VOLUME 7 - ISSUE 2
SPRING 2018

ecdpm

Great Insights

Leveraging private investment for sustainable development

The EU's External Investment Plan: Creating sustainable jobs for poverty eradication in countries near the EU and in Africa
Neven Mimica, European Commissioner for International Cooperation and Development

Policies to mobilise the private sector: Open your mind
Alexander de Croo, Belgian Minister of Development Cooperation

European development finance and the EBRD model
Suma Chakrabarti, President of the European Bank for Reconstruction and Development

FAO's approach
Interview with José Graziano da Silva, Director-General of the Food and Agriculture Organization of the United Nations

ecdpm
Great Insights

ECDPM's Great Insights magazine offers a quick and accessible summary of cutting-edge analysis on international cooperation and Europe-Africa relations. It includes an independent overview of analysis and commentary from a wide variety of experts and high-level officials and provides updates on policy debates in Africa and Europe.

Disclaimer: The views expressed are those of individual authors.

Publisher ECDPM
Executive editor Virginia Mucchi
Guest editors Sebastian Grosse Puppendahl and Jeske van Seters
Editorial and production assistance Jacquie Dias, Jeske van Seters and Sebastian Grosse Puppendahl
Web editor Jacquie Dias

Cover: design by Claudia Backes
Photo: A portrait of Managing Director Salma Salifu of Dignity DTRT Ltd., an apparal factory in Accra, Ghana. Photo © Dominic Chavez/World Bank.

Art direction and design of layout Yaseena Chiu-van 't Hoff
Design, layout and production Claudia Backes

ECDPM Head office
The Pelican House
Onze Lieve Vrouweplein 21
6211 HE Maastricht
The Netherlands
Tel +31 (0)43 350 29 00
Fax +31 (0)43 350 29 02

ECDPM Brussels office
Rue Archimède 5
1000 Brussels
Belgium
Tel +32 (0)2 237 43 10
Fax +32 (0)2 237 43 19

ISSN: 2215-0593 (print)
2213-0063 (online)

For further information or to subscribe to our newsletters, visit www.ecdpm.org/subscribe. To order a hard copy of an ECDPM publication, please email info@ecdpm.org.

This publication benefits from structural support by ECDPM's institutional partners: The Netherlands, Belgium, Estonia, Finland, Ireland, Luxembourg, Sweden, Switzerland, Denmark and Austria.

Editorial


When discussing development cooperation policy and action in 2018, it is all about leveraging: leveraging the private sector, leveraging private finance and leveraging investments by companies and corporations. More broadly it is about leveraging resources, skills and knowledge the private sector can bring to the table to support and implement the Sustainable Development Goals (SDGs). By now, there is broad recognition that the vast majority of jobs and investments is provided by the private sector, as it plays a critical role when it comes to production, investment, innovation, technology, services and finance provision. Hence, it can act as a fundamental actor promoting and contributing to sustainable, inclusive development and prosperity for all.

However, a responsible and inclusive private sector is neither a given nor an end in itself but rather one of the most powerful and important means to achieve sustainable outcomes and development, as enshrined in the 2030 Agenda. This issue of Great Insights brings together many perspectives and insights on approaches and instruments to leverage private investments that are in line with the SDGs, while recognising the need for financial returns for private actors and investors.

The articles zoom in on ways to make (core) business activities and investments more responsible, inclusive and sustainable and using scarce public (aid) resources to encourage and trigger private investments. They clearly show that 'the' private sector is a very diverse rather than homogeneous group, which needs to be properly understood. The articles also emphasise and illustrate the importance of businesses, governments, development banks and finance institutions (DFIs) and civil society, to exchange and collaborate in various ways, while taking into account differences in mandates, drivers and incentives.

It is clear from the articles that doing things differently and with more impact to achieve the SDGs requires stepping up ambitions and risk levels. It is also not just a question of finance and the leverage ratio —moving from billions to trillions— but also of quality and the right type of investments and interventions that are both additional and non-distortive, anchored in local realities.

As always, we hope you enjoy reading this issue of Great Insights, and welcome your comments and suggestions.

Guest editors
Jeske van Seters, Head of the Private Sector Engagement team of ECDPM's Economic and Agricultural Transformation programme and **Sebastian Grosse Puppendahl,** Policy Officer in the Trade, Investment and Finance team of ECDPM's Economic and Agricultural Transformation programme

Contents


Zagtouli Power plant, Burkina Faso
Photo provided by the European Commission

THE EU's EXTERNAL INVESTMENT PLAN:
CREATING SUSTAINABLE JOBS FOR POVERTY ERADICATION IN COUNTRIES NEAR THE EU AND IN AFRICA

Workers at the Zagtouli solar farm in Burkina Faso
Photo: supplied by the EC Press office

In 2015, the international community agreed on the so-called Sustainable Development Goals (SDGs) that set out a vision to overcome poverty and achieve sustainable development worldwide by 2030. To deliver on this ambitious agenda, different financing sources will have to be used. They include a much better use of domestic resources, public funds such as official development assistance (ODA), and also much increased investments. According to the United Nations Conference on Trade and Development (UNCTAD), the investment gap amounts to more than €2 billion a year.

By Neven Mimica

When investors want to seize economic opportunities, some challenges are recurrent, including access to finance, knowledge of local regulations, or lack of opportunities for risk-sharing. This is particularly pronounced in countries with less developed economic governance systems and in fragile contexts. In response, the new EU External Investment Plan (EIP) will address those challenges in order to trigger investments that contribute to our policy objectives such as overcoming poverty, fighting climate change and addressing the root causes of irregular migration. With an input of €4.1 billion, the EIP aims to leverage €44 billion of total investments in countries neighbouring the EU and in Africa. By promoting economic development, it will help create jobs, support economies and give people more opportunities in their home countries – thus also ensuring social benefits.

The Plan has **three parts:**

- the European Fund for Sustainable Development (EFSD), which includes a financial guarantee and blending instruments to leverage much more public and private investment in sustainable development;

- technical assistance to enable investors and businesses to develop bankable projects, and to improve the regulatory environment; and

- regular dialogues with governments, investors and stakeholders to improve business environment and investment climate in partner countries.

The **EFSD** comprises € 2.6 billion in so-called blending, and €1.5 billion in guarantees. *Blending* is a form of development assistance that combines EU grants with non-grant resources. Loans, equity and guarantees from development finance institutions as well as commercial loans and investments allow investors to achieve a leveraged development impact. The European Commission has been successfully using blending to support projects for more than ten years. One example is the SANAD Fund, which targets the Middle East and North Africa. It provides loans, subordinated debt, guarantees and equity financing to local partner institutions, which then lend to small businesses, fuelling their growth. Micro- and small companies account for 60% of output and 70% of jobs in these regions, so they are crucial. In addition, a technical facility co-financed by the EU with €2 million offers capacity building and support to private finance initiatives. The EU has also provided €60 million towards a total investment of €180 million by the Boost Africa initiative between the African Development Bank (AFDB) and the European Investment Bank (EIB). It fosters start-ups and small firms by supporting the commercial apparatus that engages with these companies, including venture capital funds, angel funds and accelerators. In 2017, the EU agreed to invest nearly €1.3 billion in over 50 blending projects in Africa and the European Neighbourhood under the EIP; this should unlock more than €9.6 billion in public and private investment.

The particularly innovative part of the EFSD is its guarantee element of €1.5 billion. It can cover a broad range of risks, including for local currency lending and political risks. It would only cover pre-agreed specific risks, up to a defined ceiling. The guarantee can cover risks specific to a particular sector, such as off-take risks generating electricity through solar or wind parks. The EFSD guarantee will be provided to portfolios of investment to balance risks by including both fragile and more stable countries. First guarantee agreements should be signed in the second half of this year.

The EFSD is open to contributions from EU Member States as well as other partners that could be in cash but also take different forms of guarantees. A first contribution from an EU Member State has already been received and discussions with other partners are also very encouraging.

The EFSD's guarantees will focus on **five priority areas,** the so-called investment windows. The first covers **renewable energy and connectivity.** Renewable energy is essential to build up competitive and low-carbon economies and partner countries need them to withstand the effects of climate change and protect the environment. The guarantee will also encourage investments in more sustainable, efficient and safer transport links between the EU and countries neighbouring the EU and in Africa, as well as within those regions. The aim is to improve logistics systems, unblock transport bottlenecks, and promote trade.

The second area is expanding affordable finance opportunities for local businesses that are **micro-, small- or medium-sized enterprises.** These are the main providers of jobs across developing and transition countries and an essential part of local economies. The guarantee will also help to empower women-owned businesses and young entrepreneurs. This will be achieved by supporting improvements to the legal and regulatory framework and the way countries are run (good governance) under pillar 3 of the EIP. Development finance institutions were asked to present proposals for these first two windows until the end of January. The interest of these institutions has been impressive. More than 30 investment programmes have been proposed whose total guarantee envelope would already exceed the amount of €1.5 billion that is available for all five areas.

The third area on which the guarantee focuses is **sustainable agriculture.** Here it aims to create jobs, develop value chains, diversify agricultural production, and promote local skills. We want to encourage the development of farms and agri-enterprises, including smallholders, cooperatives and small businesses, which can sustain themselves financially, and which respect the environment and workers' rights.

The guarantee's fourth focus area is **sustainable urbanisation.** The EIP will boost investment in sustainable and smart urban mobility; water, sanitation and waste management; food supply; air quality; and renewable energy and energy efficiency. By doing so, the Plan will help cities to mitigate global warming, adapt to climate change and build urban resilience.

The guarantee's fifth focus area is the fast-growing **digital economy.** The ambition is to widen access to affordable, secure broadband and digital infrastructure; improve access to finance for local start-ups; to develop e-Government and e-Health services; to promote digital literacy and skills; to foster digital entrepreneurship and job creation; and to promote the use of digital technologies to boost other parts of the economy.

The deadline for submitting proposals in the last three areas was the end of March 2018.

The Plan offers new opportunities for investors and businesses in the EU and in our partner countries. It will help us address common challenges, including poverty, migration, youth unemployment, and climate change. Investing in the EIP is an investment in peace and prosperity, not just in countries neighbouring the EU and in Africa but an investment in our European future too.

About the author
Neven Mimica is the European Commissioner for International Cooperation and Development. His full bio and blog can be found here: https://ec.europa.eu/commission/commissioners/2014-2019/mimica_en.

HOW YOU CAN ENGAGE:

If you are interested in taking part, there are several options.

The EFSD will only be directly available to development agencies, development banks, and other entities which the Commission has entrusted to manage EU funds (entrusted entities). These will manage the individual operations, which the EFSD guarantee and blending will cover.

However, if you have an investment in mind, you can fill in a webform in the one stop shop of the EIP webpage (https://ec.europa.eu/commission/eu-external-investment-plan/how-you-can-engage-external-investment-plan-one-stop-shop_en) summarising your proposed action. The Commission will share this completed form with entrusted entities and other partners. You may also choose to contact the entrusted entities directly. A list is available at the same address. Businesses and investors can also contact EU delegations in the EU Neighbourhood and in Africa.

One other important way to get involved is through the processes of formal dialogue with governments, business and stakeholders in context of pillar 3. In Africa last year we launched the Sustainable Business for Africa (SB4A) initiative. This will involve the private sector (profit and non-profit actors), facilitated by EU offices in African countries and EU business groups. To get involved, please email: EuropeAid-SB4A@ec.europa.eu.

There is also the Structural Reform Facility for the Eastern Neighbourhood, which aims to help identify and formulate reforms of laws and institutions to promote investment in areas agreed with countries in the region.

Public phones outside the Velodrome in Athens
Photo: Dan Boss/Flickr

EUROPEAN DEVELOPMENT FINANCE AND THE EBRD MODEL

The EBRD's ability to match private finance with public policy can help the world deliver its Sustainable Development Goals.

By Suma Chakrabarti

The initials EBRD stand for European Bank for Reconstruction and *Development*. But the paradox is that, despite being founded in 1991 and having the 'D word' in our title, for many years we stood at one remove from the mainstream development discourse. The principal reason for this was that the EBRD was set up specifically to promote "market-oriented economies...and private and entrepreneurial initiatives", or what I would call *economic* development across all its characteristics.

Thus, when attention was fixed on a narrower definition of the development problem, as represented by such priorities, as poverty eradication, access to education and reducing child mortality as exemplified in the Millennium Development Goals, the EBRD stood stage right, or even off in the wings.

Three important shifts in development

How times have changed! I would highlight three important shifts in development policy since that time. Firstly, the Sustainable Development Goals (SDGs) of 2015 have broadened our common agenda to embrace both economic as well as social imperatives, alongside the environment. The SDGs are also universal, so applicable to all countries, including middle-income countries, where we are on the ground.

So, our priorities have expanded to address issues as significant as inclusive growth, tackling inequality, developing strong institutions, building sustainable infrastructure and addressing climate change. Our European Union (EU) shareholders have, I would add, always been strong development champions, promoting stability, prosperity and sustainable growth.

The second shift is the now extreme urgency of tackling climate change. Europe has long driven the debate on how to address this existential challenge. Many of the regions neighbouring Europe where we work are particularly vulnerable and ill-equipped to manage its potentially disruptive impact.

Finally, we all now acknowledge that mobilising private finance is fundamental to achieving our objectives, as recognised in the Addis Ababa Action Agenda and last year's new European Consensus on Development. The annual investment needed is estimated at twenty times the current volume of official development assistance. This in turn requires recipient governments to create conditions that encourage a positive investment climate. And all official actors need to deliver their own assistance in ways that support markets and capital mobilisation.

Here again the European Union is playing a vital role in coordinating and mobilising all actors on its development and external policy agenda, including the private sector. The work that is starting on the Multi-Annual Financial Framework (MFF) provides a unique opportunity to review the overall architecture to ensure we are set up to deliver. While maintaining our global shareholder base, including our countries of operations, I am very keen to strengthen the EBRD's already extremely deep and strong relations with the EU institutions to deliver our common objectives.

Europe's global voice

But in 2018 Europe also needs to ensure its voice is heard at the global level. The G20 Eminent Persons Group on Global Financial Governance will issue its recommendations later this year. I have the great privilege of currently chairing the group of Multilateral Development Banks (MDBs) and we are already engaging in this debate. We need to focus collectively on ensuring that we deploy each institution's strengths, skills and knowledge to crowd in private finance and to support policy reform in emerging and developing economies.

Given this important context, it is not surprising that the EBRD and its business model are now no longer standing in the wings but squarely centre stage of the debate. Ever since our creation, our main competitive advantage has been our ability to match private finance with the delivery of public policy goals. For example by:

- engaging directly with and mobilising the private sector (finance);
- combining investment, policy engagement and capacity building for an enhanced business environment;
- Operating in both the private and public sectors for the benefit of both;
- maximising the impact on the ground through our network of offices and in-depth knowledge of our countries; and finally,
- taking and managing financial risk against our own capital resources.

The EBRD approach

Applying our unique business model has allowed us to build up impressive expertise in areas such as private sector climate finance; local currency financing and capital market development; sub-sovereign municipal lending and private sector support for economic inclusion. And these are the very areas which are ever more prominent within the development landscape.

Our model's success has encouraged our shareholders to expand the region in which we operate on four separate occasions. We now work in 37 countries across three continents and each successive expansion has underlined how fast we can scale up our activity and have real impact. From Mongolia to Turkey, to the Southern and Eastern Mediterranean and, most recently, Greece and Cyprus, the EBRD model has achieved results in countries very different from those centrally-planned economies where we started out. I might add that, other than the start-up Asian Infrastructure Investment Bank (AIIB), we are the only MDB which is currently growing its membership.

The skills, mindset and finance we bring to the market, differ from but also complement those of other development actors. Our commitment to the private sector does not mean that we undervalue other approaches. But we believe that we must pull together in a coordinated way, one based on common principles. All actors, bilateral agencies and IFIs must aim to crowd in, rather than crowd out, the private sector. As public institutions with taxpayer backing, we must take particular care not to distort the workings of the market. Concessional elements of development financing need to be well-targeted, time-limited and deployed to address specific shortcomings, such as market failures and affordability, not the norm.

As the EU reflects on the post-2020 development architecture, in the context of the next MFF, my hope is that whatever is put in place plays to the strengths of all European development actors. For that to happen, open access to European blending tools and financial instruments for all players is vital. This is precisely what has been done through the new European External Investment Plan (EIP), and that is a step change which I am convinced is the right approach. I also believe we can do much more to strengthen common approaches – to ensure, for example, that we speak to partner governments with one voice on key policy priorities, even as we engage on investment programmes.

As approved in 2015 and then bolstered by the Paris Agreement, the SDGs, while ambitious, offer the best summary of our most important shared priorities. With their 2030 deadline approaching, making progress on delivery — and doing so along the lines I have sketched above — is now more essential than ever.

About the author

Sir Suma Chakrabarti is President of the European Bank for Reconstruction and Development.

POLICIES TO MOBILISE THE PRIVATE SECTOR: OPEN YOUR MIND

Villagers queuing for water at a pump in Kenya's arid Eastern Province.
Photo: Flore de Preneuf / World Bank

Belgium has embraced a private sector policy for development that aims to capture the multiple perspectives and opportunities embodied by the Sustainable Development Goals.

By Alexander de Croo

When I came into office in 2014, a feeling of unease with the private sector was still palpable across the development sector. Sure enough, bad memories of past tied aid and white elephants had done little to alleviate such concerns. Nor had the Washington Consensus delivered on its promises of spurring economic prosperity, adding only to an image of unscrupulous corporations exploiting the less endowed regions of the world.

Such perceptions oddly contrasted with our domestic experience. Our own societies had historically succeeded in fostering free enterprise as the main driver for innovation, jobs and prosperity in general. It seemed as if we had a very different conception of how to help shape development in other places.

How much has changed since 2014, with the advent of the Sustainable Development Goals (SDGs)!

One of the many merits of the SDGs, has been to understand that we are now *all* developing countries in one way or another. Whether it is about gender equality or renewables, we all have significant efforts to make, regardless of our relative levels of prosperity. But recognising that we need private actors to push forward sustainable development has been no less of a game changer.

Different angles to the volte-face

One perspective has been to focus on inputs. Now conscious of the investments required to reach the SDGs by 2030, "trillions instead of billions", the need to leverage private resources has been put central to implementing the agenda.

Secondly, while the world has been converging, it became clear that a small group of countries was still being deprived of access to finance, e.g. through *Foreign Direct Investments*, necessary for their development. As such, the need to de-risk private investments in those least developed and fragile countries has since become a bigger priority for many donor governments, including Belgium.

Thirdly, for lack of true governance of certain global goods, private actors needed to act responsibly and incorporate sustainability in their business models, for which the framework of the SDG-Agenda would prove instrumental.

Lastly, kick-starting local private sector development was understood as a precondition to a positive dynamic of change. *Small and Medium Enterprises,* especially, are of essential importance since they truly harbour the economic empowerment of people.

For Belgian development policy, conceiving a private sector policy is about capturing all these perspectives. Inclusive and sustainable economic growth has therefore been an essential pillar of our development policy since 2014, firmly embedded within the SDG-framework.

A new Belgian approach

That might seem ambitious for a medium-sized donor like Belgium. Nonetheless, we believe in our added value and have been committed to take steps in modelling such a wide ranging policy.

Starting with private sector development, four objectives are now underpinning our approach:

- Provide investment capital to enable companies to contribute to the SDGs
- Promote an enabling environment (e.g. land registration, contracting laws, infrastructure...)
- Strengthen and increase supporting services to the private sector
- Develop inclusive and sustainable market systems

For this purpose, a major overhaul in our institutional setup has been implemented. Private sector development has been instilled in the organisational core of *Enabel*, the Belgian development agency, increasing partnership options and making sustainable entrepreneurship and job creation henceforth part and parcel of all new bilateral agreements.

Likewise, the Belgian Development Finance Institute, *BIO-Invest*, has opened up to private capital and increased its portfolio to include new catalytic sectors related to climate-change and digitalisation. Lower return investments will be made acceptable, allowing for more development-impact focussed strategies and increased investments in LDCs and fragile contexts.

Another objective is obviously about leveraging resources, yet it goes beyond the mere raising of capital. That is because private investors can often carry an approach that is more geared to results. This is the idea behind the first-ever *Humanitarian Impact Bond*, launched by Belgium and the International Committee of the Red Cross (ICRC) in 2017. Measured by pre-determined targets, outcome funders will repay social investors pro rata, thus spreading risks across private and public partners in the construction of physical rehabilitation centres in Mali, Nigeria and the DRC. A legal framework is currently being conceived in order to expand the scope of such innovative financing instruments.

Yet another initiative has been the *Belgian SDG-Charter,* the starting point for SDG-driven partnerships with the Belgian private sector. Signed by more than one hundred companies, civil society organisations, and the public sector, the charter serves as a commitment for all signatories to incorporate the Agenda. But it also aims to become a reference platform to forge partnerships along specific value chains and foster dialogue along topics, such as sustainable agricultural exports. At this stage, we are looking into incentivising such ventures through a *Business Partnership Facility,* allowing for financial or other support, such as counselling and knowledge sharing for scaling up.

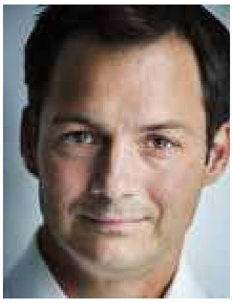
Finally, private philanthropy has been on a steady rise, up to the level of establishing itself as a formidable resource flow alongside Official Development Assistance. Herein lies an interesting alliance for medium-sized donor governments, in view of pushing a value-based agenda and filling global financial gaps. The *SheDecides-movement*, advocating girl's and women's empowerment and having raised over €400 million since last year's launch in Brussels, is a prime example of the extraordinary potential of such collaborations.

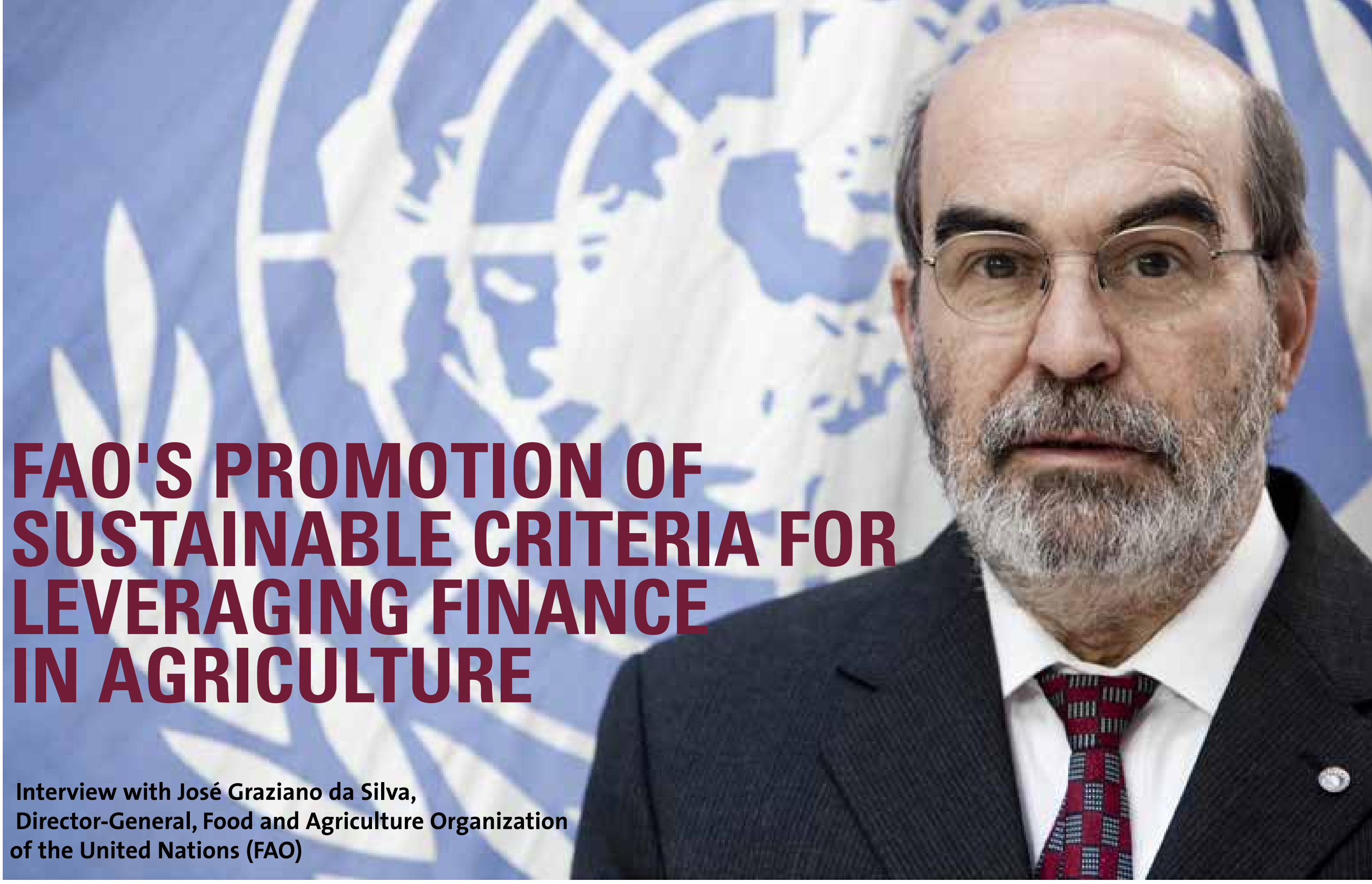
Taking the leap

With the adoption of the SDGs, development has taken a broader perspective than the *Millennium Development Goals*, not in the least with regards to involving private actors. All this is still new to our development organisations. Certainly, a lot of lessons will have to be learned and taken on board during the process, which makes it all the more challenging. But consider that, since 1990, over one billion people have moved out of extreme poverty. Much of this remarkable achievement has been private sector induced. It means that private sector policies should be explored and embraced by all development actors.
This will involve continual efforts to adapt our institutions accordingly, but perhaps above all, it will require adjusting our mindsets in order to grasp the opportunities that lie in front of us.

About the author

Alexander De Croo is Belgium's Deputy Prime Minister and Minister of Development Cooperation.
Twitter:
@alexanderdecroo





FAO'S PROMOTION OF SUSTAINABLE CRITERIA FOR LEVERAGING FINANCE IN AGRICULTURE

Interview with José Graziano da Silva, Director-General, Food and Agriculture Organization of the United Nations (FAO)

Achieving sustainable development – and the Sustainable Development Goals (SDGs) – calls for significant investment over the coming years. In the case of food and agriculture, this will need to come from governments, development partners and, on a far greater scale than in the past, from the private sector. Developing new financial models for sustainable development and ensuring harmony with the demanding policy vision and high ambitions of the 2030 Agenda is more than feasible; they are necessary and indispensable elements of our way forward.

In your view, what is the role and strategy of FAO to attract and accelerate private investments for sustainable development?

The ultimate objective is sustainability at scale. This means putting the development process – which we now understand as a universal process – on a different pathway. Development must conform to all three pillars of sustainable development: it must be socially inclusive, economically dynamic, and respectful of the needs of our common planetary home. The public funds available now, or even in the past, simply are not sufficient to achieve these transformative ambitions of the 2030 Agenda. FAO, accordingly, is increasingly concerned with mobilizing private sector investment, with a particular focus on transforming food systems, which have a powerful bearing on nearly all of the SDGs. As we know, the SDGs were developed by UN member governments – the main counterparts of FAO – but in consultation with people from all walks of life, and with the intention that they should apply to everybody – producers, including family farmers, small local companies and large multinationals, and consumers, NGOs, philanthropies, experts and individuals. Reaching so many actors requires FAO to move beyond its traditional inter-governmental sphere, and find new ways to make an impact on what is happening on the ground. The challenge is to ensure that food and agriculture sector investments encourage sustainability, based on FAO's extensive experience and technical knowledge.

Participants at the farmer-to-farmer study tour visiting an integrated agri-aquaculture farm in Oman.
Photo: ©FAO/Valerio Crespi.

Where do you see differences between FAO's past practice and new ideas and strategies?

Although FAO is an intergovernmental organisation, the food and agriculture sector – farming and food production in all their variety, along with distribution and consumption – are predominantly private activities. As such, FAO has always interacted with the private sector, though largely indirectly. Traditionally, public investment programmes supported by FAO aimed at small-scale farmers, fishers, pastoralists and forest people. This continues today, albeit with a strong focus on youth and women. FAO's contribution to public finance came primarily through the FAO Investment Centre, which supported the undertakings International Financial Institutions (IFIs), such as the World Bank and the European Bank for Reconstruction and Development (EBRD), in making investments in food and agriculture. The recently-launched EU External Investment Plan (EIP) provides FAO with a new kind of opportunity, along the lines of the private sector window of the World Bank (WB), to support direct investment in the private sector. The EIP blends traditional development assistance (ODA) to subsidize public funding and encourage lending to riskier private clients. In exchange for this subsidy, it has been proposed that the IFIs should attempt to de-risk their lending activities by explicitly linking their investments to the norms and standards of the 2030 Agenda. In this way, a powerful incentive is created for private entities to behave in ways that are consistent with the aims and aspirations of the 2030 Agenda. In the areas of food and agriculture, FAO is the world's primary supplier of these norms and standards, and can play a decisive role in enabling this linkage between lending to private entities and compliance with the UN norms embedded in the SDGs and through inter-governmentally agreed normative frameworks.

But how do you ensure that the investments are both sustainable and inclusive?

This is the crux of the matter. FAO's normative work, which combines a solid knowledge base with policy dialogue, can help address practical challenges of sustainable investment. Let's take a practical example - land tenure or land grabbing. In order to tackle these issues, the Voluntary Guidelines on the Responsible Governance of Tenure were developed under the auspices of the Committee on World Food Security (CFS). These guidelines were intended for governments to make laws that embody the notion of responsible governance, including environmental, economic and social sustainability. The technical guide for investors on the 'Responsible governance of tenure' derives from the principles in the Voluntary Guidelines, and is a practical tool for potential and future investors to ensure that their investments are sustainable. In this way, a strong UN knowledge base can underpin investment contracts - loans, guarantees and equity – signed by bankers. The same principle can apply to standards in decent employment, in the use of pesticides or other agrochemicals or in the sustainable exploitation of natural resources. Investors can commit (only) to investments which support, or even embody these principles.

What is your comparative advantage and role?

FAO is not a financial institution and does not have the mandate to leverage directly any finance; this is left to our development finance partners. However, what we can do —in accord with our mandate— is support our member countries in ensuring that public and private investments are compliant with sustainability principles. In particular, FAO is responsible for leading the work to define the SDG indicators relating to sustainable food and agriculture, which will provide a basis to assess the quality of investment. This is part of a

UN process bringing together statisticians and technical experts to define indicators of sustainability which are both meaningful, and affordable for countries to collect.

Nevertheless, how do you do this, ensuring sustainability in such investments?
Here again, the example of land tenure is an interesting one: from a policy document meant for governments, we have derived a technical guide destined for investors. Further, we can then derive an instrument, a checklist of two or three pages, that should become the technical specification of any loan contract. This practice transfers the knowledge on sustainability from regulatory frameworks into concrete practical action. That is extremely interesting, because the principle can apply not only on land tenure but also on fisheries, soil management, decent employment, child labour, carbon trading, sustainable supply chains, etc. By doing so, the knowledge built up in FAO over decades can serve a very practical purpose, informing and influencing financial transactions and investments. Exploiting more effectively the extensive knowledge capabilities here at FAO in this way is a new and exciting prospect. Ultimately, it will enable our member countries to ensure effective and sustainable investments are made which achieve impact at a scale.

So where does the FAO's complementarity towards other actors lie and how is such sustainability being monitored?
Turning norms, standards and knowledge into practical aspects of contracts and using the regulatory environment to enhance sustainability are essential and natural complements to existing areas of FAO's mandate. But financial institutions have a complementary role to play. FAO interacts with a wide range of organisations - development banks, private equity funds, private banks, etc. As a UN body we cannot give some sort of competitive advantage to one company over another, through endorsement by FAO. Our work is rather to provide sector-wide guidance on the sustainability issues raised by proposed classes of transactions. And in this context, monitoring is crucial. It is all very well to create a system to transform complex guidelines on sustainable management of soil, water, forest etc. into contractual obligations. But there needs to be follow up to ensure that these contractual obligations are actually met by the parties to the loan. That is where the custodianship of the SDG indicators entrusted to FAO means developing methodologies – and new partnerships – for monitoring, not only at country level with governments, but also at the individual investment level. To avoid conflict of interest, we will need to work with reputable service providers in the field of third-party verification, civil society organizations, universities and, of course, governments.

Looking at the Rome-based agencies, how does FAO's role relate to the International Fund for Agricultural Development (IFAD) in mobilizing private investments?
We, FAO and IFAD, work closely together, and in a complementary manner. FAO supports smallholders through policy, programming and technical advice that helps governments and their partners provide improved and more sustainable livelihood options. IFAD looks at financing smallholders and agribusiness entrepreneurs through governments to achieve a broader rural transformation with specific economic objectives. We are natural complements.

Where does differentiation between big companies and smallholders come in?
One thing is also clear: because they have more capacities, larger players have more obligations to ensure that development is sustainable in all dimensions. That said, smallholders are key agents of change, and so we must have a framework that is local and relevant. The example again, from FAO, would be fisheries, which are critical for sustainable food security. Drawing upon extensive knowledge and experience at a full range of different scales, FAO provides practical suggestions on how to achieve and maintain sustainable use of the world's fisheries. We have a global code of conduct for responsible fisheries – with a strong emphasis on the sustainable exploitation of resources; but we also have voluntary guidelines for small-scale fisheries with emphasis on local governance and the social inclusion.

About the interviewee
José Graziano da Silva has worked on issues of food security, rural development and agriculture for over 30 years. He led the team that designed Brazil's "Zero Hunger" programme and was responsible for its implementation in 2003. Between 2006 and 2011, he headed FAO's regional office for Latin America and the Caribbean. Jose Graziano da Silva became FAO's eighth Director-General on 1 January 2012.

Graziano da Silva holds a Bachelor's Degree in Agronomy and a Master's Degree in Rural Economics and Sociology from the University of São Paulo and a Ph.D. in Economic Sciences from the State University of Campinas. He has post-Doctorate degrees in Latin American Studies (University College London) and Environmental Studies (University of California - Santa Cruz).

MDB PRIVATE FINANCE OPERATIONS: LENDERS OR MOBILISERS?

Workers maintain the thermal power station at Takoradi, Ghana.
Photo: Jonathan Ernst/World Bank

Much is expected of the multilateral development banks (MDBs) as the international community confronts the daunting challenge of financing the Sustainable Development Goals (SDGs). The MDBs, especially their private sector windows (PSWs), are rightly regarded as essential actors in the challenge of moving from billions to the trillions of dollars of private finance necessary to fill yawning SDG finance gaps.

By Nancy Lee

The nature of the challenge

These institutions—the original impact investors—have an array of tools needed to address the many obstacles that block the flow of private finance for development. They are also good investments for their shareholders, as they are broadly sustainable, and they multiply and leverage the capital contributions of member countries.

Yet we observe a marked disconnect between these aspirations and actual outcomes for mobilisation of private finance by PSWs. A report just released by the Blended Finance Taskforce on "Better Finance Better World" puts 2016 mobilisation ratios for MDB PSWs at 1:1.5 for total mobilisation: that is, for every US$1 of PSW resources, US$1.5 of private finance is mobilized. The total magnitude of annual private financing mobilised by MDB PSWs, at about US$60 billion, falls far short of a meaningful contribution to addressing annual SDG financing gaps in the trillions.

Current mobilisation ratios reflect PSW business models and internal incentives that favour profitable investments for their own account. PSW shareholders expect market returns, maintenance of AAA institutional ratings, significant profits, and avoidance of distortive subsidies. This set of objectives understandably constrains the risk tolerance of PSWs. For better mobilisation, PSWs should be provided scope to take more risk, increase their operations in difficult countries and sectors, and target key gaps in capital markets that block the flow of private finance.

Two pervasive gaps play a central role in impeding the mobilisation of private finance in developing countries. Enhancing the ability of PSWs to fill these gaps would do much for strengthening both their mobilisation and development impact.

1. The scarcity of investors willing to take on the riskiest project tranches, such as first loss or junior equity;
2. Very limited early stage finance—for early stage firms, early stages of local capital market development, and pre-operational greenfield infrastructure projects.

A proposal for capitalizing special vehicles within PSWs

A solution for addressing these gaps, while maintaining the AAA rating and profitability of core PSW balance sheets, is to add special purpose vehicles (SPVs) with separate balance sheets to PSWs—purpose built for taking on additional risk. These SPVs would not be expected to achieve market returns. In fact, their financial goal could be defined simply as preservation of shareholder equity in real terms at the entity level.

They would focus on the two capital market gaps identified above. The first—increasing the amount of finance for high-risk tranches of projects—would likely deliver an early boost to mobilisation ratios, especially in middle income countries. The second—more early-stage finance—should increase mobilisation ratios over time by building stronger bankable project pipelines. The SPV toolkit would be comprised principally of equity, quasi-equity, first loss guarantees, junior debt, outcomes payments, and grants. Grants would help address pipeline problems through support for project preparation, product or business model innovation, and seeding startups. Outcomes payments would incentivise private investment with high development impact by increasing or securing returns.

The basic idea is for the two parts of the PSW—the SPV and core operations—to offer a seamless continuum of products and services to clients. In some cases, this would make deals bankable that otherwise would not pass credit committees. In others, it would make scale and much larger deals possible. And in still others, it would mean a smooth handoff from the SPV to the core PSW operations when clients or markets are ready for commercial finance and growth. A critical additional success factor would be the extent to which the two parts of the PSW would be able to rely on support from the MDB sovereign lending side—for promoting well-targeted policy and institutional reforms to make projects financially viable and for helping to finance the public share of public-private partnerships (PPPs).

Capitalising such SPVs offers certain attractive features to MDB/PSW shareholders. The amounts of capital needed would be relatively small, as the amount of finance needed for risky tranches and for early stage capital is small relative to senior and growth capital needs. Moreover, because they would be new entities, the SPV shareholder structure and governance arrangements could be established *de novo*, avoiding concerns about dilution from countries which do not wish to participate.

Project vs. portfolio risk sharing

Project origination would still largely be done by the core PSWs. It would be desirable, however, to include within the SPV a small team operating as channel for innovative business models, technologies, and financing structures. In cases where market testing and adaptation is needed to establish commercial potential, these projects could be piloted by the SPV for later scaling in collaboration with the core PSW. This internal laboratory would be important to secure a steady flow of new ideas, strengthen openness to innovation, and push out the PSW risk tolerance frontier.

Another possibility is to take a portfolio, rather than project-by-project, approach to collaboration between the core PSW and the SPV. The SPV could take on a defined high-risk tranche of the portfolio or could guarantee part of the portfolio. This would have the advantage of simplicity and of stretching core PSW capital. But it would not necessarily change staff behaviour, risk tolerance, and therefore mobilisation at the project level.

How does this proposal differ from existing special purpose vehicles?

PSWs currently raise bespoke risk-sharing funds from individual donors, which are often limited with respect to sectors and financial instruments. An important exception is the new $2.5 billion IDA Private Sector Window which is an IFC-managed SPV with broad-based donor support and flexibility regarding both sectors and blended finance tools. But this proposal would not be restricted to operations in the poorest (IDA) countries and has some important financial and governance advantages.

1. It would address critical capital market gaps and take on more risk in middle income countries (MICs) as well as in low income countries (LICs). Even with improved capital market access, MICs continue to face major challenges in mobilising private finance for sectors that are risky but critical for growth.
2. Retaining a focus on MICs as well as LICs would support a substantial improvement in mobilisation ratios and would help manage risk through diversification.
3. The resources funding the SPV would take the form of shareholder capital rather than one-time donor contributions. This financing model would establish a basis for periodic assessments of SPV capital adequacy and possible capital increases, as in the case of PSW core capital.
4. A SPV capitalisation of this nature in the IFC case would reduce future diversion of scarce IDA replenishment resources from massive public investment needs to fund private investment.
5. Under this proposal, shareholders would have the chance to create a new, fit-for-purpose governance mechanism to assess SPV performance at the portfolio level against agreed criteria for risk tolerance, returns, and development impact.
6. And finally, shareholders would be deploying their new capital in a way that incentivises and facilitates the institutional change they seek--more openness to innovation and a greater focus on mobilisation and areas and projects with greater development impact.

Two additional SPV variants worth exploring

One SPV for all. A question of practical significance is whether it is necessary or desirable to contemplate creation of an SPV in each of the MDBs. The heavy lift of creating a new entity at each institution with its own governance structure, as well as the combined multi-institution capitalisation demands and negotiations, would burden both shareholders and MDB managers. Creating one SPV that all MDBs could access would avoid this complexity. It would also facilitate collaboration across the MDB PSWs with the SPV as a common focal point. MDB PSWs could be incentivised to collaborate in order to access valuable SPV risk sharing resources. At the same time, the SPV could generate healthy competition among the MDBs because the SPV management and board would have the opportunity to compare project proposals from a number of MDBs and select the best. In addition, the SPV could develop a diversified global portfolio which would help in managing risk.

A public-private SPV. Another option with distinct advantages is an entity capitalised with both public and private capital. This would reverse the usual PSW approach to crowding in private finance—which tends to reserve the lower risk tranches for private investors. Risk tolerant impact investors and philanthropists would instead be given a chance to participate in the riskier tranches where mobilisation ratios and development impact are the highest. As a result, public shareholders would not have to bear the whole burden of capitalising the SPV and would likely benefit from innovations and efficiency gains introduced by private impact investors. For their part, private investors would benefit from MDB pipelines, institutional standards, knowledge, presence on the ground, and the opportunity for greater scale. This structure would give private sector actors, as shareholders, a seat at the governance table—not such a radical idea in a world where public-private partnerships are increasingly regarded as central to development progress.

About the author

Dr Nancy Lee is currently a Visiting Fellow at the Center for Global Development, previously deputy CEO of the Millennium Challenge Corporation, CEO of the Multilateral Investment Fund at the Inter-American Development Bank, and deputy assistant secretary at the U.S. Treasury Department.

Workers at the National Cement Share Company's new factory in Dire Dawa, Ethiopia. Photo: Gavin Houtheusen/DFID

DFIs' COMMITMENT TO MOBILISE PRIVATE FINANCE FOR THE SUSTAINABLE DEVELOPMENT GOALS

Development finance institutions (DFIs) have been investing in the private sector in emerging and frontier markets for more than five decades. Now they have embarked on a decade-long campaign to scale up financing in sectors linked to the Sustainable Development Goals (SDGs) "from billions to trillions". The author's wish list features 5 top points that can secure the right combination of policies, strategies, and work on the ground.

By Søren Peter Andreasen

EU development cooperation hijacked?

A key theme in my work at the Association of European development finance institutions (DFIs) over the past year has been how innovative financing strategies can mobilise more private finance to achieve the Sustainable Development Goals (SDGs). These global goals for 2030 to fight poverty, create jobs and prevent climate change will require financial resources far beyond what governments and development banks can provide on their own.

Key role of DFIs

As DFIs we have demonstrated how publicly-backed investments in the private sector in emerging and frontier markets can have significant positive effects on investment, job creation and economic growth – cornerstones of the global goals. The 15 European DFIs that I represent have tripled their investments in poor countries to almost US$50bn over the past 10 years. Part of this growth has been made possible by capital injections from the governments that own the DFIs. But the DFI model has also proven that it is financially self-sustaining and can go hand-in-hand with a focus on low income countries. DFIs generally achieve modest but steady profits that allow them to grow year-after-year, while raising additional funding for their investments in the markets. On top of their own investments, DFIs also already play a crucial role by mobilising private investors. They typically do this by providing risk capital to enterprises, that can then in turn raise additional funding from commercial financiers. DFIs also mobilise private investors by identifying investment opportunities and preparing transactions and structures that are ready for private investors to participate in.

Mobilisation of private co-financing is well on its way to becoming a cornerstone of modern global development policy. Donor governments across the OECD countries are studying the topic thoroughly and private sector partners are also exploring their potential role in achieving the SDGs through a series of international commissions and working groups.

Mobilisation is closely linked to *blended finance* – a catch-all description of transactions, where publicly-backed institutions, mandated to generate development impact, co-invest with financiers guided by commercial interests, that are looking to be rewarded for taking calculated risks in developing countries. The 'big idea' is that by making available publicly-backed capital to share risks with commercial investors, donors and DFIs can open the floodgates of investment into critical sectors such as financial services, sustainable energy and other critical infrastructure, as well as agribusiness.

This mobilisation is already happening at very significant scale. We have seen a tremendous growth in investment into emerging and frontier markets over the past two decades. But there is potential - and a great need – to do much more.

As large financial institutions, DFIs are sometimes compared to super tankers but unfairly so, in my view. It requires time to fine-tune the approach and DFIs already focus both on investing their own funds in valuable projects and on building relationships with private investors that can participate in these good deals. DFIs are aware of the need to mobilise as much total financing as possible in concert with private institutions. They know that they will have to build ever-closer relationships with private institutional investors and embrace innovative financing practices.

At the same time, DFIs are usually 'policy-takers', that is, they are bound by the policies set by governments and other standard-setters in the international community. As the emphasis on development finance for the private sector has grown in recent years, there has also been a surge in new policies and strategies in relation to individual bilateral and multilateral DFIs, as well as in the context of OECD and the EU. Decisions to optimise policies in one area – say, the rules for how to measure results and ensure sustainability of investments – can have great effects on outcomes in other areas, including on DFIs' ability to mobilise private finance for development.

Top five recommendations

This brings me to the wish list, which highlights five areas, where the right policies and strategies can boost the mobilisation of private capital towards the SDGs and where the wrong ones can contribute to disappointing results over the crucial next 10 years. This wish list encompasses five key points:

1. *Focus as much on project development as on financial structuring*. In discussions about financing for the SDGs, there is a fascination with high leverage ratios and structures, where a small amount of development finance can unlock a large amount of commercial finance. As a result, the development of financial structures that provide such high-leverage solutions is gaining significant attention. Yet, we should keep in mind that the challenge of financing the SDGs is not simply one of financial liquidity, i.e. moving larger amounts of financing. The real challenge is to get the right mix of financing that supports the first hard steps taken by entrepreneurs as well as the last dollar needed to reach financial close. In the marketplace for development finance the entrepreneurs always see a shortage of finance, whereas the financiers perceive a lack of bankable projects. A healthy competition for the deals as well as for the financing has expanded the investment universe year after year. It is not unreasonable to expect that DFIs can triple their own activity and private co-finance again over the next decade. But this cannot be done merely by increasing the supply of safe loans, where the private investors provide liquidity and donor agencies use their scarce resources to absorb the risk through 'credit enhancement'. Risk capital (equity and quasi-equity) will also be required as part of the financing for new projects and value-added engagement with entrepreneurs to get them off the ground and to ensure that they build a robust capital structure allowing them to obtain the lower-risk senior loans. The right mix of finance includes risk capital backed by manpower, experience and a long-term perspective. These ingredients can never be replaced by sophisticated financial structuring on its own.

2. *Acknowledge both indirect and direct roles in mobilisation.* DFIs will need to track their mobilisation of private co-finance to show their full contribution towards the SDGs. There are different statistical methods for going about this. One is to only count *direct* mobilisation, where a DFI syndicates a loan or sets up a fund with private investors and charges a fee proving its direct role. But this method misses the important role DFIs play in *indirect* mobilisation, where their investments unlock participation from other

investors. The need to avoid double-counting when two or more DFIs invest in the same project makes it potentially more difficult to track indirect mobilisation. It is virtually impossible to demonstrate the role of a DFI in unlocking a private investment with perfect attribution. But ignoring the indirect mobilisation would introduce a bias against a type of investment that requires risk capital and is work intensive. Direct mobilisation tends to be concentrated around larger investment in relatively safe assets, while indirect mobilisation involves risk capital that is work intensive and has a long-time horizon. Both types of mobilisation are necessary and one should not exclude the other.

3. *Balance additionality with mobilisation from a long-term perspective*. Development finance is used to achieve development outcomes. The DFI model aims to contribute to these outcomes by investing in projects with good commercial sustainability that also live up to high standards for environmental and social responsibility. The challenge for DFIs today is to go further than private investors in two respects: by investing in enterprises that involve too high commercial risk to be funded solely by the private market (high "additionality"), while mobilising more private co-financing. A single investment can rarely achieve the highest additionality and leverage ratio of DFI to private sector co-finance at the same time. DFI portfolios usually contain a spectrum of investments that balance additionality and catalytic effect. An enterprise that is at an early stage when a DFI makes its first investment can grow to become more mature and amenable to private investment over time. One of the key reasons that DFIs have had a high level of financial sustainability over the years is that their portfolios are well diversified. Private institutional investors are also looking for a degree of diversification in their investments, particularly when venturing into emerging markets, where they are less experienced. Some DFIs have begun to structure opportunities for private investors to participate in DFIs portfolios with an acceptable risk-return profile. Such partnerships can free up DFI financial resources for new investments and allow them more freedom to balance additionality and mobilisation in a way that produces the best outcomes on both measures over the long term.

4. *Allow profit to go hand in hand with development outcomes*. DFIs exist to provide access to risk finance but also to lead the way for private investors. They have a responsibility not to get in the way of private investors (often referred to as "crowding out"). One of the key ways of ensuring that private investors get a fair shot at financing projects in developing countries is to make sure that publicly supported investments in the private sector are made on market-oriented terms. Generally, this means that loans should be priced to reflect the risk of the client rather than the risk of the financing institution (which can in practice be zero for a government counting development finance as a fiscal expense). The track-record of DFI investments shows that projects that have made a good contribution to development outcomes are those that also have a good commercial sustainability. There is usually not a conflict between development outcomes and profit. Development finance that is priced at a lower level to avoid making a profit also drives down the returns available to private institutional investors in the market. This is exactly the opposite of the basic recipe for the "billions to trillions" transformation. To avoid this scenario, development financiers need to safeguard the commitment to investing on market-oriented terms and contribute to the long-term health of the markets.

5. *Set high and harmonised standards*. Bilateral and multilateral DFIs maintain high standards for responsible financing. For example, bilateral DFIs in Europe have committed to a level playing field for high standards, such as environmental sustainability and respect for human rights. These harmonised standards help DFIs co-invest in projects and prevents a situation where a client seeks out DFIs that have lower requirements. Bilateral and multilateral DFIs collaborate to update and finetune these standards to make sure they can continue to lead the way in terms of corporate responsibility, impact reporting etc. However, individual DFIs are always pressured to adopt their own special requirements. Divergence increases the costs for clients. It can also make it harder for private institutional investors to work with DFIs and understand the differences in their approach. It will be much easier to scale up development finance that relies on standards and methods that are high and harmonised at the same time.

DFIs are up to the challenge

DFIs already play a crucial role both in originating investment opportunities and in mobilising private investors. I believe that we will have to get these things right to reach the ambitious goals set out for 2030. I'm also convinced that if we do get them right, we stand a much better chance of going "from billions to trillions" than many think possible today. Fulfilling these five top wishes would go a long way towards securing the right mix of policies and strategies combined with the hard work on the ground that can make it happen. DFIs are up for the challenge of scaling up total financing for the SDGs.

About the author

Søren Peter Andreasen is the General Manager of EDFI – the Association of European Development Finance Institutions.

Young child listens on a mobile telephone
Photo: Arne Hoel / World Bank

ENGAGING THE PRIVATE SECTOR IN BLENDED FINANCE

To leverage the private sector as a source of financing for the SDGs, blended finance should be used to produce attractive investment opportunities. This requires a better understanding of potential capital providers and their mandates, constraints, motivations, and investment preferences.

By Justice Johnston

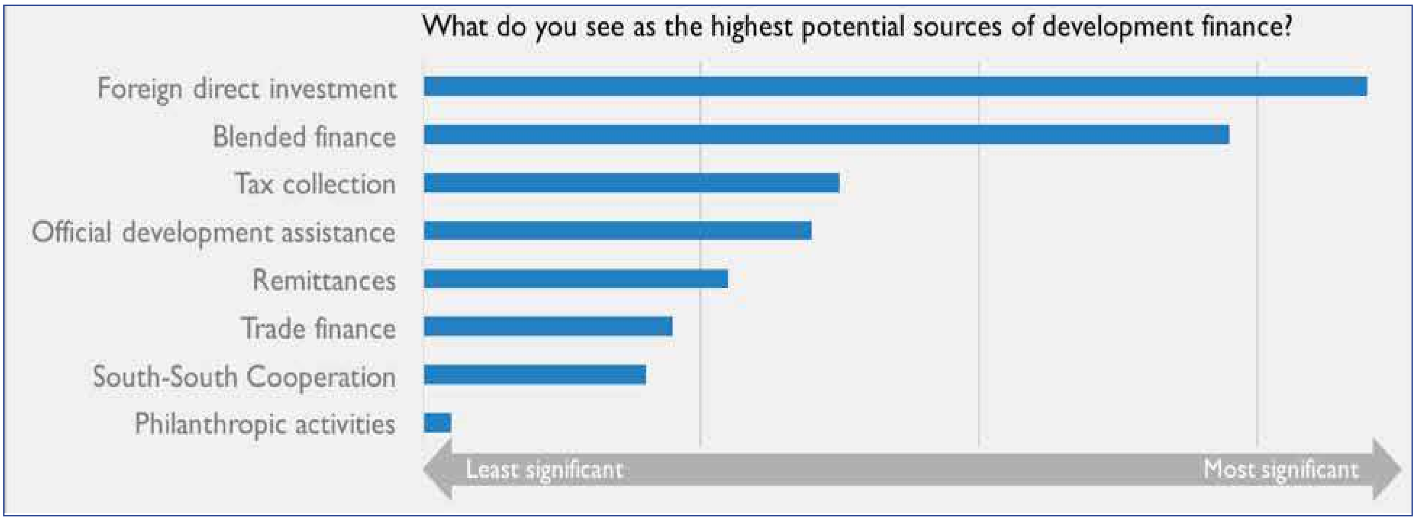
The private sector is, in many ways, the elusive yet critical ingredient in achieving the Sustainable Development Goals (SDGs) by 2030. The SDGs lay the path for creating a world that is socially fair, environmentally secure, economically prosperous, and more inclusive; but achieving them will require a new level of cooperation between the public, philanthropic, and private sectors.

The United Nations estimates that the annual funding required to achieve the SDGs is US$ 3.9 trillion, but current levels of official development assistance (ODA) and international investment towards the SDGs leave an annual funding gap of US$ 2.5 trillion. This gap cannot be closed without leveraging the private sector.

The raison d'être of blended finance

Leveraging the private sector for global development is not new. Multilateral development banks (MDBs) and development finance institutions (DFIs) have long worked with the private sector, both investing in private sector companies in developing countries and leveraging the domestic and international private sector

Figure 1: Survey of development practitioners



Source: Convergence's report, "The State of Blended Finance"

as co-financiers. But the adoption of the SDGs has led to a spike in the urgency with which development agencies – both public and philanthropic – seek to engage the private sector. Increasingly these agencies are looking towards blended finance – the strategic use of public and/or philanthropic funding – to attract the private sector to invest in SDG-related investments in developing countries.

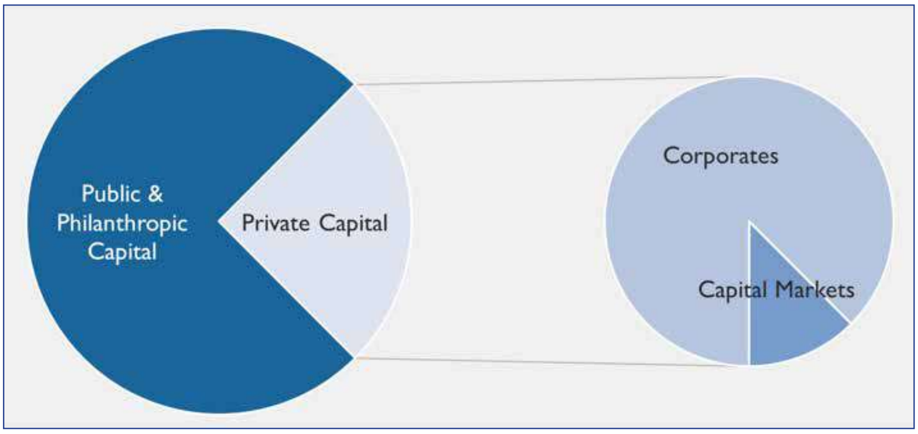
Blended finance offers an innovative approach to mitigating risk and managing returns to create competitive investment opportunities that can crowd in commercially-motivated capital at scale. Compared to impact investing and corporate social responsibility (CSR) activities, blended finance has the potential to unlock vast capital flows because (1) the private sector investor does not need to be impact-motivated and (2) investment opportunities are competitive with – or superior to – market alternatives. This means it can help public and philanthropic parties achieve their development objectives, while the private sector achieves their risk-adjusted return requirements.

To illustrate the potential of blended finance, an allocation of 10% of the Organisation for Economic Co-operation and Development's Development Assistance Committee's (OECD DAC) annual funding (i.e., US$ 14 billion) to blended finance solutions with an average leverage ratio of 4.7 could crowd-in US$ 67 billion per annum of financing to developing countries. This is twice the current amount of annual aggregate MDB and DFI financing to the private sector in developing countries.

But who is the private sector?

Over and over, the global development community references the private sector as if it is a homogenous group of potential capital providers. Yet the private sector is a diverse group that face vastly different motivations and constraints when it comes to contributing to achieving the SDGs in developing countries. At the highest level, the private sector can contribute to the SDGs as corporates or capital providers. Corporates (e.g. corporations, manufacturers, and project developers) contribute to the SDGs through direct

Figure 2: Illustrative sources of financing for the SDGs, by Convergence



Source: Convergence

investment and supply chain integration, particularly in industries like agriculture and food, renewable energy, and infrastructure. Capital providers (e.g. commercial financial institutions, private venture companies) contribute to the SDGs through the provision of long-term financing to support economic activities in developing countries. It is the capital providers, particularly the institutional investors, that are increasingly seen as a potentially major source of long-term financing for developing countries. Institutional investors are large companies that have considerable cash reserves that need to be invested. There are six institutional investor types :

- i) asset /wealth managers,
- ii) commercial and investment banks,
- iii) insurance companies,
- iv) pension funds,
- v) private equity firms, and
- vi) sovereign wealth funds

– who together represent approximately US$ 200 trillion in assets under management (AUM).

It is ambitious but not unrealistic that this scale of private investment could be directed towards the SDGs with the right investment opportunities, incentives, and enabling environment. In fact, these institutional investors already allocate over US$ 2 trillion – just over 1% of their total assets – to alternative assets (more unconventional investments that are not stocks, bonds, and cash) in developing countries and around US$ 6 trillion in alternative asset classes aligned with blended finance more broadly. Blended finance can be deployed to direct a portion of these existing capital flows towards lower income countries (e.g., Sub-Saharan Africa) and higher impact sectors (e.g., healthcare).

Further, institutional investors have invested directly in blended finance transactions in the past. Based on Convergence data, banks, asset/wealth managers, and private equity firms are the most active private sector investors, followed by pension funds and insurance companies. Banks and asset/wealth managers tend to participate in large transactions (i.e. over US$400 million in total size), while other segments, like insurance companies, participate in relatively smaller transactions (i.e. between US$100-200 million in total size). These numbers are expected to increase as private investors are looking to invest more in both alternative asset classes and developing countries as a way to diversify their portfolios and capitalise on the low interest rate environment globally.

Getting aligned with investors

In principle, blended finance holds great potential as an approach to more effectively and efficiently leverage the private sector. In practice, institutional investors have invested in one or two transactions, but few have participated regularly in blended finance transactions. To get the private sector – and specifically, institutional investors – onboard, blended finance must produce assets that they are motivated to invest in. To this end, there are three main action areas for global development policymakers:
(1) engage with investors,
(2) support an enabling environment, and
(3) build best practice.

Engage with Investors

Policymakers need to get to know the investors much better, including their i) motivations and constraints, ii) allocations and capacity, and iii) language. Most importantly, institutional investors are bound by obligations to their stakeholders to fulfill their investment mandates, including meeting certain financial return thresholds. Therefore, even where a social, environmental, or impact mandate may be of interest, they cannot sacrifice financial returns. Second, investors vary greatly among and within the segments in their allocation to and capacity for alternative

Figure 3: Private investor segments

	Segment	Investment Approach
Asset Owners	Pension Funds	Invest pension payments from policy holders to pay future retirement benefits
	Insurance Companies	Invest premium payments from policy holders to provide funding for future claims
	Sovereign Wealth Funds	Invest country's wealth derived primarily from trade surpluses and commodity revenue
	Commercial Banks	Lend to small and large businesses
	Investment Banks	Invest in and/or arrange large transactions for institutional clients
Asset Managers	Private Equity Firms	Invest institutional and own capital into private companies
	Asset/Wealth Managers	Invest institutional and retail capital in a range of investments

Source: From Convergence's report, "Who is the private sector?"

Figure 4: Impact of policy and regulation on investor segments

Pension Funds	Insurance Companies	Sovereign Wealth Funds	Banks		Private Equity Firms	Asset/Wealth Managers
			Commercial Banks	Investment Banks		

Least constraints and disincentives → Most constraints and disincentives

Source: From Convergence's report, "Who is the private sector?"

assets in developing countries (i.e. blended finance-related assets). Investors with low allocation to alternative investments in developing countries may simply lack the capacity required to participate in blended finance. Finally, public and philanthropic funders should communicate in the language of investors (i.e. the language of risks and returns) and focus on the credible, commercial investment opportunities that are presented by the SDGs.

Support an Enabling Environment
Institutional investors face a plethora of global and national policies and regulations, which have strengthened following the 2008 financial crisis. While the objective of this oversight is to ensure a stable global financial system, policy and regulation – such as Basel III and Solvency II – can be a barrier to increasing investment flows to developing countries, reducing investor appetite to take risks in markets with high perceived and real risks. In addition to an enabling regulatory environment, policymakers can also foster an enabling cultural environment. Policymakers should continue to advance efforts to describe and demonstrate the business opportunities made available by the SDGs. There are many examples of investors across the six high-potential segments (e.g., Credit Suisse, J.P. Morgan, and UBS) demonstrating an appetite to explore investment approaches aligned to the SDGs, which should be held up as benchmarks for their industries.

Build Best Practice
Policymakers need to identify and replicate best practice blended finance structures as well as support data collection and transparency. Public and philanthropic funders should collaborate on a strategic number of well-proven blended finance solutions, while also promoting standardisation and reducing complexity. It is critical that this work be undertaken in close consultation with private sector investors to ensure resulting transactions are aligned to their interests. As blended finance matures and both the impact and financial returns can be identified, it is critical to collect and disseminate this information.

One of the main factors influencing the decision-making of private investors is past performance. There is currently a paucity of return data on blended finance transactions, in particular return data for the commercial layers of capital in blended finance transactions, which can be a hindrance for attracting new investors into the field.

Homework for policymakers

For the SDGs to succeed, the private sector, and specifically capital providers, will need to play a much bigger role. But this won't happen unless policymakers have a better understanding of the private sector landscape, especially the mandates, constraints, motivations, and preferences of different investor types. A strong and more nuanced understanding of the private sector will allow the public sector to more strategically engage and leverage the private sector. This is just one step in achieving a new level of global cooperation that will be critical to the success of the SDGs.

About the author
As Associate, Justice focuses on documenting case studies on blended finance transactions, coordinating workshops and webinars and building out Convergence's database of past blended finance transactions.
Twitter: @social_justiced

IT TAKES A VILLAGE: WHY THE COMPACT WITH AFRICA MIGHT JUST WORK

Under the G20 Compact with Africa (CwA), investment environments are set to change, but it will take the collective commitment of all the Compact stakeholders. Economic transformation in Africa also depends on the private sector, so the CwA is an important part of the equation. Will it be enough?

By Rob Floyd

There is an old proverb – often attributed to Africa, and sometimes specifically to Nigeria – that "it takes a village to raise a child". Hillary Clinton brought the proverb to literary fame as the title of her 1996 book, "It takes a village: and other lessons children teach us", but it is also applicable to increasing investment in Africa. It will require all stakeholders working together towards a collective goal with mutual accountability.

The Compact with Africa

Under Germany's presidency, the G-20 launched a Partnership with Africa initiative. One of the primary components is the Compact with Africa (CwA), which was established in March 2017. Its primary goal is to promote private investments in Africa, particularly in infrastructure. The CwA is different from many past approaches in that it is truly a "compact" *without* the promise of grants, credits or loans to African governments in return for progress on policy reforms. Likewise, all members of the compacts – African Governments, G20 Governments and three international financial institutions (IFIs) (the World Bank, International Monetary Fund (IMF) and African Development Bank (AfDB)) share mutual commitments and monitoring. The CwA started with seven African countries (Côte d'Ivoire, Ethiopia, Ghana, Morocco, Rwanda, Senegal, and Tunisia) and has expanded to 11 adding Benin, Egypt, Guinea and Togo, and with more countries showing interest. Essentially the African governments commit to policy reforms that will improve their macroeconomic, business and financial frameworks; the G20 countries in turn commit to enhanced investment promotion in those countries, while the IFIs commit to increased technical assistance to support policy reform.

The CwA is not perfect. It was initiated by a quasi-formal grouping of the world's largest economies, of which many are often not aligned on issues of global importance, and which has an annually rotating presidency that leads to a proliferation of initiatives. Likewise, the CwA, as with most compacts, depends on mutual accountability. One could also argue that the world's richest nations should be supporting private investment in all African countries, not only special initiatives in a few (it should be said though that in principle membership in CwA is open to all African countries, and based on the principle of domestic ownership and commitment to reforms).

But the CwA does provide a platform for African governments, the most economically developed countries, the IFIs and the private sector to work together on aligned mutual interests – and that is a good start, particularly in an era where globalisation and deeper regional integration at times seems to be under threat.

Governments and private sector aligning on key reforms for improving investments

A defining feature of the CwA is that African governments self-identify the policy actions they need or want to undertake to enhance investment. This ideally helps ensure they are responding to the needs of the private sector – rather than to donors or lenders. Given the differences among CwA countries, the policy commitments vary widely, but there are certainly commonalities, some of which are outlined below: tax administration, public investment or special economic zones (SEZ) for instance. Of course, changing policy is the challenge, but it is also an opportunity to improve the policy environment to spur investment.

The CwA countries have each developed policy matrices, but there are defining factors shaping how – across eleven countries – they are attempting to leverage private sector finance. In surveys of the private sector, these policy issues are repeatedly identified as obstacles to investment, so it is positive to see these challenges being taken up by African governments.

Innovation in tax administration benefits all

The Ministers of Finance from the CwA countries identified domestic resource mobilisation as a priority early in the CwA process, with the African Center for Economic Transformation (ACET) supporting a CwA peer-to-peer learning platform for the African governments. This has a doubly positive impact as the private sector will be more likely to invest if tax policy is coherent, transparent and fair. Likewise, governments are likely to increase overall domestic resource mobilisation if all taxpayers meet their obligations under the law.

Some countries, such as Côte d'Ivoire and Guinea are moving towards online tax payments; while others, such as Senegal are modernising tax regimes for corporates, including replacing tax holidays and exemptions with straightforward tax rates.

Public investment is critical for success

With the recognition that the private sector is not going to fully finance most infrastructure investments, and that many infrastructure projects will require sovereign financing to lead, many CwA countries are giving due attention to improving public investment. Ethiopia has identified strengthening public investment management as a priority, while Egypt has identified the reform of appraisal, selection and monitoring of public investments as critical to ensure overall investment in infrastructure is adequate and effective. This focus on public investment is critical as public investment supports the delivery of primary public services and supports key economic infrastructure, such as transport, water, energy and telecommunications. A few years back, the IMF indicated that each percentage point of GDP increase in investment spending increased the level of output by about 0.4 percent in the same year and by 1.5 percent after four years. The provision of key services and increased overall output are both important criteria for private sector investment.

Pace and place do matter for investment

Nearly all CwA countries are also committing to accelerating frameworks for the construction of industrial parks, SEZ and similar sites for investment. Many African governments also made commitments to improve the performance of utilities. Senegal's SEZ "Triangle Dakar-Thies-Mbour" is the most ambitious. It proposes to have its own regulatory framework, including regarding labour conditions and wages. In Benin, the Special Economic Zones Act has been adopted to provide investors with security and incentives, and with plans to make the labour code more flexible for investors. In Rwanda, there are policy commitments to facilitate access to infrastructure for businesses through the development of industrial parks.

Collective action

There is a wide array of additional policy commitments by CwA countries, to include issues relating to macroeconomic performance, public-private partnerships, investment promotion and de-risking instruments, but the success or failure of the CwA will not lie in which policy actions are identified – because they all need to happen. The success or failure of the CwA will depend on whether the village of stakeholders acts in good faith, meets its commitments and creates an environment for private investments to flourish and more broadly for economic transformation in Africa.

About the author

Rob Floyd is Director and Senior Advisor at the African Center for Economic Transformation (ACET) which is based in Accra, Ghana.
www.acetforafrica.org
twitter: @RobFloydACET

Pilot in Mali for MenAfriVac immunization campaign.
Photo WHO

LEVERAGING PRIVATE SECTOR FINANCE: LESSONS FROM PHILANTHROPY

For blended finance to crowd-in private sector investment to social sectors and low-income countries, stimulate innovation and reach scale, greater risk tolerance among large providers of development finance is required. A more efficient allocation of public, private and philanthropic resources across development interventions depends on improved cost-benefit analysis based on additionality and risk-adjusted economic return.

By Annabelle Burgett and Rodrigo Salvado

The breadth and ambition of the 2030 Agenda significantly expanded the goals of development cooperation. Accordingly, the Addis Ababa Action Agenda (AAAA), which sets out the framework for delivering the Sustainable Development Goals (SDGs), covers not just domestic resources and international development cooperation, but also the role of private finance.

The Bill & Melinda Gates Foundation has seen the benefit of engaging strategically with the private sector in our programmatic work to access and harness innovation, and reach scale and efficiency, both of which can lead to big, bold and transformative solutions to the development challenges we are tackling. We've learned:

The power of blended and private investment for social sectors, and in low-income countries

A 2016 OECD survey showed that of the US$ 81.1 billion mobilised from the private sector over 2012-15 from official development finance interventions, 77% of flows were for projects in middle-income countries. Just US$ 7.7 billion (<10%) went to projects in the least developed and other low-income countries. More than two-thirds of the mobilised resources targeted the banking, energy and industry sectors. However, the foundation is assessing the relevance of blended finance in our programme areas – in global health, agriculture, sanitation and financial services for the poor – and the countries where we work, which are primarily low and lower-middle-income countries.

We are focused on the development objectives we want to achieve and identifying the right mix of resources that will deliver the most impact. We know that the private sector is not a substitute for public finance, and don't want to divert resources away from governments, which are critical in the fight against poverty. But we also know that the private sector can bring huge benefit in efficiency, management expertise, an openness to innovation, and a concern with sustainability created in part through competition. We engage the private sector when they can bring clear additional value, not just to fill a financing gap.

The importance of risk tolerance

As a philanthropic organisation with extensive experience funding innovation, we believe there is greater scope for multilateral development banks, development finance institutions and private investors to partner to scale up technologies that could reduce poverty and increase quality of life. Digital and biometric identification systems, digital financial services, and non-sewered sanitation are just few areas where promising new technologies could deliver significant improvements in the lives of the poor.

Yet we know that not all institutions are equally set up to cover the high levels of financial risk inherent in funding early stages of innovation. We need to explore new models of collaboration, to scale up the most promising technologies and innovations as they get closer to commercialisation. This will require a shift in internal incentives within development finance providers including more flexible financing policies and a greater appetite for risk. Segmenting development finance and better identifying and distributing financial and non-financial risks across different institutions will also help. We are exploring how best we can take advantage of our flexibility to structure our support of early stage innovation to facilitate later stage investment from others who can take those innovations to scale.

Global Health Investment Fund

The Global Health Investment Fund (GHIF) is a US$ 108 million social impact investment fund launched in 2012 to support the development of new drugs, vaccines and medical devices for public health challenges that disproportionately burden low-income countries. The fund is focused on late-stage global health products, and can only support products with viable business models, for example, products with opportunities in high as well as low-income markets. More than five years after launch, GHIF has committed the majority of its capital – notable because of concern about pipeline at the outset. We are excited about GHIF as an example of the potential alignment between financial and development objectives in global health R&D, and as a model of collaboration and risk sharing: the Bill & Melinda Gates Foundation and Sida provide a first loss protection up to US$ 22M and also cover a further 50% of losses after the first-loss threshold.

The challenge of allocating resources efficiently

The goal of blended finance is to ultimately enable a more efficient allocation of resources and exploit relative capabilities, where all providers and types of finance are focused on activities that have clear additionality ("doing what others cannot"). By focusing on appropriate risk sharing and mitigation, we can unlock private sector investment to do what it does best: finance commercially viable investments. In doing so, we free up scarce public and concessional resources to focus where they are most needed.

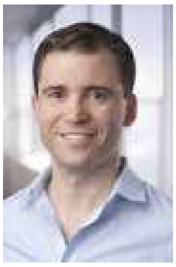
While the foundation believes that more investment is required in social sectors and human capital, particularly innovations that have the potential to deliver greatest impact in the poorest countries, the specific projects or policy reforms that are needed will vary country to country, based on the most binding constraints to poverty reduction and economic growth. Maximising the impact of development finance on poverty, therefore requires cost-benefit analysis, to determine a risk-adjusted economic (not just financial) rate of return, and to guide allocation.

Our starting point is always the programmatic goal we are working towards. The responsibility we bear as stewards underlines the importance of focusing blended finance on investments where there is commercially viable business activity beyond our engagement. This means too, that we work hard to avoid market distortion, which could ultimately undermine the sustainable market we are hoping to see, or the benefits that are brought through engaging the private sector. Sometimes, we have learned these lessons the hard way. For example: an investment we made to encourage commercial bank lending to smallholder farmers through a risk-sharing facility, which ultimately did not catalyse greater access to finance for smallholders. Once our risk-sharing facility was withdrawn, the costs to commercial banks to maintain lending were prohibitive and funding dropped.

Our experience has made us cautious but also very optimistic, as we continue to explore where blended finance can help us achieve the transformative change we seek.

About the authors

Annabelle Burgett is Program Officer, and Rodrigo Salvado, Deputy Director, at the Bill & Melinda Gates Foundation.



Cocoa beans are processed into cocoa liquor at the Golden Tree cocoa processing and chocolate plant in Tema, Ghana,
Photo: © Jonathan Ernst/World Bank

RESHAPING THE EU 'PRIVATE FINANCE FOR DEVELOPMENT' LANDSCAPE

With the ambition to move from billions to trillions in line with the 2030 and Addis Agendas, there is a need to shift towards using public interventions and finance in a smarter way, including leveraging private investments for inclusive and sustainable development. This does not only mean to integrate a private sector dimension in development cooperation.

By San Bilal and Sebastian Grosse-Puppendahl

If some of the expectations of the sustainable development goals (SDGs) are to be met, even partly, it should imply wider and more systemic changes, including but also beyond development cooperation remits. And it should concern public, private and civil society actors far beyond the few private sector experts and development financiers in the development community.

While discussions on leveraging private finance tend to focus on volumes of finance and leverage ratios achieved by public aid, the challenge is to simultaneously increase the quality and development impact of private investment. This heavily depends on the quality of institutions and policies, with a view to foster an enabling environment and conducive investment climate, as well as a proper governance framework, including in terms of transparency, accountability, inclusiveness and sustainability.

This leveraging-impact-enabling environment nexus is taking centre stage in development finance arenas. Yet, it also entails some potential trade-offs among these concomitant objectives. Most of all, it calls for differentiated approaches and complementary actions, as engagement in fragile countries or social sectors for instance should be envisaged in a quite different manner from infrastructure development in middle income countries.

Recent months have seen significant evolutions in the international development finance landscape. These include the significant increase in capital of the World Bank Group, enhancing its approach to leveraging private finance; the creation of new DFIs, as in the case of FinDev Canada, in the US with a new DFI linking OPIC and USAID, and earlier on in Italy with a new DFI in Cassa depositi e prestiti (CDP); and the increased concessionality of development institutions such as JICA, but also AFD and KfW in Europe, to mention but a few examples.
The EU finance landscape is also changing rapidly, a move that will be further stimulated by the current discussion on the reforms entailed in the new EU budget proposals for the coming years (the Multiannual Financial Framework for 2021-2027).

Reshaping the EU's approach

The recently launched EU External Investment Plan (EIP), which aims at using blended finance (along priority areas, such as MSMEs, infrastructure or energy), technical assistance and policy dialogue in a 'smarter' and better integrated way, has been considered a potential game changer in the EU's strategy of financing sustainable development in Africa. Particularly the more explicit move to use aid to leverage private finance and sustainable investment promotion becomes increasingly important and represents a major EU paradigm shift towards aligning sustainable development and financial viability of investment projects.

The ambition to work even more effectively and strategically with international and development finance institutions (IFIs and DFIs) comes at a time, where particularly the role of aid is changing with the need to be 'smarter' and mobilising private investments. Hence, blended finance and the role of DFIs and other multilateral development banks (MDBs) are increasingly important and pushed for by a variety of development actors and stakeholders in the EU, its member states and beyond. Besides the capital increase of the World Bank Group (of US$7.5 billion for the International Bank for Reconstruction and Development – IBRD, and US$3.5 billion for the International Finance Corporation – IFC) already approved, European shareholders will also have to position themselves on the European Investment Bank (EIB) proposal to create a special investment and development arm for its activities outside the EU, as well as on the proposal of the European Bank for Reconstruction and Development (EBRD) to expend its activities to sub-Saharan Africa.

Towards a European Development Bank?

In this context, the envisioned EIB subsidiary, provisionally referred to as the EU Bank for external Investment and Partnership (EUBIP), proposed by EIB President Hoyer in November 2017, entails both opportunities and challenges but certainly raises broader questions these days about its role in the wider EU institutional development finance set-up and policy framework. At the same time, the EIB proposal is highly relevant and has implications for EU member states as much as for other key actors: the European Commission, the European Development Finance Institutions (EDFI) and other IFIs and DFIs (e.g. the EBRD, IFC/WB and national development banks).

Five key areas deserve specific attention, when considering the broader EU development finance landscape and the EIB proposal in particular - which is both politically and strategically extremely relevant, and certainly a good opportunity to review and rethink existing structures and instruments:

1. **EU development finance landscape**
   The proposal has wider implications for the EU's efforts to enhance coherence and effectiveness of EU development financing, while at the same time increasing competition between DFIs participating in the EIP. It also raises questions for EU member states that are both shareholders of the EIB and have an interest in how EU development finance in the EIP will be used, in addition to having a keen interest that their own national DFIs remain strong and active. Hence, the

systemic question of how an EIB subsidiary can best contribute to the SDGs and add value to EU and member states' interests and objectives?

2. **Development impact and ambition**
While in the past there have been questions both from the European Parliament and the EU Court of Auditors about the impact of EIB operations in Africa, Caribbean and Pacific (ACP) countries, particularly in poorer and fragile countries, a new subsidiary will have to do things differently, building on past success stories, but also innovating. This does not only mean to have more impact but to be more ambitious when it comes to measuring success as well as development and financial additionality.

3. **Operational practice in terms of project selection and risk assessment**
A new subsidiary will also have to prove itself in terms of criteria and principles to assess and select projects as well as risk, as current practice seems to be rather conservative, where risk and projects are assessed according to similar criteria both inside and outside the EU. Whether operational practice will change dramatically depends on the new approaches and instruments to be adopted by the subsidiary, but also on its governance, our fourth point.

4. **Governance**
The EIB, like other MDBs and DFIs, respond to their shareholders, who tend to be rather conservative and risk averse. Currently, the EIB board is dominated by members coming from Ministries of Finance, who often have had little contact with and experience in development cooperation (finance). Hence, a subsidiary could address such governance aspects by putting up an oversight body that has extensive experience particularly with financing operations in developing and emerging economies. This could also include private shareholders, should the subsidiary open its capital to private financiers. This can ensure greater effectiveness as well as strategic guidance tailor-made towards development policy objectives, challenges and specificities, while adopting sound investment principles.

5. **Coherence, effectiveness and local ownership**
An EIB subsidiary should be part of a European effort to promote greater coherence, effectiveness and local ownership in relation to various other instruments and actors, within the EU, at the international level, and most importantly in partner countries. In particular, the role and complementarity of the new subsidiary towards other actors and initiatives, such as the EIP, other (European) DFIs and MDBs will have to be clearly defined and articulated, based on well identified added value. Most importantly, the EIB's subsidiary will have to anchor its actions in local realities, working with local actors and (finance) institutions in partner countries, contributing to their strengthening, and taking into account local political economy dynamics.

What next and beyond 2020?

This is by far not an exhaustive list, but some key considerations which will be all the more important in the context of current MFF discussions, negotiations and decision-making processes before and particularly post-2020. The merits of an EIB subsidiary as a possible European Development Bank, its usefulness and effectiveness, can only be addressed in comparison with today's development finance landscape and its rapid evolution. Reviewing and rethinking current institutions' practice, mandate and instruments seems to be most timely and welcomed. The EU can play a leading role in this respect. You can count on ECDPM to continue its modest role in stimulating and facilitating practical approaches to that end.

About the authors

Dr San Bilal is Head of the Trade, Investment and Finance Programme at ECDPM.

Sebastian Große-Puppendahl is until June 2018 a Policy Officer at ECDPM, specialised in private sector engagement and development finance.

Counting revenue from the market
Photo: © AfDB Projects, Flickr.

BREAKING NEW GROUND: DEPLOYING RISK CAPITAL IN FRONTIER MARKETS

In risky markets, donor funds are routinely deployed to make projects "bankable"- in other words to make them capable of attracting commercial financing. This type of financial engineering is known as "blended finance".

By Cécile Ambert

Beyond grants and concessional loans, donors are now venturing into risk management approaches. The catch-all term "de-risking instrument" comprises diverse types of products, with distinct benefits and ease of deployment. In the riskiest markets, financing capital-intensive commercial investment requires comprehensive risk cover. This article presents the business model and track-record of the Private Sector Facility (PSF) - an initiative of the African Development Fund (ADF), established in 2015, with a €1.3 billion target portfolio focused on private sector loans in Low Income Countries (LIC).

In frontier jurisdictions - risk increases the cost of finance.

Risk affects the availability and affordability of debt financing. When a business is liquidated after bankruptcy and only once it has repaid all its creditors, the remaining funds are the owners' equity- its risk capital. The amount of risk capital held by a lender against a specific loan is correlated to the probability that that the borrower will fail to honour their repayment obligation (its risk) and to the severity of the loss if a default occurs.

Every dollar of project or corporate loan in a LIC can utilise up to four times as much risk capital as the same project in a middle-

Figure 1: PSF risk participation structure

income country. Banks are challenged to supply long-term finance, because holding these loans on their balance sheet consumes the bank's own equity more rapidly than loans in moderate risk countries. They weigh upon lenders' portfolio quality. This worsens lenders' credit risk rating and increases their cost of funds. This translates into more expensive goods and services for African consumers, less competitive enterprises, stymied growth and job creation. Unlike their peers covering a broader range of emerging markets, African lenders face a dearth of portfolio rebalancing options. Their development finance challenge is not only one of liquidity, but of risk bearing capacity.

Risk does not disappear - it always ends up on someone's balance sheet

To scale up from "billions to trillions" requires third-party mobilisation and the co-option of financial intermediaries' infrastructure, systems and local knowledge. The innovative finance discipline is rich with experimentation. New bilateral and multilateral development banks (MDBs) are being established, traditional development assistance donors provide debt and equity financing to the private sector. "De-risking" instruments are an increasingly popular remedy to achieve a risk/reward equilibrium compatible with the appetite of commercial lenders and investors.

Box 1: Eligibility criteria and portfolio parameters

PSF Eligibility criteria:

- Operations in LIC and regional operations
- Debt and guarantee instruments
- New projects and ongoing operations
- Compliant with the Bank's policy and strategies
- Good ex-ante development outcomes and positive additionality assessment
- Originated as if the Bank were to hold 100% of the loan on its own balance sheet
- **Exclusions:** Equity and projects experiencing adverse change in project risk

Portfolio construction parameters:

- Mix of project risk profile aligned to BBB target
- Sector and country diversification
- Single name, country, exposure, sector limits
- Bank always remains the lender of record, and holds at least 1/3 of exposure

Yet, risk does not disappear - it always ends up on someone's balance sheet. In riskier jurisdictions lenders need to share the risks and potential losses and rewards with third parties. The key questions therefore are: What risks are transferred? On whose balance sheet do they end and on what terms?

The African political and credit risk insurance/guarantee sector is atrophied. Available products generally specialise in limited risks or segments, thus hindering their effectiveness as capital relief providers. Political risk cover targets specific events. Credit risk products mostly focus on trade finance or SME portfolios. In regulated sectors and enterprises with sovereign-owned counterparties, implicit or explicit sovereign counter-guarantees are often needed. In most LIC, the symbiosis between political and economic conditions is such that delineating the boundaries between the two may be quite speculative.

In the riskiest markets, tackling the gap for long-dated and high-volume credits to large corporates and projects requires capital relief, which means that the full range of default risks must be covered. Project-level risk mitigation/sharing structures have high transaction costs because of their limited scale and bespoke application. This limitation has prompted the creation of new wholesale structures offering risk management products through established development financiers.

The Private Sector Facility - a blended risk participation vehicle for private sector lending in LIC

Like other financial institutions, the African Development Bank (AfDB) has been challenged to grow its private sector portfolio in the riskiest jurisdictions. In 2014, the African Development Fund allocated a €195 million grant for the establishment of a leveraged risk participation fund. The Facility was established to share in the risk of the Bank's private sector operations to enable the Bank to stretch its balance sheet in the riskier markets, without compromising its AAA risk rating. In the light of implementation track record, the 14th Replenishment of the Fund allocated a further € 240 million thus bringing the PSF's target portfolio of credit risk exposures to € 1.3 billion.

At inception, the PSF's sponsors - the AfDB and Fund - were concerned that the vehicle should be structured in a way that would achieve leverage, effectiveness as a risk transfer vehicle, financial sustainability, and mitigate the risk of self-dealing and moral hazard. These concerns were addressed in the design of the risk sharing methodology, legal status, eligibility criteria and governance.

The PSF is a risk participant - it does not affect a project's credit quality but its partial credit risk guarantee is irrevocable, unconditional and first-demand. The Facility intervenes when projects meet its eligibility criteria and portfolio construction parameters. To mitigate moral hazard risks, it covers only part of the credit risk- losses are carried on shared basis and simultaneously with as the Bank. The AfDB acts as the lender of record and each PSF risk participation is backed by PSF equity at the average leverage ratio of 1:3. In case of default, the AfDB calls on the PSF to cover its share of the defaulting loan's repayment and interest. Given the high risk profile of its underlying exposures, PSF's target level of credit enhancement is calibrated at a BBB equivalent rating - a higher rating would have resulted in a lower leverage ratio. PSF is bankruptcy remote from both the ADF and the AfDB and is managed independently. The ADF Board is the governing body of the Facility, and a PSF Administrator is responsible for its day-to-day management. The PSF's risk and reward sharing modality is a key enabler of its business model. As a leveraged trust fund capitalised through a grant, like a revolving fund, the PSF has to operate in a way that ensures its solvency – future losses must be covered from revenue. The PSF does not introduce loan pricing market distortion but enables an optimisation of risk capital, with the redeployment of risk capital to new earning assets.

Some results

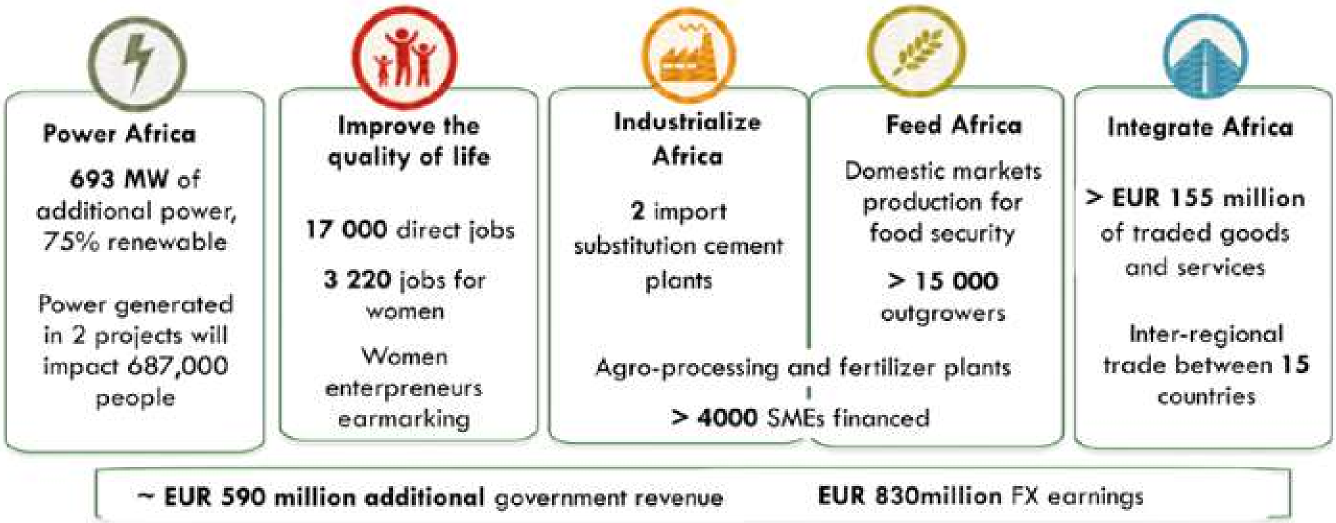
At end 2017, almost a third of the PSF's target portfolio has been committed with €460 million of guaranties approved - and signed guarantees stood at €340 million. Close to 44% of the active portfolio is in the infrastructure sector, 32% in financial, and 24% in the agriculture and industries sectors. Projects range from a rail corridor in Malawi and Mozambique, a food production factory in Mali, a commercial forestry project in Ghana, a wind power project in Kenya, a cement plant in the Democratic Republic of the Congo, a local currency line of credit to a Sierra Leonean SME bank focusing on women entrepreneurs, a power plan in Sierra Leone, and a trade finance line of credit to a Zimbabwean commercial bank.
The PSF contributes to the achievement of development results at two levels.

First, PSF contributes to transaction-specific development results. Second, it enables development results through

Table 1: Key features of the PSF

What the PSF is and does:	What the PSF is not:
A Risk Participant in ADB non-sovereign operation.	A lender (co-financier).
Guarantees part payment of principal and interest.	Directly accessible to non-sovereign borrowers.
Stretches the Bank's risk capital to enable more operations in more LICs.	Targets only high risk transactions or distressed assets.
Shares in the risks and rewards of the ADB's operations in LIC.	Subsidises the Bank's operations in LIC.

Figure 2: Highlights of development results at transaction level



* Reported indicators are project-specific (based on expected ex-ante results and actual results depending on implementation progress of the underlying transaction).

the redeployment of risk capital to new projects, which may not have been feasible given the risk capital limits capping the Bank's private sector portfolio growth in riskier markets. Since the PSF began operations in 2015, the Bank's private sector financing in LIC has increased in absolute and relative terms. It now represents two-thirds of the volume financed up from 30% in 2014.

Outlook for the evolution of the PSF in the medium term- towards an African credit risk exchange?

The Private Sector Facility is an effective balance-sheet optimisation instrument for lending in riskier jurisdictions. Over the next three years, its portfolio is set to grow in line with the ambitions of the Bank's Ten Year Strategy and its five scaled-up core development priorities for the continent, namely the High 5s – Light up and power Africa, Feed Africa, Industrialise Africa, Integrate Africa and Improve the Quality of life of the People of Africa. The immediate priority is to enhance its robustness and effectiveness as a credit risk counterparty. PSF is reaching out to prospective partners to secure additional contributions alongside with reinsurance and co-guarantees.

Beyond this consolidation phase, the PSF's business model has the potential to be truly transformational. It provides an avenue for prospective investors to deploy risk capital to a new asset class without the hassle factor of direct lending. It could also provide other African lenders an opportunity to stretch their risk capital in riskier jurisdictions. Evolving from a captive risk participation vehicle into an African credit risk exchange would see the Facility simultaneously acquire credit risk from a diverse range of African financial institutions and on-selling credit risk to investors.

The PSF is already operational and is structured to achieve scale. With its emerging track record and capitalisation, it is uniquely positioned to successfully evolve into the leading provider of long-dated exposure for the continent- enabling lenders to become more effective providers of private sector financing across their countries of operation.

About the author:

Cécile Ambert is the Private Sector Facility Administrator - an innovative facility funded by the African Development Fund, at the African Development Bank.

Factory workers producing shirts at Sleek Garment Export, in Accra.
Photo © Dominic Chavez/World Bank

THE REALITY OF ACHIEVING SUSTAINABLE SUPPLY CHAINS: A PRIVATE SECTOR PERSPECTIVE

Business seems sufficiently equipped to create and maintain sustainable supply chains. So why is the switch to sustainable proving so difficult?

By Norma Wouters-Snell

With the Sustainable Development Goals (SDGs) now in place, companies are being encouraged to implement the best strategies to contribute to human wellbeing and prosperity and the health of our environment. Within the European Union, we see individual states choosing their own particular strategies. Some, such as France, have introduced legislation, for example, its *Loi Sapin II* to counter corporate corruption and the *Loi devoir de Vigilance,* mandating disclosure regimes and requiring companies to establish 'due diligence' plans. Other countries, like the Netherlands, have opted for voluntary sectoral multi-stakeholder initiatives. The Dutch Agreement on Sustainable Garments and Textiles, for example, proves that cooperation between business, civil society, and government is indeed possible and can be highly effective, to accelerate improvements in the sustainability of supply chains.

Due diligence

The magical word in all of this is 'due diligence'. Not in the old financial sense though. Here it means mapping your supply chain in order to know exactly where potential risks lie and be prepared for any issues arising from your activities, directly or indirectly. In other words: do your homework and you will know whether or not sourcing a particular product from a particular country or even area is a good decision.

'Good decision' here refers not only to quality, price, and lead times, but even more to the safety of the product and its environmental and social impact. What does this entail exactly, when we look at the complexities of international supply chains?

Transparency

The general public tends to believe that the big names in retail are the driving force behind sustainable change. Yet, there are many more parties involved in practical implementation of the measures needed to achieve both social and environmental improvement. In addition to product requirements, sustainability requirements are ever increasing in supplier conditions. It seems that responsibility for achieving sustainable change is being pushed across international supply chains. With so many tiers in today's complex supply chains, business partners are extremely reliant on each other's performance and choices.

Two preferred ways to manage supply chain risks is to use certification schemes and audit supplier facilities for compliance with set standards. Yet, with the SDGs in place, businesses are beginning to understand that adequate supply chain risk management is more than just auditing; the actual work starts when the audit report is completed. Collecting data throughout the supply chain requires cooperation and mutual trust. And this can be achieved only by building long-term business relationships.

Risk management can cast a shadow on even long-standing relationships of trust between suppliers and their customers. Many customers now require full transparency from each and every one of their suppliers, 'just in case'. After all, should an accident or abuse come to light further down the supply chain, the company bearing the reputable name will be the one targeted. So the drive to manage risk is understandable. On the other hand, suppliers' carefully built network of producers is often a big part of their unique added value. We must understand their fear that disclosure of their production sites and sources will compromise their business. Some may worry that competitors will gain from the information or that buyers will move to direct sourcing. However, times have changed. With the world becoming ever more accessible thanks to the Internet, the drive toward transparency is a development that is futile to resist.

Creating a level playing field: Price and sustainability

The role of the suppliers who sell products to retailers is key in this whole process. When talking with suppliers, invariably one of the first topics to come up is the challenging position they are manoeuvred into by their customers (= retailers). Ergo: suppliers are pushed to meet all sustainability conditions, even though the negotiated buying price may not reflect the actual cost of integrating all these elements into the final product.

From experience in training buyers, I know that buyers are under huge pressure from senior management to achieve margin targets, while simultaneously being expected to ensure that all sustainability requirements are met. But what to do if the latter requires raising the buying price? Many a supplier has questioned the fairness of their competitors still surviving thanks to sustainability requirements being left out of the equation for the purpose of keeping prices low. It is an ever-growing frustration. The fact that end-consumer behaviour has yet to undergo the sustainability transition has not helped to speed up the process. Unfortunately, price often still prevails.

There is a crying need for a level playing field to help accelerate industry shifts to sustainable practices. We are asking businesses to integrate the SDGs into their company strategies. And it takes courage to step back from a commercially successful strategy and review it from a sustainability point of view, only to discover that it is lacking from either an environmental or social compliance perspective.

The solution

What do these suppliers need? Very practical support to help them achieve a shift to sustainability together with their business partners, government, and civil society. Personally, I believe we should work toward a more harmonised EU approach starting with the Dutch example of public-private International Responsible Business Conduct (IRBC) agreements, possibly developing these into what one day may be harmonised EU legislation. This way, we will achieve the sought after level playing field at the EU level, allowing for businesses to once again stand out because of their level of service and innovative products, with sustainability just a given.

About the author

Norma Wouters-Snell is owner of Noble Achievers, a consultancy in sustainable strategy development and practical implementation, and amfori Network representative in the Netherlands.
Twitter: @NobleAchievers

Coffee cherry picking in Bugesera district, Rwanda
Photo: Graham Holliday/Flickr.

EU LEADERSHIP TO PROMOTE RESPONSIBLE BUSINESS CONDUCT IN GLOBAL VALUE CHAINS

This article zooms in on the role of the EU to promote responsible business conduct in global value chains and particularly focuses on the challenges and opportunities for a coherent and coordinated approach.

By Jeske van Seters and Karim Karaki

The EU has played a key role in developing policies promoting responsible business conduct (RBC) with and beyond EU borders over the last two decades, as illustrated by the Corporate Social Responsibility (CSR) Strategy published by the European Commission. This strategy, originally put in place in 2002 has evolved considerably, particularly in 2011, with the redefinition of CSR - qualified by some as a paradigm shift. From "an approach whereby companies integrate social and environmental concern in their business operation and their interactions with their stakeholders on a voluntary basis", the definition and wording of CSR was strengthened to become the "responsibility of enterprises for their impacts on societies'. At the same time, the 2011 strategy opened the door for more regulatory measures to complement softer approaches.

Many policies and initiatives related to CSR - now more and more referred to as Responsible Business Conduct (RBC) - have been developed by the EU in this period, in a broad range of policy areas. At the global level, the EU took an active part in supporting the development of international frameworks such as the OECD Guidelines for Multinational Enterprises (reviewed in 2011) and the UN Guiding Principles on Business and Human Rights (2011). At the European level, the Commission uses several channels to foster RBC. Examples of specific policy measures include the EU's Non-Financial Reporting Directive adopted in 2014, which requires large corporations to disclose information about social and environmental dimensions of their business operations. The 2014 revision of the EU's Public

Procurement Directives allows for the integration of social and environmental considerations in public procurement throughout the EU. The Conflict Minerals Regulation adopted in 2017 will require importers of tin, tantalum and tungsten and gold originating from conflict affected and high risk areas to conduct due diligence in their supply chains as of 2021, to identify and mitigate the risk of financing conflicts or other related illegal practices. Last but not least, the EU supports responsible business practices through its trade and sustainable development chapters in its trade agreements, which promote cooperation on corporate social responsibility and accountability; and development cooperation with several awareness raising and capacity-building programmes and initiatives. And this is far from an exhaustive list.

Such a comprehensive approach requires strong leadership and coordination among EU institutions. This is a major challenge, given that RBC relates to the domains of many Directorates General, including Employment, Social Affairs and Inclusion (EMPL), Internal Market, Industry, Entrepreneurship and SMEs (GROW); International Cooperation and Development (DEVCO), Justice and Consumers (JUST); and Trade (TRADE). In a context where the Commission will intensify its work on RBC, different stakeholders, including the European Parliament, some EU Member States, CSOs and even some businesses have argued that a more coherent EU approach to promote responsible business conduct is now required, in the form of an EU Action Plan on Responsible Business Conduct. This Action Plan would hence succeed the 2011 CSR strategy that covered the period 2011-2014 and allow for more visibility on the RBC agenda, while potentially fostering institutional coordination.

The European Commission on the other hand argues that promoting RBC is integrated in the EU's approach to the 2030 Sustainable Development Agenda - RBC being a key factor for achieving many of the SDGs. As such, the 2030 Agenda can push the RBC agenda at EU level and beyond, and some expect the First Vice-President, who is responsible for Better Regulation, Interinstitutional Relations, the Rule of Law and the Charter of Fundamental Rights, to step up to take up this role, given his mandate to coordinate the Commission's work to implement the 2030 Agenda (while GROW coordinated the EU's CSR strategies). At the same time, integrating RBC in the EU's approach to the 2030 Agenda rather than developing and implementing a specific RBC Action Plan, risks to dilute rather than push the RBC agenda.

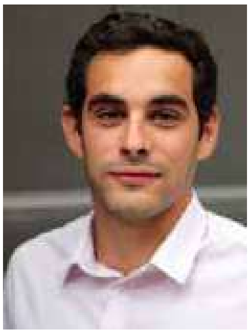
Even for sceptics of EU action on RBC, including companies, there is an increasing rationale for such a coherent and coordinated approach, given the proliferation of RBC instruments at national level. For example, different models for legally binding due diligence requirements at national level are emerging, such as the Modern Slavery Act in the UK and the Loi de la Vigilance in France, and other EU Member States considering due diligence legislation. In others, specific models for voluntary multi-stakeholder collaboration at sectoral level to promote RBC exist, such as the Dutch Agreement on Sustainable Garments and Textile and the German Partnership for Sustainable Textiles. This fragmentation creates an uneven playing field, as companies in different EU member states have to abide by different due diligence requirements and/or different multi-stakeholder procedures and targets. Furthermore, it creates large administrative burdens for EU companies operating in more than one EU Member State. If full harmonisation at EU level is politically impossible, then at least facilitating dialogue, exchanging experiences and sharing lessons learned at the EU-level makes sense.

Hence, for a more ambitious and coherent approach to RBC to materialise, Member States, the European Parliament and its voters, knowledge institutes, NGOs and companies need to press the Commission to take up this leadership. Only then can much needed RBC champions within the Commission, at different levels, emerge and flourish.

About the authors

Jeske van Seters, Head of Private Sector Engagement, ECDPM

Karim Karaki, until June 2018 Policy Officer, Private Sector Engagement, ECDPM



Banana Plantation
Photo © Christine Boose/Flickr

MULTINATIONALS: LOCAL ADAPTATION KEY TO SUSTAINABLE DEVELOPMENT

This article highlights research findings on the connections between the embeddedness of multinational corporations and their sustainability impacts in host countries. Embeddedness appears to be a critical factor in enabling the local private sector and communities to benefit from the operations of multinational enterprises in developing countries and emerging markets.

By Constantine Bartel

Multinational corporations (MNCs) face increasing public scrutiny to demonstrate that their core activities comply with mandatory and voluntary ethical, governance, and ecological standards.

However, measuring the sustainability impacts of a company's operations remains a challenge. Embeddedness is a tool that can help tackle that challenge.
Economic historian Karl Polanyi coined the term embeddedness to capture the idea that all actions that individuals choose are refracted by the social relations in which they function. In other words, MNCs do not operate in a vacuum; they are part of the communities they serve. Embeddedness of economic relations encompasses a subsidiary's engagement and its relationships with local suppliers, farmers, communities, and all other stakeholders, while strictly abiding by sustainability standards and principles. Embeddedness encompasses many aspects of society, the economy, institutions, and structures of governance, in addition to interactions with the natural environment.

The hypothesis is that locally embedded companies create positive sustainability impacts for the local population, the economy, and the environment. The 'extent' of local embeddedness refers to, among other things, collaboration with local institutions, contributions to human capital formation, the share of local suppliers, and participation in local public-private partnerships. The 'quality' of embeddedness is the actual impact of local embeddedness, in terms, for example, of fostering a transition from informal to formal economic activity and employment, improving infrastructure, or increasing savings. The methodology used to analyse embeddedness is a mixed-methods approach encompassing company surveys completed by senior management to form the baseline of a company's embeddedness. The surveys are also designed to reveal any perception gaps between senior management and stakeholders, including industry experts, the media, and local communities. 'Perception gaps' are starting points for companies to conceive innovative means of generating stronger positive sustainability impacts while minimising negative externalities and political risks.

A recent analysis, not yet published, measured sustainability impacts generated by locally-embedded Swiss-based MNCs. It includes Syngenta's agro-businesses in crop protection and the potato value chain in Kenya and Colombia; Chiquita's banana production and exports in Costa Rica, Panama, and Guatemala; and Nestlé's cocoa business in Indonesia and coffee operations in the Philippines.

Embeddedness: An innovative approach

The challenge for developing country governments is to maintain the vital role of their commodities in national socio-economic development. So far, analytical frameworks for evaluating local embeddedness of corporations were not linked to sustainability. The approach to local embeddedness of corporations took the perspective of industrial policy or risks, in the sense that embedding corporations in the local economy might increase economic dependence and influence local policy decisions in favour of external interests.

Our analysis on the embeddedness of MNCs incorporates several novelties. One of these is the advent of ISO 26000 guidelines on community involvement and development. Examination of the network relations of MNCs reveals the embedded ties that create value through mechanisms of trust, knowledge transfer, and joint activities seeking solutions to critical challenges along value chains.

Dimensions of embeddedness

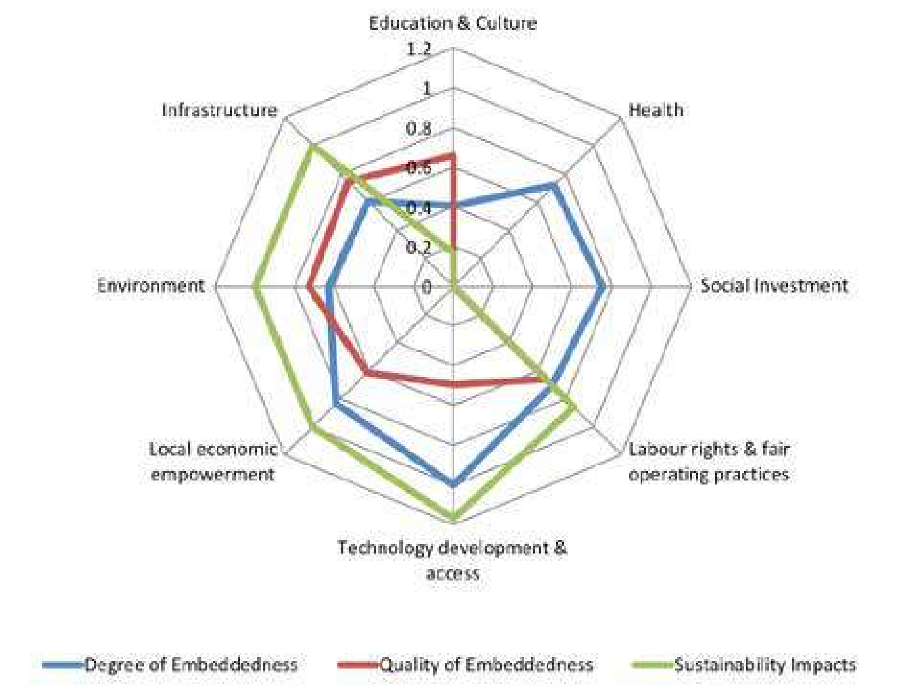
Embeddedness is not a monolithic concept. It comprises a number of core dimensions that can be achieved to different extents. Depending on the nature of their business operations, companies may choose to measure additional embeddedness dimensions and sustainability impacts.

The eight core sustainability impacts depicted are derived from ISO 26000. These are (i) economic empowerment, (ii) labour rights and fair operating practices, (iii) environment, (iv) education, (v) culture, (vi) infrastructure, (vii) health, and (viii) technology development and access.

Technology development and access is the dimension where embedded firms produce their greatest sustainability impacts, which include increased productivity, greater market access for local companies, and enhanced livelihoods. These are impacts often created and strengthened through business partnerships and collaboration with local research and technical institutions. For some firms, opportunities to improve sustainable production may depend on local firms having the capacity and ability to acquire and adopt technology and their access to capital and to markets. Such firms could improve their 'spatial' embeddedness (a non-core embeddedness dimension) by expanding joint ventures and business linkages, in order to develop local private sector capabilities. Cooperatives are best suited for the efficient and targeted delivery of knowledge and services to smallholder farmers. This vehicle is used, for example, by Mars Corporation in Indonesia with the technical support of VECO, a Belgian NGO. Mars is legally linked to farmers through purchase contracts with a farmer's cooperative.

The local economic empowerment dimension captures the effects of an MNC's local operations on the economy. For example, MNC activities may foster

Figure 1: Degree and quality of embeddedness and sustainability impacts of Company X.



entrepreneurship, boosting the local economy. Promoting entrepreneurship and creating local businesses within or outside the core value chain enables an increasing number of existing and new local enterprises to partner with MNCs in a range of value-adding activities.

Furthermore, MNCs can generate transparency and help counter corruption by transmitting best practices and standards to business partners in a host country. The presence of an MNC may similarly promote improvements in workers' rights. The presence of an MNC can attract different enterprises and services, stimulating establishment of an economic hub that advances the local economy. Creating shared value requires close relations between an MNC and local producers. Companies that are loosely associated with suppliers or supporting them at arm's length exhibit a lesser 'extent' and 'quality' of embeddedness. Being economically empowered allows poor people to think beyond daily survival and exercise greater control over both their resources and their life choices. A major focus of economic empowerment is advancement of women, addressing gender inequality. Other key areas are promotion of assets for poor people, transformative forms of social protection, microfinance, and skills training.

The environmental dimension of embeddedness includes actions that a firm undertakes to prevent environmental pollution, to foster sustainable use of resources, to protect the environment and biodiversity, to restore natural habitats, and to mitigate the impacts of climate change. Regarding the other dimensions, education and culture involves educating and enabling consumers to make informed, independent choices about products and services while being aware of their rights and responsibilities and how to act upon them. The provision and strengthening of essential physical as well as social infrastructure is fundamental to ensure people's safety, health, and productivity.

Social infrastructure impacts economic growth and reduces poverty, but it requires a good understanding of the needs of communities. Labour rights and fair operating practices are a fundamental aspect of respect for the rule of law and a sense of fairness within society. Creating and maintaining decent jobs and wages for work performed are among a firm's most significant economic and social contributions. They are essential to social justice, stability, and peace. Health is crucial for life. Undermining public health undermines communities. Firms contribute and support public health campaigns for prevention and mitigation of adverse health impacts. Social investment occurs when firms invest in initiatives and programmes designed to improve aspects of community life. Examples are education, training, cultural activities, the healthcare system, income generation projects, infrastructure development, and maintenance.

Beyond the eight core dimensions of embeddedness, positive externalities of corporations can be enhanced or impeded by the prevailing political system, political culture, local institutions, and the type of mandate governing commodity marketing boards. It is essential to understand political aspects, for example, how firms interact and comply with local institutions and the impacts of their activities in shaping public policy and collaboration. The corporations in our research stressed their 'politically embeddedness', as they complied with the laws and regulations of the host country. Politically embedded MNCs have various challenges to cope with, such as inter-ministerial coordination and information asymmetries brought about by decentralisation policies and the sometimes conflicting roles assigned to different government levels.

General conclusions

Overall, the embeddedness analysis suggests that MNCs do not necessarily represent a threat to local informal businesses and small and medium-sized enterprises. Embedded MNCs can function as enablers, boosting even the informal sector to grow in a supplier role, provided that they increase the local stock of human capital through apprenticeship programs and collaborations with local partners and universities.

Embeddedness particularly benefits the local private sector when business linkages and institutional networks lead to knowledge and technology transfer and when local firms and producers are technology-ready – able to innovate and adopt sustainable practices. Embeddedness also appears to be more effective when supported by public policies that create opportunities for inclusion.

Building on these findings, an embeddedness toolkit is being tested to enable the Swiss MNCs participating in this research to identify the strengths and weaknesses of their foreign direct investments (FDI). The aim is to enable quick assessment of the impacts of their embeddedness. Three sustainability rating and consulting agencies – InRate and Brugger & Partner – are testing a tailored version of the embeddedness toolkit as part of their sustainability assessments and company ratings.

About the author

Constantine Bartel is development and trade expert at the Centre for Corporate Responsibility and Sustainability (CCRS) at the University of Zurich and founder of the African Technology Development Forum (ATDF).

Selection of cashew nuts at the factory.
Photo supplied by Sylvie Sagbo

GROWING A FOOD COMPANY IN WEST AFRICA: WHEN BUSINESS MEANS SUSTAINABLE DEVELOPMENT

ECDPM's Fabien Tondel speaks to Sylvie Sagbo, Managing Director of SENAR Les Délices Lysa, a Senegalese manufacturer of food products, and Cécile Carlier, Director of I&P Conseil, the advisory branch of Paris-based Investisseurs & Partenaires, which supports and invests in emerging small and medium-sized enterprises in Africa.

Fabien Tondel: Can you tell us a little bit about SENAR Les Délices Lysa? What's its business model?

Sylvie Sagbo: We're a small family-owned company based in Dakar that manufactures peanut-, cashew- and corn-based food products under the brand name SENAR Les Délices Lysa. The company was founded in 1982 by my mother, Lydia Sagbo, who started out by marketing peanuts freshly prepared in a traditional way and gradually expanded the product range. I joined the company upon returning to Senegal in 2015. Up to then, I'd been working in the financial sector in France. We're now a simplified public limited company operating under the name Lysa & Co. Although I'm officially the company director, I wear many different hats, and my mother, Mamy Sagbo, still helps out.

We're planning to expand by building a new, higher-capacity production unit outside the city. The plant will comply with international standards and allow us to meet the growing demand for our products. Most of our sales are generated nationally—in Senegalese supermarkets—although we've also been seeing rapid growth in direct sales. Exports represent only two to three per cent of our total production. We owe the strength of our company to the superior taste and authenticity of the products we offer, just as my mother wanted from the beginning when she founded SENAR. And to our spirit of innovation.

Cécile Carlier: The high quality of SENAR's products and its product innovation and differentiation strategies for giving consumers what they want really make the company stand out. SENAR also successfully manages the risks related to aflatoxin. These are all important factors not only as far as the company's viability and that of the sector are concerned, but also in terms of the confidence of its investors, like Teranga Capital, the impact investment fund that recently took a stake in Lysa & Co.

How do you manage quality which is a key factor in your success?
Sylvie: Actually, our manufacturing process results in very low levels of aflatoxin, thus giving us access to international markets. The presence of this mycotoxin, which can be toxic to humans, in peanuts and cashews is a common problem in the industry. We implement a three-stage sorting procedure to minimise risk. The first stage, in which the immature seeds are removed, is overseen by our peanut supplier, whom we've worked with for thirty years. We then sort the raw product upon receiving it. Finally, we sort the nuts a third time once they've been roasted.

Our method of slow-roasting the nuts in a wood-fired oven allows us to create products of exceptional quality, which are very popular with consumers, such as cashew pralines with sesame, peanut pralines with ginger, cashew nougat with anise and pure cashew butter. We've worked closely with the Food Technology Institute of Senegal to improve our processes. For us, the markets in town are like focus groups where we can try out new products on consumers. We have an established presence at the Dakar Farmers' Market, a direct sales market promoting artisanal products.

Does social and environmental responsibility influence the way you manage your company?
Sylvie: Yes, in a number of ways. Most importantly, we offer our customers natural, safe, additive-free products produced locally. And we pay just as much attention to our employees. We provide jobs to five salaried employees, including the managing director, and to fifteen day labourers we rely on. Outside management, 80% of our workforce is made up of women. We contribute to their training, as most of them have little formal education, and provide two employees with accommodation. We also indirectly help generate employment through our peanut and cashew kernel suppliers.

We make use of various distribution channels, with a large part of our production being sold via the Auchan chain, which owns twenty supermarkets in Senegal. By establishing a presence in Africa, this brand has chosen to serve not only the middle classes, but also members of poorer communities. Some of our products are sold there in bulk, making them accessible to the less affluent.

How do you strike a balance between the company's performance and social impact?
Sylvie: Sourcing cashew kernels has become a challenge, given the strong competition in the market from buyers exporting nuts to China, India and Vietnam. When prices began to rise, we sought contract-based solutions in order to better plan and set orders in advance. With support from the NGO International Relief Development, I negotiated a contract with farmers and economic interest groups which collect, shell and peel nuts in Casamance. Monitoring operations has proved difficult, though, as has changing attitudes and practices. In the end, the arrangement just wasn't meeting our needs. So we went back to buying kernels on the spot market, although we do still plan to gain better control over our supply chains in Senegal and Guinea-Bissau.

Cécile: Ensuring proper procurement of raw agricultural materials is fundamental to impact investment. It contributes to improving impacts and reducing economic, social and environmental risks. We'd like to see links between producers, processors and consumers strengthened to help grow the sectors we invest in. Reliable sourcing is also important in that it facilitates traceability. However, the fact that informality is so widespread in Senegal, as it is in other African countries, doesn't make this approach an easy one. We often face difficulties when it comes to establishing contracts with producers and helping local agribusinesses secure seasonal operating loans.

What impacts has Lysa & Co. had that you are most proud of?
Sylvie: We've consistently offered quality products and contributed to the local economy. I'm proud our company is now moving into a new phase of development by increasing production capacity.

Cécile: The company markets quality products to Senegalese consumers, while the cashew sector has traditionally been based on the export of unfinished products with some finished products marketed by foreign brands returning to the country and targeting wealthier consumers. So this change is also a great success!

How do you finance your company?
Sylvie: In the past, we financed the business mainly with our own capital and with contributions from the family, although we did take out two small loans to buy a delivery vehicle and a bag-filling machine. But when our production rate started to rise, and given the little capital we had, it became harder to finance the purchase of raw materials. We prefer having a one-year supply of cashew kernels on hand in order to avoid supply disruptions. Banks just aren't prepared to work with businesses like ours. But since Teranga Capital invested in Lysa & Co. in 2017, our bank manager's confidence in us has grown, so it's easier now to obtain an operating loan.

Could you tell us some more about that investment? What factors made it possible?
Cécile: Teranga Capital is an impact investment fund based in Senegal, which is sponsored by Investisseurs & Partenaires (I&P). Teranga has provided Sylvie's company with debt and equity financing. Sylvie illustrates well the generational shift happening in Africa that allows for new approaches to enterprise development. African entrepreneurs used to be reluctant to borrow or to let an outsider invest in their companies' capital. Today's young entrepreneurs are more open to these ideas. I&P has a particular interest in the local agribusiness sector, since it has great economic and social potential, and offers opportunities of developing agricultural and industrial sectors. Finally, an entrepreneur's personality—especially her or his vision—is key if we're going to get involved.

Sylvie: Yes, it took some convincing for my mother to agree to take the risk. This investment will enable us to boost our production facilities, develop new products, take on staff and comply with international quality standards. In addition, we'll be able to give our employees access to complementary health insurance coverage. We're also planning to implement Ecocert organic certification.

Operating loans seem to be a major challenge...
Cécile: Yes, we at I&P Conseil are well aware of this. We're currently looking at ways to put tools in place to free up access to operating loans, which are vital for the growth of value chains. In addition, with Teranga Capital having acquired a stake in Lysa & Co., it now belongs to a network of firms and financial services providers offering other sources of support. The company is now in touch with Root Capital, an impact investor focusing on debt financing in rural areas, and with AFRIPAR, a fund that facilitates access to operating loans.

How would you like public policy in Senegal to support you in developing your company sustainably? And regional organisations?
Sylvie: We need more effective sectoral regulatory frameworks, particularly with a view to guaranteeing the supply of cashew kernels for local processing. I'd also welcome more sustained support for exporting to other African countries and internationally. We have products which are ready for export. The Senegalese export promotion agency helped us to present our products at the 2018 Paris International Agricultural Show, but this type of support needs to be longer-term. We'd like to export to Côte d'Ivoire, for instance, but I'm having trouble finding a distributor who is willing to market our products. The West African Economic and Monetary Union should facilitate the trade of local products between West African countries. Finally, I hope the public authorities will start to help the packaging sector develop. Specific retail outlets, such as hotels and petrol stations, require special packaging. Senegalese packaging companies provide services geared towards large volumes and consequently don't cater for SMEs—and that means we end up having to import, which is costly.

Cécile: As is the case in the rice sector, in which the Senegalese government requires importers to source part of their stocks locally, national and regional policies should be implemented to maximise the potential of local agribusiness sectors. Public policies should support local agricultural producers more effectively, enabling them to join forces, work together and strengthen their role as partners in value chain development. Growing companies like Lysa & Co. also need simplified administrative procedures, better access to energy and regional infrastructure development.

This interview was originally conducted in French, see www.ecdpm.org/great for the original version.

Sylvie Sagbo and Cécile Carlier

Oil rig at Ngamia 1 in Turkana County.
Photo: Demosh/Flickr.com

THE PRICE OF OIL? EXTRACTIVE DEVELOPMENT AND CONFLICT RISK IN KENYA

While Kenya moves forward once again with developing its oil resources, the recent 'hostage situation' at a Tullow Oil-owned camp in Turkana, Northern Kenya in January 2018 shows that concerns over who is benefiting from extractives development continues to create conflict risks.

By George Grayson

Oil development seems to be moving back up the agenda in Kenya, with Total's recent acquisition of its first onshore stake in one of Kenya's Turkana oil blocks and renewed discussion of a Northern Kenya pipeline following Uganda's decision to pipe its oil through neighbouring. Tanzania Extractives development forms a key part of Kenya's development blueprint, Kenya Vision 2030. However, as the 2017 elections demonstrated, political and other grievances continue to regularly lead to violence in Kenya. Parts of the country, particularly the northern counties, are affected by recurrent cycles of conflict. For investors and the Kenyan government, this presents risks to growing the extractives sector and in terms of conflict, it will be local communities who will be most affected by conflict-insensitive development.

Conflict sensitivity and the extractives

For companies operating in fragile contexts (as well as the governments that license them), there is a critical need to be mindful of the two-way dynamics between extractives development and its context. This is extremely relevant to an emerging, soon-to-be middle-income economy like Kenya keen to capitalise on its natural resources. Since the discovery of oil in March 2012 in Turkana by Tullow Oil, the process of exploration and development has been contested by communities and local politicians. Protests over the allocation of jobs and other opportunities led Tullow to suspend its operations in October 2013.

Since International Alert published its 'Conflict-sensitive business practice' in 2005, the field of business and human rights has emerged as a highly influential area of theory and practice. This guidance was further updated in 2018 and International Alert has built considerable experience working with the extractives industry promoting accountability and conflict sensitivity in fragile contexts. Peaceful economic development, that delivers benefits both to the companies involved and the local communities, can occur when conflict dynamics are understood, and measures are put in place to ensure that peace-conducive economic development occurs. Drawing on this experience, there are several key 'risk factors' in the Kenyan context that have the potential to either exacerbate existing conflicts or create new tensions around the extractives industry.

Land and governance

The interlinked issues of land and governance represent the greatest risks to the peaceful development of extractive industries in Kenya. Disputes over land ownership and access drive and sustain many of the existing conflicts. Titling practices are frequently linked to administrative irregularities, political cronyism and historical injustices relating to the colonial era and post-independence land distribution and can often lead to communities not owning the titles to the land they live and work on. This situation is further complicated by a complex regulatory framework on land ownership as well as weak institutions and unclear legislation regarding compensation for land dispossession. In many parts of the pastoralist areas where much of the oil exploration is taking place, land is classed as 'community' or 'trust' land. It is governed by customary tenure systems and a complex raft of legislation. While the 2010 constitution and 2016 Community Land Act started to clarify this situation, there are still uncertainties in how community-owned land is to be managed.

Attempts by elites to control soon-to-be valuable land can drive serious conflict. Extractives operations and related infrastructure (particularly the long-awaited development of the Lamu Port-South Sudan-Ethiopia-Transport (LAPSSET) Corridor pipeline project to run across Northern Kenya), have already led to land speculation and land grabbing as well as conflicts between communities to secure land access. Some of these land grabs are perceived as being politically instigated.

Land is not the only natural resource affected by extractives development. In Northern Kenya, water scarcity is a particular environmental concern. In Turkana, water scarcity is a critical issue due to increasingly unpredictable rainy seasons, which put pressure on pastoralists' dry season grazing land. This in turn creates competition over grazing land and water which raises the likelihood of conflict. Oil exploration and production requires considerable amounts of water and potentially increases pressure on existing demands creating conflict over water usage.

The interplay between extractives development and political dynamics can exacerbate conflict where there is a risk that development is leveraged to further political and personal agendas, such as enriching individuals or embedding political actors. Communities can become particularly vulnerable to being co-opted for political and/or corrupt ends. Kenyan politics has long been characterised by a 'winner takes all' approach to public resources which, given the levels of revenue anticipated from the extractives, has the potential to exacerbate conflict.

While devolution radically altered the political landscape in Kenya in 2013, the embedding of the new devolved system is still an ongoing process representing both a risk and opportunity for extractives development. Some of the legislation in Kenya, such as the existing Petroleum Act, has not been updated to take the new devolved system into account. The new Petroleum (Exploration, Development, and Production) Bill 2015 is set to replace the current act, but has not yet been passed. Disputes over the 'fair' levels of revenue sharing from the extractives have the potential to feed into existing tensions between the national and county governments (as was seen in March 2017 in the public dispute over the sharing of oil revenues between the President and the Governor of Turkana County). While there are tensions between counties and the national government, the county governments are key actors in determining the conflict sensitivity of extractives development in Kenya, both as conflict actors and potential 'peace-supporting' actors given their relative proximity to communities and their concerns.

Lack of community participation

Disparities between what companies and/or governments perceive as meaningful consultation, and how communities view this, can be another key source of grievance. Expectations of the extractives in terms of economic development and specific social investments are high, particularly in places like Turkana. Communities here have expressed concern over the role of politicians and some community leaders in representing their interests to oil companies. Sometimes, community engagement or awareness raising has taken place too late for them to negotiate with companies on land access or benefits.

Community expectations around local employment and business opportunities are usually very high in areas of new extractives development. While a Local Content Bill was tabled in Kenya in 2016 that seeks to ensure companies commit to maximising local employment, the bill defines 'local' broadly as Kenyan-owned firms and entities based in the country. In Turkana, while some of these expectations are being met through jobs and peripheral business opportunities (or social investments by Tullow Oil, such as school building) where these expectations remain unmet (or are unrealistic), there is a source of frustration and therefore conflict. Particularly in relation to employment, the oil industry is characterised by fluctuating manpower requirements.

Security concerns

In responding to community grievances, the use of public (as well as private) security personnel needs to be carefully managed by companies and their government partners as there are risks of exacerbating grievances by using security personnel to respond to protests. Extractives companies operating in insecure areas like Northern Kenya will often require the services of security providers (public and private) to protect their assets, infrastructure and personnel. In many of the areas of Northern Kenya where state security presence is limited, some security is often delegated to the National Police Reserves (NPR) who are recruited from local communities and armed by the police, but provided with limited training, oversight or payment. Their use in guarding private installations connected to the oil industry has can leave communities vulnerable, given that the NPR often provide the only security available.

Conclusions and recommendations

While the continued growth of the extractives sector in Kenya can bring economic and development dividends, there are clear risks relating to its potential to create new sources of tension or exacerbate existing conflicts. It is therefore important that the relevant stakeholders ensure that activities supporting the sector are sensitive to conflict dynamics. Based on this, there are some clear recommendations to be made to extractives companies, as well as the Government of Kenya, at national and county level, and development partners.

The Government of Kenya should ensure legislation on extractive industry regulation (particularly the 2015 Petroleum Bill) and land use/ownership are not only enacted and harmonised but popularised, so that they are available for use by civil society organisations, county governments and communities. They should also develop due diligence guidance for extractives investors in Kenya and clarify how public security personnel can be used for protecting private assets and personnel so that protection for the extractives sector does not leave communities vulnerable.

The County Governments can play a key role in ensuring that issues around the extractives are addressed. While there have been a lot of platforms and discussions in Nairobi, efforts are needed so this takes place at the county level as well. For this to be effective, the capacity of county governments to engage with the extractives sector needs to be built. Furthermore, it is critical that communication remains open between the national and county governments on these issues.

Companies should ensure their operational grievance mechanisms are strong and align with the UN Guiding Principles on Business and Human Rights (UNGPs) effectiveness criteria and should continue (or start) progress on the implementation of the Voluntary Principles for Security and Human Rights (an initiative designed to guide companies on maintaining safety and security while respecting human rights). Companies should explore alternative community engagement practices, such as developing community participatory monitoring mechanisms to address concerns. Many companies are implementing such programmes in other countries which could be used for learning and adaptation to the Kenyan context. Companies, through their social investment programmes, could explore supporting the development of other economic activities (such as agribusiness) to diversify local economies and take pressure off the limitations of the extractives industry.

Development partners should support the capacity building of NGOs, CSOs and community leaders to engage with extractives development (such as interpreting and communicating the findings of EIAs and social impact assessments) so that they can effectively engage with companies and the government and better communicate to and represent the interests of the communities and stakeholders they represent. They should also prepare communities to benefit from local content opportunities, particularly being mindful that most economic opportunities will come from extractives supply chains and markets, rather than through direct employment, and that local economies are built in a way that is compatible with the market.

References:

http://www.international-alert.org/publications/conflict-sensitive-business-practice-guidance-extractive-industries-en
http://www.international-alert.org/publications/human-rights-due-diligence-conflict-affected-settings

About the author

George Grayson is International Alert's Programme Development and Assessment Manager for the Horn of Africa region.
www.international-alert.org

Apparal factory worker at Bole Lemi Industrial Park

Photo: © Margaux Yost

DOING BUSINESS RIGHT IN ETHIOPIA

Interest is growing in Ethiopia as a sourcing destination for the apparel industry. As the country's landscape evolves and industrial parks rise, global brands and suppliers have a unique opportunity to invest in women's empowerment to ensure that the "Made in Ethiopia" label becomes synonymous with decent work.

By Margaux Yost and Dominic Kotas

The global market for textiles and apparel is currently worth US $1.1 trillion, and set to grow to $2.1 trillion by 2025. For the past decade, the products that sustain this burgeoning industry have been manufactured predominantly in China, Bangladesh, Vietnam, and India. In recent years, however, another country has begun to climb on lists of up-and-coming sourcing locations: Ethiopia.

Ethiopia is taking steps to encourage foreign investment, in order to support its own ambitious goal of securing middle-income status by 2025. Its second Growth and Transformation Plan (GTPII) envisages creation of 750,000 jobs in large and medium-scale industry, with manufacturing a priority. To kick-start this process, eight major industrial parks for export-oriented apparel are being constructed and coming online one by one.

An attractive proposition with major challenges

The industrial parks are financed largely by suppliers in the ready-made garment industry. They find Ethiopia attractive for several reasons, including: First, the country is strategically located for export to destinations with preferential trade agreements. Second, it has

3.2 million hectares of unexploited land and a climate suitable for growing cotton, offering the potential for vertically-integrated operations ("from fibre to fashion"). Third, it has a plentiful and growing workforce that costs less than in Asia, where workers' wages are rising.

Each of these attractions, however, has related challenges. Ready trade routes is one. A landlocked country, Ethiopia relies on the external port of Djibouti, through which more than 95% of its imports and exports pass. The Ethiopia-Eritrea war resulted in a border that is completely off limits for trade. Djibouti became the go-to trade flow route connected by one single railway which began commercial operations January 2018. Ethiopia's lack of physical infrastructure, embodied by this single railway link, is a major reason why the expansion and development of the apparel industry has slowed.

Another challenge is to make the industrial parks autonomous and efficient. Social infrastructure, like housing, has not yet been set up for workers, though most have uprooted themselves from rural homelands to take the jobs newly created. In addition, attracting talent to formal jobs in an industry that, until now, barely had a footprint in Ethiopia means onboarding a workforce that has no experience in a regimented factory setting. Developing among workers the soft skills required to effectively function in formal workplaces is seen by suppliers to the global brands as a major challenge. This could be why absenteeism and worker turnover rates remain high (up to 8% per month), despite Ethiopia's plentiful workforce.

Several international companies have made statements about "getting things right from the start"; and experiences in other countries affirm that this is preferable to retrofitting solutions. For "Made in Ethiopia" to become a force for social good, the ready-made garment industry must both understand the social challenges and commit to the empowerment of women.

Understanding the nuances of the social challenges

Understanding the social challenges associated with the industry's labour pool means understanding the composition of the workforce. Most of the people taking up the new jobs are young women, between 18-25 years old, usually unmarried and usually without children. The majority of these women left rural communities to find a job. They have little education and little awareness of their rights. Moreover, the regimented work environment that a factory setting entails is entirely new to them.

In addition, most production companies setting up in the industrial parks are Asian suppliers that have been nudged by their loyal buyers to put down roots in Ethiopia. They import most of their managers. Management teams thus consist largely of expatriates who had never before set foot in Ethiopia and know little of the local language and culture. This creates a clear divide between management and workers. That divide can be a barrier to creating an enabling and high-performance workplace. The challenges are exacerbated by the ongoing high pressure of production lines.

A recent HERproject study on the Ethiopian apparel industry sought both to map the industry's rapidly evolving landscape and to unpack the particular needs of women workers. The findings suggest that the industry could reap significant benefit from embracing a mandate to improve women's health, equality, confidence, and self-esteem.

Kicking off empowerment

HERproject is a collaborative initiative of global brands, their suppliers, and local partners. It aims to bridge the gap between workers and managers, addressing the needs of both groups. It organises workplace-based interventions to give women workers a voice, through programmes in health, financial inclusion, and gender equality, while working toward alignment of workplace systems, policies, and procedures to women workers' needs.

Since October 2017 the program has been piloting in Bole Lemi Industrial Park. The international companies investing in the initiative have the opportunity not just to build health awareness and financial literacy among their personnel, but more broadly, to increase the self-esteem and confidence of thousands of young women. There is a chance to broaden the range of choices available to the young women who have migrated from their rural homes and ensure that these women feel capable of making and acting on such choices.

HERproject will also be rolled out at Hawassa Industrial Park in 2018. Its progress, and the continued empowerment of women in Ethiopia, will depend not just on the support and commitment of international companies, but also on the political and economic wellbeing of the country. For the moment, Ethiopia's growth as a apparel sourcing country remains fragile. But if development of this industry continues, and does so in the right way, a generation of young women could benefit.

About the authors

Margaux Yost is Manager at Business for Social Responsibility (BSR). She is the global lead for HERproject's health pillar and oversees the program's expansion in East Africa.

Dominic Kotas is a Communications Associate for BSR's collaborative initiatives, providing support in particular for BSR's work on women's empowerment. associate for BSR's Collaborative Initiatives.

Factory workers at a gas pumping station, a Chevron project. Photo supplied by author

CHEVRON'S CORPORATE SOCIAL ENTERPRISE IN NIGERIA

In Nigeria, with the support of DAI, Chevron has been pursuing a business-led approach to development since 2010. The company established a local development organisation that works to find market-based solutions to local economic problems.

By Zachary Kaplan

Nigeria ranks 14th on the 2017 Fragile States Index. Half of its young population suffers from poverty, which has played a major role in the three decades of conflict in the region. Yet, the country is rich in natural resources, particularly in the Niger Delta. Chevron, a multinational energy corporation, has been maintaining operations there despite several ethnic and religious conflicts and other issues resulting from poverty—such as oil theft, kidnapping threats, or sabotage. Chevron engages in an innovative approach for local development that has shown significant results and drawn the attention of development practitioners.

Moving away from the traditional corporate cocial responsibility (CSR) model whereby a private company would finance one-off infrastructure or service programmes, Chevron decided to sustainably address the underlying development challenges of local communities and stimulate inclusive economic growth.

Corporate social enterprise

Chevron's strategy focuses on increasing incomes and employment for local people, hence leading to more stable and prosperous communities sharing in economic benefits. Social stability and prosperity reduce operational risks and improve the company's business performance, leading to what Chevron calls Corporate Social Enterprise.

To achieve this goal, Chevron created the Niger Delta Partnership Initiatives (NDPI) Foundation, an independent development organisation with an initial funding of USD 100 million. In turn, NDPI created a Nigeria-based implementing partner, the Partnership Initiatives in the Niger Delta (PIND), to institutionalise this new way of working on economic development, capacity building, peace building, and analysis and advocacy. Together, the mostly local stakeholders set out to dissect the Delta's local markets, find ways to bolster them, and improve the generation of products, services, and wages.

Unlocking local potential

PIND's economic development strategy is based on the market systems development approach that encourages market-driven solutions to drive inclusive economic growth. PIND applied its fundamental "partnership" principle to build consensus on its agenda and targets for intervention. It organised a broad consultative process, with leading public sector institutions and stakeholders in the Delta setting policy and growth agendas. Development partners active in the region—such as the World Bank, U.K. Department for International Development, U.S. Agency for International Development, and invested private sector actors, including the oil companies—participated in evidence-based analysis to prioritise areas for intervention.

These consultations used empirical research to map out economic sectors of opportunity where PIND could facilitate market growth through partnerships and by strengthening existing local capacity to lead this growth. The sector selection process targeted markets based on growth, employment, and income generation potential for PIND's targeted communities, as well as on best fit with NDPI objectives and the feasibility of working with local partners.

PIND conducted participatory value chain analyses with staff from local partner institutions in three prioritised sectors: oil palm, aquaculture, and cassava. These were followed by scoping studies that investigated weaknesses in each chain. Based on this work, PIND designed support programmes that include the poor to close the gaps found in these markets. PIND also

Figure 1: Impact assessment

Source: http://www.igdleaders.org/wp-content/uploads/PIND-NDPI-Executive-Summary.pdf

Fish Farming Chevron project.
Photo: Daniel McCloskey / DAI

worked with Chevron Nigeria to analyse Chevron's local content supply, mapping Chevron Nigeria's overall consumption of goods and services against locally sourced goods and services, and identifying the goods and services that, with some assistance, can grow to occupy a greater share of Chevron's market.

Based on this analysis, PIND narrowed the list of promising goods and services to determine the optimum point of leverage for market-strengthening interventions.

By focusing on broader value chains such as catering and marine services where Chevron's (and other oil and private companies') spend represents a strong growth market, PIND hopes to create initiatives that unlock local potential to meet that broader market.

Creating real change

In July 2016, a first impact evaluation of Chevron's corporate sociale enterprise, conducted by the Initiative for Global Development (IGD), concluded that "These catalytic resources bring hope and are captivating and empowering people of the Niger Delta."

The evaluation determined that NDPI/PIND and their partners had:

- Enhanced the attractiveness of the Niger Delta by reducing risk, which has paved the way for other development investment in the region. By demonstrating the ability to effect change in the region, NDPI and PIND had catalysed new investment of more than $92 million into the region, including more than $730,000 in new loans from local financial institutions.
- Brought 13 key innovation areas to pilot stage, with significant momentum achieved toward "stickiness" and scale, including pilots of more than 20 best practices or technological innovations, a self-sustaining movement of nearly 4,000 "peace actors," and a network of 500 organizations driving change through interventions to shift cultural norms.
- Created a blueprint for a new type of development model across Africa and beyond, which includes establishment of a physical presence and hiring of top local talent in three locations, including a world-class economic development centre in Warri.

Measuring market systems

In measuring the NDPI/PIND partnerships with stakeholders throughout the Niger Delta, the Initiative for Global Development (IGD) focused not on the achievements of any single partner but rather on the collective impact created to systems by the whole: "NDPI, PIND, and Chevron have 'moved the needle' on corporate social responsibility, shared value, and development, to a new level by creating awareness, building knowledge, and changing attitudes, beliefs, capacity, and actions in ways that permanently re-orient the hopes, aspirations, and visions of the people of a society".

"IGD's highly tailored and holistic approach necessarily eclipsed traditional metrics such as the number of jobs created or beneficiaries reached," said Bill Grant, DAI's global practice leader for market systems development. "This new methodology promises to be a valuable innovation in the field of monitoring and results measurement for tracking progress toward achieving systemic change."

Making systemic differences

Indeed, the Chevron initiative does contribute to developing key value chains and energising peace networks. The project interventions so far have led to marked improvements to the aquaculture, palm oil, and cassava sectors, benefiting those who farm, transport, process, sell, and purchase the products.

NDPI/PIND's activities were also found to spur growth in nongovernmental and civil society networks, thanks to their efforts to build local partnerships and alliances. By 2016, NDPI/PIND had developed a strong network of 511 organisations with whom they were connected directly or indirectly. Furthermore, stakeholders from the U.S. Agency for International Development and U.K. Department for International Development told evaluators that, "without the presence of PIND, they would not be working in the Niger Delta."

NDPI/PIND activities have encouraged the development of water, sanitation, and hygiene (WASH) infrastructure. The foundations' long-term WASH goals include increased access to clean, affordable water, with government addressing WASH needs and entrepreneurs seeing opportunities to fill these and other gaps in WASH infrastructure. On that front, development of business associations and business-related institutions also scored well in the evaluation.

The Chevron initiative also contributed to improved government partnering, including better collaboration with development actors, donors, and the private sector, and better alignment between federal and state bodies to prioritize and fund market systems development.

NDPI's success shows that multinational companies can contribute to systemic benefits for the local communities where they operate. Most importantly for the sustainability of this programme and others that might follow in its steps, those benefits go both ways: bolstering peace, stability, and prosperity in the region, improving the ability of Delta businesses to deliver local content, and supporting Chevron's social license to operate.

More and more, multinational corporations are appreciating their positions within local economies and looking for new ways to engage. Chevron/PIND's new paradigm, driven by business interest as well as a genuine corporate objective to leverage natural resources into local wealth creation, would seem to be a model for development way beyond the Niger Delta.

About the author

Zachary Kaplan is the Director of the Sustainable Business Group at DAI, a global consultancy company specialising in development assistance. DAI tackles fundamental social and economic development problems caused by inefficient markets, ineffective governance, and instability. The company was created in 1970 and now employs more than 3,000 and manages approximately 230 projects in 120 countries. This worldwide portfolio is supported from corporate office in the United States, the United Kingdom, and Belgium, home of DAI Brussels.

Read our latest blogs

ecdpm

Our blogs aim to deepen the dialogue on policy issues and get to the heart of the matter in an honest and concise way

International crimes during apartheid: Why Cyril Ramaphosa is still paying South African debt to foreign banks

Jan Vanheukelom, 14 May 2018

The biggest mystery about apartheid has been solved. We now know how the apartheid regime in Pretoria could continue to buy arms after the global mandatory arms embargo in 1977. Sanctions-busting prolonged the life of white rule and created the conditions, networks and bad habits that linger on today.

Local authorities in EU external action after 2020: Strategic actors or distant voices?

Jean Bossuyt, 7 May 2018

A new buzzword has appeared in the richly endowed development jargon: multi-actor partnerships. It reflects the gradual realisation that central governments alone cannot deliver the goods. Effective collaboration with other actors, including civil society, the private sector as well as local authorities, is key to transform economies, galvanise societies and ensure better governance.

The EU budget proposal for external action: How much, what for, and what we still don't know

Andrew Sherriff and Mariella Di Ciommo, 7 May 2018

After reading last week's proposal by the European Commission for the next EU budget and, in particular, the details related to external action, we have put together the key points on how much will be spent on what, and a list of important elements to watch out for in the proposal.

Three ingredients for a future-proof funding for migration

Pauline Veron and Anna Knoll, 30 April 2018

When it comes to migration, the next EU budget is an important occasion to look back at what has been done so far and transform it into lessons for the future.

OUR NEXT ISSUE OF GREAT INSIGHTS WILL BE ON BREXIT, SUMMER 2018, VOLUME 7 - ISSUE 3

To subscribe to Great Insights please go to **www.ecdpm.org/subscribe**

To read previous issues of Great Insights, go to **www.ecdpm.org/great**

Latest ECDPM publications

What is the European External Investment Plan really about?

Sebastian Große-Puppendahl and San Bilal, ECDPM brief, March 2018.

Leveraging more impactful private investments will be key to address current development challenges and for promoting sustainable development in line with the UN 2030 Agenda. Raising to the challenge of addressing the root causes of migration, creating decent jobs and fostering sustainable and inclusive growth, the European Union (EU) launched at the end of 2017 the European External Investment Plan (EIP).

The European External Investment Plan: Challenges and next steps for a game changer

San Bilal and Sebastian Große-Puppendahl, ECDPM brief, March 2018.

The European External Investment Plan (EIP) provides an attractive framework to leverage private investments differently, improving on current practices to foster sustainable and inclusive growth and to create more decent jobs. It can represent a major paradigm shift in EU development policy and influence the way the EU will position itself beyond 2020, as the EU seeks to use more strategically its aid and policy-clout to leverage private investments in a fully integrated manner.

Artisanal gold mining in DRC: Time to get down to earth?

Karim Karaki, ECDPM paper, March 2018.

In the Eastern provinces of the Democratic Republic of the Congo (where most of the Congolese gold is mined), artisanal and small-scale (ASM) gold mining contributes to the livelihood of about 200,000 miners and their families. This type of mining however, has a significant environmental and social impact.

Multi-stakeholder initiatives on garments and textiles in Germany and the Netherlands

Jeske van Seters, ECDPM briefing note 100, March 2018.

Garments and textiles value chains offer opportunities for inclusive growth in many developing countries in Asia and increasingly also in Africa. They are faced, however, with many social and environmental sustainability challenges. This briefing note provides insights on national multi-stakeholder sector initiatives that have been developed in both Germany and the Netherlands to improve social and environmental conditions along the entire supply chain, and looks at the role of the EU in such a context.