare provision is inadequate and few of the poor have pensions, targeted interventions to support older workers, for example through retraining, will become increasingly important.



SOURCE: The Conference Board Total Economy Database; UN Population Division; McKinsey Global Institute analysis

4. New Technologies

There is hope that new technologies will lead to productivity gains that offset the effect of a stagnant workforce. In MGI's view, technologies also have the potential to help developing countries leapfrog traditional barriers to growth. Information communication technologies can help citizens hold governments more accountable, and can also be used by governments to improve business enabling environments. Digitial land registration is a powerful example of this. Companies such as Trimble, Thomson Reuters and DigitalGlobe offer high-resolution maps based on satellite imagery and other data to government land administrators in the developing world. By clearly delineating property owned by small landholders, governments can enable landowners to obtain mortgage-backed loans. In Uganda, digitising land titles has made them more portable, allowing the government to open regional offices that made it easier for people to access the data and get their records[8].

The same technologies also offer opportunities for PSD interventions. At the DCED Annual Meeting, Michael Anthony presented the RIICE programme – a public private initiative which uses satellite photography to predict levels of rice production. It then targets insurance to communities likely to be affected by changing weather patterns. While such technology programmes can be complex and time-intensive to set up, they can offer effective opportunities for improving the livelihoods of the poor. In order to maximise these opportunities, RIICE directs subsidies to consumers – in this case of the insurance products – as opposed to the businesses offering the products. This is because the information gained from using satellite photography demonstrates a clear business case with low-risk for these businesses.

Technology also has the potential to improve the monitoring systems of a wide range of PSD interventions. Mobile phones are not a new technology, but their usage is now so widespread that

[7] Justin Yifu Lin, 2012, Youth Bulge: A Demographic Dividend or Demographic Bomb in Developing Countries?
[8] http://www.scidev.net/global/governance/news/technology-praised-for-assisting-land-tenure-reform.html

projects can use them as a primary means to collect data. With mobile phones, projects can collect information from a wider group, more quickly and cheaply. Photo messages can verify data collected, while videos can provide in depth qualitative insights.

5. Leveraging the Power of the Private Sector

As aid flows decrease relative to global capital flows, understanding how to better leverage private sector resources a force for development will become ever more important.

Lessons in effective public-private cooperation from a business perspective were presented by Richard Northcote of Bayer MaterialScience, which is working to develop sustainable solutions for underserved markets, such as better affordable housing and improved food preservation. He emphasised the challenge of finding partner organisations with shared visions and motives, and the critical role of supportive individuals within organisations in establishing effective partnerships. In contrast to the common perception that partnerships should involve the core business of companies, he argued that business ventures aiming to achieve development impacts should be ring-fenced within companies (as each partnership involves a different business model). This means that companies are not limited to activities which have the short-term commercial returns demanded in normal private sector operations. The pressure to exaggerate the success of partnerships for reputational reasons, which can come at the expense of achieving real impact, may be avoided by deciding not to publicise partnerships until results have already been achieved.

Another option in partnering with the private sector is to target investment funds. Many funds now have significant expertise in investing in emerging and developing market companies; donor support can allow them to take on projects which are high-risk but have the potential to achieve significant development impact. Peter Damgaard Jensen presented the investments by PKA, a Danish investment manager, in inclusive businesses in developing countries. He stressed the demand from customers to make socially responsible investments with development impacts. There is also a business case for helping to ensure that the companies invested in perform well – this translates into good exit opportunities for PKA. A good regulatory environment is critical in enabling such investments, which points to an additional role for donors.

In recent years, donors have also paid considerable attention to partnering with multinational corporations in global value chains, which already represent 80% of world trade and are likely to further grow in importance in the future. However, there is a growing amount of research that cautions against the risks of such 'mega-Public-Private Partnerships' with large corporates. At the Annual Meeting, Ajmal Abdulsamad of Duke University presented a review, which found limited evidence on the impacts of public-private partnerships on producer incomes and highlighted the risk that they reinforce existing power asymmetries between large buyers and poor suppliers. Robin Willoughby of Oxfam presented a paper arguing that partnerships with commodity buyers in particular can increase the monopsony of these buyers and leave the farmers who rely on them even more vulnerable to risk. In order to avoid this, producers should be linked to multiple buyers.[9] More generally, there seems to be a need for more careful analysis and design of partnerships with multinational companies in order to ensure pro-poor impacts. Some practical advice on how to achieve this is emerging. A recent example is a collaborative project between Oxfam, IIED and Unilever, which gathered lessons learnt on how lead firms can effectively include smallholders in their procurement. The project also lead to the creation of guiding principles for fair and inclusive smallholder-based supply chains that can be used by companies or development partners.

[9] Such findings are also echoed by other recent research, such as the seminal report 'Capturing the gains', which examined factors influencing the likelihood of small producers' and workers' economic upgrading through participation in global value chains.

6. Next Steps

It appears that, in the coming years, PSD professionals will need to work in potentially unfamiliar places (cities) and with different target groups (older workers). This presents potential challenges. Cities often have less clear social structures, and encounter problems with gang control. Older workers may be less flexible. PSD professionals will also need to learn how to cooperate more effectively with the private sector and emerging powers – both of which have their own worldviews, cultures and vocabularies. Working through new tools (innovative technologies) has the potential to improve PSD programming and monitoring.

DCED members have expressed particular interest in improving their strategies for private sector engagement. There are opportunities to learn from the experiences of other players in this field. For example, several large NGOs have taken the lead in engaging business more effectively in their work. Methods include developing new processes to select partners, and promoting changes in their organisational culture, team structures, and recruitment and training of staff. The DCED plans to explore such experiences further. In an effort to learn more from the business community itself, the DCED's 2016 Annual Meeting, hosted by the Swedish International Development Agency, will be oriented around inputs from Swedish companies. Task teams on both non-financial and financial forms of partnerships with the private sector were also formed at the 2015 Annual Meeting.

In order to better understand opportunities for leveraging private sector capital, the DCED is supporting a Danida-led initiative to review current experiences and options for donor support in the field of impact investment. Many global initiatives on innovative financial instruments have been established recently (see for example a recent press release by the WEF). However, so far there is limited agreement on terminologies and definitions, and little coordination between emerging initiatives; these will be priorities for future work.

The DCED Secretariat welcomes any further updates, from member or non-member agencies, on their work to respond to the mega-trends identified in this synthesis note.

Click on the link below for the DCED's 2015 Annual Meeting Page, with a range of further useful resources on the theme: http://www.enterprise-development.org/page/event?id=151