KEY MESSAGES

ECDPM analysis of donor strategies and instruments to leverage private sector investment using ODA

The European Centre for Development Policy Management (ECDPM) undertook on behalf of the Swiss Development Cooperation agency (SDC) a quick survey of the strategies and instruments used by the EU, Germany, Sweden and the UK to utilise Official Development Assistance in order to leverage additional private sector funding or investment. For the purpose of this survey, *programmes, funds and instruments* have been looked into that are designed and run by donors to have a leveraging or catalysing effect by providing part of the total requisite funding as ODA (e.g. through using loans, equity investment, mezzanine finance or guarantees) in order to attract additional funding from private companies to invest in projects and initiatives in developing countries with explicit development impact objectives[1].

The results of this survey are presented in the attached matrix. Sources used to complete the matrix are noted in the 'Sources' tab. Key messages are outlined below from an analysis of the findings noted in the matrix, revealing several lessons for donors wishing to engage more structurally with the private sector in order to leverage additional resources for development objectives. Nevertheless, the limited scope and timeframe of this research mean that this analysis should not be considered exhaustive of strategies and instruments to engage with the private sector.

The broad conclusion drawn from this analysis is that, while these donors appear to agree on the objective of using ODA to catalyse private sector finance (i.e. recognise the potential additionality of private investment leveraged through ODA), use standardised frameworks to assess and evaluate investment projects and can furthermore demonstrate some measure of leverage, they do not (yet) have common or clear strategies for this type of ODA spending, nor developed systems to measures amounts invested or, crucially, assess the results and impact of these projects. Whereas these donors do succeed in attracting more private investment, until they can demonstrate clear impact on poverty this usage of ODA will remain open to scepticism and criticism. The current context of discussion on the ODA definition as well as on financing the post-2015 framework for global development underlines the urgency of addressing this issue.

1) Donors have similar strategies and interests for using ODA to catalyse private investment, but have no specific policy framework for this

Whereas all donors note poverty reduction and inclusive and sustainable development as the end-goal, the donors surveyed stress subtly different aspects for/of working with the private sector – including scale benefits, private sector development in developing countries, economic interests of the donor and encouraging frontier investments including clean technologies. Essentially, donors intend to invest in enhancing the positive impact of the core business of private sector actors for developing countries (as explicitly expressed by Sweden). Donors invest in capital-intensive sectors where there is an obvious role for the private sector, including infrastructure, health, industry, agriculture and, more recently, climate, environment and energy.

The donors surveyed are explicit and focused in engaging with the private sector for identified outcomes, rather than seeing 'PSD' as a catch-all term for all aid interventions involving the private sector. However, this survey did not find any specific strategies detailing the donors' particular objectives and methods for leveraging private finance. The EU may be an exception to this, as its EU Platform on Blending in External

[1] This is not an exhaustive definition. In a recent Topic Guide, the following broad definition of blended finance can be found: "Blended finance, in this guide, refers broadly to the complementary use of grants (or grant-equivalent instruments) and non-grant financing from private and/or public sources to provide financing on terms that would make projects financially viable and/or financially sustainable." See http://www.evidenceondemand.info/topic-guide-blended-finance-for-infrastructure-and-low-carbon-development-full-report

Cooperation is assessing existing blending mechanisms and developing a common results-based framework for measuring the impact of blending operations[2]. This is likely to feed into a clearer statement of intent of the European Commission (on top of the documents not in the public domain reviewed for this survey) on investing ODA through regional investment facilities for blending.

The majority of donors do not clearly distinguish between developing countries, but rather note 'emerging markets' or a continental focus. Some target specific riskier markets, particularly least-developed countries and fragile states, using separate instruments (see below).

2) Donors use a variety of instruments to target (parts of) the private sector

Most instruments managed by single donors are relatively straightforward in their design and application, consisting of common debt instruments (short- and long-term loans and mezzanine financing, both concessional and non-concessional) as well as equity investments, which are deployed to rapidly provide capital to firms wishing to expand or for projects with a funding gap. Such instruments can hardly be classified as 'innovative', rather filling a gap left by the local (or international) financial sector and markets. Care is usually taken to ensure due diligence on the part of the lender, and to put up collateral on the part of the borrower.

Alternative instruments include investments or risk guarantees in a variety of forms, usually on concessional terms, which ease some (usually financial) restraints on private sector actors. The donors surveyed also commit a significant amount of resources targeting private sector development through multi-donor or multilateral funds. Aside from the obvious potential scale effects of such funds (allowing donors to effectively address large resource gaps and global problems), it is noted that these arrangements are often managed by an independent and closely scrutinised organisation (e.g. a World Bank trust fund or fully independent organisation). These aspects make such funds attractive for private sector actors (and thus donors wishing to attract their investment), particularly large multinational companies willing to commit funding or services at international level over a number of years.

Donors furthermore tend to have specific arrangements for providing support to pioneer or start-up investments by SMEs in developing countries. This could be due to a number of reasons: first, donors will be conscious of the fact that SMEs provide a majority of jobs worldwide. Furthermore, SMEs offer opportunities to invest in the early adoption of, for instance, innovative and inclusive business models or clean technologies that suit donors' development objectives. Lastly, the necessary investment and barriers to monitoring would presumably also be lower than for working with, for instance, multinational enterprises. Challenge Fund arrangements and instruments for match funding (notably through equity and quasi-equity investments and direct loans) appear to be common and effective in this regard (and actively promoted by DFID). Such models can also be usefully scaled up, as has been done in the Africa Enterprise Challenge Fund. An essential learning in this regard is that such funds need to be accompanied by technical assistance facilities or business development services if they are to support and promote nascent industries sustainably.

DEG, Sida and DFID are particularly keen to support pioneer investments in inclusive and innovative business models and/or in up-scaling existing businesses in high-risk markets, targeting the needs of the poorest in developing countries. They manage specific funds or instruments for this purpose, which are aimed at absorbing start-up risk for businesses – while they do not appear to make special provisions in the terms and structure of their investments from the materials available, these instruments do have a lower leverage ratio than others (1.5-2 : 1). The only programme designed to invest specifically in high-risk areas, CDC's Frontier

[2] See http://ec.europa.eu/europeaid/news/2012-12-12-platform-blending-funds_en.htm. Thus far, an initial assessment and comparison of the performance of different blending mechanisms was undertaken, a common set of results indicators that reflect outputs and intended outcomes of projects was agreed, and key lessons for achieving specific result areas were identified.

Investments, was only launched in 2013, as was DFID's Impact Fund, which does not require its investments to be profitable (only to break even).

3) Donors make use of explicit, standardised investment principles to select and evaluate projects

Bilateral donors' and DFI's instruments widely use project eligibility and assessment criteria based on the IFC's Environmental and Social Performance Standards and Development Outcome Tracking System (DOTS) and EDFI's Environment, Social Matters and Governance (ESG) Standards[3]. It would seem that, following a lengthy and broad-based consultation process of the IFC's previous standards in 2009-11, most donors and financial institutions investing in developing countries subscribe to such endorsed investment standards.

These standards and frameworks incorporate ex-ante, annual and ex-post measurement and monitoring of qualitative and quantitative indicators for results (in financial performance, economic performance, environmental, social and governance results and improvements and private sector development). Criteria used by donors in this survey absorb these standards, but furthermore also generally reflect international development commitments such as the Busan principles, as well as the donor's own development objectives. Nevertheless, while they are certainly applied ex-ante, few instruments publish reports on how grantees meet the requirements, and fewer still demonstrate that they monitor these requirements throughout the life cycle of the project, despite noting that this is done.

4) Both opportunities and risks for investment are noted, and a key concern remains the 'additionality' of the ODA provided

Aside from the commonly stated risks and opportunities of investing in the private sector in developing countries, reiterated from the private sector development strategies, instruments are promoted for tapping into the opportunities to scale up businesses and enable capacity transfers. At the same time, the most commonly heard of risk and objection to investing ODA to leverage private finance in developing countries is the lack of (proven) additionality.

All donors noted are concerned that their investment facilitates a project that would otherwise not have taken place. This investment should, furthermore, have both a risk-reducing and demonstration effect, meant to encourage subsequent private investors to enter new or risky markets. The effect can however equally turn out to be that 1) investments which would have taken place are subsidised (in part because they can demonstrate to donors to be the 'best of the worst' investments) and 2) markets can appear to be subsidised by foreign investors (donors) and thus not viable for private investors to enter. An ODA component may therefore have an unintended 'crowding out' effect.

Whether ODA does indeed have an additionality over existing, separate grant aid and loans, whether this be in economic and financial terms, in project scale and timing, project quality, innovativeness or influence on national policy dialogues and reforms, is at this moment the subject of much debate but not yet accurately measured (even less so than their development impact, see below). It should in any case not be forgotten that financing leveraged through ODA does not necessarily translate into new or pioneer projects (additionality), or into increased development impact. This is in part due to the fact that investments in private sector activities will to an extent always be driven by market demands and commercial interests, through which a compromise with stated development objectives and desired outcomes is not always possible.

5) There is no common method for quantifying ODA investments in private sector development

[3] See http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework/, http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IDG_Home/Monitoring_Tracking_Results/Tracking_System and http://www.swedfund.se/en/files/2010/08/09-05-07-edfi-principles-responsible-financing-signed-copy.pdf.

It is hard to accurately quantify ODA budgets designated for private sector development as a goal, or used to leverage additional funding, using OECD statistics. Although equity investments and public-private partnerships are noted as flows and channels of ODA respectively, there is no corresponding code for the purpose of such investments in private companies, nor an accurate enough definition to conclude that these flows are indeed invested in the private sector with the aim of attracting additional investment. A recent study furthermore shows that donors use different DAC codes in their reporting to quantify support to private sector development (Kindornay & Reilly-King, 2013). ECOSOC suggests a typology for public aid for private investment, reproduced below – while the definitions do not cover all aspects noted in the attached matrix, it provides a basis for discussion on how to better capture public aid for private investment in DAC ODA statistics.

Typology proposal for 'public aid for private investment' based on available ODA statistics[4]

Feature	*Description*
Equity investment	Direct financing of enterprises in a developing country, which does not imply a lasting interest in the enterprise. They can be either indirect, when channelled through financial intermediaries, or direct.
PPP	Aid channelled through associations formally established as a PPP, excluding equity investments.
Economic services	Aid allocated to business and banking services, excluding aid channelled via PPPs or equity investments
Productive sectors	Aid allocated to agriculture, industry, fishery, mining, tourism & construction sectors, excluding aid channelled via PPPs or equity investments.

6) Donors are successful at achieving leverage, but do not go in-depth to measure development impact

While the information available is incomplete, the average leverage ratio for smaller investment projects appears to be around the 4:1 mark, whereas larger investments can see leverage ratios of up to 12:1 or 34:1. Reports, evaluations and case studies on these instruments that note an actual leverage ratio are therefore overwhelmingly positive. There are however few in-depth or systematic evaluations of these instruments (the majority of which are also quite new) – it is therefore not possible in the scope of this study to draw conclusions on what instruments or arrangements are particularly useful to attract investment from particular segments of the private sector, or yields better project results. Indeed, on a case-by-case basis, it is often simply the structure of the individual loan or grant that determines the parties' interest.

Beyond this, the development impact of investment projects by bilateral donors is generally measured according to the number of jobs created or secured; tax and export earnings raised; reductions in emissions, etc. Whereas these are important proxies for impact on wider development goals, investments projects' contribution to poverty reduction and sustainable development, as well as their complementarity with other projects, is implied rather than demonstrated. Donors could invest more effort in clarifying both the theory of change of their investment in particular projects, as well as the specific added value of the donor's involvement – for instance, DEG has detailed theories of change for each project, while Swedfund provides details in case studies on the benefits of its accompanying capacity building endeavours and self-reporting on economic, social and governance performance of projects.

On the other hand some multi-donor financial instruments appear to invest more in demonstrating the impact of their investments, in part due to the closer scrutiny effected on them by (among others) the donors themselves. In designing their instruments, bilateral donors could draw on the monitoring and evaluation frameworks of these multilateral instruments. Useful examples include:

[4] See http://www.un.org/en/ecosoc/newfunct/pdf13/dcf_switzerland_first_complete_draft_public_aid_as_a_driver_for_private_investment.pdf

- The *Private Infrastructure Development Group*'s (PIDG) project results monitoring sheet[5], comprising an extensive survey of the most salient aspects of infrastructure investment projects, which can provide a useful template for other funds. It also includes questions directed towards demonstrating the additionality of any given project;

- The *Africa Enterprise Challenge Fund*'s (AECF) impact framework[6] measures not only the success of the investment (turnover and profitability), but also its impact on households (disaggregated as consumers and suppliers of the business or project supported) and jobs (disaggregated by gender and age). It furthermore makes effort to monitor the impact of investments on the market system in which they are effected, estimating whether each project has the effect of being replicated (through crowding in, copying of the business model or copying of the practices); influences factor or other market prices; is linked to regulatory changes or promotes innovation. While not as in-depth as would be desirable, this framework has the benefit of thinking beyond the project, and reflects the philosophy of the instrument well (in this case a challenge fund which aims to 'start races rather than pick winners').

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[5] See http://www.pidg.org/resource-library/results-monitoring/pidg-results-monitoring-sheet.pdf
[6] See http://www.aecfafrica.org/impacting-development