PRIVATE SECTOR ENGAGEMENT

DEVELOPMENT CO-OPERATION **FUNDAMENTALS**

WHY IS IT IMPORTANT?

- **Official development assistance (ODA) and public sector solutions alone are insufficient** to achieve the sustainable development goals (SDGs).
- The 2015 Addis Ababa Action Agenda, 2030 Agenda, and the Paris Climate Agreement all recognise the essential role of private sector engagement (PSE) in ensuring sustainable social, economic and environmental outcomes.

PSE fits within DAC members' broader development policy

PSE in development co-operation leverages private resources, expertise and innovation potential to achieve development outcomes

Private sector actors see sustainable development as critical to their own sustainability and they increasingly contribute to the SDGs

INTERNATIONAL STANDARDS

- The Kampala Principles promote ownership of private sector engagement (PSE) by partner countries and ensure the alignment of PSE projects and programmes with national sustainable development priorities.
- The MNE Declaration is the International Labour Organization instrument that provides direct guidance to enterprises (multinational and national) on social policy and inclusive, responsible and sustainable workplace practices.
- When engaging the private sector, governments should make sure that businesses meet expectations laid out in the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct and UN Guiding Principles on Business and Human Rights.
- The OECD DAC Blended Finance Principles for unlocking commercial finance for the SDGs help all providers of development finance –partner governments, development co-operation agencies, philanthropies and other concerned stakeholders – to design and implement blended finance programmes effectively. They build upon already established commitments on ODA targets, leaving no-one behind, development effectiveness and untying aid (see also OECD Blended Finance Principles Guidance.
- Inclusive development partnerships, including the private sector (II.5), are one of the pillars of the OECD Development Assistance Committee (DAC) Peer Review Methodology.
- DAC members have agreed to untie ODA in the DAC Recommendation on Untying Official Development Assistance. The DAC is reviewing the Recommendation to clarify how private sector instruments should be treated and monitored in terms of untying ODA (see also the Fundamentals document on Untying ODA).

CORE PRINCIPLES

Effective private sector engagement requires:

- Having an adequate strategy, skills and systems in place
- Using the most suitable instruments, grounded in the partner country's development priorities
- Engaging with partners to leverage their expertise and achieve scale
- Focusing on additionality and impact
- Recognising the private sector's need for financial sustainability
- Partnering with domestic firms without tying investment-related aid to them

GOOD PRACTICES

Having an adequate strategy, skills and systems in place

Objectives and modalities for PSE need to align with the overall development co-operation strategy and with partner country priorities. Staff need capacity to engage with the private sector and results need to be tracked to help decision making and learning.

1. Strategy

- The Swiss Agency for Development and Cooperation (SDC) has adopted a Handbook on Private Sector Engagement that defines objectives for PSE as well as the principles and modalities for engaging.
- The Netherlands has a theory of change that defines the challenges for private sector development, and the changes needed to achieve the desired impacts and outcomes.
- Italy passed a law in 2014 that underlines the need to involve the private sector in development, encouraging the financing of local small and medium-sized enterprises.
- Belgium's Development Finance Institution (BIO) has a theory of change focused on specific sectors and aligned with the SDGs.

GOOD PRACTICES

Having an adequate strategy, skills and systems in place (cont.)

2. Skills

- The United States Agency for International Development (USAID) has a dedicated focal point to support and train other units, as well as a community of practice and biennial private sector engagement fora to link staff in partner countries with those at headquarters.

3. Monitoring and evaluation

- Canada's development finance institution FinDev has an impact framework focusing on market development, gender and climate.
- The U.S. International Development Finance Corporation (DFC) has created a development impact measurement tool, the Impact Quotient (IQ). The IQ is used primarily to provide an “objective and systematic assessment of potential and current projects including any potential negative environmental, social or development risk”.

GOOD PRACTICES

Using the most suitable instruments, grounded in the partner country's development priorities

Financing constraints can be addressed with financial instruments, while knowledge and capacity constraints can be addressed with non-financial instruments. Specific sectors (e.g. agriculture, green energy) can be targeted depending on partner country's priorities.

1. Financial instruments

- **Grants:** Non reimbursable transfers in cash or in kind. See for instance Korea's Inclusive Business Solution Programme and the Czech B2B programme.
- **Debt instruments:** Transfers in cash or in kind for which recipients incur legal debt. See for instance OeEB long-term loans.
- **Equity investments:** Purchase of stock in a company, typically associated with voting rights, or buy shares in collective investment funds. See for instance equity investments by the US International Development Finance Corporation and the Investment Fund for Developing Countries.
- **Guarantees:** Risk-sharing agreements under which the guarantor agrees to pay part or the entire amount due on a loan, equity or other instrument to the lender/investor in the event of non-payment by the borrower. See for instance Sweden's guarantee instrument.

GOOD PRACTICES

Using the most suitable instruments, grounded in the partner country's development priorities (cont.)

2. Non-financial instruments (technical assistance and capacity building)

For the public sector

- The European Commission's Technical Assistance and Information Exchange (TAIEX) instrument supports public administrations on a wide range of topics (e.g. competition policy, financial services, SMEs and industry).
- The Czech Ministry of Finance provides technical assistance to developing countries in the field of public finance and regulation of financial markets. This can indirectly promote local private sector development.
- Expertise France assists partner countries in the implementation of economic policies that improve the business climate and innovation ecosystems.

For the private sector

- The British International Investment (BII) provides technical assistance to support its pipeline and portfolio companies.
- The EU and the International Labour Organization's Responsible Supply Chains in Asia programme helps companies take action to respect human and labour rights and environmental standards.

GOOD PRACTICES

Engaging with partners to leverage their expertise and achieve scale

Engaging with multilaterals, other donors, civil society organisations (CSOs), and business associations through multi-stakeholder partnerships can leverage expertise and achieve scale.

CSOs:

- Through the Dutch Diamond Approach, the Netherlands aims at linking the corporate efficiency of the private sector with the local knowledge of CSOs.

Multilaterals and other donors:

- Japan has worked with Germany, the International Finance Corporation (IFC), and the OPEC Fund for International Development (OFID) to invest in the largest photovoltaic power plant in Jordan to increase the country's renewable electricity supply.
- The International Mobilisation for Climate Action (IMCA) is a collaborative partnership led by Denmark, Finland, Sweden, Norway, and the USA, aiming to mobilise significant private capital for climate mitigation and adaptation, biodiversity and nature in emerging markets and developing countries (blended finance).

GOOD PRACTICES

Focusing on additionality and impact

Private sector engagement is ODA-eligible if it conveys development additionality coupled with financial or value additionality.

Development additionality

Deliver development impact that would not have occurred without the partnership between the official and the private sector

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Financial additionality

When private sector partners are unable to obtain financing from capital markets (local or international) for a specific activity at the necessary terms and/or scale, or where it mobilises finance from the private sector that would otherwise not have been invested

OR

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Value additionality

When the official sector provides or mobilises, non-financial value to private sector partners that the capital markets would not offer and which will lead to better development outcomes (e.g. investment conditionality, active ownerships, capacity building activities, advisory services, technical assistance)

GOOD PRACTICES

Focusing on additionality (cont.)

These forms of additionality are interconnected and not mutually exclusive:

- The Huruma fund – a partnership between Spain, the European Union and private sector investors – shows efficient use of public resources to attract private investment in high-risk areas. It convenes both financial and development additionality (e.g. supporting smallholder agriculture to reduce poverty).

Establishing frameworks that ensure and assess additionality will lead to better development results:

- The German Investment and Development Corporation (DEG) has developed the Development Effectiveness Rating (DERa) with the KfW Group, which assesses additionality and expected development outcomes, and is integrated into investment decision-making and monitoring processes.
- Norway's development finance institution (Norfund) has defined its approach to assessing additionality. This sets out its ambitions of investing in the poorest, most capital-constrained and riskiest markets with high development needs, while improving the social and environmental performance of these investments.

GOOD PRACTICES

Recognising the private sector's need for financial sustainability

It's important for the private sector to have a financial return to ensure sustainability and avoid market distortions.

- The European Union launched a communication in 2014 calling for a stronger role for the private sector in achieving inclusive and sustainable growth in developing countries, and outlining criteria for partnerships with them. One of these criteria is "neutrality", which stresses the importance of avoiding market distortions.
- When the International Finance Corporation (IFC) offers financing to local banks in developing countries that lend on to small and medium size enterprises, it designs its financial support carefully to ensure that local banks remain financially sustainable while reaching SMEs. For instance, the IFC does not require local banks to lend to SMEs at such a low rate that these banks would make a loss.
- The Slovak Agency for International Development Co-operation (SAIDC) provides grants for feasibility studies which can help assess both the financial sustainability and development impact of private sector projects.
- One of Swedfund's investment pillars is financial viability, and ensuring that companies are profitable in the long–term.

GOOD PRACTICES

Partnering with domestic firms without tying investment-related ODA to them

- **Technical co-operation*:** Geberit, a Swiss sanitary technology company and the Swiss Agency for Development and Cooperation (SDC) co-finance a collaboration to improve the quality of vocational education and training for plumbers in partner countries. The project aims to increase young people's employability and income, whilst also giving Geberit better access to skilled workers in those countries.
- **Public-private partnerships:** The SDG Impact Finance Initiative is a partnership between Swiss public and private players that aims to mobilise more than USD 1 billion in private capital to advance measurable impact in developing countries. ODA is used to de-risk and leverage the resources of Swiss banks.
- **Strengthening the business climate in partner countries:** The Dutch Theory of Change for Private Sector Engagement identifies strengthening the business climate as one of its priorities. Promoting enabling business environments in partner countries can help both domestic and non-domestic firms operate in partner countries.
- **Investing in Responsible Business Conduct (RBC)**: Companies do not always have sufficient know-how to assess and address sustainability risks in developing countries and may not have sufficient capacities to respond to RBC-related regulatory developments while competing with less engaged businesses. To disseminate standards, raise awareness, level the playing field and change business practice, the Dutch government has supported the creation of multi-stakeholder sectoral agreements.

* Technical co-operation is not considered as tied aid under the DAC recommendation on Untying ODA.

MEASURING SUCCESS

How do we know if DAC members are moving in the right direction?

- DAC members have systems in place to monitor and evaluate the impact of PSE. They report their PSE activities to the OCED/DAC which increases transparency on additionality and impact.
- Increased PSE does not lead to increased tied aid (either de jure or de facto), as measured by the tying status of ODA by DAC members.
- Private financing mobilised for development increases.
- Companies increasingly see the SDGs as part of their core business and use the impact standards for financing sustainable development.
- The business climate in developing countries improves, and small and medium enterprises in developing countries flourish and hire more employees.

RESOURCES

- The Global Partnership for Effective Development Co-operation's PSE website provides details on the Kampala Principles for effective private sector engagement.
- The OECD's Private Sector Engagement for Sustainable Development: Lessons from the OECD DAC highlights good practice, provides a typology of PSE and outlines key lessons learnt from the practical experiences of DAC members. Peer learning: Lessons from DAC members on effectively engaging the private sector in development co-operation provides further information on PSE.
- The OECD-UNDP Impact Standards for Financing Sustainable Development (IS-FSD) guide public and private investors seeking to optimise their contribution to the SDGs, enhancing transparency in investment reporting and combatting "impact washing" - a process in which investors claim alignment with development goals without meaningful evidence.
- The Foreign direct investment-FDI Qualities Policy Toolkit provides guidance to governments on policy and institutional reforms that can enhance the impacts of investment in four areas of the SDGs: productivity and innovation, job quality and skills, gender equality, and decarbonisation. The FDI Qualities Guide for Development Co-operation guides development co-operation actors in mobilising and enhancing the impact of foreign direct investment.
- In 2023, the OECD DAC agreed on new reporting rules for private sector instruments such as loans, equity and guarantees: Batch 1, Batch 2, and Batch 3
- OECD Data Explorer is a database that provides a comprehensive perspective on development finance.

Relevant topics in this series

Untying ODA – while engaging with the domestic private sector to achieve development results can be beneficial, DAC members have agreed to untie ODA.

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DEVELOPMENT CO-OPERATION **FUNDAMENTALS**

This series unpacks development co-operation standards and illustrates how DAC members are applying them. Applying standards can help all actors to fulfil their ambitions and commitments.

Each ***Fundamentals*** document introduces a key aspect of effective development co-operation, sets out ***basic standards***, offers ***good practice*** examples, and identifies ***relevant resources.***

Other topics in this series, which will be expanded and updated over time, can be found on the Development Co-operation TIPs • Tools Insights Practices peer learning platform. For comments, contact **DCD.TIPs@oecd.org**.