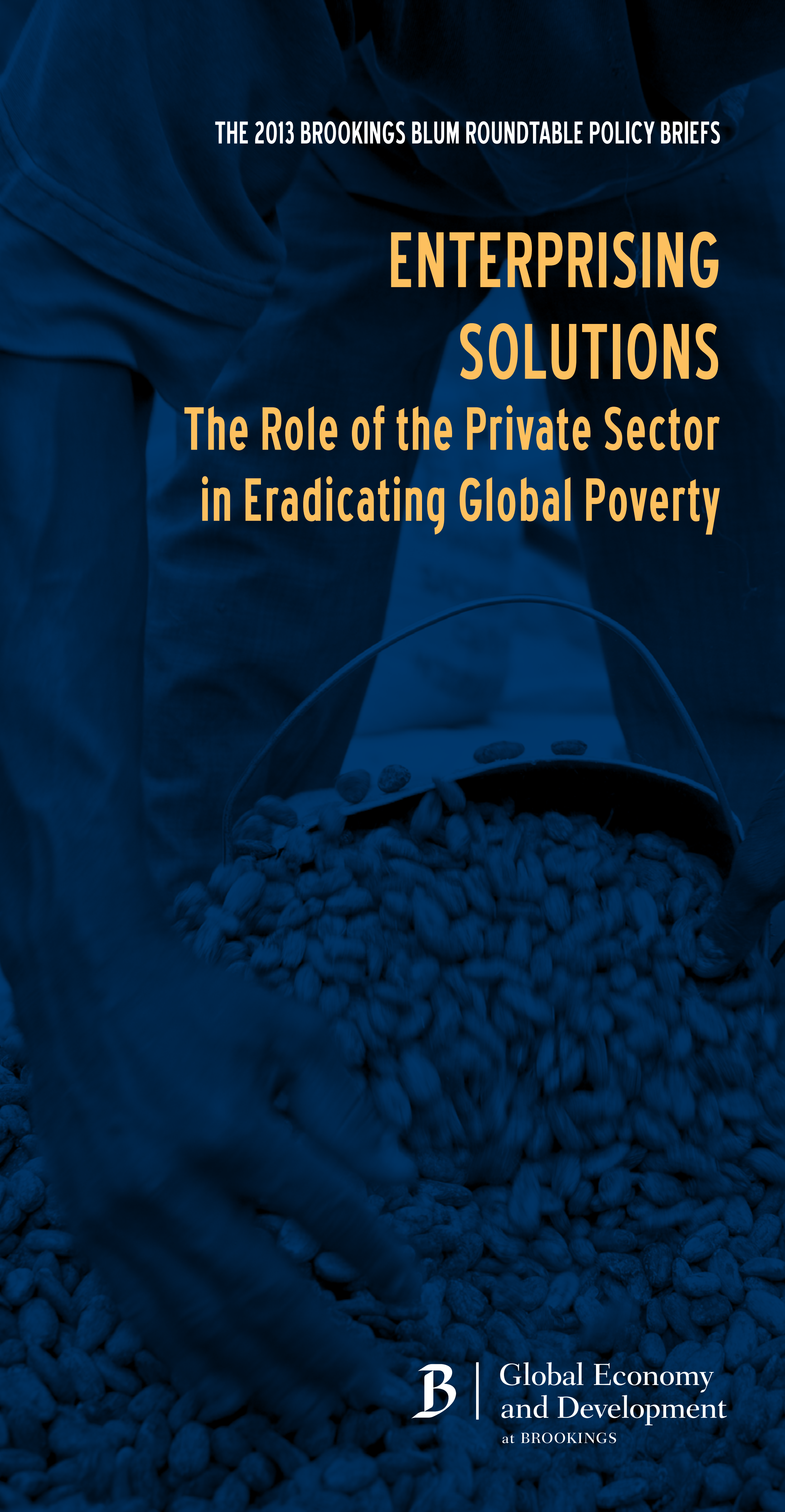

THE 2013 BROOKINGS BLUM ROUNDTABLE POLICY BRIEFS

# ENTERPRISING SOLUTIONS

## The Role of the Private Sector in Eradicating Global Poverty

Global Economy and Development
at BROOKINGS

# Contents

# Introduction

What role, if any, should businesses and the private sector play in the fight to end global poverty?

With more than a billion people living in extreme poverty worldwide, ending poverty will require robust and broad-based economic growth across the developing world, sufficient to generate decent jobs for a global labor force that is expected to expand by half a billion people by 2030. Affordable solutions must be found to meet people's demand for food, quality education, housing, healthcare and other basic needs. Major new investments will be required to plug the financial gaps associated with global development challenges, such as the estimated $1 trillion to $2.5 trillion annual shortfall in financing for climate change mitigation. On all these fronts, the private sector, from small- and medium-sized enterprises to major global corporations, must play a critical and expanded role.

The following briefs examine how the contribution of the private sector can be enhanced in the push to end poverty over the next generation, as well as how government can work more effectively with the private sector to leverage its investments. These policy briefs were commissioned for the 10th annual Brookings Blum Roundtable on Global Poverty, held in Aspen, Colorado from August 4-6, 2013. The roundtable brought together high-level government officials, academics, development practitioners, and leaders from business, foundations, civil society, and international organizations to discuss "The Private Sector in the New Global Development Agenda" and find new ways to alleviate poverty through cross-sector collaboration.

**Reimagining the Role of the Private Sector in Development:** Against the backdrop of the evolving post-2015 agenda to succeed the Millennium Development Goals, Homi Kharas discusses how the private sector can contribute to poverty reduction and sustainable development, and how governments can work with it more effectively to mobilize long-term private finance; generate innovative technologies and business models; and build mechanisms to hold the private sector accountable for development results.

**A New Economic Path for Sub-Saharan African Countries through Private Impact Equity:** Jean-Michel Severino and Pierrick Baraton examine the growth of private equity in the developing world, with a particular focus on its growth in sub-Saharan Africa. They assess the emerging world of impact investment and identify factors that inhibit investor interest in frontier markets.

**Goods, Services and Jobs for the Poor:** Ashish Karamchandani and Harvey Koh explore the scope for market-based solutions that provide goods, services and jobs for the poor, explain why these solutions are having difficulty reaching scale. They argue that aid donors and philanthropy play a key role in supporting these ventures.

**The Case for Capital Alignment to Drive Development Outcomes:** John E. Morton and Astri Kimball argue that the tools, resources and energies of philanthropic and private capital can be aligned in pursuit of targeted development challenges in such a way that crowds in private investment capital—both from impact investors and more commercial investors. They make the case that development finance institutions, such as OPIC, are uniquely positioned to be the connector that helps align these groups.

**Women, Entrepreneurship and the Opportunity to Promote Development and Business:** Carmen Niethammer provides an overview of the global landscape of women's entrepreneurship, the challenges that women face in accessing finance, and the challenges in capacity-building programs targeted at women entrepreneurs. Niethammer draws on practical experiences from the public and private sectors in both emerging and developed markets to identify potential solutions and enablers.

**The Role of the U.S. Government in Promoting Private Sector Development Solutions:** John Podesta and John Norris assert that it is time to alter the way one thinks about the relationship between public and private financial flows targeted for international development from the United States. Instead of determining where the private sector adds value in development projects, the authors argue that the public sector should focus on where it can benefit and provide leverage for the now much larger flow of private capital to the developing world and emerging economies.

*Prepared by Christina Golubski, Global Economy and Development, Brookings Institution.*

# Reimagining the Role of the Private Sector in Development

**Homi Kharas,** Brookings Institution

## EXECUTIVE SUMMARY

The private sector is willing to contribute more to sustainable development, but companies lack models of what to do and how to engage in partnerships with the public sector. The private sector is needed to develop and take to scale new patterns of sustainable production. But for it to do so, it needs to form new partnerships with aid agencies and other public financial institutions. These partnerships should focus on:

- Mobilizing long-term private finance for sustainable development;
- Generating more innovation in technologies and business models;
- Building mechanisms to hold the private sector accountable for development results.

Every high-level development report and project now has private sector involvement. The time is ripe to systematize this approach and experiment with new forms of public-private partnerships.

## WHAT'S THE ISSUE?

In today's world, only a minority of people (about 2 billion of the global population of 7.1 billion in 2013) enjoy a lifestyle that reflects a middle-class or higher standard of living, where the basic necessities of life are met and where families have some discretionary income to enjoy a vacation and leisure activities, pay for good-quality and differentiated products that meet their taste and aspire to own their homes and educate their children. We need to reimagine a world where, within 15 to 20 years, most people (at least 5 billion) will have such a lifestyle. This progress will be driven by population and income growth in developing and emerging economies, which, if current trends continue, will create a large, majority, global middle class that will demand much higher levels of consumption. Demand for food, water and energy, for example, is forecast to grow by 50, 40 and 30 percent, respectively, by 2030. Meeting these needs with business-as-usual production would be simply unsustainable. Carbon emissions would be too high, aquifers and soil quality would degrade too far and competition for land use would create significant social tensions. The world of 2030 will be a world of resource scarcity.

The private sector appears ready to take on a far more significant role in sustainable development than ever before. The High-Level Panel advising U.N. Secretary-General Ban Ki-Moon on the post-2015 development agenda consulted the chief executive officers of 250 companies that command annual revenues of $8 trillion and are located in 30 countries.[1] Their conclusion was a consensus that sustainability needs to be built into their corporate strategies in order to take advantage of the commercial opportunities for growth and the compelling business case that underpins sustainable development, a new form of development that is being championed by the United Nations and development agencies around the world.

The companies that were consulted spoke of the importance of public-private partnerships as a delivery mechanism, with precise targets, regular milestones and clear accountability. They framed the business case around four pillars:

- *Innovation and growth:* Addressing the needs of poor and near-poor consumers in developing countries—and, more broadly, mitigating climate change—opens up huge new opportunities for innovation, market development and growth.
- *Resource scarcity:* Most of the inputs that business needs—land, water, energy and minerals—are becoming increasingly scarce and ever more expensive. To remain cost competitive, forward-looking companies understand that in the coming decade they will need to do more with less.
- *Cost saving:* Managing operations sustainably by minimizing energy, water and packaging and eliminating waste saves companies significant sums of money.
- *Employee engagement, motivation and retention:* The best university graduates are becoming more selective. They want to work for companies that are not only financially successful but also possess socially conscious values and thus want to "do the right thing" and contribute to a better world.

However, these companies also said they have trouble implementing sustainable development without complementary action by the public sector. At the most basic level, the public sector needs to make sure that the private sector has the right incentives to embrace sustainable development, and where it does not already have these incentives, to use tax, subsidy and regulatory instruments to align private incentives with sustainable development. The most egregious example of how private and social incentives can be mismatched is in fossil fuels, where governments across the world provide an estimated $1.9 trillion per year in producer and consumer subsidies, contributing to climate change. Other examples are easy to find—poor management and subsidized boat construction have led to massive overfishing in international and coastal waters. Lack of payment for implicit ecoservices, like the flood mitigation provided by mangrove forests, has generated large unintended costs from development projects.

These are all examples of inefficient development. They can be solved by sharing information and creating public policy that mimics what an efficient market solution would be if there were proper markets for all environmental and social goods and bads. The politics may be difficult—for example, full costing of water and greenhouse gas emissions could raise the price of wheat fourfold—and ensuring fair social and distributional consequences from exploiting natural resource assets is challenging, but there are many good examples from which to draw lessons.

"Getting prices right" is a necessary but not sufficient condition for achieving sustainable development. Two other things also need to happen to realize the potential of a vastly more prosperous world in 2030, given the limitations of natural resources—what have been termed "planetary boundaries." First, there needs to be significant innovation in moving to more sustainable patterns of production. And second, these innovations need to spread at scale throughout the world. Together, innovation and scaling up are key characteristics of sustainable development. For both, the private sector is indispensable, but it is not yet contributing to its full potential. The issue is how to encourage the formation of public-private partnerships that can do better on both counts.

## WHAT NEEDS TO HAPPEN, AND WHY?

*Mobilizing Private Finance*

Massive investments are needed to implement sustainable development; most estimates of the incremental investment spending that is needed in developing countries are at least $1 trillion a year more than what is currently spent.[2] Aid remains an important source of finance for some low-income countries, but it is clear that the bulk of this funding will need to come from the private sector. Talk about using aid to catalyze private finance has been common but, thus far, the experiences of public-private partnerships suggest that existing mechanisms will not suffice.

In the aggregate, there is no shortage of money; global savings total more than $18 trillion a year. Nor is there a shortage of high-return projects in sustainable development. Most studies show rates of return of high double-digit levels in energy, power and transportation, but new mechanisms to identify and fund such projects are needed.

One promising initiative is the Power Africa program announced during President Barack Obama's recent trip to Africa. This initiative seeks to double access to power in sub-Saharan Africa, providing 10,000 megawatts and contributing to the $300 billion in investment needed to achieve universal access to modern energy sources, according to the International Energy Agency.

A list of 30 priority projects has been identified as the core program for Power Africa. Technicians to provide host governments with technical assistance are being provided by the U.S. Agency for International Development (USAID). The Millennium Challenge Corporation will embed the projects in its country compacts. The U.S. Overseas Private Investment Corporation will commit up to $1.5 billion in financing and insurance. The U.S. Export-Import Bank will provide up to $5 billion in export credits for U.S. firms. Private companies, including General Electric, have indicated a willingness to provide money and technology.

Though it is a promising beginning, Power Africa indicates the scale of the challenges involved. One initial obstacle is developing a full pipeline of the best projects. There are few large-scale facilities available to do feasibility studies. The World Bank and the African Development Bank have some capability, but it falls far short of what is required. This bottleneck has been identified several times in the past, including in the submission by the Multilateral Development Bank Working Group on Infrastructure to the Group of Twenty, but no action has been taken to improve the situation.

A second concern is the difficulty of coordinating multiple agencies in a partnership. If project success depends on the use of a broad array of tools—including technical assistance, guarantees, financing, export credits and the like—and each agency has its own procedures and timetables, projects that are already complex become hard to bring to a financial completion. The risk of failure goes up substantially and, when added to the already high risks of investing in low-income countries, can make the investment seem unattractive to a private investor. It would be preferable to have multiple instruments combined in a single agency rather than spread out, as is currently the case.

Third, far too little attention is paid to the precise nature of risk mitigation. The main categories of risk include macroeconomic risk (especially exchange rate risk, which can make fees unaffordable if a full pass-through is possible, or raise costs if there is only partial pass-through); political risk (almost all public-private partnerships are recontracted at some point, and regulatory regimes and dispute resolution mechanisms can be a problem in some countries); technology risk (especially when operating in a new environment); business model risk (especially when scaling up is needed to bring down unit costs); construction risk (with major social risks concerning land in particular); and operating risk (on both the revenue and cost sides, including the costs of recruiting and training key personnel).

Even this partial list shows the limitations of existing public agencies in trying to be truly effective in catalyzing private funding. In many instances, they simply do not have the instruments to bring down risks to acceptable levels. More creativity is needed in risk-taking and risk-mitigation (through guarantees), first-loss financing, feed-in tariffs and other types of contingent financing.

Experimentation with new instruments in official aid agencies will not happen automatically. Bureaucratic risk-aversion seems to be too strong. One idea is to force the issue by asking aid agencies to set an explicit target for the volume of private sector financing that is catalyzed by each dollar of aid. Based on existing experience, a leverage ratio of at least 5:1 should be feasible. This would give a clear target to each agency to force it to adapt to a new world where long-term private financing for sustainable development is needed.

*Generating More Innovation*

With the public sector increasingly bogged down in dealing with fiscal problems and political crises, innovation to solve global problems is being driven by private sector solutions. The increased demand for resources created by a larger and more prosperous global middle class is estimated by McKinsey & Company to be between 30 and 80 percent by 2030.[3] A substantial portion of that demand will need to be met through productivity improvements, and the greatest scope for productivity gains is in developing countries. The challenge is to get the right mix of policies to support more sustainable production and consumption patterns. If the right policy mix of prices, access to capital and awareness raising (by both consumers and producers) can be put in place, there is scope for considerable productivity increases through innovation in all three basic systems of land, water and energy.

The prevention of land degradation and the restoration of already degraded soils are among the most cost-efficient ways of increasing the availability of land for agricultural use. No-till agricultural techniques, along with other measures to conserve and improve carbon in organic matter and improve the water holding capacity of soil, have been developed and can be implemented with sufficient capital and operating cost expenditures.

Increasing small-holder farm yields, large farm yields and reducing food waste are other examples where innovation and productivity gains are potentially substantial. Precision farming equipment, irrigation, infrastructure investments and access to power can all generate substantial increases in food supply. Food waste can be reduced by using better storage techniques (including cold storage) and transportation modes. These investments and innovations will become more attractive as food prices rise.

Innovation in reducing water use is another priority. Major savings are available by reducing municipal water leakages and from using better irrigation techniques and pricing policies. For example, thanks to subsidies, India uses 40 times more water per ton of wheat than Russia—and water is 20 times as scarce in India.

Energy is the third major sector where innovation is essential. Building efficiency provides the scope for the largest gains, thanks to the massive new construction that is needed to manage urbanization in developing countries. The world's urban population is growing by about 100 million people per year, and how these people are housed and transported will drive the demand for energy.

Beyond innovation in physical technology, there is considerable promise for innovations in processes that can speed the dissemination of proven technologies. The Innovations for Poverty Action nonprofit, for example, evaluates techniques that can bring down poverty rapidly. Its current list of technologies with a proven impact comprises chlorine dispensers to improve safe water, school-based de-worming, investment vouchers for small-holder farmers and remedial education. Delivering these programs at scale requires innovating with business models and delivery systems.

How can we encourage more innovation? The most significant issue is how to reduce uncertainty. Private investors are reluctant to innovate without some sense of the long-term prices that will prevail. Under current conditions of major subsidies, prices depend significantly on political processes that determine the extent or speed of a reduction of subsidies. A lack of clarity on these processes and the timeframe for implementation hampers innovation.

A second source of uncertainty is the absence of financing structures that can fund the various stages of innovation, from proof of concept to viable business models at scale to implementation.[4] Products that do not yet exist in a domestic market (e.g., solar units or microleasing) can take 8 to 20 years before reaching significant size, while products that replace existing goods and services with better or cheaper versions can scale much more quickly (three to five years).[5] Tailored financing for each development stage, and sustained financing to cover costs until scaled-up operations can generate a self-sustaining operation, is necessary.

Third, innovation will not happen without more coherence in global development policies. Subsidies to the private sector are needed to fund innovations, but such subsidies are illegal under current World Trade Organization rules, creating the risk that new products could be threatened with trade sanctions, as is currently happening with solar panels. This uncertainty about future policy adds to innovation risk.

*Becoming More Accountable*

Although the private sector is an indispensable partner for poverty reduction, it is viewed with deep skepticism in many parts of the world as a reliable development partner. The private sector today needs to overcome the legacy of socially damaging behavior by a few companies in the past, as well as demonstrate that a market economy can contribute effectively to solving social and economic problems.

Firms, especially those in extractive industries, are increasingly aware that their "license to operate" and the value of their brand depend on the trust they can build that they are contributing to solving long-term development problems. The opportunities for growth are better in a country or community that is also growing and prosperous, but firms do not explicitly monitor the contribution they make to this broader type of performance. As a result, the language and information systems that managements use to make decisions can be limited.

Firms need to be aware of layers of accountability. They are, first and foremost, responsible for the impact of their direct operations along financial, social (e.g., how many jobs created) and environmental dimensions. However, they have found that people also hold them accountable for the actions of their suppliers, for the distributors and retailers associated with the firm and for the health of the broader community that they support and influence. Brand management requires an understanding of each of these layers. The recent U.N. High-Level Panel on the post-2015 agenda recommends that large firms (along with governments) start to report systematically on their financial, social and environmental footprint, along the lines recommended by the Global Reporting Initiative, in a concerted effort to transparently demonstrate that the private sector can be a trusted partner in development.

Several industry standards on reporting are being developed in a range of sectors—including extractive industries, palm oil and finance—and these standards should be encouraged. Other standards pertain to land acquisition by foreign investors. In each case, there is a move to go beyond "do no harm" to proactively promote good practices through a dialogue that builds an international consensus around norms.

## WHAT'S NEXT?

For some time, the development discourse has been cast as a debate as to whether the public sector or the private sector is better equipped to contribute to poverty reduction. But now it is time to put this debate aside and to recognize that the answer must be that both should act together. The private sector will not contribute fully if it is simply left to its own devices by government—that line of thinking needs to be debunked. There are too many policy issues that generate risk for private investors that need to be sorted out. Equally, the public sector cannot go it alone. It has neither the resources nor expertise to develop scaled-up solutions to the most pressing social and environmental issues of the day. New public-private partnerships are needed.

Finance, innovation and accountability can all be advanced through public-private partnerships that lay out expectations for firms and governments in a transparent way. These partnerships are based on total clarity about what each party does. This is a strong incentive to start to develop a new language of business impact that recognizes the broader contributions that the private sector makes to development and poverty reduction.

New partnerships would work better with new instruments. One innovation that appears promising is the new Global Development Innovation Ventures platform of USAID, the U.K. Department for International Development and the Omidyar Foundation. This platform provides a variety of new tailored financing solutions.

Another instrument could also be to use leverage targets to encourage aid agencies to engage more proactively with the private sector. Absent that, bureaucratic inertia could turn the "scaling up" agenda into an episodic feel-good exercise with one or two examples but without the needed change in agency culture.

Third, more attention could be paid to risk mitigation instruments. One way to encourage this attention would be for guarantees and other risk instruments to be counted explicitly toward meeting aid commitments. Currently, they are not even measured in international reporting, let alone valued in terms of the impact achieved.

Finally, a new dialogue on the treatment of subsidies and patents on goods and services that are geared toward development solutions is needed. Innovation must be encouraged, but in a way that allows for rapid dissemination at reasonable cost.

## ENDNOTES

1. "A New Global Partnership: Eradicate Poverty and Transform Economies through Sustainable Development," report of the High-Level Panel of Eminent Persons on the post-2015 development agenda to U.N. Secretary-General Ban Ki-Moon, May 30, 2013.
2. Amar Bhattacharya et al. "Infrastructure for Development: Meeting the Challenge," G-24 Secretariat, 2012.
3. Richard Dobbs et al., "Mobilizing for a Resource Revolution", McKinsey & Company, 2012.
4. USAID's "Development Innovation Ventures" is a pioneering model that explicitly recognizes these stages.
5. Mike Kubzansky, "Why Business Models Matter," in *Getting to Scale*, edited by Laurence Chandy et al. (Washington: Brookings, 2013).

# A New Economic Path for Sub-Saharan African Countries through Private Impact Equity

**Jean-Michel Severino and Pierrick Baraton**, Investisseurs & Partenaires

## EXECUTIVE SUMMARY

Private equity investments are on the rise in Africa and, adjusting for economy size, are as important to the continent as for the average emerging market economy. These investments are demonstrating profitability: Private equity deal multiples in Africa, based on performance over the past nine years, are estimated at roughly 8x. Equity investments can play an important role in resolving some of Africa's most pressing development challenges: solving the financing constraints facing African firms; meeting unsatisfied demand for goods and services among the continent's low-income households; and ushering in much-needed structural transformation for Africa's immature economies by improving firm competitiveness. Impact investors can be especially effective. Further growth of private equity depends on achieving economies of scale—transitioning away from small deal size and small size of funds. Governments can assist by providing financing (through development finance institutions) and enabling regulation.

## WHAT'S THE ISSUE?

The past several years have witnessed a boom in the economic growth of sub-Saharan Africa. The region has experienced an average 5 percent yearly increase in its real gross domestic product (GDP) since 2002, making it the world's second-fastest-growing region behind East Asia.

This dynamic is changing perceptions of Africa. As perceptions evolve, so too have international investment trends. The growing interest of investors in Africa is palpable: Foreign direct investment toward sub-Saharan Africa increased fivefold between 2000 and 2011. There has also been a gradual reorientation of local and international investments in the continent beyond traditional natural resource exploitation to infrastructure and indigenous corporations.

In this context, private equity is becoming a significant player. According to the Emerging Market Private Equity Association, private equity flows to sub-Saharan economies increased sharply between 2002 and 2008. The size of investment funds raised expanded 15-fold while capital investments expanded 5.5-fold—to $2.2 billion and $2.9 billion, respectively.

The global financial crisis hurt private equity in emerging markets, and flows are still recovering. Nevertheless, the share of private equity invested in emerging countries in 2012 devoted to sub-Saharan Africa rose to 4.9 percent in 2012, against 2.2 percent in 2010. Private equity in the region as a proportion of GDP stands at 0.09 percent. This percentage is lower than in emerging Asia, but is equal to the average for emerging economies and is only slightly lower than for the BRICs (Brazil, Russia, India and China).

Most investments continue to be below $25 million and targeted toward South Africa, the Democratic Republic of the Congo and Nigeria, which together account for 61 percent of the number of investments. Banking and financial services were the most popular sectors for investments in 2012, followed by agribusiness, industry and manufacturing. Private equity, in particular, gives investors a wider exposure to sectors and to companies at different stages of development that the few African stock markets cannot provide.

A minor but important share of private equity to Africa falls under the rubric of impact investment. The impact investment market is difficult to measure, but, based on a recent survey (2013),[1] JP Morgan and the Global Impact Investing Network identified global impact investments worth $8 billion in 2012, of which over $500 million is devoted to sub-Saharan Africa. These investments are mainly targeted toward microfinance, housing, food and agriculture, and clean energy and technologies. These numbers describe a nascent and limited phenomenon when compared with the GDP, private flows and population of the continent.

Greater flows of private equity to Africa should be encouraged in order to accelerate the continent's development. Private equity can help resolve the significant financing constraints Africa faces at multiple levels. African firms have only limited access to funding, while African economies as a whole face massive financing needs.

African banking systems operate largely on a short-term basis (more than 80 percent of deposits are short-term deposits or deposits with a maturity of less than one year),[2] have high intermediation constraints (loan/deposit ratios are 30 percent lower, on average, than in banks in other developing countries) and have high interest rate spreads and margins (interest margins in African banks are 44 percent higher, on average, than in the rest of the world). Nonbanking segments of Africa's financial system show an even lower degree of maturity than banking. For instance, only 24 of the 53 African countries have stock markets, and only a few of these are liquid (Egypt, Morocco and South Africa). It is, therefore, the inefficient allocation of financing as much as its level that serves as a constraint on African economic development.

This problem is all the more acute given that African economies have major investment needs for infrastructure, natural resources and agriculture. For instance, it is estimated that the continent will require around $390 billion in infrastructure investments over the medium term, mostly for energy. This need is equivalent to about one-third of sub-Saharan Africa's GDP in 2012. In the long run, infrastructure needs can be counted in trillions of dollars. These volumes are far beyond what national governments or development finance institutions can realistically address.

Private equity, and impact investments in particular, can play a more fundamental role in ushering in much-needed structural transformation for Africa's immature economies.

Manufacturing industries remain very small in Africa, representing only 10 percent of its GDP—a share that declined by around 1 percentage point between 2006 and 2011.[3] Indeed, manufactured goods represent only 23.5 percent of sub-Saharan exports, against 83.5 percent in Asia. African economies also have a very low level of diversification.

Africa's difficulty in developing its industry represents a broader failure to move toward more productive, value-added activities and to achieve more inclusive economic growth. Despite rapid economic growth, the creation of economic and social opportunities for the younger generation remains a crucial challenge for African governments. Indeed, the employment-to-population ratio has remained virtually constant over the last 20 years (from 59 percent in 1991 to 60 percent in 2011).[4] Most African countries continue to have a high proportion of jobs in the primary sector. As a result, poverty has not declined as fast as one might have expected given the pace of economic growth.

The deficit in firm competitiveness, largely the consequence of institutional and geographical factors, explains why African economies have not undergone the same structural transformation as, say, Brazil or China. Infrastructure gaps and a difficult business climate have exacerbated direct and indirect costs for African companies. Frequent electricity shortages, high transportation costs, the lack of financing and bribes are key challenges. African companies lose about 13 percent of their working time because of selective power cuts, compared with only 1 percent for Asian companies. Transportation costs are more than double those in East Asia. Labor costs are higher than in other regions at the same level of GDP: Southeast Asia labor costs are 40 percent lower than in Africa. Although business competitiveness has improved over the last couple of years as the level of human capital and governance have progressed, sub-Saharan Africa's companies are the least competitive in the world, according to the Global Competitiveness Index.

Despite its steady economic growth, Africa suffers from an acute deficit in social and environmental development. The public sector still experiences difficulties delivering high-quality services. At the same time, the dearth of private companies explains why high-quality services are so expensive and are restricted to the upper middle classes. These private companies, especially the smaller ones, are generally insensitive to social, environmental and governance goals, or have neither the financial means nor the capacity to address those challenges.

By nurturing companies targeting unsatisfied demand for basic needs or by accelerating innovation, impact investing can precisely help African economies to address development challenges. For instance, local generic medicine producers allow the sale of drugs at lower prices than if they were imported and contribute to improved health outcomes. Impact investment also contributes to sustainable development by fostering environmental, social and governance practices in local firms. Respecting international standards can improve local companies' competitiveness and minimize negative externalities that spring from firms' activities.

Impact investment may also allow Africa to ultimately own its corporations. There is a risk that Africa's current economic model will result in foreign businesses dominating the supply of goods to its domestic market, as well as the continent's exports to the outside world, be they Chinese, European, American or Indian. Avoiding this outcome represents a social, political, cultural and economic challenge. Providing temporary equity and compensating for the current low level of savings on the continent will allow African entrepreneurs and companies to be part of the feast—and not just consumers.

## WHAT NEEDS TO HAPPEN, AND WHY?

*How Africa Has Become More Attractive for Private Equity*

The phenomenon of private equity's expansion in Africa is inseparable from the broader story of the continent's improving economic performance. The factors behind Africa's growth takeoff are numerous and contrary to commonly held assumptions. For instance, while the increasing exports of natural resources to emerging markets has been and remains an important cause—the African Development Bank evaluates this contribution at 35 percent since 2000—African countries with small natural resources endowments have also experienced much faster economic growth.

According to the International Monetary Fund's regional economic outlook,[5] the key to Africa's growth surge is the improvement of its institutional environment and economic policies. Over the last decade, the average inflation rate has halved, and public debt, including external debt, has decreased sharply, thanks largely to the Heavily Indebted Poor Countries initiative. In addition, the share of exports in GDP has grown at a two-digit rate, assisted by an improvement in the terms of trade (+77 percent between 2000 and 2011). Another factor has been the rise of Africa's domestic (nontradable) economy. Private household consumption increased by 61.5 percent between 2000 and 2011.

The improvement in Africa's macroeconomic conditions is particularly significant from an investor's standpoint. For a long time, investors viewed Africa as a land of over-indebtedness, high inflation and volatile exchange rates—a perspective that is now changing, thanks to the strengthening of public administration and government capabilities.

Also significant from an investor's standpoint are microeconomic reforms to the business environment. For instance, the cost for starting a business decreased by 70 percent in sub-Saharan Africa between 2003 and 2011, and the time needed to register a property was divided by two during the same period.[6] While the business environment in Africa remains, on average, more difficult than in other emerging markets, the gap is smaller than imagined; according to the *Doing Business* report, the average ranking of sub-Saharan African countries is 134th, compared with 116th for the BRICs.

According to a recent study by RisCura, African private equity deal multiples are estimated at roughly 8x based on performance over the past nine years.[7] Although the BRICs boast a better performance, with an average multiple of about 10x, this result is mainly skewed upward by China, with its two-digit multiple level (approximately 17x); by contrast, Brazil's and India's multiples average only 7–8x. These numbers should be treated with caution, because much of the information related to private funds is not disclosed; our experience suggests that the true multiples are lower. Nevertheless, with multiples probably close to those for Brazil and India, sub-Saharan assets can be viewed as a good investment opportunity for venture capital companies, especially compared with the IRRs observed on mature markets.

### *Ongoing Challenges for Private Equity*

Even with the most assiduous attention to country and sector performance in determining investment choices, it is impossible to predict economic or political events. Investors have most control in executing business models. Active shareholders can play a significant role in the implementation of a company's business strategy. Potential internal failures can be overcome through active support from investment officers or capacity building.

The scarcity of high-skilled and experienced local staff makes the hiring of quality middle management difficult for investee companies. Local regulations in certain countries can preclude governance arrangements that might otherwise identify and overcome inefficient management. For example, the OHADA legal system, which covers all the francophone countries in West and Central Africa, as well as some others, makes it difficult for minority shareholders to recover decision rights if the CEO performs badly.

Taxation is often a problem for private equity. African tax systems vary considerably, but more and more countries heavily tax profits on equity when investors exit. This is especially a problem in the absence of a taxation treaty between investor and investee countries; double and excessive taxation occurs in these cases and represents an obvious constraint for investors.

Exits in sub-Saharan Africa are more complicated than in other emerging markets, especially given the scarcity of listed markets. With the exception of some initial public offerings (mainly in South Africa), the majority of exits in the last couple of years have been direct sales to strategic investors. Secondary exits remain rare due to the lack of sufficiently mature assets available for other financial investors. Investors have therefore often opted to invest in African companies throughout their entire life cycle.

### *A Focus on Impact Investment*

According to the Global Impact Investing Network, "Impact investments aim to solve social or environmental challenges while generating financial profit." However, given the diversity of social goals pursued by impact investors on the one hand, and the wide variety of options to reach these goals on the other hand, classifying impact investment remains a work in progress.

A key definitional question is how social/environmental objectives and financial objectives are weighed. While impact investment captures a range along the spectrum, a key point of impact investment is that the two concepts of maximizing profit and maximizing impact must somehow be harmonized. A useful distinction can be made here between impact investments and social businesses. "Impact investments" aim at optimizing financial returns with an impact floor, as opposed to "social businesses," which aim at optimizing societal impact within a financial floor.

This statement is nuanced by the different heights at which the impact floor can be set and the implications this has for financial returns. Impact investment "finance-first" vehicles expect close-to-market financial performance, and impact investment "impact-first" vehicles will accept a much lower level of financial performance and are therefore often indistinguishable from social businesses. Even the latter can reach acceptable financial returns in some cases, as shown in table 1.

**Table 1. Investment Categories**

| | Standard Profitable Targets | Low Profit Targets |
|---|---|---|
| Standard profitable vehicles | Market-vehicles | Finance-first vehicles |
| Low profitability vehicles | Impact-first vehicles | Impact-first vehicles/NGOs |

Financial vehicles that address standard profitable targets may also qualify for the impact investment category when, for instance, the cost of reaching out to those targets is excessively high. It is questionable whether a financial vehicle that sets standard profitable targets and gets standard financial returns can still be considered part of the impact industry. Usually the answer is no, but one can imagine cases where the market would fail to address a specific target, and the financial instrument would have a clear and measurable social goal.

In every instance, what matters is that "impact investment" vehicles should have clear and measurable policy goals beyond, or in parallel to, financial targets. It is also important that these performances be assessed against these policy goals, be they environmental, social, cultural or ethical.

In many developing countries, impact investors cite a lack of investment opportunities as an important obstacle for growing business. This is generally not the case in sub-Saharan countries. Projects are numerous, and considerable dynamism exists in the business at the bottom of the pyramid.

Quality issues are more challenging: Many first-time or social entrepreneurs lack managerial skills and strengthening them is an unavoidable task and burden for investors. Technical assistance is often necessary to support this area.

Exits are also an important challenge for impact investors. Some investors are fortunate that entrepreneurs are willing to buy back their shares when an impact fund exits. In many cases, quasi-equity or debt-related structures offer a good alternative if valuation problems are too difficult to be solved.

## RECOMMENDATIONS

*A Challenge of Growth*

There is a growing recognition that existing financial resources are insufficient to address Africa's severe poverty, inequality, environmental destruction and other development issues. At the same time, a growing segment of the financial community recognizes that this situation also presents both business and impact opportunities. The growth of private equity, with a focus on impact investments, seems to have the potential to complement government and philanthropy by unlocking significant resources.

Given the imbalance between the amounts currently raised and invested in impact activities throughout Africa (probably no more than about $300 million annually) on the one hand, and the size of the continent as well as its population (more than a billion people) on the other, the industry, as already highlighted, faces a challenge of growth. Private impact equity and lending economic models are mainly governed by three factors.

The first factor is the *profitability of the targets themselves*. If one targets social businesses, returns may be low by nature. Even theoretically, profitable targets may return little money if they are located in politically unstable areas or mainly address start-ups with high-failure ratios or costly monitoring activities. The second factor is the *size of the deals*. Even if one targets profitable activities, addressing smaller corporations will lead to small returns, given that the fund business is mainly a fixed-cost business. This is the reason why venture capital is so rare, and small and medium-sized enterprise financing has been abandoned by traditional market players.

Finally, the third factor is *the size of funds*. The smaller funds are, the more expensive they are to run, since governance reporting and best financial practices represents a significant fixed cost.

There is little one can do and should do about the first two factors. Both the level of expected profitability and the size of deals are part of the nature of the impact business. But the third factor is a very important reflection of the efficiency of this activity. Not only should we have more impact funds in Africa, addressing more challenges and active in more regions, but they should also be larger to diminish costs and to allow for better management.

*The Need for Regulation and Funding*

Governments can do much to support the needed growth of this sector. The first area is regulation. In many countries, it is difficult to identify the appropriate legal regime under which impact investment activities fall. In some settings, funds may not be permitted at all. Financial corporations may be subject to major regulatory barriers, making it difficult to develop small vehicles with limited financial means and modest teams. In general, financial regulations have tended to support the concentration of corporations and made it difficult for smaller vehicles to function, given that they lack the capacity to deal with onerous regulatory constraints, such as anti-money-laundering rules.

In both developed and developing countries, specific frameworks should be created for impact investment activities. These frameworks would create a climate of confidence for impact investors and ensure that laws are appropriate to the size and the profitability of the sector.

A second area is funding. As we have seen, impact investment is still a very small sector. It has to compete with many "competitors" in accessing funding. Most impact investors do not benefit from tax incentives. The bulk of the competition comes from the regular private sector and takes place especially in competition for funds from development financial institutions. The latter have so far contributed only modestly to funding impact investments, with a few bright exceptions. Many do not consider supporting impact investing part of their mandate, or deem impact investment not profitable enough. They are right: Many public institutions dedicated to supporting the private sector have been mandated over decades to demonstrate that investing in developing countries is definitively profitable and that more private investment should go into that direction.

It would be good and wise to start balancing the legitimate historical mandates of those institutions with a focus on social, environmental, cultural and poverty challenges. It is time to move into less profitable areas that will have a higher impact on those dimensions. This would be a major shift for many development finance institutions, which are traditionally risk averse and focused on high returns. However, this shift is important, given that the traditional supporters of impact investment (family foundations, high-net-worth individuals and private industrial firms) will probably reach their technical limits in the coming years.

Third, impact investment also needs more dialogue, more technical progress and more capacity building. Most firms are young; concepts are new. Proof of results is limited, and evaluation is only starting to be mainstreamed. Technical impact assessment is an area where much progress can be made. Thus, capacity building and research need to be supported by both foundations and governments. Investment firms, with their limited financial and human capacities, cannot be expected to fund or deliver these needs on their own.

## CONCLUSION

Private impact equity is a new and exciting sector. We should address its agenda with enthusiasm and realism: Like any financial instrument, impact investment has its contribution, its limits and its risks. It needs regulation (please make it light and efficient, for once!), support, further thinking and, overall, more experience to understand better to what it can really contribute. Learning while doing is going to be very important—as it has been, for instance, in the area of microfinance.

Let us embark on this new venture boldly, but with the right critical and learning frame of mind that can allow all stakeholders to progress. Hopefully, experience and theory will show us more and more efficient ways to meet the challenges of sustainable development.

## ENDNOTES

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# Goods, Services and Jobs for the Poor

**Ashish Karamchandani and Harvey Koh,** Monitor Deloitte

## EXECUTIVE SUMMARY

Market-based solutions have the potential to provide goods, services and jobs for the poor at scale. Success in microcredit and many exciting new ventures have led to an explosive growth in expectations, but the data on the ground are less rosy. Few models are reaching scale. The reason is that these solutions are tackling some of the world toughest problems in difficult environments, and hence they both require innovative solutions and must address ecosystem barriers. Addressing these twin challenges requires significant resources, time and persistence. There are also high chances of failure, and even with success, returns may be moderate. However, given the upside in terms of social impact at scale, it is important to support such solutions, and philanthropies and aid donors have a vital role to play.

## WHAT'S THE ISSUE?

Historically, efforts at development have focused on two relatively separate paths. The private sector focuses on economically attractive opportunities to provide products and services, and in the process grows the economy, generates tax revenues and creates jobs. The government focuses on providing an enabling environment for the private sector and, along with donors, philanthropies and nonprofits, addressing market failures and providing public goods, especially for the poor. Both paths have had limited success in effectively serving the poor. In the past 10 to 15 years, there has been an increasing recognition of, and interest in, a third path to development—leveraging the effectiveness of the private sector to benefit the poor—using market-based solutions to provide goods, services and jobs to the poor (or, as this segment is often called, the "bottom of the pyramid" (BoP)). Part of the attractiveness of these solutions is that they are commercially viable, and hence can be self-sustaining and scalable without requiring huge and ongoing subsidies.

Some exciting market-based solutions have demonstrated this potential. Microcredit has reached over 100 million low-income households. Mobile money has ten million active subscribers in East Africa. Solar lanterns are now serving 3 to 5 million households in India and Africa.

These successes have led to an explosive growth in expectations—from the investment community to governments. A recent J. P. Morgan report estimated the size of the impact investing market (i.e., investing in commercial ventures that create a social impact) as a "trillion dollar asset class."[1] Governments and philanthropic players have initiated Social Impact Funds to harness the private sector to address problems of poverty (e.g., the India Inclusive Innovation Fund and the Africa Enterprise Challenge Fund).

And while many of the solutions appear promising, few are reaching scale. A study by Monitor Inclusive Markets of the most promising market-based solutions in Africa identified 439 ventures, of which 130 were commercially viable and 59 were at scale or clearly on the path to scale.[2] A Monitor analysis of 50 inclusive businesses in Africa indicated that net operating margins were, at best, between 10 and 15 percent—a far cry from the "market returns" many investors are expecting.

Also, most of the solutions are being developed by social enterprises and not corporations. The hope that corporations would increasingly serve the BoP, including areas of social benefit, is not materializing at the rate required to produce scale impact. While corporations in some industries are extending their products and services to the BoP (e.g., companies that produce fast-moving consumer goods and pharmaceutical companies that use smaller pack sizes and telecommunications companies that use prepaid services), these are typically in situations where the business model for the higher end market can easily be extended to the BoP. Only a limited number of corporations have tried to develop new models that are required to engage this segment. And of those that have tried, relatively few have succeeded.[3]

## WHAT NEEDS TO HAPPEN, AND WHY?

This lack of scale from social enterprises and low interest from corporations is not difficult to understand. At the end of the day, these market-based solutions are tackling some of the toughest problems of society that the private sector, the government and the social sector have not been able to address. Tackling these problems requires *innovative business models* and *operating in difficult environments*.

Typically, an effective business model will require innovation in multiple areas. A good example is Husk Power Systems (HPS), which provides off-grid energy in Bihar, one of India's least developed states. Its core innovation is a pioneering technology that transforms rice husk into gas, which is used to generate electricity. In addition to this innovation, HPS had to create a distribution system (which it did using low-cost bamboo poles), develop a low-cost metering and theft protection system (the company says it has the world's lowest cost smart meters), and create a simple tariff structure and a corresponding billing and collection system (as its customers were not familiar with buying electricity). In addition, as it was difficult to source gas-powered generators, HPS developed the capability to convert diesel-powered generators. Finally, because it had difficulty sourcing skilled staff in rural Bihar, it started "Husk University" to train the workers they needed.

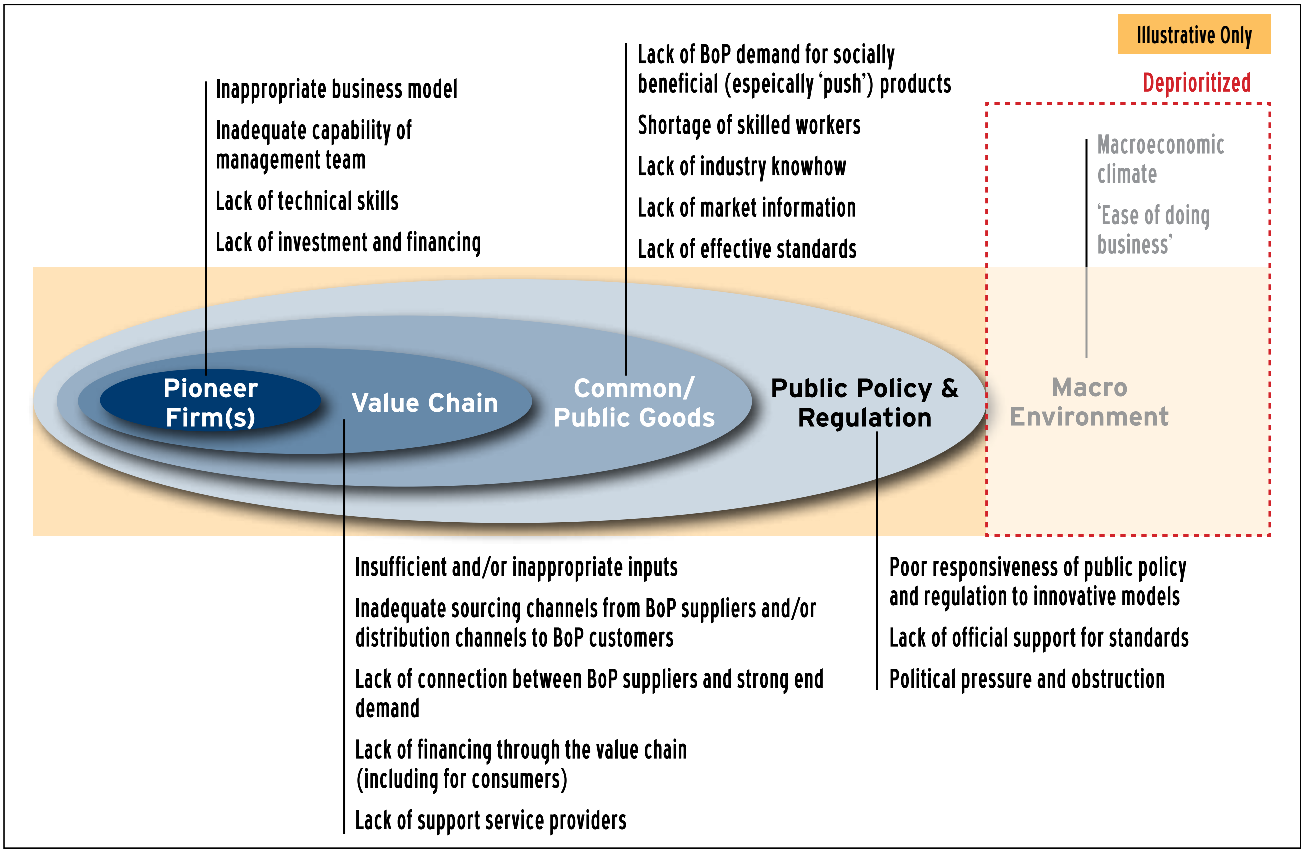
It is difficult to identify all the elements of the solution upfront. The core innovation may have been be created and tested, and a detailed business plan developed—what the customer will get, how it will be delivered and the economics of the venture—in other words a "blueprint" of the business. But the real work begins when one starts "validating" the business model on the ground. Issues one has not thought of crop up, plans must be modified, and new elements must be developed. Often, one must rework the entire business model.

The development and validation of the business model require creativity and business acumen, not to mention significant financial resources, time and persistence. And at the end of the day, the model may or may not work—and even if it works, financial returns may be limited, as margins tend to be low and, once a model is proven, copycats emerge.

Moreover, the challenge is not limited to the business model. As mentioned above, these market-based solutions need to work in difficult environments. Our experience with over a thousand ventures in this space has helped us understand the layers of challenges beyond the business model with which these ventures need to deal (see figure 1 below). In addition to the challenges for most new ventures (e.g., getting finance and building a team), these ventures also need to assemble the value chain to deliver their solutions (e.g., create a distribution mechanism and arrange for financing for the value chain, including for customers), work on what are typically considered public goods (e.g., educate the customer of the value of the product, especially for "push products" like insurance and clean drinking water) and also address regulatory issues and policy.

While these challenges are significant, the potential upside is huge, as can be seen from two models that have scaled, microcredit and contract farming. There are a number of stakeholders committed to seeing the field of market-based solutions succeed, and the key is to (1) have reasonable expectations and (2) provide the nurturing environment that will allow more market-based solutions to reach scale so they can be leveraged for developmental impact.[4]

Figure 1. Ecosystem Barriers to Bringing an Innovative Business Model to Scale




Source: Monitor Deloitte

## RECOMMENDATIONS AND NEXT STEPS

First, we need to have *realistic expectations* about both the applicability of these solutions and the effort it will take to get them to scale. Market-based solutions are not a panacea. While market-based solutions can be effective in many areas, in others commercially viable models do not exist, and services therefore need to be provided by government or by philanthropy. Even for market-based solutions that have the potential to create social impact at scale, getting these solutions to work and reach scale will take significant time, resources and effort—and many innovative efforts will fail. Also, financial returns are likely to be modest, especially for pioneer enterprises. These barriers need to be recognized by all stakeholders, including members of the impact investing community, among whom many feel they can get market returns from such ventures.

Second, *business models matter*, and we need to focus on getting them right. As mentioned above, these are tough problems where traditional solutions are not working and creative, new solutions are needed. These solutions usually involve multiple innovations and are not easy to develop. Even a great idea is unlikely to work at first. Instead, it requires significant on-the-ground validation and refinement, which in turn require resources, time and persistence.

Third, *we need to attract more of the right people and players into this space*. Our experience has been that the majority of the entrepreneurs in this field are people who have great ideas and passion but who lack experience in business or in scaling organizations. We believe that future success hinges on being able to attract more *business builders*—professionals who have experience in building scale businesses—into this field. It would also be good to attract more corporates into this space, as they already have many of the capabilities and resources required to develop and scale market-based solutions. It will be important, however, because financial returns may be modest or may take time, that corporates take a wider, longer-term perspective as they design, test and implement such initiatives.

Fourth, *we should build conducive ecosystems* to accelerate the scaling of effective business models. As mentioned above, even if one gets the business model right, because one is working in difficult environments, numerous *ecosystem* barriers must be addressed—from assembling value chains, to creating public goods, to addressing regulatory issues and policy. Many impact investors and companies are unwilling or unable to even think of addressing these barriers (particularly regulation and policy), yet, for the majority of market-based solutions, resolving these barriers is key to success. Policy and regulation are typically geared toward existing markets, models and players, and may unwittingly strangle new innovations before they have the opportunity to achieve impact at scale. Policymakers need to recognize this challenge and adapt policies to allow innovative market-based solutions to succeed and reach scale. Also, as new innovations come to market and scale, there is often a need to redefine or create standards and mechanisms for appropriate regulation.

Fifth, *"soft capital" from philanthropies, aid donors and governments is critical to the development of market-based solutions*, from nurturing pioneer enterprises to addressing ecosystem barriers. The development and validation of effective business models require significant financial resources, time and persistence. As our team highlighted in a recent report,[5] given the high level of risk and the modest rates of return even when pioneering ventures succeed, there is a need for funding and support that are interested in developmental impact, and are willing to accept low or even negative financial returns. Meanwhile, ecosystem building can create powerful externalities that can help many firms operate and successfully reach scale, but whose value is difficult for any one investor or firm to capture and monetize. We believe that philanthropies, donors and governments need to step into these gaps to provide much-needed support.

Sixth, last but not the least, we need *to become better at blending and coordinating a range of different types of capital and different interventions from players across the private and public sectors,* recognizing the complex, multifaceted nature of the challenge of scaling market-based solutions. The evidence suggests that market-based solutions can be helped in reaching sustainable scale by having dedicated *market facilitators* who can work with different actors to bring otherwise disparate elements together and help guide the development of new, inclusive markets over time. We are now conducting further research into this and hope to have findings to share in early 2014.

## ACKNOWLEDGMENTS

The points laid out in this brief have been developed over the past seven years through the work of the Monitor Inclusive Markets team. Specifically, we would like to acknowledge the thought leadership of Mike Kubzansky, now with Omidyar Networks, who co-started Monitor Inclusive Markets and led its work in Africa.

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# The Case for Capital Alignment to Drive Development Outcomes

**John E. Morton and Astri Kimball,** Overseas Private Investment Corporation

## EXECUTIVE SUMMARY

The emerging markets have largely emerged. According to the International Monetary Fund, the combined GDP of the emerging markets will overtake that of developed economies within the next two years. Foreign direct investment in emerging economies now outpaces investment in developed countries and, between now and 2030, some 2 billion people, largely in emerging markets, will join the global middle class. Today, private capital investment is the major driver of growth and improvements in quality of life around the world. In the past few years, private investors have begun to express a new and growing interest in investments in sustainable economic development that contribute to addressing global development challenges. But to date, hundreds of billions of dollars in potential private investment remains on the sidelines because it also requires other, complementary capital to accompany it. At the same time, both philanthropic capital and the new breed of double-bottom-line impact investors are increasingly focused on how to connect with and leverage more commercially focused private capital. Thus there is now a unique opportunity to align the tools, resources and energies of philanthropic and private capital in pursuit of targeted development challenges in such a way that crowds in private investment capital—both from impact investors and more commercial investors. Development finance institutions are uniquely positioned to be the connector that helps align these groups. The products already exist to deliver on this potential. What is now needed is a process innovation.

## WHAT'S THE ISSUE?

Today, there is widespread recognition that large amounts of capital that could have a tremendous development impact is sitting on the sidelines because it requires risk mitigation, facilitation or partnerships with other capital providers along the risk-capital spectrum. Just like businesses, development projects need different types of capital from different providers at different stages of their evolution. Few actors possess all the necessary types of capital instruments to address the range of investment opportunities. In other words, the proverbial "layers of the capital cake" are rarely coming together at the right time in the investment life cycle. This is the case despite a rising chorus of voices urging more active alignment of tools and capital.

> **Distinct Capital Groups**
>
> **Philanthropic capital:** Funds traditionally spent as grants with no or limited expectation of financial returns.
>
> **Private capital**
>
> *Impact capital:* Funds seeking to generate both a financial return and to proactively create environmental and social benefits.
>
> *Commercial capital:* Funds traditionally seeking to maximize financial return exclusively.
>
> **Development finance institution capital:** Capital from public sector bilateral and multilateral agencies geared toward catalyzing private sector investment for development.

There is growing interest and activity among private investors to invest in ways that are aligned with their values and that solve development challenges. Recent surveys suggest that, in the United States alone, financial advisers are recommending that up to 2.5 percent of total client assets under management (or $650 billion) be allocated to so-called sustainable investments. At the same time, investors are increasingly turning to emerging markets. In 2012, for the first time ever, flows of foreign direct investment to developing countries exceeded those to developed countries. However, the vast majority of financial advisers report that they do not have either a sufficient command of emerging markets or origination capabilities to recommend these investments to their clients.

The impact investing sector—characterized by investments that proactively seek to generate financial and social/environmental returns—is coalescing. Estimates from the Monitor Group indicate that the sector will grow tenfold over the coming decade, reaching more than $500 billion in assets. Other estimates give an actual figure several times larger. There is an active debate in the field about whether impact investors are, or should be, willing to accept subcommercial returns. This brief makes the case that, in certain circumstances, this debate could be put aside.

Private philanthropies working in developing countries have grown rapidly, led by the Bill & Melinda Gates Foundation's pioneering work on global health and development. In recent years, the top 10 private foundations alone have spent upward of $3.5 billion annually on global causes. However, the operative word here is *spent*. What if a portion of that $3.5 billion could be repurposed as *investment* and deployed explicitly and specifically with an eye to mobilizing some portion of the hundreds of billions in private capital identified above?

Finally, public sector bilateral and multilateral development finance institutions (DFIs) that work exclusively to catalyze private capital flows into developing countries have become a rapidly growing, powerful part of the global development architecture. These DFIs—which include the World Bank's International Finance Corporation (IFC), the Dutch FMO, and the U.S. government's Overseas Private Investment Corporation (OPIC), as well as roughly 20 other agencies established over the past several decades in most developed countries—operate with the private sector on a commercial basis and are financially self-sufficient. The Center for Strategic and International Studies (CSIS) reports that the combined annual investments of these DFIs have grown fourfold in the past 10 years alone, from $10 billion to $40 billion.

Today, the examples of alignment between private and philanthropic capital are too few and too far between, with a handful of well-known and frequently cited successes. Furthermore, those successful examples that exist are often one-off, deal-by-deal solutions, as opposed to more efficient, intentional and strategic partnerships that enable greater scale and impact. The reasons, which are well known to those active in emerging markets, are myriad and include, to name but a few, (1) the difficulty of aligning different organizational processes and incentive systems; (2) information asymmetry; (3) the high cost of deal origination; (4) small deal sizes and/or a lack of effective aggregation mechanisms; and (5) overly conservative perceptions of market risk. A further key constraint is that the relevant cast of characters is not used to partnering together in this way. Investors looking for a market return may not be used to partnering with philanthropies. DFIs may focus on the underlying project and related diligence and not other sources of capital that could leverage the impact of DFI support. Philanthropists can be wary of providing grant money that will create profits for others, even though "sustainability" (i.e., profitability) is a goal shared by most philanthropists.

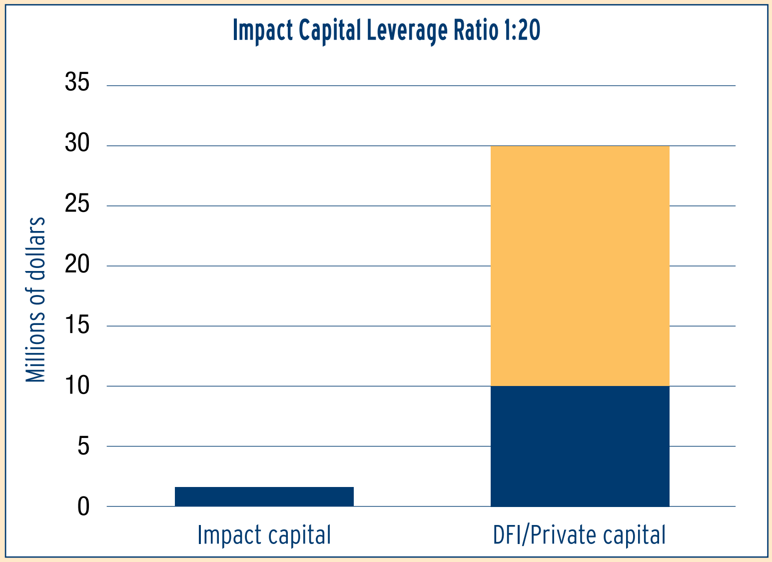
The good news is that DFIs are ideally positioned, both in mission and in expertise, to help bring these distinct pools of capital together and reduce the asymmetries between them. They have deep experience in emerging markets and a healthy risk appetite, while, at the same time, they are commercially oriented and focus nearly exclusively on working with the private sector. More important, every dollar invested by a DFI tends to catalyze multiples more in private investment.

### Consequences of Failed Alignment: Off-Grid Power in Afghanistan (Small Scale)

A successful private developer seeks to build and install biomass-powered generation systems in rural Afghanistan. A small-scale project, serving 20 villages, can break even in a relatively short period of time. A DFI is prepared to provide $10 million in loans, alongside an additional $20 million in private commercial equity, to build several systems that will serve another 200 villages, but only once the small-scale business model is proven (i.e., the project has reached the breakeven point and the fees are being properly collected to generate cash to pay back the loans). The private developer is willing to put in $1 million of his own money, but needs another $1.5 million to build the first small-scale system and prove out the model. The successful model will trigger the $10 million in DFI financing and $20 million in additional private financing. Without that $1.5 million in early-stage and higher-risk capital, no generators will be built.

Meanwhile, in a neighboring province, a donor agency spends $1.5 million to construct a system that will serve 20 villages. They are completed and operational, but no additional funding was foreseen or available to build more. Because the grant money is not connected to the larger sums of DFI money with a shared purpose of providing power to the villages, the additional $31 million in investment does not happen, and small-scale systems serving 220 villages go unbuilt.

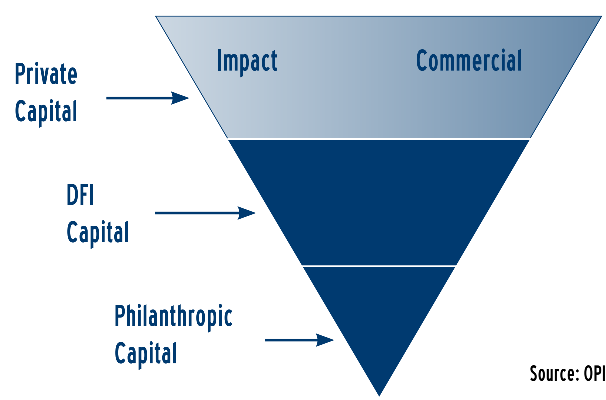
The chart to the right shows the leverage impact of alignment: $1.5 gets you $31.




## WHAT NEEDS TO HAPPEN, AND WHY?

Fortunately, a solution is within our sights. Together, philanthropists, impact investors, DFIs and even commercially oriented investors can achieve far more than any one of these could achieve on its own. By combining their resources and expertise, they can drive significant amounts of capital into the development arena. This requires a process innovation.

Philanthropists and donors have expertise in seeding and supporting early stage projects as well as the risk appetite to invest at the pilot stage. DFIs have a long and successful track record of investing to scale up projects that are commercially viable in frontier markets, but they often do not have all the expertise or instruments needed for a given project. Private investors can potentially take projects to the next level. *What is needed is a means of aligning philanthropic, private and DFI resources in a way that enables capital to be deployed effectively toward agreed-on priorities.*



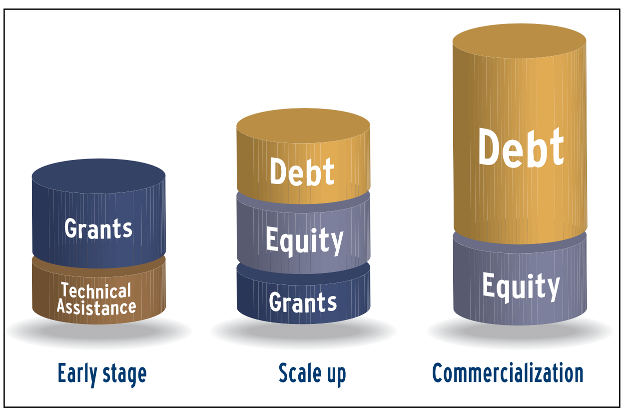
Source: OPIC

When philanthropic capital is invested in a way that catalyzes development finance institutions, which in turn catalyze commercial capital, it means that capital flows will increase toward targeted sectors, regions and development priorities. More intentional alignment with philanthropic and impact capital can "crowd in" both DFI money and other private capital by bringing together complementary skills, risk appetite and investment instruments.

Alignment can be as broad or as tailored as desired by the partners. Imagine an aligned investment vehicle targeting agricultural projects in sub-Saharan Africa, or renewable energy projects in Latin America, or infrastructure projects in Southeast Asia. One could just as easily construct a global facility that seeks to support the provision of liquidity to small and medium-sized enterprises. The key is finding the proper partners whose geographic, sectoral and risk appetites are most closely aligned.

Different sectors need different approaches to achieve alignment. New technologies and business models that have a higher probability of failure will need significant equity capital to maintain growth and achieve market penetration. Infrastructure requires blended financing with significant concessionary components, with grant support for project preparation and transaction costs. And in other sectors, financing is dominated by corporate investors that are unwilling to take on risky projects with long payback periods without guarantees or first-loss capital cushions.

Different Stages Require Different Capital Mixes




Source: OPIC

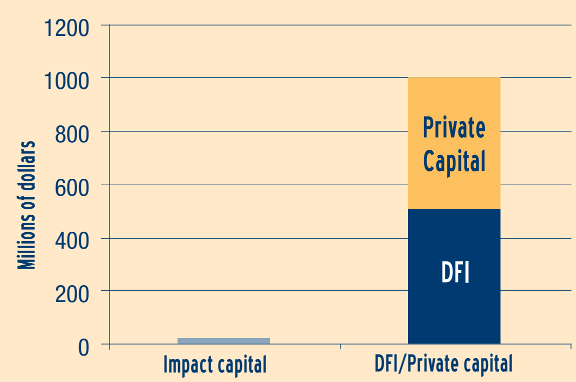
**Results of Strategic (Ex-Ante) Alignment: Clean Energy in sub-Saharan Africa (Medium Scale)**

Despite abundant sources of clean energy, over two-thirds of sub-Saharan Africans lack access to electricity. More than 85 percent of those living in rural areas lack access. Despite the presence of a number of programs to support clean energy development in Africa, OPIC found that many transactions were not moving forward because of the lack of small amounts of project preparation funds for outlays, such as environmental impact assessments, land surveys and legal consultation.

The African Clean Energy Finance initiative is an innovative partnership that aligns, in a proactive and targeted manner, $20 million in early-stage project preparation support alongside up to $500 million in long-term project finance from OPIC. Conservative estimates are that this alignment of technical assistance and DFI finance will catalyze at least that much again in private investment into deals in the solar, wind, geothermal and biomass sectors.

The chart below shows the leverage impact of alignment: $20 million gets you $1billion.

Impact Capital Leverage Ratio 1:50




Source: OPIC

This type of tiered alignment of capital offers discrete advantages to each layer.

*Advantages for the philanthropist or donor/grant capital:*

- Achieves greater development impact for every dollar spent.
- Satisfies program-related investment criteria for tax-exempt organizations.

- Staff selects sectors and causes capital to flow to it; decision is in the hands of the philanthropist/impact investor.
- Assures the sustainability and scaling up of projects.
- Benefits from the expertise of financier.

*Advantages for development finance institutions' debt or guarantee providers:*

- Has lower risks.
- Transactions come together when otherwise might not.
- Benefits from expertise of early-stage investor.
- Maximizes development impact.
- Is able to work with nontraditional actors or operators with fewer resources.

*Advantages for the impact/private investor:*

- Origination of high-impact emerging market investments is expensive and is effectively outsourced to DFI.
- Benefits from legal, business and character risk due diligence policies of DFI.
- Can benefit from "halo" and advocacy work or a government co-investor.
- Ongoing reporting, monitoring and impact reporting augmented by DFI.

*Indicative pipeline*: An indicative list of the types of deals currently seeking impact capital within the pipeline of the U.S. government's development finance institution, OPIC, is given in appendix A.

## RECOMMENDATIONS, NEXT STEPS AND DISCUSSION TOPICS

In this brief, we make the case that there is a big and ever-growing opportunity to more intentionally align capital to profitably and sustainably affect positive development outcomes in emerging markets around the world. Over the last two decades, emerging markets have evolved largely from aid to investment destinations. Yet our thinking on how to realize development goals through private investment has been slower to evolve. Development finance institutions represent the connective tissue linking philanthropic and private impact capital. It is well past time to more strategically align the interests, expertise, capital and risk profiles of key partners to achieve greater financial and development impact. A sample term sheet for one such envisaged aligned capital facility is given in appendix B.

## QUESTIONS FOR DISCUSSION

- How do we build trust between the providers of philanthropic and commercial capital?
- What sectors and regions lend themselves most notably to this type of aligned facility?
- What type of facility or vehicle is best situated to blend the various layers of capital?
- How do we distinguish between grant and early-stage/risk capital?
- How do we distinguish between "impact investors" and mainstream investors who seek to invest in profitable businesses with a social purpose?
- How do we overcome the barriers to aligning staff incentives and organizational systems across diverse capital providers?
- How can we move quickly and diligently to operationalize several large-scale demonstration efforts?

## APPENDIX A

### Illustrative DFI Deals That Need Equity

| Country | Sector | Description | Estimated Investment Gap | Total Project Costs |
|---|---|---|---|---|
| Afghanistan | Health | Expand local manufacturing of simple pharmaceuticals | TBD | TBD |
| South Asia | Education | Establish educational initiative to promote critical thinking, creative problem solving and conflict resolution in Pakistan, India, Afghanistan, Bangladesh and Sri Lanka | TBD | TBD |
| Haiti | Manufacturing | Expand existing plastics recycling plant | $750,000 | $3,500,000 |
| Egypt | Health | Expand existing ophthalmology clinic in Fayoum | $300,000 | $1,000,000 |
| Haiti | Manufacturing | Expand existing processing company | $300,000 | $1,000,000 |
| Costa Rica | Agriculture | Establish a banana starch manufacturing plant | $5,000,000 | TBD |
| Egypt | Recycling | Establish a waste motor oil recycling plant to produce base lube oil in an environmentally friendly manner | $1,000,000–$2,000000 | $6,500,000 |
| Dominican Republic | Energy efficiency | Establish a compressed natural gas distribution company that utilizes an energy-saving U.S. technology | $1,500,000 | $4,800,000 |
| Zambia | Consumer goods | Expand an existing fast-moving consumer goods distribution company to enable it to improve its distribution | $200,000 | $800,000 |
| Pakistan, Tanzania | Health | Expand a mobile technology company with a presence in Nigeria and Kenya that utilizes proprietary “brand protection” technology to combat counterfeit goods, primarily in the pharmaceuticals industry | $200,000–$500,000 | $1,750,000 |
| East Africa | Renewable energy | Manufacture clean cook stoves in East Africa | $1,000,000 | $3,500,000 |
| Ghana | Health | Build and expand X-ray imaging centers in the underserved cities of Accra and Kumasi | $350,000 | $1,200,000 |
| Nigeria | Health | Expand a pharmaceutical distribution company so that it can hire more pharmacists as well as develop and market new products | $1,000,000 | $3,500,000 |
| South Africa | Renewable energy | Expand a solar institute that will educate engineers, investors, product developers, marketing managers and policymakers on clean energy practices through various workshops and classes | $5,000,000 | $12,500,000 |
| Multiple | Renewable energy | Aggregate and sell carbon credits by partnering with microfinance institutions (MFIs) | $1,400,000 | $3,000,000 |

| Country | Sector | Description | Estimated Investment Gap | Total Project Costs |
|---|---|---|---|---|
| Africa | Renewable energy | Establish loan facility for on-lending to network of African MFIs; loans will be used to fund an expansion of microloans for water and renewable energy | $2,000,000 | $12,000,000 |
| Haiti | Water | Start up for network of for-profit water kiosks in Haiti | $2,000,000 | $6,000,000 |
| Multiple | Impact investing | Establish fund to invest in first-loss tranches of impact investment funds or as first loss directly into impact investment companies | $5,000,000 | $50,000,000 |
| Global | Agriculture | Establish a global fund for microfinance and agricultural cooperatives | $5,000,000–$7,000,000 | $35,000,000 |
| Global | Small and medium-sized enterprises (SMEs) | Invest in a range of financial intermediaries that target SMEs through a global fund | $4,500,000–9,000,000 | $45,000,000 |
| Cape Verde | Renewable energy | Develop, construct and operate $7.4 million wind-powered water desalination project, plus another four projects totaling approximately $28 million (same technology, different municipalities) | TBD | $28,000,000 |
| Tanzania | Renewable energy | Develop, construct and operate two mini-grid biomass power plants, combined capacity 6.3 megawatts | Up to $3,000,000 | $18,000,000 |
| Kenya | Education | Expand a for-profit primary school project expected to reach over 100,000 children | TBD | TBD |
| Mozambique | Agriculture | Establish a greenfield nut-processing facility | $350,000–$500,000 | $2,500,000 |

Note: TBD = to be determined

# APPENDIX B

**Sample Term Sheet[1]**
**Aligned Capital Facility For Impact Transactions**
**Summary of Principal Terms and Structure**

| Term | Description of Terms |
|---|---|
| **GENERAL AND PARTIES** | |
| Facility | The Aligned Capital Facility ("ACF" or the "Facility") will bring together capital sources from a range of investment stakeholders (referred to as "Aligned Capital"): (i) to bring together market transactions that are not otherwise getting done because of a lack of early-stage/seed capital and/or first loss capital; and (ii) to attract new, and likely first-time, investors to participate in impact investing transactions by bridging the funding gap under (i) and by providing co-investment opportunities to the pipeline of development finance institutions (the "DFI Pipeline").<br><br>The Facility will be a structured financial vehicle created as a permanent investment company that will be able to make equity, debt and guarantee investments. Sector and region agnostic, the Facility's pipeline of evaluated transactions come from the DFI Pipeline and will focus on deals that demonstrate use of Aligned Capital to reach closure and to deliver appropriate financial and robust non-financial returns.<br><br>ACF will play the role of companion investor alongside one or more DFIs who have prepared a transaction and seek Aligned Capital to complete the deal. A transaction that qualifies for ACF will be referred to as "Qualifying Investment." On the basis of ACF's investment capital, it will have two "wallets" from which to invest in a Qualifying Investment: (i) ACF Capital; and (ii) ACF Co-Investment Capital, both of which are described below.<br><br>The Facility will be funded by equity and debt. Legal form and jurisdiction of the Company are to be finalized, with likely selection of a Delaware LLC.<br><br>The Facility will be externally managed by an experienced third-party manager with impact investment credentials. |

[1] This term sheet was prepared by, and benefited from the seasoned expertise of, Laurie Spengler and a team at Shorebank International Ltd. (SBI), a provider of capacity plus capital solutions that contribute to a more inclusive and sustainable global economy. The capital advisory services team at SBI specializes in designing and structuring layered vehicles of aligned capital to fuel impact transactions around the world. The authors are grateful to Laurie and her colleagues for their time and efforts.

| Term | Description of Terms |
|---|---|
| Facility Funding | The ACF will be funded with various layers of capital:<br><br>• Equity<br>○ Grants.<br>○ Catalytic Share Class—this layer will be subscribed by philanthropic investors seeking to catalyze transactions to successful closure that may not otherwise be funded because they are perceived as too early or too risky.<br>1. Program-related investments / venture equity/first-loss/early-stage capital<br>2. Mainstream equity<br><br>• Debt<br>○ Development Loan Tranche—this will be a mezzanine layer of 10-year duration and carrying a development coupon in the range of [3-5] percent; this tranche will be subscribed on a deal by deal basis by Development Finance Institutions seeking ACF Capital to support investment deals in the DFI Pipeline.<br>○ Commercial Co-Investment Loan Tranche—this will be a pool of investment capital that can be tapped for investment in Qualifying Investments that will carry the same (or better) return profile as that of the DFI investor in the Qualifying Investment (explained below); this tranche will be subscribed by investors that may be new to impact investing.<br><br>Investors in the Catalytic Share Class may also participate in the Development Loan Tranche and/or the Commercial Co-Investment Loan Tranche. |
| Objectives and Advantages | The expected results of ACF include: (i) expanding the range of high- impact transactions that are funded; and (ii) using philanthropic capital to demonstrate the power of courageous capital to catalyze transaction flow and to crowd-in new investors to the industry. |
| Sponsor/Anchor Investor | ACF will be anchored by [Foundation/Philanthropy] as the lead Catalytic Shareholder and by Development Finance Institution as lead Development Loan investor. |
| Investees | ACF will invest directly into "last mile" transactions and will not be a source of funding for impact investment funds. |
| Management | ACF will be managed by an experienced third party with demonstrated capabilities: (i) to vest potential Qualifying Investments; (ii) to determine the amount of funding to come from ACF's two wallets—ACF Capital and ACF Co-Investment Capital; (iii) to negotiate the terms of investment; and (iv) to monitor and report on the performance of the Qualifying Investment.<br><br>In selecting the appropriate manager, the following considerations will be made:<br><br>• Specialist transaction capabilities;<br>• Development market experience;<br>• Credentials in the impact investing and triple/double bottom line space; and<br>• Experience working with DFI Pipelines. |
| Pipeline of Qualifying<br><br>Investment Opportunities and Relationship with<br><br>Development Finance<br><br>Institutions | DFIs will be the source of ACF deal flow.<br><br>The Facility can be increased in size and scale on the basis of pilot. |

| Term | Description of Terms |
| --- | --- |
| Initial Target Amounts | • Equity: $ [TBD] million<br>• Development Investment Loan: $ [TBD] million<br>• Co-Investment Loan: $ [TBD based on size of DFI pipeline]<br><br>**Note:** Grant funding, if secured, would be used to accelerate operational ramp-up. |
| Tenors | • Development Investment Loan: [10 years]<br>• Co-Investment Loan: [Commitment is 10 years with tenor for each investment determined by the Qualifying Investment]<br>• Equity: N/A |
| **DEVELOPMENT INVESTMENT LOAN TERMS** | |
| Maturity | [x] years from Closing |
| Availability Period | [y] years from Closing |
| Repayment | TBD |
| Interest Period | [Semi-annual] |
| Interest Rate | [TBD- anticipated range of 3-5 percent] |
| Currency | [USD] |
| Security | [TBD] |
| Conditions Precedent | Customary provisions |
| **OTHER** | |
| Transaction Criteria | ACF will invest only in direct transactions (not funds) where it considers that (a) the transaction would otherwise not be funded due to a lack of Aligned Capital and (b) there is a reasonable prospect of completion because:<br><br>• The investee is investment-ready;<br>• A DFI investor has undertaken due diligence;<br>• In addition to ACF Capital there is room for ACF Co-Investment Capital; and<br>• The timeframe for completion is approximately 6 months.<br><br>Investment sizes will depend on the underlying DFI pipeline but would be expected to be within a wide range. |
| Transaction Mechanics | • ACF will be contacted by a DFI for consideration of an investment within the DFI Pipeline;<br>• The ACF application will include the DFI underwriting package (e.g. due diligence, investment memorandum, etc.);<br>• The ACF Manager will determine whether the transaction is a Qualifying Investment;<br>• The ACF Manager will negotiate the terms of the deal for both the ACF Capital and the ACF Co-Investment Capital;<br>• Upon successful closing of the deal; the ACF Manager will monitor performance of the Qualifying Investment and report to the ACF investors. |
| Return Expectations | ACF's return expectations are appropriate financial returns accruing to the ACF Capital and the ACF Co-investment Capital with robust impact returns. A detailed financial model will be prepared to demonstrate these returns on a portfolio basis. |

<table>
<tr><th>Term</th><th>Description of Terms</th></tr>
<tr><td>Documentation</td><td>Documentation required will include (but not be limited to) the following:<ul><li>Constitutional documents;</li><li>Shareholder agreement;</li><li>Facility agreement between the Borrower and each lender to set out the terms of the Loans.</li></ul></td></tr>
<tr><td>Fiscal Year</td><td>The fiscal year end of the Company shall be [31 December] of each year.</td></tr>
<tr><td>Industry Contributions</td><td>The activities of ACF are expected to contribute to the development of the impact investment industry through:<ul><li>Demonstrating the power of Aligned Capital;</li><li>Bringing to market deals that are otherwise not getting funded;</li><li>Leveraging the pipeline of Development Finance Institutions;</li><li>Crowding in new investors to invest alongside Development Finance Institutions;</li><li>Sharing lessons learned on the effective use of Aligned Capital;</li><li>Dissemination of quantifiable results:<ul><li>Number and type of transaction benefitting from Aligned Capital</li><li>Transaction preparation periods</li><li>Size of transactions successfully closed</li><li>Number and composition of investors</li></ul></li></ul></td></tr>
</table>

# Women, Entrepreneurship and the Opportunity to Promote Development and Business

**Carmen Niethammer,** Odebrecht[1]

## EXECUTIVE SUMMARY

Female entrepreneurship represents a vast untapped source of innovation, job creation and economic growth in the developing world. The barriers to women's entrepreneurship are various: Women face greater obstacles in accessing credit, training, networks and information, as well as legal and policy constraints. The World Economic Forum shows little progress in narrowing the economic gap between women and men. Yet not all is lost! Innovative initiatives to promote women's entrepreneurship—driven by both the private and public sectors—are on the rise.

This brief provides an overview of the global landscape of women's entrepreneurship. It aims to demystify the challenges that women face in accessing finance, and it highlights some of the typical challenges regarding capacity-building programs targeted at women entrepreneurs. Above all, this brief focuses on potential solutions and enablers by drawing on practical experiences from the public and private sectors in both emerging and developed markets. It concludes that innovative partnerships, particularly when private and public sector entities are involved, are beginning to make a dent, with the potential for large-scale impact. Those who embrace women's entrepreneurship as an opportunity are likely to reap the rewards in new market opportunities and higher development impact.

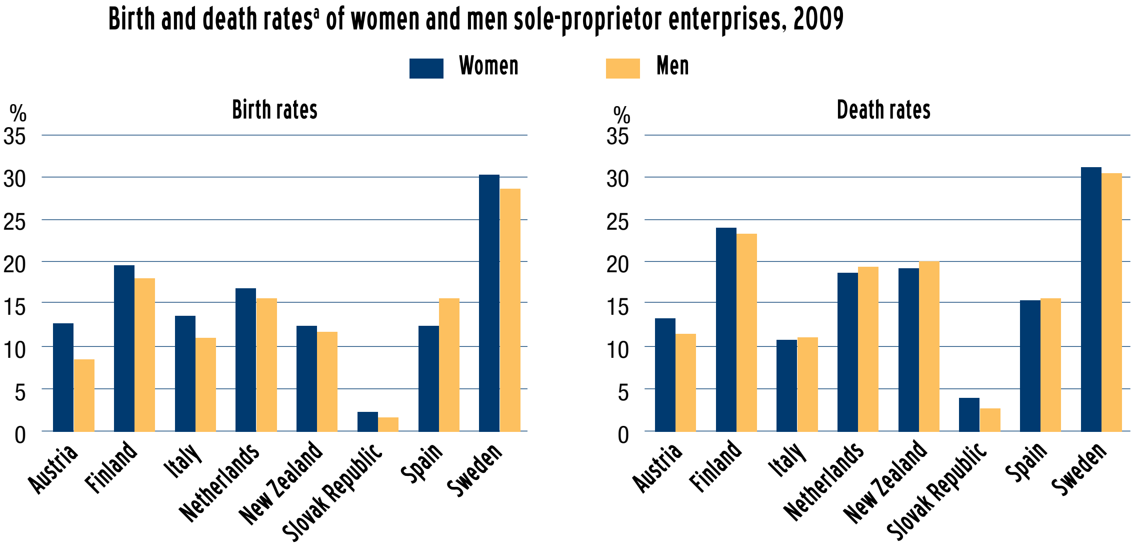
## THE LANDSCAPE OF WOMEN'S ENTREPRENEURSHIP AROUND THE WORLD

*Women's entrepreneurship matters for business and development.* Women-owned businesses already contribute significantly to the world economy, and their number has grown over time. These firms represent a significant share of employment generation and economic growth potential. This contributes significantly to development beyond enterprise growth and turnover numbers. "Women are better at managing the budget and better at making key financial decisions that impact the family such as a child's education," noted Mastercard's group head for Asia, Pacific and the Middle East and North Africa.[2] A recent survey in Asia found that when it comes to home finances, women generally play a leading role. Women's leadership in South Korea, Indonesia and Vietnam was especially apparent when making decisions about their children's education, and women also were the main decisionmaker when it came to key household purchases. It is estimated that women-owned small and medium-sized enterprises (SMEs) represent 31 to 38 percent (8 to 10 million) of formal SMEs in emerging markets.[3]

*The number of female-owned enterprises is growing at a faster pace than that of male counterparts*—with no evidence that women-owned enterprises fail at a faster rate. New, internationally comparable data on female entrepreneurship from countries belonging to the Organization for Economic Cooperation and Development show that the "birth rates" of female-owned enterprises are higher than those of male-owned ones (see figure 1).[4]

The "ratio of opportunity to necessity entrepreneurship" is typically higher in high-income countries than in low-/middle-income country groups, the effect being significantly greater for women entrepreneurs,

Figure 1. The Birth Rates of Female-Owned Enterprises Are Higher Than That of Male-Owned Ones




a) Births refer to the creation of new enterprises with employees or to transitions of existing enterprises from 0 to 1+ employee(s). Deaths refer to the dissolution of enterprises or to transitions to no employees.

Source: OECD Secretariat estimates based on statistics produced by National Statistical Institutues. Death rates for Italy, the Netherlands, Sweden and the Slovak Republic refer to 2008.

StatLink http://dx.doi.org/10.1787/888932676735

Source: Organization for Economic Cooperation and Development, Closing the Gender Gap: Act Now (Paris: OECD Publishing, 2012).

according to the Global Entrepreneurship Monitor.[5] In other words, the poorer the country, the more likely that women's entrepreneurship is driven by necessity. Regardless of gender, entrepreneurial activity is typically higher in low- and middle-income countries than in high-income countries.

*Women increasingly outnumber men in universities and graduate schools in emerging markets (including the BRIC countries—Brazil, Russia, India and China), representing a growing talent pool and a huge opportunity for both business and development.* In countries where the public sector's role for female employment is diminishing and where private sector careers are not easily being pursued, women look to establish and grow businesses themselves. From a public sector perspective, an unutilized educated workforce is costly and not effective. In Brazil, Russia and the United Arab Emirates, for example, women remain a disproportionately untapped source of talent.[6]

*The promotion of women's entrepreneurship can play a particularly important role in conflict-affected countries.* Although destruction affects all, conflict often leaves women to carry the double burden of economic and family responsibilities. Women who can no longer rely on steady earnings from male household members during times of hardship must often make ends meet by engaging in informal micro-income-generating activities. Giving women a stake in the national reconstruction process by investing in their economic participation, including through entrepreneurship, is crucial for effective and sustainable development of the already-fragile economies of conflict-affected societies.[7]

*Women-owned enterprises are well-positioned to enhance national prosperity and to contribute to economic growth and development.* Many are growth-oriented and are increasingly operating firms across all industry sectors and engaging in global trade. It is against this backdrop that both the private and public sectors are innovating—to identify opportunities to promote women's entrepreneurship in order to harness this untapped potential.

## UNRAVELING THE MYSTERY OF WOMEN'S LIMITED ACCESS TO FINANCE

*The business rationale for investing in women-run enterprises is gaining support on compelling economic grounds.* "Gender equality is a core development objective in its own right—and, also smart economics," highlights the *World Development Report 2012: Gender Equality and Development*.[8] Despite this growing awareness, and the fact that women-owned businesses represent a strong potential source of future economic growth and job creation, there are notable differences between women- and men-owned businesses: Women-owned businesses are concentrated in industry sectors where firms are typically smaller (e.g., retail and services, compared with manufacturing).

*Women entrepreneurs are more likely to cite access to finance as the first or second barrier to developing their businesses.* There are significant gender differences in the access to and use of credit—particularly formal credit. Businesses managed by women are less likely to receive a loan than firms managed by men, although the differences narrow with firm size and are smaller among formal businesses. It is estimated that women-owned businesses have an annual financing gap of $290 billion to $360 billion in unmet financing needs, according to a report commissioned by the Group of Twenty.[9]

*Women have a lower formal bank account penetration than men in every region, particularly in developing countries*, confirms the new Global Financial Inclusion Index (Global FINDEX), which measures how people in 148 countries save, borrow, make payments and manage risk. In South Asia, where the gender gap is the largest, only 25 percent of women report having an account, compared with 41 percent of men. Moreover, unbanked women in developing countries are far more likely than men to report not having an account because "someone else in the family already has one." Globally, 26 percent of women report this as the reason they do not own an account, compared with only 20 percent of men. While men give this as the fourth most-cited reason reason why they do not have an account (after "too expensive" and "too far away"), for women this is the second most-cited reason.[10]

Women start with less capital than men and are less likely to take on (additional) debt to expand their business. Since financing choices and capital availability are key enabling factors for firm size and growth, it is critical to ensure that women are aware of the availability of financing and have full access to it.

*Commercial banks have started to recognize the business case for banking on women and tapping the women's market.* Over the past 10 years, there has been increasing recognition among commercial banks in both developed and developing markets that targeting the women's market is profitable. For example, Banque Libanaise Pour Le Commerce (BLC) launched its Women's Empowerment Initiative in 2012 and offers a range of services tailored to women-owned businesses. For BLC, extending outreach to female entrepreneurs is not only good business ethics; it is also good banking.[11] The initiative—which, in addition to credit, also includes nonfinancial services such as a dedicated Web site that enables businesswomen to tackle professional challenges and also provides legal advice—makes it easier for these businesses to access the needed capital to expand. The initiative is already demonstrating promising results: Within a year, BLC increased the number of loans to women-owned SMEs by 55 percent and the number of women-owned deposit accounts by 17 percent.

BLC also is a member of the Global Banking Alliance (GBA) for Women, a worldwide consortium of financial institutions promoting women's wealth creation. The GBA was originally founded by four commercial banks from developed countries—Westpac in Australia, the Royal Bank of Canada, the Bank of Ireland and Fleet Bank in the United States—which, having recognized the business case for banking on women, subsequently aimed to become the banks of choice for women entrepreneurs. Since 2000, the GBA has grown to become a 31-member institution that works in more than 135 countries to build innovative, comprehensive programs that provide women entrepreneurs with vital access to capital, markets, education and training. The two newest members of the GBA—Banco Nacional de Costa Rica, and the National Bank of Abu Dhabi—view the women's market as a key driver of financial sustainability, not just as a community relations or corporate social responsibility initiative.[12] By providing technical assistance and peer learning, the GBA serves as a global clearinghouse for best practices. Using its collective voice, the GBA also advocates for greater awareness of women's vital economic role as consumers, investors and job-creating entrepreneurs.

*But all finance is not the same: There are notable differences between short- and long-term financing needs.* For example, surveyed women business owners in the Middle East and North Africa (MENA) are more interested in long-term capital than short-term capital, with interest in supply chain and equity financing as well. An IFC-supported report, published in partnership with Vital Voices and the MENA Businesswomen's Network, examined women business owners' demand for capital, information and training to grow their businesses across eight economies in the region.[13] While 80 percent of respondents use personal checking accounts, just 18 percent report having a commercial bank loan, and even fewer respondents (10 percent) have a line of credit for their business.

*While access to debt financing has improved for women-run companies, emerging research shows that these firms only receive a very small share of private equity capital relative to those managed by men.* For example, in the United States, which has very well-intermediated markets, women-owned businesses receive less than 5 percent of venture capital funds invested in companies.[14] In emerging markets, this discrepancy is even greater. And in developing countries, where microfinance projects are common, private equity is largely unknown. This poses a particular issue for women-owned businesses that are too big for microfinance and too small for loans from commercial banks.

*Investing in women-led firms may be a better investment because firms that invest in women-led firms have higher returns on their investments*, suggests new research by the U.S. Small Business Administration.[15] Moreover, the share of angel investors who are women has increased significantly, from 12 percent in 2011 to 22 percent in 2012. The CEO of Womenable suggests that angel investing and crowd funding (which are in growth mode compared with venture capital) are more attractive to women because they are more egalitarian and open.[16] This situation is attracting both female investors and female entrepreneurs to the marketplace.

*Given the variations and nuances of issues regarding women's access to finance, a concerted effort at raising the profile of women-targeted investments, particularly equity, is important.* Some suggest targeting businesswomen through existing investment funds. Others call for a dedicated investment fund for women in order to institute a women-focused approach, potentially with higher demonstration effects and impact. There has been much talk but little action in this area, acknowledging the difficulty of persuading key players (fund managers, investors, partners) to come together in pilot markets. While some good research on the potential size of a profitable women's market has been conducted, more can be done to better communicate the potential value proposition.

## IN SEARCH OF BANKABLE WOMEN

*Experience shows that the impact of increasing women's access to finance is greater if capacity-building programs targeted at women entrepreneurs are offered to complete the package.* Research suggests that women have weaker business backgrounds than men, including a lack of relevant (technical) education and a lack of business experience. On average, across 15 European countries, only 11 percent of women who started a new enterprise in 2002 had run another business before the startup, compared with 18 percent of men. In the United States in 2007, 42 percent of male business owners and only 28 percent of female entrepreneurs had previous self-employment experience.[17] A study that looked at 34 countries in developed and developing economies in Europe and Asia found that female-owned firms, overall, were about 1.5 years younger and mainly operated in the services sector.[18]

Not surprisingly, limited access to skills training and networks thus continues to be among the main-cited obstacles mentioned when it comes the growth of women-owned businesses. In response, numerous government-supported capacity-building programs have been established to target women specifically.

*Corporations and nongovernmental organizations (NGOs) have provided women entrepreneurs with skills training and mentoring, often as part of corporate social responsibility initiatives. While some of these initiatives have begun to show promising results, the overall impact has been less clear.* For example, a recent assessment of a business training program in Sri Lanka showed that it had not had a significant impact on the survival or growth of existing subsistence enterprises run by women, in either the short or medium run.[19] On the other hand, Goldman Sachs' "10,000 Women Program," which has only been operational for a relatively short period and with whom IFC has collaborated in the past, is already showing promising results, according to a 2012 assessment by the International Center for Research on Women.[20] Eighteen months after completing the program, 66 percent of graduates had created new jobs, 80 percent had experienced revenue growth and 70 percent had increased profitability.

*There is a need to improve results measurement frameworks and to systematically document what works and what does not.* Taking stock of the available evidence on the impact of business training (focusing on 14 impact assessment studies), it turns out that we know very little about the effectiveness of business training that can guide policymakers.[21] Connecting (trained) women with access to finance and scaling-up successful initiatives that are financially sustainable are of core importance.

*What we do know is that the "women's market" is far from homogenous, and that training providers and partners both need to understand the specific training needs of various segments in the market.* In addition to providing appropriate, affordable training, partners need to take into consideration women's time and mobility constraints, as well as the specific support women need at different stages of their business life cycles. In some cases, for instance, classes may want to offer child care services. In Yemen's gender-segregated context, some women trainees, particularly at the startup phase, preferred to have women-only classes with women instructors.[22] Women with more established businesses, on the other hand, valued mixed learning environments. They indicated a greater willingness to pay for classes where their peers were both men and women because they viewed men as having greater business experience and success.

*A common challenge for most training programs is the link to women's access to finance, even when funding requirements are small.* Recognizing that 6 of the 10 fastest-growing economies in the world are in Africa, the Coca-Cola Company developed a program that empowers women as part of its core business strategy. The innovative initiative "5by20" aims to reach 5 million women entrepreneurs in Coca-Cola's value chain (as fruit growers, distributors, retailers and consumers) around the world by 2020. Partnering with NGOs, Coca-Cola provides these women with business skills training and access to mentors.[23] To tackle the obstacle of (trained) women's access to finance, Coca-Cola and IFC announced a $100-million, three-year joint initiative to provide much-needed access to finance for thousands of women entrepreneurs in Africa and other emerging markets.[24] By working through a network of local and regional banking institutions, the goal is to provide financing and business skills training to women entrepreneurs across the Coca-Cola value chain, starting with Access Bank in Nigeria, which has had a successful women-targeted program since 2006.

*Technology, such as mobile telephones, can play an important enabling role in providing women entrepreneurs with access to finance and development.* In addition to providing access to credit, innovative initiatives like the Village Phone program in Africa also provide entrepreneurs with the necessary training to set up phone service businesses, thereby increasing women's economic participation and development, particularly in rural communities. Linking large telecommunications operators with women entrepreneurs who sell airtime to women and men in their local communities can be a "triple win" situation: It provides local entrepreneurs with an opportunity to build a new business; it helps telecom companies expand their market reach; and, perhaps most important, it closes the gender mobile phone gap by providing women with access to vital information and networks. Here, too, the business case is clear: Research shows that bringing mobile phone penetration among women on par with that among men could enable mobile operators globally to collectively earn $13 billion in additional revenue each year.[25]

*Typically, a challenge for successful management training programs is to reach scale and maintain the cost-effectiveness of training programs while simultaneously increasing women entrepreneurs' access to finance opportunities.* Moreover, graduates of the most successful training programs can face nonfinancial bottlenecks, such as laws and regulations and women's access to markets and networks, which often hamper women's access to finance.

## CONNECTING WOMEN ENTREPRENEURS TO NEW MARKETS: THE ROLE OF SUPPLIER DIVERSITY PROJECTS

*Managing gender issues in the supply chain and connecting women to new markets can have a direct effect on a company's bottom line.* In 2007, the U.S. Women's Business Enterprise National Council conducted a survey of 1,227 female consumers between the ages of 35 and 55 years. Of the survey participants, 79 percent said that knowing that a company purchases from women-owned businesses was likely to compel them to try the product or services provided by that company. The survey findings also confirmed that awareness of a company's commitment to buy from women-owned businesses can enhance consumers' loyalty to that brand.[26] In the U.S., over 80 percent of multinational corporations are now requiring supplier diversity efforts from their tier one and tier two suppliers.

*Almost no government expenditures are procured through women-owned businesses, and the potential business case for governments to promote supplier diversity efforts (including from women-owned enterprises) is significant.* Based on an average of the largest 176 economies in the world, government expenditures amount to about 33 percent of gross domestic product (GDP), of which almost none is procured through women-owned enterprises, according to WEConnect International.[27] They point to the business case for governments to promote supplier diversity in three areas: It allows governments to address inequities in the marketplace; it enables governments to tap the economic potential of women-owned businesses; and it introduces qualified women-owned vendors into the supply chain, which adds value and innovation, increasing the innovation of high-potential enterprises and, hence, purchasing options for all. Some also argue that supplier diversity (including women-owned enterprises) adds to purchasing options and increased competition in the supply chain, leading to superior cost economies.[28]

*Globally, only two governments have supplier diversity legislation with an explicit focus on women-owned businesses*—the United States and South Africa. In the United States, the government aims to reach its 5 percent goal for contracting from women-owned businesses, from a baseline of 3.4 percent in 2010. Research suggests that in 2012 women-owned businesses contributed to 13 percent of the American workforce and accounted for 8 percent of all business revenues.[29] In developing markets, policymakers in India and Mexico are directing government procurement policies to promote SMEs. Mexico established a public procurement set-aside of 25 percent, albeit without a gender focus to date. In India, the Micro, Small and Medium Enterprise Agency found that, when comparing similar companies owned by women and men, companies owned by women employ more people. India is one of the few governments that asks all registered companies to disclose whether they are women-owned.

*In postconflict countries, governments can play a proactive role in promoting women's participation in nontraditional sectors as part of reconstruction efforts.* In 2005, the Iraqi coalition government focused on integrating women-owned businesses in its reconstruction bids. Due to targeted efforts in the first year, over 250 Iraqi women-owned businesses vetted contracts with the Gulf Region Division for Reconstruction Work, representing approximately $200 million of construction and nonconstruction contracts. In addition to providing opportunities for women-owned SMEs to participate in large-scale bids, the reconstruction effort gave women the chance to enter previously male-dominated fields. Ranging from contracts for engineering design and the construction of buildings to contracts for the supply of office materials, women-owned businesses competed for and won approximately 15 new contracts each month.[30]

## THE PRIVATE SECTOR'S ROLE IN HELPING SHAPE POLICIES AND REGULATIONS

*Today, barriers to gender equality remain enshrined in legal regimes across the world. A lack of legal parity between women and men is also associated with lower labor force participation by women and lower levels of women's entrepreneurship.* Only 38 out of 141 economies set out equal legal rights for women and men in key areas such as opening a bank account, getting a job without permission from their spouse and owning and managing property.[31] Many advocate for "fixing" the law, which is certainly a step in the right direction. Yet differences between the de jure and de facto situations are likely to prevail. Where legislation is gender-neutral, governments need to ensure that nondiscrimination is actually practiced, especially in times of recession, when backsliding or a lack of enforcement may occur.[32]

*The private sector can play a proactive role in promoting regulatory reforms that can benefit women entrepreneurs* (including credit bureau and registry rules that improve women's capacity to build reputation collateral). For example, in Uganda the DFCU Bank took the lead in shaping the government's banking policies. DFCU had built a successful portfolio of business loans, leases, mortgages and other products targeting women entrepreneurs. The effort began in 2007, when research showed that Ugandan women owned nearly 40 percent of registered businesses but were receiving less than 10 percent of commercial credit. To better reach this profitable women's market segment, DFCU worked with the regulators to modify the legal opening hours of financial institutions to include weekends, when time-constrained businesswomen were more likely to visit their branches. Recognizing that women had difficulty providing collateral in the form of land property, which is typically required to obtain commercial credit, DFCU went ahead and introduced group borrowing as well as a land loan to enable women to acquire collateral. DFCU also started emphasizing equipment leases over traditional loans to enable women to build a credit history.

*Building successful credit histories is not just an issue in Uganda, but also in many developing countries, where women are more likely than men to lack traditional banking relationships, which can keep them outside the reach of credit reporting systems.* An innovative solution to assess individuals' creditworthiness outside the banking system was put in place in Rwanda, where two mobile phone companies and an electricity and gas company have shared information with the country's credit bureau since April 2011.[33]

## CONCLUSION AND RECOMMENDATIONS

Women's entrepreneurship will increasingly matter for both business and development. While women still face obstacles to establishing and growing their businesses, the good news is that there now are a variety of documented successful approaches to promote women's access to finance, training and markets. Building on these available case studies and emerging business networks, both public and private sector players have an opportunity to collaborate in order to bring these initiatives to scale. Each market is unique, and women entrepreneurs' demands are not universal; instead, they need customized solutions. The following recommendations are offered for discussion:

*Recommendations for policymakers and governments:*

- Ensure that legislation provides equal opportunities for women and men.
- Where legislation is gender-neutral, ensure that nondiscrimination is actually practiced.

- Partner with private sector companies (including financial institutions) to enhance regulatory frameworks for the benefit of women entrepreneurs (e.g., credit reporting, opening hours of financial institutions).
- Explore opportunities for supplier diversity policies that promote sourcing from SMEs (including from women-owned enterprises).
- Further knowledge about opportunities and obstacles faced by women-owned enterprises.

*Recommendations for the private sector:*

- Conduct market research to identify the potential business case for women-targeted interventions.
- Look for opportunities to finance women-owned SMEs, including sources of finance and equity capital.
- Join programs that provide knowledge on how to profitably reach the women's market (e.g., the Global Banking Alliance for Women for financial institutions).
- Explore partnerships that better link access to finance with capacity-building programs (including targeting entire value chains).
- Identify support-program mechanisms for women entrepreneurs that can have an impact on the entire value chains where women entrepreneurs are concentrated.
- In partnership with research institutes, improve results measurement frameworks so as to better capture the success factors of capacity-building programs for women entrepreneurs.

## ENDNOTES

1. The author is on temporary assignment from IFC´s Women in Business Program. IFC is part of the World Bank Group. The views, advice, opinions and other statements expressed are those of the author and were not reviewed or endorsed by, and do not necessarily represent the views and opinions of, Odebrecht S.A., IFC or its Board of Directors, the World Bank or its executive directors, or the countries they represent.
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# The Role of the U.S. Government in Promoting Private Sector Development Solutions

**John Podesta and John Norris,** Center for American Progress

## EXECUTIVE SUMMARY

A series of seismic changes are fundamentally altering how we can best think about the relationship between public and private flows of funds targeted at promoting development. This shift is reflected in the policies of the Obama administration, yet U.S. assistance programs have not sufficiently evolved to take advantage of the new development landscape. Most members of the development community, including those in the private sector, still tend to behave as if those firms and nonprofit organizations that are responsible for the 87 percent of private flows to development need to figure out how to work with the 13 percent of U.S. government flows, rather than the other way around. A new mindset should focus on where U.S. official development assistance uniquely adds value. This is likely to be where official U.S. assistance can complement other, larger private flows. U.S. assistance will need to both effectively partner with the private sector on joint development initiatives in agreed-upon areas and also serve as a constructive force in shaping a more enabling policy environment that ultimately draws in more private capital. The former may include sharing development know-how and good practice with private sector partners. The latter may include investing in infrastructure, market making and strengthening institutions.

## WHAT'S THE ISSUE?

A series of seismic changes are fundamentally altering how we should think about the relationship between public and private flows targeted at promoting development. The most obvious trend—and the one referred to most often—is the huge shift in financing for development that has occurred over the last two decades. Whereas U.S. assistance spending once dominated financial flows headed for the world's developing countries, U.S. official development assistance is now an ever-dwindling proportion of an ever-growing pie. Total U.S. resources dedicated to development in 2010 amounted to $204.5 billion, 87 percent of which was private flows. The percentage of government funds dedicated to development will only continue to decline in the U.S. and global mix over time. Domestic resource mobilization within developing countries, remittances, private investment and private philanthropy all now outpace America's foreign aid spending—and that is not a bad thing.

The second major shift has been the sharp spike in the number and different types of donors around the globe, which has forced the United States to engage in more collaborative approaches to aid. Whereas the United States often used to be the lone donor operating in a country in the 1960s and 1970s, nations like Russia, China, Brazil, India, the United Arab Emirates and Kuwait have joined the ranks of donors, as have almost all members of the European Union. Private philanthropies like the Bill & Melinda Gates Foundation disburse more funds annually than many bilateral donors.

In short, there is more money available for development and more players are involved in development than ever before. Against this backdrop, there has also been an explosion of new public-private partnerships taking place on everything from immunizations to reforestation to water and sanitation. These partnerships have often been the most visible form of the government's work with the private sector in advancing development, but they are by no means the only avenue for this effort.

The recently completed report of the U.N. High-Level Panel on the post-2015 development agenda, an effort in which we were both honored to take part, acknowledged both Post-2015 Development Agenda, and a new global sense of multilateral partnerships as fundamental to the core goal of eradicating extreme poverty by 2030.

The Obama administration has certainly placed a heavy emphasis on capturing the dynamism of the private sector in its policy approach to development. The president's Global Development Policy, released in 2010, not only identified development as a key leg of our national security strategy but also made clear that the U.S. government needed to embrace a "new operational model that positions the United States to be a more effective partner and to leverage our leadership."

By any measure, the U.S. Agency for International Development (USAID) under Administrator Raj Shah has enthusiastically embraced partnerships with the private sector as a hallmark of its approach to development cooperation. Furthermore, there have been some real accomplishments in that regard. The New Alliance for Food Security and Nutrition is an innovative partnership designed to lift 50 million people out of poverty over 10 years and represents substantial commitments from African governments, the Group of Eight and the private sector. According to the U.S. government, the New Alliance now represents more than $3.75 billion of commitments from more than "70 global and local companies to increase the incomes of smallholder farmers through essential actions like expanding seed production and distribution, and developing infrastructure."

Similarly, the Child Survival Call to Action brings together an incredibly diverse set of actors—governments, multilateral institutions, donors, companies, private philanthropies and others—in an effort to prevent some of the close to 10 million deaths of children under the age of five every year.

Increasing numbers of global companies are demonstrating not only a genuine commitment to sustainable development but also real ingenuity in how they go about it. Consumer product giant Unilever is utilizing its sophisticated marketing tools as part of a global hand-washing campaign. While that may sound rudimentary, it has obvious public health benefits. Unilever cites a clinical trial conducted by their brand Lifebuoy in India showing that increasing hand washing led to a 25 percent reduction in diarrheal disease, a 19 percent reduction in acute respiratory infections and a 46 percent reduction in eye infections. Unilever stresses that this campaign is good for its bottom line, is good for consumers and is making a real contribution to public health. Along these same lines, Coca-Cola has invested in water projects across Africa, recognizing that clean water is essential both for human development and for producing its soft drink products.

U.S. assistance has also taken an increasingly catalytic approach to innovation and to working in conjunction with the private sector and academia to promote new technologies and ensure that they are adaptable to local conditions. U.S. government efforts to set up a major constellation of research institutions working on development have enormous potential.

The emerging emphasis on public-private partnerships and figuring out how U.S. assistance can better harness the dynamism and power of private capital for lasting development is welcome and, in many ways, overdue. Yet this emphasis also begs a larger question: Have U.S. assistance programs sufficiently evolved to take advantage of the new development landscape? We would argue that they still have further to go.

## WHAT NEEDS TO HAPPEN, AND WHY?

We simply need to go much further in shifting U.S. assistance programs to where they truly add value in the current environment and provide the skills and resources that others cannot. We also need to address the enduring perception in many quarters that public-private partnerships are more about public relations than about actually leveraging investment and making a development impact.

One of the hurdles to such a value-added approach can be found in the traditional way in which the U.S. government targets its assistance. During the period in which the U.S. government was one of the few players in the development landscape, the controlling philosophy of its aid programs was much like that of the U.S. Postal Service. U.S. foreign aid was directed to almost every country and involved in every sector. The government reasoned that if the U.S. were not there, no one would be, and thus it was quick to overlook bad governance and a lack of local commitment to reform.

Yet that tendency to try to do everything everywhere is now a direct hindrance to moving toward operations that would better complement private investment in development. While the current U.S. administration has rhetorically embraced the idea of being more selective, it has found this selectivity much harder to actually implement. USAID—often buffeted by pressure from the State Department and Congress—has a very hard time leaving countries. Indeed, in the president's 2014 budget request, the administration proposes aid in some form for 143 different countries, with 99 slated to receive economic assistance and 134 to receive security assistance. Many private sector partners have expressed frustration in dealing with USAID's sprawling mission structure around the globe, suggesting that agreements and arrangements made in headquarters have not always been clearly transmitted or prioritized within individual missions.

Frustration with the mile-wide, inch-deep approach to assistance, which has always been driven in part by extensive congressional earmarks, led the George W. Bush administration to establish the Millennium Challenge Corporation (MCC). The MCC's key approach has been to focus more, and better-concentrated, assistance in countries that meet predetermined eligibility criteria based on rigorous standards and data. An overall approach in which all U.S. assistance programs targeted fewer countries with greater resources would likely be more effective in delivering change in this new environment.

In reality, most members of the development community, including private sector firms, still tend to behave as if those firms and nonprofit organizations that are responsible for the 87 percent of private flows for development need to figure out how to work with the 13 percent of U.S. government flows, rather than the other way around. It is a rare partnership, indeed, in which a 13 percent stakeholder sees itself in a majority position. In this new era, U.S. government assistance needs to be deployed in a truly catalytic fashion, taking on the roles that the U.S. government is uniquely positioned to fulfill. U.S. assistance will need to both effectively partner with the private sector on joint development initiatives in agreed-upon areas and serve as a constructive force in shaping a more enabling policy environment that ultimately draws in more private capital. Several areas stand out in both regards.

One of the most obvious areas is that of infrastructure. Making connections for the poorest of the poor to the economic and social lives of their countries is good for the poor, good for development and good for business. Accomplishing this task, however, often requires significant investments in infrastructure, including roads, ports, telecommunications, water systems and more. The U.S. government does not need to be the sole financial backer of such efforts that, by their nature, should likely include domestic resource mobilization, funds from international financial institutions and, in most cases, the private sector itself. The U.S. government, through Overseas Private Investment Corporation loan guarantees and other mechanisms, can help prime the pump for these crucial infrastructure investments. It can also greatly facilitate planning and help make sure that infrastructure development is done in a socially and environmentally responsible fashion. U.S. assistance will be even more crucial when looking at the complex negotiations that are often involved in developing regional infrastructure. Here, the administration's recently announced Power Africa initiative is an encouraging step that seems to rely on a diverse set of tools to move this agenda forward, including loans, technical assistance and traditional grants across multiple agencies.

Indeed, many of the most important obstacles to growth in a place like Africa today relate to the flow of goods and services over borders, the difficulty of navigating customs regimes and the failure to develop adequate infrastructure—much of which should be considered and rationalized on a regional basis. Addressing these key constraints to growth remains an important need that no private company, nongovernmental organization or philanthropic group is likely or able to take on. Strengthening regional linkages and trade is an area in which U.S. development expertise and skilled diplomacy can work hand in hand with international financial institutions like the World Bank and the International Monetary Fund to create an enabling environment that will not only spark private investment but also make it far more likely that existing development programs succeed.

U.S. assistance therefore needs to increasingly focus on how it can help transform markets to maximize social benefits and minimize environmental damage. In many cases, this may entail the U.S. government working with large coalitions of companies on issues that are essentially "pre-competitive." The Tropical Forest Alliance is a good example of this approach, with the alliance working to mobilize and coordinate actions by governments (in the case of the U.S., through USAID), the private sector and civil society to eliminate deforestation from palm oil, soy, beef and paper supply chains by 2020. Development becomes sustainable when business, development experts, governments and citizens are able to truly marry a profit motive to practices that deliver needed goods without needlessly eroding the environment.

In addition to helping clean up supply chains, more and more U.S. assistance should be dedicated to tackling the institutional barriers that prevent domestic resources and private capital from driving development. The U.S. government has taken some useful steps forward in this area. As noted, the MCC's transparent and rigorous application of standards and data in determining eligibility for its funding has sent a very positive message that money will flow toward reform. If such practices were more widely applied across the entirety of the U.S. government's economic and security assistance portfolios, U.S. assistance could serve as a bellwether to help inform private philanthropy and private capital where their investments are most likely to succeed. This, in turn, would help generate positive competition from reform-minded countries to shape an enabling environment that is friendly to investments in education, business, health care, infrastructure and other key areas.

The U.S. government has also developed the Partnership for Growth initiative, which brings together multiple U.S. government agencies—USAID, the State Department, the MCC and others—on the basis of a technique championed by the MCC to jointly analyze the key constraints to growth within a country. After jointly identifying constraints to growth, the U.S. government develops a joint plan with the focus country to address these core constraints. Thus far, the Partnership for Growth initiative has only been active in four pilot countries, but it and the work of the MCC are both pointed toward a much-needed systems approach to growth.

Ideally, this approach should be scaled up and expanded. Not only should the U.S. government use its analytical firepower and diplomatic leverage to identify and address constraints to growth within a country, it should also do so on a regional and subnational basis. What are the obstacles to achieving better, more sustainable and equitable growth within a megacity or across a region like East Africa? How can these structural impediments be coherently and systematically addressed through policy change and investment?

Another vital focus for the U.S. government needs to be helping countries emerge from conflict and assisting them while still in conflict. The United

States has long been the most generous provider of humanitarian assistance in the world, and it will likely remain so. However, in a world where more than 40 percent of the world's poorest of the poor live in fragile and conflict-affected states, that is no longer enough.

In particular, the U.S. government and institutions like the World Bank need to do a far better job of finding ways to energize private sector investment in countries that are trying to emerge from conflict or are undergoing a democratic transition. Positive economic growth is highly correlated with the likelihood that a country does not slip back into conflict and instability. However, in a world with many investment choices, private capital is often very reluctant to move toward risky investment climates. Thus, it will likely take some creative measures that put a positive thumb on the scale, such as risk insurance or other means of partially underwriting investments, to help get much-needed capital flowing in these environments. This is exactly the kind of role that the U.S. government can play while few others could step up to the plate.

U.S. assistance also has an important role to play in helping countries establish viable social safety nets that provide a floor of protection to the poor and cushion them from shocks. Social safety nets are a cost-effective investment against the many risks that can derail progress in areas like economic development, health, education and food security. These protection programs help ensure that a family with some degree of income does not fall back into extreme poverty when a husband unexpectedly falls ill, when drought destroys two-thirds of the family's crops or harvest, or when food becomes otherwise unaffordable because of a sudden global spike in prices. Ultimately, these safety nets will need to be owned and managed at the national level, but outside assistance is often instrumental in getting them up and running, providing an important measure of resilience in an increasingly volatile world. When discussing what governments can do and what business can do, it is important to note that public funding and social safety nets are increasingly vital, given the relative volatility of markets, food prices and climate in today's world.

Finally, the U.S. government has been in the development business a long time. It has a very strong repository of best practices and ways to evaluate whether assistance programs are effective. With increasing numbers of donors, and more and more public-private partnerships in the landscape, effective evaluation of these programs is essential—all the more so given lingering suspicions between civil society and the private sector in many countries. Public-private partnerships can mobilize money and seem fantastic on paper, but if they are not consultative with the people they are designed to assist, they simply will not be effective.

## RECOMMENDATIONS

In summary, we would make several key recommendations: The U.S. government should increasingly apply a "constraints to growth" analysis on a regional basis; it should work with multilateral partners and the business community to develop specific mechanisms to jump-start investment and growth in post-conflict and transition countries; and it should bring a more focused approach to supporting and funding early-stage, market-based solutions that cry out for the patient, low-return and sometimes high-risk capital that only governments are equipped to provide.

The U.S. government has come a long way in revolutionizing a mutually beneficial relationship between the public and private sectors vis-à-vis development. This trend enjoys unusually bipartisan support in Washington, a city where bipartisanship has fallen on hard times of late. Equally true is the assertion that the U.S. government has much further to go. When we start talking about "private-public" relationships, rather than the other way around, we will probably be well on our way.

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1775 Massachusetts Avenue, NW
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202.797.6000
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