

# Study of how the Australian Aid Program can Strengthen Links with Business and the Private Sector

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The views contained in the paper are those of the author and are not indicative of the views of the Australian Government or the Review Panel.

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## **1 Executive Summary**

This study has been commissioned to examine how the Australian aid programme can strengthen links with business and the private sector and will feed into the independent Review of Australia's Aid Program. The study examines two quite distinct dimensions of how the aid programme works with the private sector. Private sector development refers to how the agency supports the development of the private sector in its partner countries as a way to sustainably reduce poverty. Engagement with the private sector refers to partnering with the private sector as critical actors in the development process.

### *Donor Experience*

The terms of reference specifically request that lessons learnt from other bilateral agencies be considered. There are a number of common elements that characterize the experience of the bilateral agencies. All donor agencies have recognized and reacted in some way to the rapidly changing global environment. The increasing importance and size of the private sector and its centrality to the lives of the poor is clear. The role of new sources of financing and new technologies is also clear. The emergence of new partners and the development of a multitude of multi stakeholder groups and coalitions is recognized as an important part of the new global architecture with deep consequences for the future of international development cooperation

Against this background, most of the agencies reviewed have undergone at some point in the last decade a significant change process to accommodate internally the changing external reality. It is quite common for reference to be made for the need for a change in culture in the agency. The change process has always been accompanied by political leadership and strong champions within the agency.

All donor agencies have made strong policy statements regarding their approach to PSD. Some see the PSD agenda as transformative to their agencies work; all have supported a strengthening in the agency's work in the PSD area. Donor agencies have recognized that corporate policy can only be effective if it is translated into programming instruments. The strengthening of work on PSD has tended to break down into three categories: policy and enabling environment for businesses work, engagement with the private sector as actors, and investment support. Donors have chosen many different ways of organizing these functions. Some agencies combine into one department the policy and partnership functions while others keep these separate. Many agencies have a separate investment arm.

The donor agencies have addressed many of the same challenges and experimented with very similar instruments and mechanisms. Work on the enabling environment, inclusive markets and access to finance, private sector involvement in service delivery models and infrastructure, the development of PPP's, the creation of challenge funds, support to SME's, investment support, participation in new multi stake holder fora – these and many others feature in donor programmes.

All donor agencies have had to address the challenges related to institutional capacity. Most donor agencies are staffed by generalists and the need to develop specialist streams is a recurrent theme.

## *Australia's Experience*

AusAID's experience to date in working with the private sector points to a number of conclusions:

### *The Challenge*

The way AusAID partners with the private sector needs to be seen within the broad context of a whole of government approach. In a rapidly changing world, the relevance and effectiveness of aid programmes will depend on their ability to strengthen their linkages with a broad range of actors, including the private sector and to leverage the much greater weight and influence that these actors can bring to bear.

Within this complexity it is critical that good development outcomes represent the cardinal objective in AusAID's work. The integrity of the programming process, country driven programming processes and respect for the specificity of country and local situations must remain paramount.

There is broad recognition that with globalization the role of the private sector continues to evolve with major implications for the respective roles of aid and private sector interventions. There is broad agreement that the private sector is the engine of growth and that markets are central to the lives of the poor. In short there is recognition that the private sector must be part of meeting the challenge of pro poor growth.

A common refrain from both the private sector and AusAID is the lack of a strong policy framework to guide PSD and business engagement work. A broadly held view is that while the commitment to the PSD agenda is reflected rhetorically, it is not borne out in reality. Quite a few comments deemed that there was a cultural issue that AusAID was still grappling with in that the agency has always seen itself as primarily a government to government institution and this was heavily embedded in its way of working. At the same time it is important to recognize that Australia's aid programme addresses many issues of critical importance to the private sector. The Importance of the private sector for addressing development challenges is clearly acknowledged by the Australian Government. This broad support needs to be differentiated from directly strengthening linkages with the private sector which is the subject of the terms of reference of this study.

Programming instruments need to be responsive to the policy framework. A programming process that did not create an expectation for broad multi stakeholder consultations, including the private sector, would be problematic if PSD policy is to be credible.

### *Major Programme Areas*

The five major areas of aid expenditure are expected to continue to be education, health, infrastructure, rural development and governance. These all play a critical role in supporting a vigorous private sector. AusAID's substantive work in PSD falls primarily into three categories.

The first category relates to programme areas where AusAID has gained considerable experience and where it is committed to working largely through multilateral institutions.

The promotion of **good enabling environments for PSD** has always constituted one of the major pillars of AusAID's work on PSD.

**Access to financial services** is a very important issue and has a significant place in AusAID's programmes.

AusAID has experience in private sector involvement in the **development and provision of basic services** (infrastructure, health and education); in some cases working through PPP type arrangements.

The second category relates to programme areas where AusAID already has experience and in which Australia has the potential to make a distinctive contribution.

The approach of focusing **on market development to improve livelihoods** takes AusAID the next logical step from its support to the Enterprise Challenge Fund and strengthening the business enabling environment. The case for this approach is well established. The poor are highly dependent on effectively functioning markets both as consumers and producers.

The **extractive industries** sector has in most countries in which it is significant the potential for a major transformational impact. Its impact dwarfs that of many other interventions. For that reason it requires enormous care to ensure the appropriate public financial management and regulatory and legal frameworks. From a developmental perspective, interventions in this sector have major consequences for the achievement of virtually every MDG. As a world leader in this industry with wide ranging experience, Australia is positioned to play an especially important role in this sector.

Both AusAID and private sector colleagues stressed the importance of initiatives to build up **human skills** and the skill base of the local private sector. This ranges from leadership programmes to business volunteers.

The third category relates to the development of initiatives and instruments which show promise but still need considerable work. These include:

**Women in Business:** AusAID's gender work is focused on promoting gender equality and empowerment, equal access to gender responsive education and health services, women in leadership, and the safety and security of women and girls in conflict affected situations.. In different aspects of this work the dimension of women's leadership in business has come up but it is not a central focus of the agenda.

**Enterprise Challenge Funds:** The general view is that challenge funds have emerged as a new and useful instrument which can be used to support working with the private sector in a more direct approach. They are not a panacea but they are a useful instrument which if deployed strategically can add value.

**Pro Poor business models:** AusAID's outreach to business on the promotion of pro poor business models is done primarily through two instruments – the Business for Millennium Development (B4MD) initiative and the Business Call to Action (BCTA). The perception of Australian private sector stakeholders is that discussion of pro poor business models has received very little attention in business circles.

### *Engaging with Business*

The need for more outreach and engagement by AusAID with the private sector is a recurrent theme.

An important component in advancing engagement is pure information exchange. Private sector colleagues express an enormous interest in knowing more about what AusAID is doing in country. They want to be able to make substantive input into programme formulation. A number of proposals were made to set up workshops and consultative fora of different types to make this possible.

### *Institutional Challenges*

Both the need for a strong and coherent policy framework and the need for capacity to sustain much more proactive engagement point to the need for an institutional home and ownership for PSD. This point was stressed consistently by many AusAID and private sector colleagues. This challenge is common in all donor agencies making a push on PSD. Whether the policy and engagement functions should be brought together in a single office or whether they are separate is a matter of choice.

A commitment to PSD requires a review of the resources required to provide critical mass to be credible. Engagement is very labour intensive and a commitment to serious engagement cannot credibly be pursued staffed by half a person. Policy work requires a skills mix which might be found in technical skills dispersed through the agency but may also require some selective external recruitment.

A concern expressed has been that a strong commitment by AusAID to PSD and engaging with business will take the agency in many new directions at a time when it is already overstretched. This is not an argument for cutting PSD out but it is a strong argument for being very selective in choosing those areas where AusAID believes it can make a distinctive contribution in PSD.

There is no golden bullet or short cut to strengthening AusAID's linkages with business. What is required is a balanced set of measures that would be implemented over time. They require management to initiate a change process as has been done in many other donor agencies. It is often said that it is impossible to over communicate in leading change processes. In this regard, a proactive communications strategy to support whatever change process is put in place would be essential. This is especially important given the continued sensitivity of many of the issues.

### *Summary of Recommendations*

The recommendations constitute a package that derives from the interviews and the material reviewed. Realistically a 2-3 year programme would need to be put into place to implement what would constitute a significant shift in AusAID's approach to the private sector. At all times programming must be driven by the objective of achieving the best possible development outcomes and be responsive to realities on the ground. Not every recommendation will be considered practical or desirable. A critical mass of steps would need to be taken to generate a virtuous circle between strengthening the policy framework, aligning programming instruments, engaging actively with the private sector, providing institutional focus and coherence, strengthening workforce capacity, and demonstrating concrete results through a select number of flagship initiatives.

### *Policy Recommendations*

AusAID should launch an inclusive process to formulate a high level policy statement of its approach to private sector development and its engagement with business. This statement should define the core strategic directions of the agency's approach to private sector development and engagement.

The high level policy statement should make reference to the significant contribution that Australia makes to providing an enabling environment in which the private sector can flourish.

As a step in this process Ausaid should associate itself with the Bilateral Donors' Statement in Support of Private Sector Partnerships for Development (Sept 2010 at the MDG Summit).

### *Programming Process Recommendations*

Country strategy programming instruments should provide for situational assessments to inform better aid delivery strategies. Guidelines should provide for consultation with the private sector together with other non-state actors in country strategy preparation processes at the country level.

### *Engaging with Business*

Policy and engagement workshops could be held with major Australian stakeholders to share information on AusAID's overall strategic thinking on the one hand and the private sector's development interests on the other.

Consideration should be given as to the desirability of creating a development investment vehicle, drawing on the experience of a range of bilateral and multilateral agencies.

The possibility for further engagement and eventual collaboration around corporate social responsibility agendas and commercial strategies to meet the needs of the poor should be explored in specific development contexts.

The possibility of an initiative which would bring private sector expertise into AusAID and develop innovation and technology partnerships around specific objectives could be explored (AusAID's version of DFID's Touchstone Business Groups).

### *Institutional Recommendations*

For an initial phase, a change process with clear benchmarks for success should be seen to be driven by top management, perhaps supported by a dedicated task force as a transition to being fully institutionalized. Clear focal points and responsibilities need to be identified for Private Sector Development and Engagement with Business.

Consideration should be given to establishing a knowledge network that captures knowledge relating to PSD and business engagement.

An overall review of staffing requirements and a skills mix review should be undertaken to make practical recommendations on what measures could be adopted to make AusAID better able to support



PSD and to engage with business. The possibility of taking in secondments from the private sector should be explored.

A review of constraints in existing programming modalities that represent barriers to engagement should be undertaken (drawing on the experience with ECF).

### *Flagship Programme Initiatives*

AusAID's work in the core areas of health, education, infrastructure, rural development and governance will continue to frame its PSD activities. These areas are all critical drivers of an inclusive and growing private sector. As the aid program increases in these five areas, it will be necessary for AusAID to better understand how improving human resources or infrastructure will then promote economic activity and create jobs; otherwise the influence of its interventions will not be maximized or self-sustaining.

AusAID should continue to support programs that aim to improve the business enabling environment, involve the private sector in the development and provision of basic services and provide access to financial services. Within this overall context, a key challenge is to identify areas where AusAID through its experience and comparative advantages could be expected to make a distinctive contribution. Designation as a flagship programme signifies a commitment to ensuring that AusAID has the critical mass capacity to provide leadership on this issue and will be recognized as a 'player' in the field. The final selection should be on the basis of rigorous analysis and should be subjected to a stringent demand test to ensure that there really is a strong demand from the countries for these services.

A number of current initiatives should be brought together into a cohesive **Business Leaders Programme** focusing on development challenges. Supporting **women business leaders** should form one of the cornerstones of this programme.

**An Extractive Industries for Development Forum** should provide an internationally recognized centre of excellence for convening interested parties into analysis and dialogue on ways that international development aid and the extractive industry can work together to ensure that the sector realizes the unmatched potential it has to have a positive transformative impact on development outcomes.

**Market Development to Improve Livelihoods** should grow into a practice area in which AusAID gains an international reputation for competence and expertise.

AusAID should develop a **new enterprise Challenge Fund (Mark II)** which will serve as a strategic instrument in the realization of the PSD programme that AusAID decides to put into place.

AusAID should build on its commitments to B4MD and BCTA to engage with business on strong outreach and advocacy around **Growing Inclusive Markets**.

The possibility of building on the work undertaken on **business volunteering** should be explored. The development of opportunities to promote volunteerism by Australian business to share their expertise with developing countries is potentially a very powerful instrument.

## **2 Background**

This study has been commissioned to examine how the Australian aid programme can strengthen links with business and the private sector and will feed into the Independent Review of Australia's Aid Program. The study examines two quite distinct dimensions of how the aid programme works with the private sector. Private sector development refers to how the agency supports the development of the private sector in its partner countries as a way to sustainably reduce poverty. Engagement with the private sector refers to partnering with the private sector as critical actors in the development process. This may or may not lead to private sector development, but it does entail private sector involvement in finding solutions to development challenges.

According to the terms of reference, the rationale for the study stems from the recognition that the private sector can help achieve development outcomes and that donors such as Australia can play a catalytic role in this regard. In brief, the study is to assess the following elements:

- The effectiveness and efficiency of existing efforts to promote private sector led development
- The pros and cons of the Australian aid programme having greater engagement with business
- Lessons from other multilateral / bilateral donors in engaging with business

If warranted, this study is to make recommendations on how AusAID could improve its engagement with the private sector, taking into consideration:

- Which approaches work well for other donors.
- The benefits from a development effectiveness standpoint.
- The potential for strengthening links between government, NGOs and business groups.
- The benefits, costs and risks of greater links between the Australian aid programme and Australian business.

## **3 Methodology**

The study is based on a desk review complemented by extensive interviews (mostly by telephone) with some 50 persons. This included AusAID officials, private sector leaders from both Australia and partner countries, and officials with responsibilities for engagement with the private sector in some 10 donor (multilateral and bilateral) agencies.

## **4 The Changing Global Context which Frames Development Cooperation**

### **i. The Changing Concept of International Cooperation**

The objective of the independent review of aid effectiveness is to examine the effectiveness and efficiency of the Australian aid programme and to make recommendations to improve its structure and delivery. This provides the context for this specific study on the scope for strengthening links between AusAID and the private sector. A review of the contribution of the private sector to overall effectiveness must have as a starting point an analysis of the changing context of international development cooperation itself. A detailed analysis is clearly beyond the terms of reference of this study. But without reference to a broader framework, a study of the role of the private sector could miss the core challenge and opportunity that the current environment presents. It is for this reason that this first section of the report briefly addresses the overall context.

There are a multitude of studies and analyses that point to the transformation that has been occurring over the last decade in the practice of international cooperation. For reasons of space, we will limit ourselves to two examples : the first is the recent 450 page report of the World Economic Forum's Redesign Initiative, the second the collection of essays in the November/December issue of Foreign Affairs entitled 'The World Ahead'.

The WEF undertook a major stakeholder consultation as the basis for its Report on Global Redesign. It concluded that 'the revolution that is required is in our conception of the international system- in our understanding of the additional modes of cooperation and sources of capability available in a more interconnected and interdependent world. 'The report argues that most of the crucial problems the world faces such as poverty and climate change require resources to be mobilized on a scale that far exceeds those of governments and international organizations. " Success is only possible by using limited official resources in ways that leverage much larger private and civil society flows of funds and capabilities .' The report argues that we should 'start by embedding our intergovernmental institutions and processes in wider processes and networks that permit scaled and continuous interaction among all stakeholders and sources of expertise in global society in the search for better solutions.'

The World Ahead contains a dozen articles from leading policy makers and practitioners. Hilary Clinton argues the United States needs to redefine American diplomacy and development by reaching beyond governments. It needs to engage in a new public diplomacy which leverages the private sector and civil society and mobilize technology. She describes US Ambassadors in the future as CEO's of multiagency missions extremely well connected to the private sector and civil society. Joseph Nye of Harvard argues that in an information based world, power diffusion may pose a bigger danger than power transition, meaning that the core challenge is to recognize you can only achieve outcomes with the help of others. Eric Schmidt, former CEO of Google, explores the implications of the explosion of internet and cell phone technologies and concludes that governments will need to build new alliances that go well beyond classic government to government contacts.

Policy makers will form their own views on future trends in development cooperation. The point being stressed here is that a study of the effectiveness of Australian aid policy which does not address the

question of broader trends in the form global cooperation takes in the future risks solving yesterday's problems.

ii. The Importance of the Domestic Private Sector

The critical importance of the private sector as the engine of growth has during the course of the last decade been widely affirmed. As asserted by the World Bank in its 2005 World Development Report:

'Private firms are at the heart of the development process. Driven by the quest for profits, firms of all types – from farmers and micro-entrepreneurs to local manufacturing companies and multinational enterprises – invest in new ideas and new facilities that strengthen the foundation of economic growth and prosperity.

The Cairns Compact For Development sets as its first principle "a recognition that broad-based private sector led growth was essential to achieving faster development progress and that donors should encourage the private sector, including through micro-finance and support for large-scale private sector projects."

Domestic private investment averaged 10-12% of GDP in the 1990's compared with 7% for domestic public investment and 2-5% for foreign direct investment.

It is against this background that the PSD agenda has assumed such prominence in major intergovernmental fora over the last few years. The OECD/DAC has issued what could be described as a call to action on private sector development. In September last year some ten donors committed in very strong terms to PSD in the context of the MDG summit. Even more recently, the Seoul G20 summit commissioned follow up action on different aspect of the PSD agenda.

It continues to be the case that economic growth and private sector development do not necessarily and automatically translate into direct benefits for the poor who continue to be the principal target of publicly funded aid programmes. However there has been an increasing awareness of the centrality of a vibrant and active private sector to the everyday lives of the poor. This point was made powerfully by the report issued by the UN Commission on the Private Sector and Development co-chaired by Paul Martin and Ernesto Zedillo. There are three realities that put the private sector at the heart of pro poor growth. The first is the overriding role of the private sector in economic activity. The second is that the great bulk of the poor live in the private sector. In countries with GDP per capita under\$500, microenterprises and SME's represent over 75% of all employment. 63% of health care expenditures in poor countries is in the private sector compared to half that number in OECD countries. The third reality is that the poor often pay more for worse products. Extreme inequality, market failures, distorted prices, disrupted supply chains – these all provide opportunities for business to be profitable while greatly supporting and helping the poor.

With the development of strategies for pro-poor growth, pro-poor business models and growing inclusive markets, the centrality of the private sector to the development process has been largely reconciled with the focus on the priorities and the needs of the poor. The development community is

increasingly leaving behind the old divide between the pro-business / profit camp on the one side and the pro-poor camp on the other.

### iii. The Growth of International Private Flows

The development landscape has been heavily influenced over the last two decades by a rapid increase in international private flows. FDI inflows to developing and transition economies amounted to some \$550 billion in 2009. For the first time developing and transition economies are now absorbing half of global flows. FDI together with other sources of private finance now dwarf official development assistance which stood at \$160 billion in 2009. According to the Centre for Global prosperity at the Hudson Institute, in 2007 public sector aid only constituted some 17% of donor nation's economic engagement to the developing world.

Another characteristic of the emerging landscape is that it is highly fragmented; there is a multiplicity of instruments and types of funds. There is also the phenomenon of a rapidly changing complexion in the source of funds, with a dramatic increase in flows from China, India, Brazil etc. There has also been a dramatic increase in the role of financial institutions and the ability to participate in capital markets. For example it has been estimated that over the next 5-10 years investing for impact could create a market amounting to some \$500 billion. The emerging markets private equity association has nearly \$500 billion under management focused on high potential companies in emerging markets. Social entrepreneurship is another avenue showing promise in supporting new business models. Business coalitions such as the WEF, WBCSD and the Global business Coalition on HIV/AIDS, TB and Malaria are playing increasingly active roles. (This draws heavily on Jane Nelson's draft paper)

None of these developments detract from the critical role of public institutions and public funding. It is important always to be country specific; there continue to be a number of countries whose access to the increasing private flows remains close to nonexistent. Nonetheless, the balance and relative weights of public and private financing are clearly undergoing a dramatic shift.

Australia confronts the same reality. For the decade and a half up to 2006, aid doubled to some \$2.4 billion whereas foreign investment went up almost tenfold from \$712m to \$6 billion. Australian natural resource companies are estimated to have current and prospective investment of about \$20 billion in African countries. Between 2000 and 2010 it is estimated that \$200 billion accrued to African governments in oil revenue alone. The consequence for development cooperation is that it increasingly has itself to shift from trying to fix problems on its own to leveraging solutions through partnerships.

### iv. The Focus on the Business Enabling Environment

The major expansion in the volume of private sector flows and the increasing recognition given to the centrality of the domestic private sector to the development process led increasingly to attention being focused on the enabling environment. The size of private sector activity led naturally to emphasis on the leveraging of this sector of activity as a whole. Early efforts to directly subsidize enterprises led to charges of picking winners (often badly) and distorting the market. Maximum leverage was seen to exist in creating the best possible conditions for the market to operate effectively and with a minimum of

barriers. The work of the World Bank on barriers to business made a major contribution to this work. Today all donors engage in work on the enabling environment. This work is usually run out of economic policy departments or in the departments established to promote private sector development where these have been created.

It is necessary to acknowledge that the assumption that improving the BEE automatically (or is sufficient on its own) leads to PSD, or better PSD, or pro-poor PSD, has been challenged in recent years. Many of the challenges faced by poor producers may not be addressed through BEE. This has driven the interest in the need for more targeted interventions (such as Business development services, challenge funds, etc) to make markets function more effectively for the poor as a complement to BEE work.

The issue of engaging with the private sector and its leaders as a critical force in development and the achievement of social stability and democracy finds less voice in donor programmes. This critically important area often falls between the cracks between an economic policy lens and a partnership lens. The need for a governance lens provides an interesting challenge.

v. The Private Sector, Science and Technology

It is not possible today to have a knowledgeable discussion about issues related to climate, energy, IT, food, health and many others without recognizing the critical role played by the private sector in finding solutions. In many cases only the private sector has the technology and only they can ensure the scale and replicability. In the area of environment and climate, this was already recognized at the 2002 Johannesburg UN Environment Summit when for the first time the generation of public-private partnerships was incorporated as one of the major outcomes of the conference. Post Copenhagen Accord, a significant part of the financing that will be required is expected to be provided by the private sector. The point is strongly made in a study recently completed by Gordon Conway( formerly President of the Rockefeller Foundation and more recently Chief Scientist to the UK Government) which analyses how today's emerging science innovation systems require building private-public partnerships. He contrasts this with the old introverted nationally controlled and public sector dominated approaches. Conway's analysis could be of great interest in Australia where already there are very strong linkages between the development community and research institutes and universities. Green technologies and water management provide two examples of areas where Australia has a distinctive contribution to make.

vi. Corporate Social Responsibility

The shifting balance and weight between the reach of the public and private sectors inevitably raised new challenges to the emerging private sector of demonstrating a broader responsibility commensurate with its increasing influence. The concept of CSR is the subject of considerable confusion and debate. It is often used to cover a range of activities. For our purposes we will differentiate three types of initiative of interest to the development community. The first relates to efforts to influence the behavior of the private sector with respect to such issues as sustainability, human rights, corruption etc. The UN Global Compact launched by Kofi Annan in 2000 is an example of this. Today some 2000 companies have subscribed to a number of core principles. The second relates to community investments by companies

that are investing in that community and have an interest, both practically and reputation ally, in ensuring a healthy and productive environment. The third is companies that engage in purely philanthropic activities by engaging in initiatives clearly not related to their core businesses. All three areas provide opportunities for strengthening engagement between the aid community and the private sector.

This report does not cover the area of expanding corporate and independent foundations. Foundations with global reach such as Gates etc. are playing increasingly important roles in convening, research and financing. Philanthropic foundations are now an integral and significant part of the development community's landscape and need to be considered in any comprehensive approach to engaging with civil society and the private sector.

#### vii. Growing Inclusive Markets

It is important to differentiate between the relatively new focus on growing inclusive markets and the traditional forms of corporate social responsibility. Growing inclusive markets approaches explore how businesses can significantly impact on development outcomes for the poorest by aligning their core business strategies with the interests of the poor both as consumers and producers. The focus is on long term sustainable business strategies that become part of the core business strategy as opposed to corporate social responsibility and essentially philanthropic activities. In practice developing and aligning new business models often requires some incentives or short term subsidy to convince companies to experiment with the aim of responding to market failure and 'crowding in' entrants to previously underserved markets. But in the end the business model needs to be sustainable and profitable. Ultimately growing inclusive business strategies and building them into the business model needs to be owned by business development leaders in the company as well as with vice presidents for external and public relations. Growing Inclusive Markets principles have become quite pervasive in the PSD programmes of many aid agencies.

#### viii. The Concept of Development Effectiveness

Over the past decade the international development community has focused both on increasing the quantity of aid but also the effectiveness of that aid. The Paris Declaration of Aid Effectiveness (2005) identified a number of principles which the majority of recipient and donor countries are committed to implementing. In a number of cases, promoters of the importance of private sector engagement are quick to provide arguments how this is fully consistent with the five Paris principles of ownership, alignment, harmonization, managing for results and mutual accountability. This issue needs to be confronted more directly. The emphasis on transferring resources through the use of government systems is in many cases not going to facilitate the development of public-private partnerships.

Several points need to be considered. The Paris Declaration acknowledges the importance of engaging with a broad range of government, non-government and private sector stakeholders in the development process. However, the principle of Ownership and Alignment is often narrowly interpreted to mean partner Government ownership and alignment behind Government systems. Arguably this has contributed to a bias towards government to government aid programs. Public –private partnerships in

many cases are not primarily about funding; they are often just as much about technology transfer, innovation etc. There is no question that engagement strategies are much more likely to be opportunistic in character and they require much more flexibility. This opportunism should not be seen as prejudicial to sustainability. Paradoxically, replicability and going to scale are best ensured through incorporation within a successful business model. Another challenge relates to the DAC's harmonization agenda. Donor harmonization around policy in the social sectors is proving to be much easier than it is in reaching consensus around issues pertaining to the PSD agenda.

What is critical to effectiveness is that an active policy of engaging with the private sector needs to be complemented with a strong policy framework, and a constant interaction between the policy framework, country programme processes and business engagement. This requires institutional coherence and coordination. This is a very clear lesson learnt from the analyses done of the experience of AusAID with its Challenge Fund.

## **5 The Role of ODA in supporting the Private Sector**

### **i. Principles from the OECD/DAC**

The OECD / DAC issued in 2006 its report 'Promoting Pro-Poor Growth: Policy Guidance for Donors'. One section was devoted specifically to private sector development. The report reaffirmed that the private sector is the main engine of growth. It stressed that the way the private sector develops can have a strong bearing on the pattern of growth, influencing the extent of its impact on the poor. The report calls on donors to revisit how they are supporting PSD. To increase the impact of PSD on poverty reduction donors should help to bring about systemic change that alters the incentives for the private sector, including by encouraging the public sector to foster a more conducive enabling environment. Systemic change requires increasing the capacity of governments at all levels to promote pro poor markets outcomes and a combination of institutional and policy changes aimed at accelerating the development of markets the poor need to improve their livelihoods. The report states that 'donors should regard PSD as a major, if not central part of the country assistance they provide'. In this respect this may require donors' agencies to realign their approaches and introduce a range of organizational changes. Annex 1 contains a summary of proposed actions for consideration by donor agencies.

### **ii. Principles from the Donor Statement at the 2010 MDG Summit**

At the United Nations MDG Summit in September 2010, some 10 donor agencies issued the 'Bilateral Donors' Statement in Support of Private Sector Partnerships for Development'. The statement is reproduced in Annex 2. The declaration reaffirms that the private sector is the engine of economic growth and development. It is noteworthy in going further, for example in stating 'that rather than viewing the private sector merely as resource providers, we choose to recognize the private sector as equal partners around key development issues and will enter into partnerships with local and international companies of various sizes.' The statement represents a significant commitment to the value and importance of working and engaging with the private sector by ten important donor agencies.



iii. Follow up to the G20 Seoul Summit

The most recent strong political message from the international community on the critical role of the private sector in generating growth and development was reflected in the Seoul G20 Summit multi-year action plan on development. The action plan covers a number of areas, including infrastructure, enhancing trade capacity and access to markets, private investment and job creation, food security, and financial inclusion. With regard to infrastructure, the plan requests the MDB's to develop comprehensive infrastructure action plans that increase public, semi-public and private finance. The action plans are to identify opportunities to promote public-private and semi-public partnerships. It is also to improve the domestic infrastructure investment climate. It created a high level panel for infrastructure investment.

The action plan seeks to support responsible value adding private investment and job creation. It requests a number of agencies to develop key quantifiable economic and financial indicators for measuring and maximizing economic value added and job creation arising from private sector investment in value chains. Action will be taken to strengthen financial markets support to SME's. The Action Plan seeks private sector support for the increased investment needed for agricultural development. Finally the Action Plan establishes the Global Partnership for financial inclusion. It refers to the SME finance challenge fund and the finance framework for financial inclusion. It also commits to adopting the G20 Financial Inclusion Action Plan. Treasury and AusAID had a lead role in developing the G20 principles for innovative financial inclusion. The aim is to help provide a framework of incentives for the various banks, insurance, and non-bank actors involved, while ensuring fair conditions of competition between all financial service players.

In sum the Action Plan on Development adopted by the Seoul Summit provides another very strong indication of the commitment of the international community to the centrality of the private sector to successfully pursuing a growth and job creation agenda.

## 6 Typologies of Intervention

A number of analytical frameworks identifying different typologies of intervention have been selected. These provide a variety of rationales for why the private sector and development agencies can find mutual advantage to working together.

Engaging Business in Development was published by the Global Public Policy Institute in 2007. It identifies two principal reasons for donor agencies to engage in partnerships with business. The first is they hope to generate maximum positive development impact from private sector activity in developing countries, or to alleviate potential negative externalities. Secondly, they engage with business in order to attract or mobilize new investments for developing countries. These investments must generate positive development effects.

The report argues that companies will engage with development agencies if it helps them to explore or test new investment opportunities and markets. Secondly they will have a strong interest if this facilitates actual investment. Third they will engage with aid agencies if this collaboration translates into an improved operating environment for their investment. In all cases business expects a measurable return on their investment. The GPPI study argues that in many cases CSR activities fall within this framework since they rarely have purely philanthropic motives.

From this analysis, the GPPI study defines three partnership models. The Probing Business opportunities model seeks to mobilize development relevant new investments for developing countries which also identify potentially profitable business opportunities for businesses. They kick in at a point when the investment curve is not yet known or fully understood by the investor. The second partnership model is the Fostering Sustainable Business model. This type of partnership provide actual investment support for the private sector, seeking to enable investment with high development value that otherwise would not have taken place. The third partnership model is the Corporate Development Responsibility model. CDR partnerships go well beyond a company's core business activities, seeking to strategically improve their immediate operating environment.

A report was commissioned in 2009 by SIDA to review new approaches and donor agency experiences regarding support to business for development (B4D). The report identifies three basic types of business initiatives which track very closely with the GPPI study. The first is to explore new investment opportunities by researching, testing or piloting initiatives at a preliminary stage. Pilots are useful to test the basic assumptions of an operating model. The second type of initiative is to implement sustainable investment decisions through starting up new enterprises or partnerships or expanding an existing enterprise. The motive is to obtain public sector support for investments that are potentially profitable but face market challenges that need to be tested. The third is to introduce development initiatives that have a positive direct or indirect impact on the business operating environment for their investment.

A draft report on the role of the private sector in development was prepared for the European Commission late 2010. That report differentiates between two types of instrument: what it refers to as the "consortium model" on the one hand and the "challenge fund" on the other. It defines the consortium model as usually a group of partners from non-ODA backgrounds. It is often quite informal

and open to new partners. It is heavily results oriented. The ODA input is usually envisaged as short term. Partners each enter the arrangement for their own specific purposes; the ODA input is intended to provide leverage on the development impact. In that sense the ODA component is provided to finance the development impact and the partnership allows that input to achieve greater leverage than it would have otherwise been able to do. A prominent example of the consortium model that is reviewed in some detail below is USAID's GDA model.

The challenge fund model has the specific objective of getting the most cost effective results from open competition for a specific objective. The underlying rationale is competition between various partners to identify the best proposal. It encourages novel ideas and innovative approaches. The object of the challenge is a concrete development result. The precision of the objective allows usually for quite a lot of flexibility in the terms of the management and administration of the challenge. Examples of the challenge fund model reviewed later include DFID's challenge fund, the AECF and Australia's Enterprise Challenge Fund.

Jane Nelson at Harvard University has developed a number of different typologies to describe emerging partnerships between the private and public sectors. For example in "Building Partnerships", she identifies a number of different areas in which the United Nations system partners with the private sector. These include:

- Promoting PSD in developing countries, including initiatives to create a better enabling environment.
- Enhancing the direct development impacts and multipliers of private investment.
- Harnessing business resources and competencies to support other UN goals, such as delivering public goods and addressing global issues.
- Sharing and spreading universal values, for example through the instrument of the Global Compact.

She notes that there are potentially three resources for cooperation. The first is core activities and competencies, such as investment, employment, training, technology etc. The second is policy input, including technical advice and the application of knowledge. The third is philanthropy. The source of the resources invested defines the major characteristics of the intervention to be made.

## 7 Donor Experience: Introduction

Donor experience is reviewed in three categories: bilateral, multilateral and multi stakeholder. This review does not aim to be comprehensive. Rather it seeks to identify a number of donor experiences which have raised specific issues and challenges which could be of interest as AusAID looks to the future. In this sense the report is deliberately selective. For example in reviewing the US experience, it would take a major treatise just to capture the multitude of agencies working on PSD. This report has focused on the GDA because it seems to be of direct relevance for AusAID.

### i. Donor Experience: Selected Bilaterals

#### *USAID*

USAID presented the Global Development Alliance (see below) approach to partnerships as a new way to implement foreign assistance. Andrew Nastios, then Administrator of USAID, said that the “ first appeal of this was to link the development of civil society and private institutions, profit making and nonprofit in the United States, with those that were emerging in the developing world. “ Secretary of State Powell introduced the GDA as a “new strategic direction for USAID. “

Today the Private Sector Alliance Division, the successor of GDA, is housed in the Office of Development Partners. It serves the following main roles:

- Directs USAID towards more strategic alliance building.
- Serves as a leading partnership body in the US Government.
- Liaises as a key point of contact for businesses, foundations, etc. which hope to become engaged in alliances with the agency.
- Advances practitioner knowledge and understanding of best practice in partnership building.

Today GDA is one of a number of different kinds of PPP’s that USAID pursues. Originally GDA pursued essentially CSR type business alliances. This has now evolved and currently many new alliances are driven from the business side of the company. GDA also started by and large with one to one relationships with individual companies. Today practice is much more complex, often involving multiple partners each contributing specific value. Overall much more complex and multifaceted partnerships are being built today and this is reflected in the broader mandate of the new Division compared to the GDA when it was created.

Within USAID, the Office of Development Partners covers partnerships with businesses, NGO’s, volunteers and universities. The Bureau for Economic Growth, Agriculture and Trade has responsibility for PSD policy and issues relating to enabling environment, barriers to business etc. This bureau has development credit authority, in effect a guarantee authority that can be provided to private financial institutions, for example in micro finance. Within the State Department, the Global Partnerships Initiative has been established. This was created to be at the vanguard of the administration’s commitment to a new public diplomacy. It has convening power over all US agencies dealing with PPP’s and pursues high visibility partnerships.

The Global development Alliance has been the flagship of USAID's outreach to the private sector. It was launched with very high profile and under strong leadership in 2001(see above ). The GDA model of public-private alliances welcomed private sector partners as collaborators in the implementation, design and funding of development projects. It has been described as both a very broad and open approach. Within the first eight years, the GDA claims to have formed more than 900 alliances formed with over 1700 distinct partners, leveraging some \$9 billion in combined public-private resources.

Originally GDA was established as an independent office reporting directly to the Administrator. The need for a central office close to the Administrator's office was deemed essential to get the initiative off the ground in a general atmosphere of considerable antipathy to a development institution working side by side with the for profit sector. The idea was that this would evolve over time as the interest in developing PPP's and the ability to do so would progress as their value was demonstrated. Today much of the capacity to engage in partnerships now resides in the operational bureau. The Partnership Office now serves a somewhat different function, supporting the operational bureau, providing incentives to innovate, and being a centre for agency learning and knowledge management ( still very much work in progress ). The Private Sector Division still controls some funds for use as seed money, but the amount of central funding has been considerably reduced from the startup phase. The policy is very clear today that any PPP's generated from the Partnership Bureau have to be owned by an entity outside the Partnership office.

GDA was guided by a number of key principles that addressed some key issues:

- The objective always had to be the proposal with the best possible development outcome
- Transparency in the process was critical to the credibility of the programme. There was wide publicity and an annual report was provided.
- The initiative was not limited to US companies.
- Resources from both partners were often given to third party implementers.
- The initiatives were very outcome focused.
- There was an intensive technical appraisal process.

A number of challenges emerge from the GDA experience:

- Engagement with partners is a very time consuming process.
- Engagement with private sector partners requires a new skills mix.
- It was a mistake to put numerical targets on the number of PPP's to be signed. This provided the wrong incentives and the quality of the partnerships suffered.
- There should not be a focus on the financial contribution that the company brings. More important are the skills, technology and innovation that the company brings to the problem.
- To support country operations, an effective knowledge management system that captures experience and lessons learnt is critical to success.
- The test of success is whether PPP's are mainstreamed throughout operations as a way of working and delivering results.

GDA adopted a demand driven approach to incorporating outreach to business in the country programming process. GDA developed an assessment methodology on local businesses which was available to country missions that were interested in using it. GDA wanted country missions to adopt the methodology because they were convinced it would increase the effectiveness of their programme. This required an extensive training programme. 35 workshops covering 1000 staff were held. Training was deemed an essential component of the GDA rollout.

This year USAID has reintroduced a policy requiring the roll out of country strategies. This has raised to the fore the issue of what kind of consultation is expected in this process with the private sector. One reflection was that the reality of USAID's experience with PPP's is that fundamentally when one analyses the process, PPP's are still primarily viewed as implementation tools. There is still not a clear differentiation between the concept of partnership and that of awarding a contract or a grant. They still tend to do the same kind of thing. A problem is defined, a solution is proposed and the company is then contracted to do that specific job, hence limiting the job to the narrowest slice of what it has the potential to do. The private sector is interested in a strategic partnership; they see their value added as contributing to the definition of the problem and the analysis of options for solutions. This is seen as the core of the challenge USAID faces in getting full value added from a new generation of PPP's.

#### *CIDA (Canada)*

Canadian CIDA has reached a critical juncture in its approach to private sector development. Following Prime Minister Paul Martin's co-chairing of the UN's Commission on Private Sector and Development in 2004, CIDA drafted a strategy covering economic growth and private sector development. However over the next 3-4 years, the agency became heavily focused on health and education and the challenge of economic growth faded. There was no institutional base for it in the agency and it had no strong champions. The situation was such that country missions became unclear as to whether consultations with the private sector was within their terms of reference. Formally there was no group within CIDA that had responsibility for interfacing with the private sector. In 2008/09, interest in trade and development issue revived, fueled in part by Canadian mining companies. CIDA was increasingly encouraged to work the potential for CSR related programming around mining company activities, especially in Peru, Bolivia and Columbia. Canadian companies had over time developed good CSR practices but they had problems interfacing with local communities and counterparts. Local populations were ill equipped to deal with the companies. Pilot projects were developed to strengthen the capacity of small Andean communities to work with these Canadian companies. Resources in these cases were not transferred to the companies. These initiatives have since led to the formulation of a CSR Policy paper jointly owned by CIDA and the Trade Department.

CIDA is now again engaged in drafting a strategy document on Stimulating Sustainable Economic Growth. The draft strategy prioritizes three paths:

- Building economic foundations: Support willing governments to build the necessary policy frameworks.

- Growing business: Enhance the financial viability, productivity and competitiveness of micro, small and medium sized enterprises.
- Investing in people.

Some of the key challenges CIDA now faces are the following:

- The new growth strategy would be led out of the Strategic Policy and Performance Branch. There is currently a Partnership with Canadians Branch but to date this has not engaged with the private sector. There is discussion of the possible role of a Chief Economist should CIDA decide to create such a post. The issue of institutional leadership for this new emphasis on growth and the private sector remains a clear challenge.
- While CIDA has experience in programming on issues related to the enabling environment, the Growing Business objective will require major adjustments - in skills mix, technical knowledge, outreach to the private sector at the country level, instruments of delivery etc.
- The new priorities need to be reflected in the country programming guidelines. Adjustments are already being made to ensure consultation with the private sector is an integral component of the programming process in those countries that chose to have sustainable economic growth as one of their focus areas.

#### *SIDA (Sweden)*

SIDA's work with the private sector took on significance in the 1990's when it became evident that its focus on rural development necessitated a good understanding of the way agricultural markets worked and the constraints that existed to the functioning of those markets. Recently, in 2009, the Swedish Government launched a new policy for economic growth which includes private sector development. Clear guidelines stipulate that SIDA should work and consult with non-state actors, including the private sector as well as civil society. This is reflected in country programming guidelines.

Responsibility for private sector work is shared between a number of entities. Within SIDA, the Thematic Department includes the lead specialists and they coordinate SIDA's overall policy work on PSD. The Department for Global Partnerships is responsible for the partnership function including reaching out to the private sector as development actors. This houses the B4D initiative (see below). Regarding the split between the Partnership and Policy functions, it has been stressed that the Partnerships group see their function as not just private sector development as such but as the challenge of engaging businesses as partners for development. Another entity that performs many of the IFC type functions in the Swedish system is Svedfund. However, the division of labour is not clear cut as SIDA retains a number of financing and guarantee functions. A reason argued for why SIDA should retain some of these functions is that if SIDA wants to mainstream operations such as B4D throughout its operations, then putting the functions into silos could be inimical to this wider purpose. SIDA needs to maintain the ability to look across all non-state actors and the role they play in the development process.

B4D is one of SIDA's flagship programmes. It was launched some 5 years ago and quickly encountered considerable internal resistance. A core perception remained that business simply want more business –

this translated practically to tied aid and this was to be resisted. In time the challenge was re framed as the question of what can business do for development and poverty reduction in particular. This was seen more as an equal relationship, not a contractual one. This required a considerable change in mindset. Over the last couple of years, B4D has received more support and today is managed by a core team of 4 staff.

B4D covers a range of initiatives. These include CSR initiatives, challenge funds, PPP's, innovative financing, market transformation, innovations against poverty, social entrepreneurship, dialogue partners etc. A core premise of B4D initiatives is that they have to be managed in the line. Mainstreaming remains a key challenge.

### *Norway*

Norwegian policy on PSD has evolved over a decade and is most recently reflected in a 2009 strategy . Learning from the Norwegian experience is greatly helped by a recent extensive evaluation that has been conducted. This evaluation extracted from this experience a number of principles:

- A dynamic, vibrant private sector is critical for long term sustainable poverty eradication. PSD is a government development priority.
- PSD includes both creating a conducive enabling environment and providing support at the company level.
- Key objectives are strengthening profitable enterprises in the South and creating employment
- The support should address the economic marginalization of poor countries.
- Ethical standards e.g. labour, human rights gender, etc. should permeate all PSD support.
- The Norwegian business sector should be mobilized for investments, trade and cooperation with Norway's partner countries.
- The support should utilize sectors in which Norway has a comparative advantage.
- The support should work towards a more comprehensive support for business development at country level.

Norway has a number of instruments with which to pursue its PSD objectives. Two play a central role. Norad, the Norwegian development agency, manages a number of PSD programmes which are managed by the Department for Private Sector Development and the Environment. These include the matchmaking programme and the application based support programme. The major criticism of these programmes is that they are implemented in a largely uncoordinated and non-transparent fashion. Business related assistance receives very little active support, coordination and systematic follow up either at headquarters or in the country missions.

The second instrument is Norfund. Norfund has played a very successful role in promoting venture capital for SME financing. It has become a major investor in Hydropower and it has a strong presence in microfinance. The evaluation argues strongly that Norfund's ability to develop specialization and professionalism within a very clearly defined mandate has enabled it to provide high quality services.



Against this background the evaluation's key strategic recommendation is to establish a much more rigorous division of labour between Norfund as the centre of all interventions at the company and financial systems level and Norad as the focal point for support for improving framework conditions for businesses. The evaluation also stresses the need for improved knowledge sharing and management. It argues for Norfund's increased ability to undertake higher risk-ventures and joint-ventures around key development issues. It encourages the creation of a policy framework around microfinance given the prominence of this 'industry'. Finally it encourages exploring new models in PSD with a view to increase leverage of donor funding with the donor community e.g. through challenge funds, output based aid, funds for innovations etc.

### *DFID (UK)*

DFID is currently engaged in a major new push with regard to its engagement with the private sector and the priority it attaches to it. The level of ambition involved is reflected in DFID's new vision for its work in the private sector as explained by Andrew Mitchell, UK's development minister.

In announcing the establishment of a new private sector department, the minister announced the intention to prompt and help catalyse change across DFID to deepen DFID's capability to work with and enable private enterprise to improve the prosperity and well-being of poor people. The press release announced that DFID would be recast as government department that understands the private sector and brings the wealth, knowledge and creativity of the world of business to support the UK's development efforts.

The minister stated : " I want this department ( the new Private sector Department ) to be the place that lives and breathes the new DFID culture of private sector led development, an example for other development bodies to follow...Aid is a means to an end, not an end in itself. It is the private sector that creates the jobs, goods and services that the world's poorest people so desperately need to lift themselves out of poverty... I want DFID to learn from business...I want to explore how we might enrich DFID's own talent pool with a series of short term secondments from the private sector in order to inject new, business savvy DNA into the department..."

The new direction is aimed at stimulating the private sector to become a much bigger engine of growth. The new measures introduced include more private investment, reduced barriers to growth, reform of the CDC (UK's investment arm) and a renewed push for successful completion of the Doha trade talks.

DFID has for over a decade put forward a number of high level policy statements regarding the role of the private sector in development and DFID's approach to this. The latest such policy document was produced in 2008 entitled Private Sector Development Strategy. Prosperity for all: making markets work. That document indicated that DFID would help maximize the private sector impact on the MDG's in three ways:

- Working with international and domestic private companies to boost the positive impact of their core business.

- Working with country governments and international agencies to create an enabling environment allowing markets to work with greater efficiency and fairness.
- Investing in research and knowledge management that supports private sector development.

In January 2011, DFID's new Private Sector Department was launched. DFID's new approach to working with the private sector is to be published in May 2011. At this time the remit of the new department includes the following:

- Pioneering and scaling up new business models that enhance the firm's contribution to development
- PPP's
- Fair and ethical trade
- Financial sector development
- Catalyzing private investment in business, infrastructure and basic services [AusAID is partnering with DFID in the Private Infrastructure Development Group on an investment vehicle called InfraCo Asia].
- UK shareholdings in CDC, IFC, MIGA etc.

Prior to the reorganization in January 2011, DFID's private sector work was concentrated in the Growth and Investment Group. Within this group, the Business Alliances Team (BAT) led DFID's work with international business in all major aspects i.e. engagement, policy and implementation. The new department is structured into four teams: Infrastructure, energy and basic services, investment and finance, business engagement hub and policy and management.

The business and engagement hub will take over the functions of the Business Alliances Team. Its core functions include responsibility for business partnerships (e.g. BCTA and BIF) as well as support to country offices. The hub will have central funds at its disposal for such initiatives as BCTA / BIF. It will also support business standards work. It will also control a number of the centrally managed challenge funds. On the other hand the Africa Enterprise Challenge Fund (AECF) is managed by the Africa Department (see below).

The new department will include around 20 specialized staff with private sector and economic expertise. It will both work on new approaches to invest in the legal, financial and physical infrastructure in the poorest countries as well as with international companies to develop new business models that contribute to development and are profitable. In the new arrangements, policy and enabling environment work will be done separately in a new Department of Growth and Agriculture.

An interesting focus of the current reform thrust is the decision to revitalize the CDC, the Government's development investment vehicle. The current view is that the CDC needs to rediscover its original vocation to be at the cutting edge of managing opportunity and risk in countries and areas which would otherwise have major difficulties in attracting investment. In an early stage the CDC is viewed as perhaps having had too poor a record in achieving reasonable investment returns. More recently, its performance is viewed as having become too traditional and in this sense too risk averse. This is attributed to the fact that the management of CDC was contracted to an outside Fund whose major focus was on financial performance rather than development opportunities and innovation. The stated

goal of the new policy is to revitalize the CDC and make it once again a key component in the UK's arsenal of development instruments. In this regard the challenge of staffing a revitalized CDC and attracting the right mix of specialized staff is seen as critical.

The use of challenge funds has been a highly visible part of DFID's engagement with the private sector. The Business Linkages Challenge Fund (BLCF) was launched in 2001 and has provided grants for business initiatives that aim to improve business competitiveness and benefit the poor. Resources have been allocated on a competitive basis. Initiatives have mobilized mostly large international and national companies by transferring skills, knowledge and technology, by improving sourcing, working on supply chains, and improving access to markets. The programme has been evaluated and overall is considered to have produced significant results although it remains difficult to come up with an authoritative, quantifiable conclusion as to costs and benefits. The BLCF was closed in 2008 and has in effect been succeeded by the Africa Enterprise Challenge Fund (see below). The progression from a centrally managed challenge fund to a geographically and sectorally defined challenge fund managed in the line reflects deliberate policy. The idea was that the core concept of a challenge fund should be managed centrally as a pilot for demonstration effect and should then be picked up in the line if it has proved its utility as an instrument.

Another DFID programme of interest is the Business Innovation Facility (BIF). BIF aims to scale up DFID's engagement with business by providing technical advice, brokering and knowledge and information services to the private sector as well as to country offices, partner governments and other potential stakeholders. Key features are:

- Coordination at the country level with country based offices of all stakeholders.
- Leverage through the use of DFID's international network to tackle local issues.
- Development lens to help companies link their core business to development priorities.
- Finance on matched basis to support initiatives that scale up local development benefits.
- Open access to all companies (including national and international).
- Measuring impact of local partnership initiatives.

A number of issues have been commented on with respect to the way DFID has gone about pushing forward the PSD agenda:

- While it is certainly the case that the new government is responsible for giving a major new push, it is also the case that PSD was already high on the agenda in the old government. Moreover it has been stressed that there are strong internal champions of this agenda within the leadership of DFID.
- A clear challenge facing the PSD team is to increase the understanding within DFID as a whole of the value added partnerships with the private sector can bring, especially among staff with little or no experience of the private sector.
- One of the core pillars of DFID's new business plan is wealth creation and country programmes need to assess and align these programmes to reflect this priority. Consultation with the private

- Traditionally coordination between policy, PSD and the regional desks has tended to be ad hoc. With the new arrangements DFID is working to formalize effective internal coordination arrangements.
- Similarly DFID is now reviewing ways to promote policy dialogue with the private sector, both at central and country level. DFID is anxious to get private sector expertise into DFID. It is reviewing the concept of Touchstone Business Groups to get expertise into ad hoc sector focused groups which could work through a specific issue. The potential for secondments is also being pursued.

### *The Netherlands*

The new Dutch government has made a strong policy statement shifting focus from the social sectors to economic growth, including a PSD agenda. In a communication to the Dutch Parliament, the new Government has stressed the value brought by the Dutch business community with its innovative technologies in such areas as energy, environment and health care combined with its knowledge of the market and its understanding of what is feasible. This shift in emphasis will be reflected in policy guidelines by May. This also needs to be understood within the broader context of a stronger focus on economic diplomacy. The need for a whole of government approach which adopts a more integrated approach to economic development is receiving high priority from the government.

From 2011 it is expected that a new generation of country programme documents will heavily reflect the new priority being accorded to PSD. Due to the country driven nature of the programming process, this is unlikely to find expression in a heavy headquarters generated set of instructions. Nonetheless it is clear that local embassies are eager to respond to the clear new policy direction indicated by the government.

The rationale for the new policy is that as the engine of growth, private sector development is what makes sustained public social investment possible. There is concern that this argument could lead to a thin line being blurred where Dutch commercial interests intersect with and could eventually distort development objectives. Dutch policy continues to stress the primacy of the Development Objective and it is important to ensure that this continues to be the case.

Currently, the Directorate-General for International Cooperation (DGIS) is responsible for all development cooperation policy, implementation and funding. DGIS believes it is important to benefit from the experience and knowledge of private sector actors and is committed to getting private sector actors more engaged. The Sustainable Economic Development Department (DDE) comprises three divisions:

- International markets division
- National policy environment division
- Entrepreneurship and business development division

DDE focuses on policy issues relating to the enabling environment for business but has relatively limited capacity for policy work and much of this is actually done through the IFC on the one hand and local embassies on the other.

DDE's work to stimulate business investment is contracted out to:

- Netherlands Development Finance Company (FMO). This is the Government's financial instrument. FMO has its own procedures relating to the hard investment part of the portfolio but DGIS has more influence on the soft loan part of the portfolio.
- Centre for the Promotion of Imports from Developing Countries.
- Agency for International Business and Cooperation (EVD). This is an agency of the Ministry of Economic affairs. In effect it implements projects for both the Development cooperation and the Economic Affairs ministries. The ministry providing the funding maintains overall responsibility for the programme. The Private Sector Investment Programme (PSI) is the largest of EVD's programmes. It provides subsidies for northern business partnerships with southern businesses. Key criteria for the programme include that a local company is an investment partner, the investment is innovative, and the risks are high and commercial financing is not available. There is a separate window for fragile states. EVD also runs the Development Cooperation Matchmaking Facility. This targets small and medium sized companies in emerging markets looking for a Dutch partner.

DGIS has given high priority to pursuing PPP's in specific areas, for example the Sustainable Trade Initiative. This overall PPP initiative was in response to the Johannesburg summit which promoted a new generation of PPP's as an outcome of the conference. The ministry of Foreign Affairs is currently involved in 75 PPP's, investing a total of some 750 million euros between 2003 – 2012. The private sector and other have invested close to 1.5 billion euros. The initiatives include government representatives, the private sector and different international agencies and local NGO's.

### *The European Commission*

The European Commission's strategy for PSD in the ACP countries focuses on five priority areas:

- Improvement of the macroeconomic framework and regulatory environment for enterprise development.
- Investment promotion activities.
- Facilitation of investment financing and development of financial markets.
- Support for small and medium sized enterprises in the form of non-financial services.
- Support for micro-enterprises and micro-finance.

In order to support the contribution of European companies to business development in Africa and to ensure cooperation between the various stakeholders, the idea of a common platform for discussion forms part of the overall vision.

ii. Donor Experience: Selected Multilaterals

*Asian Development Bank*

ADB has given priority to PSD since 1999 and operations in this area were guided by policy papers issued in 2000 and 2001. Since that time, ADB members have given increasing importance to PSD and it has become a driving force for change in the overall orientation of the Bank. The 2006 Private Sector Development Strategic Framework and the 2008 Long Term Strategic Framework of the ADB 2008-2020 represent major steps in this regard. Both documents were the product of an extensive process of consultation and were led by major task forces.

The 2006 strategy states that a central challenge facing ADB is how to transform itself from an institution focused broadly on public sector lending into a more agile bank that can meet its overall objective of poverty reduction. It asserts that successful implementation requires an ADB wide commitment to PSD.

Institutionally, the strategy strengthened the profile and role of the Private Sector operations Department (PSOD). This department performs policy, engagement and financing functions with respect to the private sector. The strategy called for closer collaboration between PSOD and the regional departments. As a guiding principle it urged regional departments to 'think private sector' and urged PSOD 'to think development impact'.

The strategy document analyses a number of the key issues making it difficult for ADB to meet the growing demand for services in PSD. These included:

- Weak leadership. This was seen to have weakened since 2000
- ADB's readiness overestimated. There was a limited understanding of the consequences for the Bank of taking PSD fully on
- Lack of performance indicators and targets made strategic clarity difficult
- Weak implementation, including lack of screening mechanisms and inadequate attention to quality issues in country strategy programming
- Policies and business processes not conducive to PSD
- Weak skills base
- Lack of clear accountabilities and limited team work

The need for close integration of PSD into country strategy programming processes is stressed. Each country strategy is to define ADB's PSD role in the country, while recognizing that the role will be different in each country.

The strategy concludes with a set of priority actions required to operationalize the vision. These include:

- Achieve strategic clarity at the corporate level.
- Establish the country strategy programme as the platform.
- Establish best practice policies and business processes.

- Establish clear accountabilities and teamwork.
- Develop market oriented products and services.
- Develop a capable and motivated staff.

The very strong thrust reflected in the 2006 PSD strategy is reflected in the 2008 Long Term Strategic framework for 2008-2020. Within the overall mission (see above), it is stated that ADB will focus on five drivers of change:

- Private sector development and private sector operations
- Good governance and capacity development
- Gender equality
- Knowledge solutions
- Partnerships

With regard to ADB's PSD activities, it will:

- Work with the private sector to generate greater economic growth.
- Assume greater but thoroughly assessed risks and act as a catalyst for investments that the private sector might not otherwise be willing to make.
- Help countries attract direct private sector investments.
- Invest in infrastructure and advice on enabling environment issues to spur market led growth.
- Will use as instruments direct financing, credit enhancements, risk mitigation guarantees and innovative financial instruments.
- Promote public-private partnerships in all of its core operational areas.

The strategy also gives high importance to the generation and dissemination of knowledge solutions and to making partnerships a core element of its business model.

The strategy concludes by mapping out a set of operational and institutional goals to achieve ADB's transformation to 2020. These include scaled up PSD and private sector operations in all operational areas, advancing partnerships, and expanding knowledge networks. A specific operational objective is for ADB's support for the development of the region's private sector to increase significantly, both in the number of ADB financed projects and in its share of ADB's annual operations with a target of 50% by 2020. Institutionally there is a focus on the need to develop its technical, financial and economic expertise resulting in a realignment in its skills mix. PSOD has succeeded in recruiting a number of staff directly from the private sector.

### *World Bank*

The World Bank Group works comprehensively on PSD. The World Bank itself does extensive policy work and PSD related programmes are financed from both IBRD and IDA resources. In the IFC and MIGA, the World Bank Group has two significantly growing and effective instruments to reach out directly to the private sector. It is not feasible to attempt to cover the full range of the Bank's work in this field. There are a number of developments in the Bank's work in this area which are pertinent for this study.

In its 2002 Private Sector Development Strategy, the Bank described its evolution through a number of phases. In the 60's and 70's, the predominance of state led development and import substitution policies meant that the Bank did not focus on the promotion of private capital and investment. After the 1982 debt crisis, emphasis shifted to macro-economic stabilization and the opening up of economies to trade and foreign investment. This was in time complemented by increasing attention to PSD . In the late 90's there was disenchantment with the performance of directly lending to firms; direct investment declined and increasing attention was given to privatization, reflecting disappointment in the experience with state owned enterprises. In 1993 PSD became a major pillar with the creation of the finance and private sector development vice-presidency. This in turn reflected a renewed push towards a more activist role. On lending operations, particularly to SME's, were promoted. In short for several decades now the Bank has worked on the PSD agenda as a critical component of its understanding of and approach to development. At the same time this period has seen a considerable evolution in the Bank's approach, its areas of focus and its institutional arrangements.

The last major comprehensive policy private sector development strategy was produced in 2002. The strategy was organized around two principles:

Extending the reach of markets.

- Investment climate issues were to be part of a systematic and regular analysis in preparation of country strategies.
- Direct public support to firms. There was to be continued support to entrepreneurs, with a focus on SME's.

Access to Basic Services

- Infrastructure. There was to be continued support for private participation in infrastructure, focusing on establishing the framework under which private provision is likely to make a positive contribution, and on improving regulatory regimes and building institutions.
- Social sectors. The Banks' work on private participation in the social sectors was to continue.
- Output based aid. There was to be continued support to output based approach.

Currently work is being completed on policy documents that address the challenge of how the Bank should position itself with regard both to Finance and PSD, in particular in the light of the financial crisis.

Currently PSD is driven from three sources: a number of organizational units dedicated to PSD work, a number of knowledge networks, and the geographical departments. Of interest for this study is the reach of the vice presidencies for finance and private sector development (FPD) and for business advisory services (BAS). FPD is the only department which straddles both the World Bank and the IFC: the vice-president is double hatted. BAS is within IFC.

FPD is implementing a new vision of how to organize its work in Finance and PSD. FPD is organizing itself into six practices. In finance, these relate to financial services, financial inclusion and capital markets. In PSD, these relate to the investment climate, innovation, entrepreneurship and technology and competitive industries. FPD is positioning itself around what it refers to as the missing middle: that is a focus on sectors as opposed to what it sees as the Bank's focus on the national framework and IFC's



focus at the company level. The new practice architecture is intended to provide better opportunities to leverage global knowledge effectively. PSD's vision is anchored in a strong, coherent framework for knowledge management.

IFC's business advisory services (BAS) provide support to governments, local authorities as well as to companies. BAS has four practice areas: investment climate, finance, PPP's and sustainable business. In addition BAS has an innovation group that is moving forward with the work on inclusive business models which it believes has considerable potential to grow (the portfolio is currently estimated at around \$4billion).

In terms of mind set and culture, BAS staff draws two distinctions between IFC and the World Bank. The first is that while the primary client of the Bank is government, in the case of the IFC it is the firm. While the Bank remains primarily in the business of lending and providing grants to governments, the IFC remains focused on advisory services to and investing in firms. The second is that while the relationship between the Bank and its donors is characterized as a partnership, the IFC describes its relationship with its donors as an investor relationship. This analysis points to some of the challenges faced by public aid agencies as they expand into the PSD agenda.

### *UNDP*

UNDP first starting working on a PSD agenda with the appointment as Administrator of Bill Draper in 1986. Draper was a very successful venture capitalist from Silicon Valley and he could not understand how a development institution could be so disconnected from the world of business and entrepreneurship. The institution reacted quite skeptically for some time. Country demand for capacity building programmes for SME's and various investment support schemes grew in the 90's. In 2000, a new partnership bureau was established which brought together in one place responsibility for all of the agency's major partners. The idea was to consolidate in one place all the key partnership functions so that there would be a clear location in the organization where the interests and concerns of all UNDP's partners were addressed. This included a new division for the private sector.

UNDP worked closely with the Global Compact launched in 2000. UNDP took on the role of providing a country platform for the launch of national compacts. This kept considerable focus on essentially a CSR agenda. Confronting financial problems at the time, there was also a push to see the private sector as a source of funding for programmes supported by the organization. This created skepticism on the part of the private sector as well as the NGO community and this focus was short lived.

Increasingly UNDP found itself confronted with requests from developing countries for more support on the PSD agenda. In a number of countries adopting a strong PSD agenda remained politically quite complicated and the support of the UN was deemed important. It was against this background that the Secretary General launched the Commission on Private Sector Development co chaired by Paul Martin and Ernesto Zedillo. The publication of *Unleashing Entrepreneurship* was widely considered to represent a watershed in embracing the centrality of the private sector in the lives of the poor by the UN.

Following this logic UNDP has over the last four years embraced and championed the concept of Growing Inclusive markets. With the establishment of a Growing Inclusive Markets Advisory Board comprising many of the global actors in this space, the publication of Strategies for doing Business with the Poor, and the holding of numerous workshops and launches at the country level, UNDP has pursued a very focused approach of trying to add value by pursuing a specific approach and building a technical base to support this work.

At the same time UNDP has continued to respond to country demand across a wide range of issues, ranging from microfinance to legal empowerment of the poor. In this regard it faces the same challenge as other agencies of being spread thin on a wide range of issues in many countries. With the need to ensure more coherent programming, new matrix arrangements were put in place to bring together the partnership, policy and geographic functions.

iii. Multistakeholder Groups

*The Global Fund to fight Aids, Tuberculosis and Malaria*

A brief reference is included to the Global Fund because it represents a somewhat unique public private partnership between governments, the private sector, civil society and the affected communities. All of these partners are represented on the Global Fund's Board. The private sector is represented by a private sector representative who in turn is supported by a group of companies organized by the Global Business Coalition on HIV/AIDS, Tuberculosis and Malaria. At country level the local private sector is also able to contribute. The bulk of funding comes from governments but the private sector also contributes. The private sector has also been a full partner in certain countries in grant implementation. In seven countries in Asia and Africa the private sector has played the role of principal recipient in implementing the grants. The Fund represents a partnership model which is challenging traditional assumptions.

*The Africa Enterprise Challenge Fund (AECF)*

The AECF was established as a special partnership initiative of the Alliance for a Green Revolution in Africa (AGRA) which hosts the AECF. The Board of AGRA has the ultimate fiduciary responsibility and accountability for the performance of AECF. The Governing Council of the AECF, consisting of the donors to AECF and AGRA, is the decision making body of the fund. The overall objective of the AECF is to promote new ideas that will lead to growth in the rural economies of Africa, generating employment and creating new opportunities for systemic change in the markets that serve them. The AECF is a competition open only to for profit companies which are intending to start new ventures in specific fields. Each window has a special focus but the overall field is the set of value chains linking rural areas to their local and international markets, in services as well as goods. The fund was launched in 2008. In the first seven rounds it had 3124 registrations of interest, resulting in 1440 applications out of which eventually 39 companies emerged as winners. The AECF is a very promising model of the role that a well-designed challenge fund can play.

## *BCTA*

The Business Call to Action describes itself as a global membership network of companies, governments and development organizations working to identify and promote business models that contribute to long term development and commercial goals. The BCTA was launched in 2008 to encourage businesses to accelerate progress towards meeting the MDG's. The core principle behind this initiative is that it challenges companies to develop inclusive business models that impact on the lives of the poor while still being commercially viable.

Currently BCTA receives financial or in kind support from AusAID, the Netherlands, DFID, USAID, UNDP, the UN Global Compact, the Clinton Global Initiative and the International Business Leaders Forum.

For businesses, BCTA provides a global, highly visible platform to demonstrate their commitment to eradicating poverty. By joining the BCTA, companies get access to global knowledge and expertise on inclusive business models. The value attached to being a part of a community of practice is credible in so far as the principle of finding ways to develop inclusive models while remaining commercially viable remains in force. BCTA provides a good example of new emerging forms of multi stake holder groups working together to find solutions to common development challenges.

### iv. Donor Experience: Conclusions

Donor agencies each have their own history, experience and political realities. There are differences between the realities facing bilaterals, multilaterals and multi stake holder groups. Differences in size have major consequences for breadth of ambition, ability to achieve critical mass, and the scope of the envisaged mission. The composition of partner countries for each donor has deep consequences for the prioritization of PSD activities.

These differences make what is common about donor agencies experience with PSD over the last decade all the more compelling:

- All donor agencies have recognized and reacted in some way to the rapidly changing global environment. The increasing importance of private sector actors and the size and impact of their investments is evident to all. The centrality of the private sector and markets to the lives of the poor is clear. The emergence of new sources of financing and new technologies is also clear. The emergence of new partners and the development of a multitude of multi stakeholder groups and coalitions is recognized as an important part of the new global architecture with deep consequences for the future of international development cooperation.
- Against this background, most of the agencies reviewed have undergone at some point in the last decade a significant change process to accommodate internally the changing external reality. It is quite common for reference to be made for the need for a change in culture in the agency. The change process has always been accompanied by political leadership and strong champions within the agency.

- All donor agencies have made strong policy statements regarding their approach to PSD. Some see the PSD agenda as transformative to their agencies work; all have supported a strengthening in the agency's work in the PSD area.
- Donor agencies have engaged extensively with a range of broad intergovernmental initiatives including those launched by the OECD/ DAC, the UN MDG Summit and the Seoul G 20 Summit. A number of donors referred to the absence of Australia among the signatories of the Bilateral Donors Statement in Support of Private Sector Partnerships for Development at the MDG Summit.
- The strengthening of work on PSD has tended to break down into three categories : policy and enabling environment for businesses work, engagement with the private sector as actors, and investment support. As described above, donors have chosen many different ways of organizing these functions. Some agencies combine into one department the policy and partnership functions while others keep these separate. Most agencies have a separate investment arm (usually characterized by having its own procedures and staffed by specialists rather than generalists).
- Even where the establishment of a separate investment arm is not envisaged or considered viable or desirable, there are clear lessons to be learnt from the operations of these offices that merit attention (the evaluation of Norway's approach to PSD provides an excellent example of this).
- The donor agencies have addressed many of the same challenges and experimented with very similar instruments and mechanisms. The development of PPP's, the creation of challenge funds, work on inclusive markets and access to finance, private sector involvement in service delivery models, participation in new multi stake holder fora – these and many others characterize donor initiatives. Evaluations often indicate the achievement of some positive results but usually find it very hard to demonstrate in measurable terms the precise impact of the intervention. It can be particularly difficult to be sure in the case of PPP's whether public support was the decisive factor in private sector investment. Ultimately there can be no generic prescription for which instruments to choose. The choices to be made reflect the specific contexts in which agencies operate.
- Donor agencies have recognized that corporate policy can only be effective if it is translated into programming instruments. Most agencies attach huge importance to protecting the integrity of the programming process and in particular to protect the country driven nature of the process. Nonetheless most of the agencies have introduced at a minimum clear expectations of an inclusive programme formulation process that includes non-state actors. Agency procedures range from analysis of the enabling environment for business to simple consultation with business among others.
- All donor agencies have had to address the challenges related to institutional capacity. Most donor agencies are staffed by generalists and the need to develop specialist streams is addressed in a variety of different ways. In the case of PSD work, the need for a different skills mix is a recurrent theme.

- Related to this is the challenge of knowledge management and developing the capacity to capture and generate knowledge from experience in the field. This is an area in which many donors are to be found wanting.

## 8 Australian Experience

### i. The Policy Framework

Australia's aid programme addresses many issues of fundamental importance to the private sector. In this regard it is important to recognize the value of the AusAID programme to the private sector. The fact that education, health, infrastructure, governance and rural development are critical building blocks for a viable private sector still needs to be differentiated from directly strengthening linkages with the private sector which is the subject of the terms of reference of this study. Major programme areas are analyzed below. One way to understand AusAID's private sector development and engagement work is to group it into four main areas : improving the business enabling environment and setting the foundations for inclusive and sustainable economic growth, supporting livelihood and enterprise development, supporting private sector participation for more effective delivery of social services and infrastructure, and supporting partnerships with business.

A common refrain from both the private sector and AusAID is the lack of a strong policy framework to guide PSD work and engagement with the private sector more broadly. A common view is that while the commitment to the PSD agenda is reflected rhetorically, it is not borne out in reality. Quite a few comments deemed that there was a cultural issue that AusAID was still grappling with in that the agency has always seen itself as primarily a government to government institution and this was heavily embedded in its way of working. The sense that PSD is not in reality a high priority for the agency, that there is very limited institutional capacity and no sustained engagement was one widely shared both by private sector as well as AusAID colleagues.

Certainly the importance of the private sector is acknowledged by the Australian Government. Nonetheless, perceptions are influenced by the fact that the last private sector policy framework was issued in 2000. The 2006 White Paper on Development Aid is committed to growth but relatively little attention is given specifically to PSD. The 2010-11 budget document gives little focus to PSD matters.

There was a widely shared view that the current development environment is undergoing major change and that it was important that AusAID take practical measures to position itself with regard to the PSD agenda. Some argued that the issue goes beyond that of a PSD programme as such and relates to the larger challenge of developing a new public diplomacy. It is increasingly important to develop channels outside the government and to develop strong people to people relationships. This raised the question of a whole of government approach.

A number of AusAID colleagues stressed that an effective and properly functioning public sector can in many cases be the most critical challenge facing the private sector and that AusAID's comparative advantage might continue to lie in focusing on the enabling environment provided by the public sector.

There is no question that the existence of an effective public services is of critical importance to a vibrant, functioning private sector. At the same time, the great majority of interviewees made it clear that it was time to institutionalize and concretize the rhetoric on the critical importance of the private sector as the engine of growth.

In reviewing the Australian Aid programme's linkages with business, it is important to recognize the significant contribution Australia makes to programmes committed to fostering a positive enabling environment. Infrastructure development, for example the large transportation programmes in Indonesia and Papua New Guinea, is obviously a critical ingredient in the development of markets. Aid for trade also directly benefits business and it is estimated that Australia spent some \$600m in 2009-2010 on aid for trade investments. In many of these cases Australia works through multilateral channels which provide a cost effective way to pursue this work. A challenge is to deal with the fact that this approach tends to result in low visibility and recognition within the private sector and this needs to be counteracted. Another challenge is that AusAID staff may lack the skills for policy engagement with the Banks.

Private sector colleagues stressed the importance of the agency investing in understanding the way the private sector works and the contribution they can make. There was a clear sense that there was insufficient outreach to develop that understanding. AusAID colleagues largely shared that view but they also expressed the need to undertake much more country and sector specific analysis to permit the agency to fully grasp the opportunities and risks of engaging with the private sector on the ground.

A significant characteristic of the AusAID programme that needs to be borne in mind in the articulation of overall policy is that it is highly focused geographically. In particular there are a few countries (Indonesia and PNG) and regions (Pacific) where AusAID has a leading donor profile. In each case the local private sector has very specific attributes that determine the most appropriate response. As Australia increases its aid commitments to Africa, a different set of challenges presents itself. And it is important to recognize the very particular and often critical role the private sector plays in fragile state and post conflict settings. Ultimately the details of the policy chosen need to build on these realities.

#### ii. Information, Consultation and Facilitation

A recurrent theme was a high demand for better much information on what AusAID was doing on the ground. There was a very high level of interest among private sector colleagues to have programme information that could provide the basis for a more substantive dialogue and for possible opportunities to work more closely together. The Business Councils were deemed to have an important function but they did not provide the platform for substantive programmatic discussions with AusAID. The private sector is looking for an opportunity to provide an input into the strategic direction of programming, in particular at the country level. They are consistent in stating that this is not about business opportunities and a reversal to tied procurement but shared development interests, in their case relating to the effectiveness of their investments. The fact that both Australian aid and private sector interest in FDI are increasing significantly makes dialogue with the Australian development community more important to the private sector as a factor in its investment strategy and possible partner.

Specific proposals made to developing mechanisms for a structured dialogue included for example in PNG the establishment of a High Level Advisory Group with Government and business and the holding of a workshop to present and discuss the content of AusAID's PNG programme. Another proposal at the corporate level was the establishment of a Business Advisory Council to advise the Director General of AusAID along similar lines to what has been done with the NGO community.

Very positive comments were made to examples of practical collaboration at the project level where it was possible to identify win-win scenarios. Going beyond information sharing, there was interest in an AusAID facilitation role between the private sector and Government. It was also felt that AusAID could usefully play a convening role to try and build more trust between civil society organizations and companies.

### iii. Institutional Framework

Another strong theme is the need for a much greater degree of institutional coherence and a clear organizational home for the PSD agenda. This is a question of where the agenda gets championed internally, where the substantive work get done, where the dedicated staff with the skills sit, and what the telephone number is which companies can call to have detailed discussions and do follow up.

Currently in AusAID it is generally perceived that there are two hubs : one relates to policy work on different aspect of PSD and is located in the Economic, Rural Development and Infrastructure Branch and the other relates to the partnership function and compromises half a dedicated staff's time located in the Sustainable development and Partnership Division. In both cases resourcing is broadly considered insufficient for any serious push on a PSD agenda. Beyond this many critical dimensions that would be integral to a PSD agenda are to be found around the agency; for example support to women business leaders is covered in the Gender Section, Extractive Industries in the governance Branch etc.

The reality that the PSD agenda cuts across a large part of the thematic and geographic desks in the agency is probably a healthy sign that the agenda is at least in some respects already quite embedded in different aspects of the agency's work. This situation is quite familiar in many donor agencies. But in most donor agencies there are usually two corporate pillars that provide overall coherence. The first is that institutionally the policy and partnership functions are clearly defined and located (sometimes together and sometimes separately). The second is that overall coherence is provided through clear policy guidance.

The preparation of this report did not yield a sustained discussion around the viability or desirability of the creation of an Australian investment vehicle. Such a discussion would benefit from the extensive experience with such instruments from a range of agencies, both large and small. In particular such instruments tend to have a significant influence on the broad relationship between national aid programmes and business.

An issue that has come up consistently both from AusAID and private sector interviewees is the challenge an active PSD agenda presents to the skills mix of the agency. In the experience of many donor agencies, the need to address the skills mix always emerges as one of the central management challenges in being able to push the agenda forward. The need to bring in staff with experience of the

private sector is often raised; one contribution to a solution is to look at the possibility and desirability of bringing in some private sector staff on secondment for specific assignments or for a limited time duration. Another dimension of the skills mix challenge which has been raised is the need to institutionalize specialist streams that give recognition to the contribution of specialized substantive staff.

Many donor agencies have over the last ten years emphasized their role as sources of knowledge. Currently today there is a rural development network and an economic network but no PSD network. The overall issue of the importance of knowledge networks and whether they are deemed useful on the ground raises broader issues. But if PSD is to develop as an internal substantive practice, the capturing of knowledge and its dissemination will become an important element.

Consideration also has to be given to the appropriate funding base to support an active PSD programme. The question is the extent to which modest resources should be made available for corporate initiatives, in particular those geared to engaging business. Experience from other donor agencies is that some funding to provide the necessary incentive is desirable. However funding of this type should remain an incentive at the margin and should never become a driver of the agenda.

#### iv. Programming Process

AusAID issued a Policy note on Country Strategy Development ( May 2010), a Guideline note on Country Situation Analysis ( May 2010) and a Guideline note on Completing a Quality at Entry Report (July 2009). The Country Strategy development note highlights the importance of a Whole of Government approach to the country strategy development process and stresses that the CSA in particular is a key point for engagement and dialogue among WofG partners. It notes that aid is not development and stresses the importance of an inclusive process in formulating strategy. The overview of the programme process stipulates that it should be “informed by consultation with stakeholders including Australian NGO’s, civil society, academic and research organizations and other development partners...”

The Guideline note on country situation analysis explains that while CSA is a classified Australian Government document, this in way precludes consultation on key development issues with the partner government and with other stakeholders, including NGO’s, civil society and other development partners. Identifying critical opportunities and constraints to development will examine detailed analysis of many factors; special reference is on capacity at both the political and public sector level. The private sector does not feature in those elements to be analyzed deemed critical to achieving successful development outcomes.

The guideline on completing a quality at entry report specifies a number of the elements that need to be covered. These include assessments related to environment, gender equality and sustainability. No requirements are established relating to the enabling environment of the private sector or consultation with business.

A number of colleagues both from the private sector and AusAID urged that to make progress on a PSD agenda will require more programmatic guidance. Such guidance is the norm for many donor agencies.



Respect for the country driven character of the programming process needs to be maintained and the nature of the guidance should not be to make PSD activities in any way mandatory. However the programming process can encourage norms of consultation and analysis to ensure that a properly inclusive approach has been pursued.

v. Major Programme Areas

The five major areas of aid expenditure are expected to continue to be education, health, infrastructure, governance and rural development. These all play a critical role in supporting a vigorous private sector. Applying a private sector lens to these core programme areas would stimulate a better understanding of the most effective ways to stimulate pro poor growth.

AusAID's substantive work in PSD falls primarily into three categories. The first category relates to programme areas where AusAID has gained considerable experience and where it is committed to working largely through multilateral institutions and/or with other bilaterals.

1. The promotion of **good enabling environments for PSD** has always constituted one of the major pillars of AusAID's work on PSD and this should continue. AusAID has been heavily committed as have many donors in supporting the promotion of an enabling environment for the private sector. This has been particularly important where AusAID has a strong presence and carries weight with the government. An important component of this has been its work supporting aid for trade. Policy support for this work has been divided between headquarters and country offices, especially the largest ones which have dedicated capacity for this work. Generally there is no question that enabling environment work remains high on the list of donor priorities. It offers one of the best chances for pursuing policy change that can have a truly systemic impact. Nonetheless the view has also been expressed that the impact of donors on enabling environment issues is often exaggerated and that it is important to go beyond these macro type issues and have a direct impact on the lives of the poor. This is not so much an argument for diminishing the value of this work but rather a reminder of the need for balancing the respective roles of such elements as enabling environment, leadership development and support to the growth of properly functioning and effective markets.

2. **Access to financial services** is a very important issue and has a significant place in AusAID's programmes. Currently this is an area which AusAID largely contracts to the Multilateral Development Banks (MDB's). The issue of access to finance and providing financial services for the poor has been given increasing focus. For example, In 2010 Australia co-chaired the G20 Access Through Innovation Sub Group of the Financial Inclusion Experts Group. Access to finance focuses attention on the consequences of exclusion from markets (in this case financial markets) as well as on the power of new technologies to find solutions.

AusAID has considerable experience with these issues across a broad range of its country programmes. While it maintains some technical capacity at headquarters the approach has been largely to work through the MDB's. ADB, the World Bank, the IFC and UNCDF are considered to have the expertise and level of specialization required to engage in both key aspects of the work – policy work and advisory services on the one hand and investment activity on the other.

The Pacific PSD Initiative was established in 2006 by the ADB, supported by AusAID. ADB's 2010-14 Pacific Strategy reiterated that a key driver for change in the Pacific was strengthening the environment for private sector development. PSDI 2 builds on the reform momentum gained in the first phase in the legal and regulatory environment, SOE reforms and access to finance. It remains unclear to what extent AusAID has the capacity to engage fully in policy dialogue with ADB.

The same uncertainty characterizes AusAID's relationship with IFC in this area. For some time AusAID has financed IFC's presence in the Pacific and other areas. IFC found it difficult to make a business case in the smaller markets and AusAID's support was critical in ensuring their presence in these markets. In the original model, IFC was expected both to provide advisory service as well as to do project facilitation leading in some cases to investment. Over time it continued to be difficult to make a business case for direct investment (the markets were simply too small) and IFC shifted to focusing on improving the climate for commercial banks to expand their services. On the investment side IFC has increasingly moved to the largest markets and countries.

Currently IFC's partnership with AusAID is based on a four year programme cycle and it focuses on four business lines:

- Access to finance
- Investment climate / enabling environment for business
- Sustainable development advisory service
- PPP's

AusAID's commitment to access to finance is reflected in its strategy for 2010-2015: Financial Services for the Poor. The strategy identifies four desired outcomes:

- a policy and regulatory environment that allows institutions offering financial services for the poor to enter the market and grow.
- Financial service providers and infrastructure that have greater capacity to provide services to the poor.
- Innovative models of financial service provisions that are used to reach the underserved.
- Increased client capacity to understand and use the services.

The Australian government does not have a specific arm acting as a financial instrument. The Export Finance and Insurance Corporation would be the closest thing but this is very largely trade driven. Investment facilities are quite common in many of the aid donor countries. In the absence of such an entity, consideration needs to be given to the instruments and mechanisms that AusAID wishes to use in facilitating access to finance. The IFC is pursuing an approach in the Pacific of working through the banks by taking on some of the risk they would assume in providing services for underserved markets and they are encouraging AusAid to participate in this programme by sharing in the risk. Another mechanism could be to develop an ECF phase 2 which focused specifically on addressing gaps in the SME's access to financial services. A third option would be to explore the establishment in some form of a modest financing instrument. Alternatively, AusAID could stick with capacity and advisory services and leave investment to the multilaterals and others.

3. AusAID has experience in **private sector involvement in the development and provision of basic services [infrastructure, health and education]**. One view is that the agency has experience in this in the infrastructure programme, but far less experience in health and education which are AusAID's largest sectors. This might be through PPP type arrangements or through full privatization. AusAID works to improve the capacity of governments to attract and regulate private sector investment in the development and cooperation of basic services. Most of the PPP's in the infrastructure and service delivery areas which are supported by AusAID are done through the MDB's. PPP's have become increasingly prominent in the portfolio of ADB in the large emerging economies in Asia. In this context the role of PPP's (where often the line between public and private is itself becoming murky) in the evolving composition of development cooperation raises strategic considerations that bear some consideration.

The Evers report reviews AusAID's experience with PPP's. His report concludes that there are two roles which AusAID is more likely to play than others. The first is support to improving the enabling environment for PPP's. The second is financing what the report calls pro poor extensions of infrastructure or service delivery PPP's in health and education, through appropriate forms of subsidy, including in particular output based assistance. The report argues that it makes sense for AusAID to continue to work through the multilateral banks with regard to the preparation and funding of large infrastructure PPP's. The report provides a useful analysis of the substance of the advisory services required to support the enabling environment for PPP's, describing the legal and administrative requirements and the desirable screening processes.

The Evers report concludes with a number of recommendations relating to both supports for infrastructure and service delivery PPP's. These include (in brief):

- AusAID's main method of providing financing for infrastructure PPP's requiring large investments should continue to be through the MDB's.
- AusAID should continue to provide advisory service both through the MDB's and bilaterally in countries where AusAID has a big presence.
- AusAID should continue to explore possibilities for output based aid as a way to incentivize private sector involvement in delivering basic services to low-income communities.
- AusAID should continue to support preparatory and transaction services for PPP's through multi donor trust funds.

With regard to service delivery PPP's:

- AUSASID should continue its support to the Global Partnership for Output based Aid.
- AusAID should look for new opportunities to introduce service delivery PPP's or to increase the performance and output basing of its assistance through public agencies or challenge funds.

Overall the Evers report strongly advocates AusAID's continued work in infrastructure and service delivery through the MDB's which have the critical mass and expertise to do this work. The report leaves open the possibility and indeed desirability of AusAID engaging bilaterally in some of the advisory work

on the enabling environment and extension of service delivery aspects of PPP's but it remains difficult to reach an informed assessment of AusAID's current commitments in this area. In this regard, a rapid bottoms up survey based on direct input from the field of current experience on these two aspects specifically could be very useful.

The Eyers report also recommends that AusAID should be able to respond positively to serious partnership proposals from companies and that there could be advantages in AusAID taking initiatives to form special purpose alliances with Australian business. InfraCo Asia could be one way to do this.

The second category relates to programme areas where AusAID already has experience and in which Australia has the potential to make a distinctive contribution.

4. The approach of focusing **on market development to improve livelihoods** takes AusAID the next logical step from its support to the Enterprise Challenge Fund and strengthening the business enabling environment. The case for this approach is well established. The poor are highly dependent on effectively functioning markets both as consumers and producers. The approach is tried and tested in many countries and has been adopted by quite a number of donors. AusAID to date has considerable experience of working on rural development market approaches in some half dozen countries in Asia and the Pacific and there is considerable interest as AusAID expands in Africa.

5. The **extractive industries** sector has in most countries in which it is significant the potential for a major transformational impact. Its impact dwarfs that of many other interventions. For that reason it requires enormous care to ensure the appropriate public financial management and regulatory and legal frameworks. From a developmental perspective, interventions in this sector have major consequences for the achievement of virtually every MDG.

Australia is positioned to play an especially important role in this sector. In short, Australia:

- Is a world leader in the extractive industry.
- Has considerable whole of government experience in developing extractives- related regulatory frameworks, benchmarks and standards.
- Has considerable experience working in resource rich developing countries.
- Is already delivering programmes designed to improve the governance capacity in these countries in Asia and the Pacific.
- Has experienced industry associations such as the Minerals Council of Australia.
- Has experienced indigenous organizations.

Two additional points can be added. The first is that many countries, especially in Africa, and the PNG gas project, are requesting Australian assistance in this sector. The second is that the sector is undergoing major adjustments as emerging economies are playing an increasingly decisive role, a point presumably of some strategic significance.

The further point can be made that companies in the extractives sector in many fragile and conflict states are in practice performing quasi governmental roles with huge development consequences. In recognition of what is at stake in these situations AusAID may consider entering into PPP's to facilitate a

two way transfer of experience and expertise in relation to the protection of human rights and the broader implementation of CSR activities in accordance with best practice. Recognizing that government capacity in these situations can be minimal, AusAID may consider temporarily assisting and funding extractive companies on a not for profit basis to deliver basic services.

In discussing some of these issues with colleagues from AusAID and the private sector, different views clearly prevailed. One view expressed by some was that the extractive industries sector presents enormous risks. AusAID should contribute on enabling environment type issues such as supporting the host government in negotiating contracts, public financial management and set environmental and social safeguards but should not form any financial partnerships with companies. The logic was that such a partnership would associate AusAID with company decisions which carried huge reputational risk with very little control. Another view was that engaging in these kinds of PPP's would not make sense for AusAID specifically in Africa given AusAID's profile and limited resources there and the need therefore for strategic focus.

A different view was there was a strong demand for Australia to be better positioned on this issue. AusAID's role was to ensure that the extractive industries sector plays a positive and constructive role in the development of the country. This sector has a proven capacity to generate corruption outcomes inimical to human and sustainable development. AusAID must use its position in the sector as an opportunity to facilitate better governance and better development outcomes. Companies have a real interest in getting better rules in place, ensuring security and providing effective delivery of basic services.

There is no question that AusAID's policy on this issue needs to be pursued with great caution within a very clear policy framework. Taking policy forward would benefit greatly from an inclusive and highly transparent multi-stakeholder forum that could debate and dialogue over the issues. The policy will have to be able to adapt to different circumstances and needs to take account realistically of what AusAID can contribute given its resources in different regions. Over the long term, this report does not believe that disassociating AusAID from the actions of Australian companies represents a credible Australian policy option to manage reputational risk.

With regard to AusAID's commitment to broad issues of transparency and accountability, its continued support to the Extractive Industry Transparency Initiative (EITI) remains important.

6. Both AusAID and private sector colleagues stressed the importance of initiatives to build up human skills and the skill base of the local private sector. One approach is through **leadership programmes** and intensifying business leader networks between Australian and partner country business leaders. AusAID also has extensive experience with scholarship programmes and Australian universities represent an enormous resource and asset for the entire region. AusAID's support to the Australia Pacific Technical College (APTC) as well as for in country technical and vocational education and training (TVET) and tertiary education are good examples. The possibility of expanding courses and scholarships specifically tailored to business could be further explored.

Another area with enormous potential is **business volunteers** following a review of the AusAID Volunteer programme in 2009, a new and integrated Australian Government volunteer programme has been designed in partnership with three core partners. One of them, Austraining International, represents Australian business Volunteers (ABV). ABV also offers ongoing services to private sector organizations to manage corporate volunteering initiatives specific to their organization. It would appear that the trend in the last two years has been towards a more integrated approach to volunteers. There are no doubt excellent corporate reasons for this policy. The question poses itself whether a high profile business volunteer scheme could not make a significant contribution with a broader Australian audience to the objective of AusAID reaching out and strengthening links with the private sector.

The third category relates to the development of initiatives and instruments which show promise but require further analysis and still need considerable work. These include:

**7. Women in Business:** AusAID's gender work is focused on promoting gender equality and empowerment, equal access to gender responsive education and health services, women in leadership, and the safety and security of women and girls in conflict affected situations. There has been a strong push on violence against women which is clearly linked with economic empowerment. In different aspects of this work the dimension of women's leadership in business has come up but it is not a central focus of the agenda. For example recent initiatives on women's leadership are heavily focused on the political dimension. One area of particular interest that is being explored is the intersection of the extractive industries sector and gender issues. A broad challenge identified is the need to move from programmes that essentially promote discussions and networks to translating this into a more action / output oriented framework.

**8. Enterprise Challenge Funds:** The ECF was launched in 2007. It was conceived as a broad based fund but did develop some focus in areas of access to finance, agribusiness and aspects of supply chain management. An interim evaluation has been done. While stating that it remains too early to make judgements on outcomes, it was generally positive on the way projects were progressing.

The general view emerging is that that challenge funds have emerged as a new and useful instrument which can be used to support working with the private sector in a more direct approach. They are not a panacea but they are a useful instrument which if deployed strategically can add value. A number of specific arguments have been made as to the intrinsic value of this approach (see Chilver, Van Diermen, and Jones) These include the use of incentives to take on risks that companies would otherwise not have been prepared to do, the ability to catalyse and promote new business models resulting in greater inclusion of the poor, and the challenge fund process which requires close engagement with private sector actors.

Evaluation and analysis also points to some important lessons. The most critical point is that the absence of a strategic policy framework is a "failure that resonates throughout all aspects of ECF operations". The problem here is that as a centralized multi-country competitive grants programme, with no particular thematic or sectoral focus, the ECF struggled to offer real strategic value to AusAID

programme. In short without a clear strategic framework, it is difficult to embed these types of initiatives into the fabric of the country programme.

Other issues relate to the lack of any focus making specialization impossible. There were real accountability issues in the governance and management arrangements that were put in place. There was a problem in the rigid procedures that were put into place by the management of the fund, resulting in a lack of flexibility that was quite contrary to the original spirit of the design. There was inadequate time for due diligence to be performed. One view expressed was that the fund should have operated more as a venture capital facility and should have been open to commercial financing. The view was also expressed that a dedicated team of specialists would be a more effective way of implementing the programme than depending on country offices.

A logical conclusion to be drawn from this evidence is that a well-designed, focused and embedded challenge fund could be an effective instrument if it is designed as part of a coherent PSD strategy. As an ad hoc instrument it can generate useful projects but it is not likely to generate systemic change. If AusAID does decide to commit to a coherent PSD strategy, this would be the time to move on to the formulation of a phase 2 challenge fund that could serve in a focused way the objectives set out. A new fund should be thematically and geographically focused and it should be embedded in the country programming process

**9. Pro Poor business models:** AusAID's outreach to business on the promotion of pro poor business models is done primarily through two instruments – the Business for Millennium Development initiative and the Business Call to Action. B4MD has been supported by AusAID since 2008. Its mission is to “provide a leadership forum that will drive economic development in the emerging markets of the Asia and Pacific in a way that contributes to poverty alleviation.” They started essentially as an advocacy group and have more recently become involved in a few projects on the ground believing that practical demonstration was critical to the mission's success.

The origins and mission of BCTA are explained above. AusAID supports BCTA. It is noteworthy however that BCTA has had very little success in mobilizing Australian companies to join this initiative.

The perception of private sector colleagues is that discussion of pro poor business models has received very little attention in business circles. It was commented that the broader subject of CSR in general receives much less attention in Australian company board meetings than would be the case for example in US or European board meetings. Nonetheless there are a few leading companies that are committed to this agenda and see it as important to their businesses. Moreover, over the next 10-20 years the huge expansion of Australian companies throughout Asia and into Africa will give increased prominence to these issues. While some seed funding to support this work is important real emphasis was put on the importance of leadership and advocacy in this area. Business leaders will respond positively if they receive a strong message that the Government is strongly committed to this agenda. Without this message, this agenda will simply not make it to board meetings.

With regard to broader CSR activities companies have expressed considerable interest in developing partnerships that support the development environment around company investments. The case of the

delivery of basic services for communities impacted by extractive industry investments has been referred to above. Also as already mentioned, the Evers report urges AusAID to consider PPP's to complement investments with development activities. While caution and judgement need to be exercised there are good opportunities to achieve good development outcomes by getting effective leverage by bringing together private and public interventions.

One interesting opening in the area of pro poor business models is the rising interest of universities and business schools in exploring pro poor business models, the work on inclusive markets and all of the thinking around Prahalad's bottom of the pyramid analysis. UNSW and the Melbourne business School were cited. The space for bringing together university researchers, AusAID practitioners and Business could be explored further.

## ii. Australian Experience: Conclusions

A review of AusAID's experience to date in working with the private sector points to a number of conclusions:

- There seems to be broad recognition that with globalization the role of the private sector continues to evolve with major implications for the respective roles of aid and private sector interventions. There is broad agreement that the private sector is the engine of growth and that markets are central to the lives of the poor. In short there is recognition that the private sector must be part of meeting the challenge of pro poor growth.
- It is also clear that the way AusAID partners with the private sector needs to be seen within the broad context of a whole of government approach. This report believes that the need for AusAID to position itself clearly on this issue is not optional. In a rapidly changing world, the relevance and effectiveness of aid programmes will depend on their ability to strengthen their linkages with a broad range of actors, including the private sector and to leverage the much greater weight, influence and resources that these actors can bring to bear. Leveraging assets one does not control carries risks but these are quite manageable compared to the risk of being marginalized through comparative isolation.
- Within this complexity it is critical that good development outcomes represent the cardinal objective in AusAID's work. Complexity must not be allowed to detract from this principle. The integrity of the programming process, country driven programming processes and respect for the specificity of country and local situations must remain paramount.
- Working with markets and private sector actors requires a level of flexibility and a degree of opportunism that challenges many traditional aid processes. This makes the need for a coherent policy framework all the more pressing.
- The experience of other bilateral donors clearly suggests that developing PSD requires high level leadership backed by a strong policy commitment reflected in a clear policy statement. PSD challenges a number of often deeply rooted assumptions and legacies. At the same time it carries real risks and these need to be managed through well-conceived and coherent policy instruments. For both these reasons the articulation of a strong policy framework is important



- Programming instruments need to be responsive to the policy framework. There is no reason to be heavy handed or to hardwire new requirements into the programming process. However the programming instruments need to be responsive to the direction policy is taking. A programming process that did not create an expectation for broad multistakeholder consultations, including the private sector, would be problematic if PSD policy is to be credible
- With regard to the substantive focus of AusAID's work on PSD this report has differentiated between three categories. The first category relates to programme areas where AusAID has considerable experience and where it is committed to working largely through multilateral institutions. The second relates to areas where AusAID has experience and has the potential to make a distinctive contribution. The third relates to the development of initiatives and instruments which show promise but still need considerable work. These distinctions are important in order to be able to reach consensus on areas in which AusAID itself will focus. This is reflected in the proposals relating to flagship initiatives.
- It is important to recognize with respect to the first category that strengthening the business enabling environment, strengthening private sector participation in the effective delivery of basic services ( including infrastructure ) and providing access to finance all represent significant contributions by Australia to supporting a vibrant private sector. Australia as discussed has also made a major contribution to aid for trade. This work does not always get sufficient recognition, in part due to the fact that it is largely implemented through multilateral institutions and therefore gets considerably less visibility.
- The need for more outreach and engagement by AusAID with the private sector was a recurrent theme. It is clear that the responsibility for the lack of sufficient engagement to date lies with both sides. Both AusAID and private sector colleagues felt that their colleagues were not reaching out, but when asked what they had done to reach out the answers were not altogether compelling. Where there is consensus is that the linkages have not been made and that this should change.
- An important component in advancing engagement is pure information exchange. Private sector colleagues express an enormous interest in knowing more about what AusAID is doing in country. They express an interest in wanting to be able to make substantive input into programme formulation. A number of proposals were made to set up workshops and consultative fora of different types to make this possible.
- There is a concern that this type of engagement may reflect an interest in business opportunities. While this will occur on occasion, private sector colleagues were quite clear in rejecting the idea that contracts and tied procurement were driving their interest in closer collaboration. They pointed to the realities on the ground and the need for effective partnerships that create win-win situations as reason enough.
- Both the need for a strong and coherent policy framework and the need for capacity to sustain much more proactive engagement point to the need for an institutional home and ownership for PSD . This was another point stressed consistently by many AusAID and private sector colleagues. This challenge is common in all the other donor agencies making a push on PSD that this report has reviewed. Whether the policy and engagement functions should be brought

- A commitment to PSD requires a review of the resources required to provide critical mass to be credible. Engagement is very labour intensive and a commitment to serious engagement cannot credibly be pursued staffed by half a person. Policy work requires a skills mix which might be found in technical skills dispersed through the agency but may also require some selective external recruitment (long or short term).
- A concern expressed has been that a strong commitment by AusAID to PSD will take the agency in many new directions at a time when it is already overstretched; more, not less, focus is needed. A few colleagues both from AusAID and from the private sector argued that given resource restraints, AusAID was much better off focusing its attention on the delivery of key services, especially health and education, and should not expand their area of intervention. AusAID should not get into “fashionable areas “which the private sector was quite capable of handling without public sector support. In the view of this report, this is not an argument for cutting PSD out but it is a strong argument for being very selective in choosing those areas where AusAID believes it has a comparative advantage and can make a distinctive contribution in PSD. This needs first and foremost to reflect the priorities and realities of the countries that AusAID works in.
- The last set of recommendations made by this report relates to what has been called flagship initiatives. These have been selected on the basis of the interviews and the analytical material available. They represent areas where AusAID through its experience and comparative advantages could be expected to make a distinctive contribution. The final selection should be on the basis of rigorous analysis and should be subjected to a stringent demand test to ensure that there really is a strong demand from the countries for these services.
- There is no golden bullet or short cut to strengthening AusAID’s linkages with business or approach to strengthening the private sector. What is required is a balanced set of measures that would be implemented over time. They require management to initiate a change process as has been done in many other donor agencies. It is often said that it is impossible to over communicate in leading change processes. In this regard, a proactive communications strategy to support whatever change process is put in place would be essential. This is especially important given the continued sensitivity of many of the issues.

## 9 Summary of Recommendations

The recommendations constitute a package that derives from the interviews and the material reviewed. Realistically a 2-3 year programme would need to be put into place to implement what would constitute a significant shift in AusAID's approach to the private sector. At all times programming must be driven by the objective of achieving the best possible development outcomes and be responsive to realities on the ground. Not every recommendation will be considered practical or desirable. A critical mass of steps would need to be taken to generate a virtuous circle between strengthening the policy framework, aligning programming instruments, engaging actively with the private sector, providing institutional focus and coherence, strengthening workforce capacity, and demonstrating concrete results through a select number of flagship initiatives.

This package of recommendations comes out of the analysis that is presented in the sections on international donor and Australia's experience. That in turn derives from a rich interview process as well as a significant amount of written material within the limited amount of time available. The concluding chapters of those two sections lead directly into these recommendations. Going forward, the path AusAID chooses is only likely to achieve its objectives if every opportunity is taken to ensure that the process followed is inclusive and that the management of the process is an integral part of the change being sought.

### *Policy Recommendations*

- AusAID should launch an inclusive process to formulate a high level policy statement of its approach to private sector development and its engagement with business. This statement should define the core strategic directions of the agency's approach to private sector development and engagement. It should clearly articulate its position vis a vis the centrality of the private sector to pro poor growth, it should clarify its commitment to engage with local and Australian business as actors, and it should specify those areas in which Australia believes it has a distinctive contribution to make.
- The high level policy statement should make reference to the significant contribution that Australia makes to providing an enabling environment in which the private sector can flourish. This includes support to improving human resources, infrastructure, rural development as well as more targeted interventions in improving the policy and regulatory environment for private sector development. It needs to articulate clearly the reasons why multilateral channels offer in many cases the most effective channel for implementing these types of programmes.

As a step in this process AusAID should associate itself with the Bilateral Donors' Statement in Support of Private Sector Partnerships for Development adopted Sept 2010 at the MDG Summit. ( See annex 2 )

### *Programming Process Recommendations*

Review current country strategy programming instruments regarding provision for situational assessments to inform better aid delivery strategies.

Include in appropriate guidelines process for consultation with private sector together with other non-state actors in country strategy preparation process at the country level and in the design of new programs or the review of existing ones. The form this could take will vary between countries and programme areas.

### *Engaging with Business*

Policy and engagement workshops could be held on a regular basis with major Australian stakeholders to share information on AusAID's overall strategic thinking on the one hand and the Private Sector's development interests on the other. This should aim to determine how to institutionalize this both at headquarters and country level. A special focus should be on innovative approaches to optimizing the value added the private sector can contribute.

The possibility for further engagement and eventual collaboration around corporate social responsibility agendas and commercial strategies to meet the needs of the poor should be explored in specific development contexts (e.g. community development and banking for the poor in post conflict / fragile state situations).

Consideration should be given as to whether a modest financial facility to support engagement with business would be appropriate and useful (this could take the form of a window in a Challenge Fund Mark 2 or a new light touch Partnership Fund).

The possibility of an Engagement initiative which would bring private sector expertise into AusAID and develop innovation and technology partnerships around specific objectives could be explored (AusAID's version of DFID's Touchstone Business Groups).

Consideration should be given as to the desirability of creating a development investment vehicle, drawing on the experience of a range of bilateral and multilateral agencies in loans, guarantees and equity financing. This would have significant consequences for the architecture of Australian aid's linkages with the private sector.

### *Institutional Recommendations*

For an initial phase, a change process with clear benchmarks for success should be seen to be driven by top management, perhaps supported by a dedicated task force as a transition to being fully institutionalized.

Clear focal points and responsibilities need to be identified within AusAID for Private Sector Development (Policy) and Engagement with Business (Partnership). These could continue to be located in separate offices or be combined into a broader Private Sector Office.

Clarity needs to be established with regard to the responsibilities of these functions vis a vis private sector work in policy and geographical units.

Consideration should be given to establishing a knowledge network that captures knowledge relating to PSD and business engagement. The network should be focused on issues and areas of particular interest to AusAID and remain manageable.

A skills mix review should be undertaken to make practical recommendations on what measures could be adopted to make AusAID better able to engage with business. The possibility of taking in secondments from the private sector should be explored.

A review of constraints in existing programming modalities that represent barriers to engagement should be undertaken (drawing on the experience with ECF).

A review of staffing requirements both at headquarters and at country level needs to be done to determine critical mass, especially in relation to committing to flagship initiatives.

### *Flagship Programme Initiatives*

AusAID's work in the core areas of health, education, infrastructure, rural development and governance will continue to frame its PSD activities. These areas are all critical drivers of an inclusive and growing private sector. As the aid program increases in these five areas, it will be necessary for AusAID to better understand how improving governance, human resources or infrastructure will then promote economic activity and create jobs; otherwise the influence of its interventions will not be maximized or self-sustaining.

AusAID should continue to support programs that aim to improve the business enabling environment, PPP's for delivery of social services and infrastructure and access to financial services. Within this overall context, a key challenge is to identify areas where Australia through its experience and comparative advantages could be expected to make a distinctive contribution. These flagship initiatives have been selected on the basis of the interviews and the analytical material available. Designation as a flagship programme signifies a commitment to ensuring that AusAID has – or develops - the critical mass capacity to provide leadership on this issue and will be recognized as a 'player' in the field. The final selection should be on the basis of rigorous analysis and should be subjected to a stringent demand test to ensure that there really is a strong demand from the countries for these services.

**A Business Leadership Development Programme:** Within AusAID work on aspects of business leadership is taking place in the Governance branch, the Gender unit, thematic areas and in some country programmes. Within the private sector different councils and fora serve as leadership groups. Universities are engaged, for example, through the leadership awards. The possibility of bringing a number of these together into a cohesive Business Leaders Programme focusing on development challenges, perhaps focusing in a certain region, should be reviewed. Supporting women business leaders should form one of the cornerstones of this programme.

**An Extractive Industries for Development Forum** should provide an internationally recognized centre of excellence for convening interested parties into analysis and dialogue on ways that international development aid and the extractive industry can work together to ensure that the sector realizes the unmatched potential it has to have a positive transformative impact on development outcomes. The forum should bring together AusAID, other government departments, the companies, NGO's and university and research specialists. The forum should host transparent and rigorous dialogue on a full range of issues including the way forward in developing PPP's in this sector. The Forum should have the ambition to take on an international profile. In this respect it might explore the possibility of exchanging information and experience with emerging economies. The Forum could concentrate its work in Africa but this should not be to the exclusion of other areas, particularly those resource-rich countries in Australia's immediate region. The potential for replicating this model in a selected number of other sectors (e.g. tourism, banking, education, water management, green technologies) should be kept under review.

**Market Development to Improve Livelihoods** should grow into a practice area in which AusAID gains an international reputation for competence and expertise. The initiative should be resourced at headquarters sufficiently to ensure it can provide leadership to a global programme potentially covering all the regions AusAID serves. This would build on the considerable experience AusAID already has in this field.

AusAID should develop a **new Enterprise Challenge Fund (Mark II)** which will serve as a strategic instrument in the realization of the PSD programme that AusAID decides to put into place. Experience suggests that challenge funds can provide a useful instrument to provide incentives to take on risks that companies would otherwise not be willing to do, to catalyse new more inclusive business models, and to engage directly with the private sector. The new challenge fund instrument should be both geographically and sectorally focused.

AusAID should build on initiatives such as the Business Call to Action (BCTA), and the work of organizations such as Business for Millennium Development (B4MD) that aim to engage with business on strong outreach and advocacy around **Growing Inclusive Markets**. The core of this initiative is to provide the empirical data and share practical experience of pro poor business models that have been adopted by companies as part of profitable business strategies. The benchmark for success would be getting the importance of these types of activities recognized in company boardrooms.

The possibility of building on the work undertaken on **business volunteering** should be explored. The development of opportunities to promote volunteerism by Australian business to share their expertise with developing countries is potentially a very powerful instrument. Currently while business volunteers are a part of AusAID's support to volunteers, it does not have a high profile.

## Annex 1: Report from the OECD/DAC on PS: Recommendations to the Donors

### OECD Report on Private Sector Development

#### Summary of Key Recommendations for Donors

- General Approaches to bring about more sustainable and pro-poor outcomes in PSD:
- Encourage entrepreneurship and investment by lowering the risk and costs of doing business
- Work to identify and unlock the potential for economic development in sectors and regions where the poor are concentrated
- Remove barriers to formalization
- Advocate the use of market based approaches as a way to address obstacles to market development and avoid the risks related to providing direct support to firms. Focus on value chains and clusters
- Promote competitive markets for poor consumers
- Strengthen the functioning of natural resource markets by improving legal, regulatory and administrative frameworks
- Promote deeper and more competitive financial markets
- Advocate the use of gender analysis tools in development programmes
- Encourage private provision of basic service and infrastructure to the poor through public-private partnerships

#### Approaches to pursue in dialogue and work with developing country governments:

- Mainstream strategies for PSD for pro-poor growth into national development frameworks
- Link and to the extent possible merge PSD programmes and governance programmes under a comprehensive strategy
- Facilitate structured, inclusive and effective public-private dialogue processes as a key element in successful institutional reform. Organize it at national, sub national and local levels
- Build capacities within stakeholder groups to organize themselves, to analyze key constraints and to participate in policy dialogue

#### Approaches for donors to pursue:

- Integrate PSD as a central theme of donors ' country strategies
- Employ a programmatic approach
- Consider the merits of long term interventions
- Improve and formalize donor coordination, alignment and harmonization mechanisms
- Consider organizational changes

## Annex 2: Donor Statements at the 2010 MDG Summit

### Bilateral Donors' Statement in Support of Private Sector Partnerships for Development

As members of the international bilateral donor community, we recognize the tremendous impact that private sector actors can have on development and we commit to working together to meet the Millennium Development Goals (MDGs). These objectives have been previously outlined in the Millennium Development Goal– *Develop a Global Partnership for Development*. In the ten years since the MDGs were established, the international community has made great progress in developing partnerships with business and we come together today to renew and give greater meaning to our commitment.

1. We recognize that the private sector is the engine of economic growth and development – creating jobs, goods and services and generating public revenues essential to achieve the Millennium Development Goals. Through our individual institutions we are engaging actively with both local and international businesses on development projects and we have many successes to demonstrate the value of those relationships.
2. We also recognize the important role that multilateral institutions and business organizations, including the UN Global Compact, continue to play in advancing sustainable business models and markets to build an inclusive global economy.
3. Rather than viewing the private sector merely as resource providers, we choose to recognize the private sector as equal partners around key development issues and will enter into partnerships with local and international companies of various sizes. We aim to collaborate with companies that focus not only on profit margin, but also on social and environmental impact, and whose work harmonizes with our developmental goals.
4. We recognize there are many different ways to engage with the private sector:
  - We work with the private sector to implement inclusive business models – sustainable, market based solutions that are commercially viable and can deliver measurable, impactful and scalable development results for those at the base of the pyramid.
  - We work with the private sector to promote responsible business practices in areas such as human rights, labor, environment and anti-corruption.
  - We work with the private sector to address operational and humanitarian challenges through corporate social responsibility programs which serve both development interests and long term business interests, improving not only the quality of life in developing countries, but also the competitive environment for companies, their license to operate and their reputational Capital.
  - We actively engage the private sector in public-private policy dialogue and advocacy around issues of global and national importance, including achieving the MDGs, addressing climate change, improving the investment climate and enhancing aid effectiveness.
5. While there are various ways of engaging with the private sector, we recognize certain common elements exist throughout all our partnerships. In particular, we believe true partnerships must leverage the skills, expertise and resources of all parties, and that all parties must share in the risks and rewards of the partnership.



6. We recognize the important role donors can play to help businesses overcome the challenges they face in contributing to the MDGs, including the culture shift required in balancing development objectives against maximizing return on investment, moving to inclusive business models, managing risk and measuring impact.

7. To foster a more robust private sector role in development, we as donors commit to:

- Share the risk of investment to spur and leverage the creative investments of private capital through the use of catalytic and innovative financing, including matching grants, loans, equity and guarantees, and develop new partnership mechanisms which improve our collaboration.
- Work with developing country governments to establish a **supportive enabling environment** through policy and regulatory frameworks that create incentives for stronger private sector participation in development.
- **Facilitate stronger relationships** between private sector actors and other national stakeholders, including governments, civil society and local small and medium enterprises to support country ownership.
- **Promote partnerships** that improve the lives of both men and women in order to secure equal opportunities.
- **Build the capacity** of local private sector partners to develop socially responsible business initiatives by providing targeted technical assistance.
- **Increase awareness** through facilitating dialogue, developing tools, and supporting learning which showcases the powerful and positive role that well-functioning inclusive markets can play in achieving the MDGs.

8. We recognize the important role that science and technology play in spurring creative and effective development solutions. The private sector is a key driver of innovation, and we will work to integrate these innovations into our programs.

9. We recognize that partnerships with the private sector have the greatest impact when they are strategic programs- become scalable and sustainable when they are integrated into broader strategic initiatives.

10. We are committed to working with the least developed countries and countries struggling in conflict and fragility, as well as with middle income countries with thriving private sectors.

11. We are committed to the Principles of Aid Effectiveness as detailed in the Paris Declaration and Accra Agenda for Action and will explore how these principles intersect with the work of these partnership communities.

12. We encourage the private sector to commit to an ever increasing role in and responsibility for international development and invite businesses to further shape our understanding of the roles they can play as development partners, so that jointly we can promote a lasting global partnership for development.

### Annex 3: Selected References

An enormous amount of material was reviewed and used from the websites of donor agencies. There is no attempt here to reference the websites and the material they contain. This bibliography is selective and contains articles, reports, informal papers and drafts and policy statements that have been particularly useful.

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- Unleashing Entrepreneurship : Making Business Work for the Poor Report to the Secretary General UNDP 2004
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- Financial Services for the Poor : Strategy for the Australian aid Programme 2010-2015
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- Draft Paper on sustainable development in the extractives sector AusAID 2010
- Multi-country market development facility: Programme Design Document AusAID 2009
- Final Report on the Australian Government Volunteer Programme 2009
- Australia's strategic approach to aid in Africa 2011- 2015 AusAID 2010
- Private Sector Development through Australia's aid programme AusAID 2000
- Australian Aid: Promoting Growth and Stability 2006
- AusAID Budget 2010-11
- Selected Country / regional Programme Documents AusAID
- Policy: Country Strategy development 2010
- Guideline; Completing a Quality at Entry report 2009
- Guideline : Country Situation Report 2010

#### Annex 4 Consultations

Consultations took place with AusAID staff and representatives from the Australian private sector and civil society. Donor governments and agencies consulted included the United States, the UK, Canada, Netherlands, Sweden, Norway, New Zealand, DCED, OECD/DAC, ADB, World Bank, IFC, UNDP and BCTA.