THE PRIVATE SECTOR AND AID EFFECTIVENESS: TOWARD NEW MODELS OF ENGAGEMENT

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Executive Summary

The relationship between the private sector and official aid donors is evolving. Because of the private sector's growing engagement in development, more strategic collaboration is needed between private enterprises, donors, governments, foundations and other nonstate actors. To achieve better aid effectiveness and development outcomes, the private sector and official donors must

- cooperate to improve business investment climates,
- establish or strengthen mechanisms to ensure mutual accountability,
- scale up innovation to build inclusive and green value chains,
- coordinate efforts to strengthen health systems,
- build coalitions to enhance humanitarian assistance and
- integrate private sector participation into the dialogue on aid effectiveness.

Introduction

During the past decade, most bilateral and multilateral donors and development finance institutions have increased the resources they allocate to enabling and engaging with private enterprises. Despite these efforts, better engagement is needed. The percentage of official development assistance targeted at catalyzing the private sector—whether as a desired development outcome or as a development partner—remains low. Better analysis of the different business models, technologies and financing mechanisms being employed by private enterprises to address development challenges is required. There is insufficient coordination and little shared learning on different donor strategies, modalities and instruments to engage with the private sector and to help overcome market failures. Joint efforts are needed to raise public awareness in donor countries of development success stories, not only humanitarian crises. And there is a need to not only expand but also move beyond project-based cooperation between donors and private enterprises toward more systemic solutions.

Private-Sector Engagement in Development

The private sector covers a wide range of actors, from smallholder farmers and microenterprises to small and medium-sized firms and large domestic and multinational corporations. It ranges from firms and financiers driven by the motive to maximize profits to social businesses, social enterprises and impact investors that employ market-based approaches with explicit social and/or environmental objectives. And it includes business associations, enterprise networks, producer cooperatives and business leadership coalitions. The key contributions these private enterprises make to development include:

- generating jobs and income,
- delivering essential products and services,
- building physical and communications infrastructure,
- leveraging science and technology,
- mobilizing financial resources,
- investing in human capital and workforce development and
- spreading international norms and standards.

According to the Hudson Institute, private capital investment, together with global philanthropy and remittances, accounted for 75 percent of the developed world's economic dealings with developing countries in 2009, dwarfing official development assistance. Although short-term capital declined dramatically in the face of the worldwide financial crisis, foreign direct investment decreased by a smaller amount (from an estimated $189 billion to $178 billion). This type of investment from the United States actually grew to $54 billion in 2009, and U.S. corporations donated about $7.7 billion in philanthropic contributions. There has also been an increase in South–South private investment flows, with a focus on infrastructure, mobile telecommunications, agriculture, banking, retail and natural resources.

These cross-border private capital flows are often sources of new ideas, technologies, resources, skills and business models. They can make valuable contributions to economic growth and development on top of the essential role played by a productive and diversified domestic private sector.

Donors' Engagement with the Private Sector

During the past decade, most international donors and institutions have increased their engagement with the private sector. These new engagements have included bilateral donors, the United Nations, development finance institutions, and new multistakeholder institutions and initiatives.

Bilateral Donors

The members of OECD's Development Assistance Committee have employed a variety of new strategies, engagement models and financial and technical assistance facilities to promote private-sector development and to leverage private resources in efforts to meet the UN Millennium Development Goals and enhance humanitarian assistance. A 2009 study by the U.S.-based Business Civic Leadership Center reviewed the private-sector engagement strategies of 10 bilateral agencies that account for about 75 percent of official development assistance. It found that these agencies were focusing more of their resources on the private sector and that most had established dedicated units, funds and initiatives to form partnerships with businesses. A few of these—such as the Deutsche Gesellschaft für Technische Zusammenarbeit's Public–Private Partnerships Program, the U.S. Agency for International Development's Global Development Alliance and the U.K. Department for International Development's Challenge Funds—have now been operating for 10 years and offer useful lessons on what has and what has not worked, having catalyzed some 5,000 projects among them.

The United Nations

Many UN agencies, funds and programs have increased the level and quality of their private-sector engagement. New initiatives, such as the United Nations Global Compact, have also been created. Since this compact was established in 2000 under the leadership of the secretary-general, it has become the world's largest corporate citizenship initiative with more than 6,500 signatories, of which about 4,400 are from developing countries and 30 are from national or regional networks. The compact is funded primarily by bilateral donors and is governed by a multistakeholder board, and it requires corporate signatories to commit to a set of 10 principles in the areas of human rights, labor, the environment and anticorruption—and to report publicly on their progress. In addition, it works with other agencies to engage businesses in finding innovative solutions to development problems and in addressing climate change and water security.

The United Nations Development Program's Business Call to Action and Growing Inclusive Markets are two other new initiatives that are mobilizing the private sector to support development goals globally and at the country level. The United Nations Foundation, working through the UN Office for Partnerships and other agencies, has leveraged donor, philanthropic and private investments from a wide variety of sources to fund and scale up programs in areas such as women and population and climate and energy. Some 40 funds, programs and agencies also participate in the UN's Private Sector Focal Points network, which was established in 2004.

Development Finance Institutions

Bilateral and multilateral development banks and development finance institutions have also increased the level and range of the financial and advisory services that they offer to the private sector. As the World Bank's private-sector arm, the International Finance

Corporation offers a useful barometer. The IFC's investments have grown from $5.3 billion in 2005 to an anticipated $12.6 billion in 2010, and its number of projects has more than doubled, from about 236 in 2005 to an anticipated 528 in 2010. It now operates in 60 countries that are eligible for the World Bank's most concessional loan terms, compared with 29 countries of similar status five years ago, and it is extending its services to microenterprises and small enterprises and to finance market-based solutions to deliver health, housing, education and financial services for poor people.

In addition to increasing the size and reach of its portfolio, IFC is focusing more explicitly on the development impact of its clients. Its performance standards on social and environmental sustainability were launched in 2006 and have become a global benchmark. Similar approaches have been adopted by more than 30 OECD export credit agencies, 15 European development finance institutions and more than 70 financial institutions that are signatories of the Equator Principles, which cover 75 percent of all project financing in developing countries. The regional development banks demonstrate similar trends and actions. According to the World Bank, since 2000, the nonsovereign lending of the multilateral development banks has been their fastest-growing portfolio, albeit having started from a small base.

New Multistakeholder Institutions and Initiatives

An important trend during the past decade has been the establishment of new multistakeholder institutions, initiatives and funds that are financed and governed by a combination of donor agencies, philanthropic foundations, companies and business associations. Some were established as, or became, independent entities, and others are housed within existing public or nonprofit institutions. Many are global, and others are regional or sector specific.

Some of these institutions focus on mobilizing innovative funding mechanisms, harnessing market forces, overcoming market failures and/or addressing governance gaps to achieve greater scale in tackling complex, systemic challenges in global health and nutrition, food security, financial services for poor people and climate change mitigation and adaptation. Four notable examples of such organizations are the Global Fund to Fight AIDS, Tuberculosis and Malaria, the Global Alliance for Improved Nutrition, the Clinton Global Initiative, and the Alliance for a Green Revolution in Africa—all of whose operations have been catalyzed by funding from public donors, corporations and philanthropic foundations such as the Bill & Melinda Gates Foundation and the Rockefeller Foundation.

Other multistakeholder initiatives are focused on improving sector-wide accountability and transparency for social, environmental and human rights performance in industries and supply chains that have a major influence on development, such as extractives, manufacturing, agriculture, electronics, pharmaceuticals and construction. Examples include the Extractive Industries Transparency Initiative and the Voluntary Principles on Human Rights and Security, which focus on oil, gas and mining; the Fair Labor Association, which focuses on the apparel sector; the Equator Principles, which focuses on project finance; the Marine Stewardship Council, which focuses on fisheries; and many fair trade and sustainability certification programs in agriculture and consumer goods.

Business-led coalitions have provided an increasingly important platform for convening multistakeholder initiatives and mobilizing private-sector engagement in development. They include the World Economic Forum, the World Business Council for Sustainable Development, the International Business Leaders Forum, the Initiative for Global Development and Business Action for Africa.

These examples offer only a glimpse of the rapidly expanding and diversifying landscape of institutional engagement between the private sector and the donor community. These types of efforts focus on three main objectives:

- *Catalyzing domestic and international private investment to drive economic growth and opportunity.* Donors have provided policy support to developing country governments to improve the overall business climate for investment and financial and advisory support to private firms—ranging from large corporations to low-income producers and producer associations.

- *Leveraging the private sector as a partner to achieve broader development goals*. Donors have provided catalytic financing, convened multistakeholder initiatives, developed tools and undertaken capacity building to increase the broader development impact of private-sector activities. This has included efforts to spread responsible business standards and improve corporate accountability and transparency; engage companies and social enterprises in meeting the Millennium Development Goals and in promoting green growth by leveraging core business competencies, value chains and science and technology and/or harnessing resources from corporate philanthropy and volunteering; and working with companies to mobilize resources to improve the coordination and effectiveness of humanitarian responses.

- *Integrating the private sector's voice and experience into global policy dialogues*. Multilateral and bilateral agencies have taken measures to engage private enterprises and their representative bodies more systematically in global policy dialogues and as formal advisers to major donor programs.

Recommendations for Enhancing Collaboration between the Private Sector and Donors

There are thousands of individual project-based development partnerships between companies, donors, foundations and NGOs. Ongoing efforts are needed to increase the quantity, improve the quality and, when appropriate, increase the scale of these partnerships.

Simultaneously, there are untapped opportunities for groups of companies, donors and other development actors to collaborate in a more collective manner to achieve system-wide change and increase the scale and impact of joint efforts. The aforementioned multistakeholder initiatives provide existing examples of systemic collaboration. These multistakeholder efforts are not easy to establish or sustain. They require new modes of thinking and new operating models. They require leaders who can broker diverse and sometimes mutually distrustful institutions and individuals. Yet they are worthy of increased attention, analysis and experimentation. The following six areas offer particular potential for this kind of collaborative leadership.

First, cooperate to improve business investment climates. Donors, companies and foundations should create joint financing, technical assistance and/or data collection facilities to improve business climates for private investment. By focusing regionally, nationally or subnationally, these initiatives can prioritize key productive sectors and/or leverage resources for fragile states. The private-sector contribution should involve market-driven technical input, training and capacity building and not only funding. Three current examples are the Africa Investment Climate Facility, the Middle East Investment Initiative and the Emerging Africa Infrastructure Fund. The Center for Global Development has proposed a "Doing Business Facility," which would draw on the empirical foundation of the World Bank's Doing Business Project to deliver concrete financial incentives for the best business climate reformers.

Second, establish or strengthen mutual accountability mechanisms. There are opportunities for donors, companies, foundations, NGOs and research institutes to scale up or strengthen the multistakeholder accountability mechanisms that have been established during the past decade, and also to create new ones. Initiatives such as the Extractive Industries Transparency Initiative, the Roundtable on Sustainable Palm Oil, the Fair Labor Association, the Ethical Trade Initiative and the Access to Medicines Index offer very different financing and governance models for promoting responsible business practices and transparency in strategic industry sectors. Some promote greater public-sector transparency. They warrant detailed analysis and a collective effort to increase their scale or replicate them.

Third, scale up innovation to build inclusive and green value chains. The two increasingly interdependent challenges of poverty alleviation and climate change call for new technologies, new financial instruments, new business models and new value chains that (1) include poor people as producers, employees and consumers; and (2) use fewer natural resources to produce more products and services.

Donors, governments, companies, social enterprises and philanthropic foundations should all collaborate to make key value chains more inclusive and environmentally sustainable. The need and the potential are especially great in sectors such as agriculture, health, water and sanitation, energy, housing and financial services. Although such approaches are at an early stage, especially where corporations are playing a leadership role, there are interesting models that could be learned from, adapted, experimented with, and, where relevant, scaled up. In agriculture, corridor initiatives such as those being spearheaded by the World Economic Forum's "New Vision for Agriculture" in Mozambique, Tanzania and Vietnam and the commodity value chain initiatives being cocreated by agribusiness companies and organizations such as the Bill & Melinda Gates Foundation and TechnoServe offer collaborative models for the way forward.

Fourth, coordinate efforts to strengthen health systems. There is a potential to take a more systemic approach to strengthening health systems. Companies in many industries, not only health care, are already active in workplace programs and community efforts to address chronic and infectious diseases in developing countries. Collective business initiatives such as the Global Business Coalition on HIV/AIDS, TB and Malaria and country-level counterparts have mobilized private-sector leadership in tackling specific disease burdens. Multistakeholder global health partnerships offer innovative models for leveraging private finance, technology and networks to serve poor people, both globally and at the country level. These vertical initiatives provide lessons for launching country-led alliances aimed at strengthening health systems in a more integrated manner.

Fifth, build coalitions to enhance humanitarian assistance. Humanitarian crises are likely to increase in the face of climate change and in fragile states. Hundreds of companies and their employees already provide cash and product donations on an individual basis to humanitarian agencies and NGOs. A few are using social media networks and cause-related marketing campaigns to multiply these contributions. At the same time, there are opportunities for more systemic multistakeholder efforts to improve coordination, scale impact, manage costs and enhance effectiveness. Examples are emerging and need to be supported, studied and, where relevant, scaled up or replicated. They include the Partnership for Quality Medical Donations, NetHope, the Emergency Capacity Building Initiative and evolving cooperation between mobile telephone and financial service providers to facilitate donations, remittances and communication after disasters.

Sixth, integrate private participation into the aid effectiveness dialogue. Few private enterprises or their representative bodies have participated in the High-Level Dialogues on Aid Effectiveness. The Paris Declaration and the Accra Agenda for Action mention the private sector only six times, mostly in passing. In addition to the more vertically oriented recommendations outlined above, the private sector could be more effectively engaged on these three platforms:

1. Within developing countries, there is a need to explicitly broaden the concept of "country ownership" to include private-sector leaders and leaders from civil society—not only representative business groups but also top business, civic and academic leaders—to form high-profile coalitions that can help government officials identify priorities for inclusive and green growth and develop implementation strategies and public campaigns. Lessons can be learned from the Country Coordinating Mechanisms of the Global Fund, and from initiatives such as South Africa's Business Trust, which is jointly administered by government leaders and corporate CEOs to harness business resources for development.

2. Within donor countries, there is an opportunity to scale up business engagement in advocacy and public awareness efforts. In the United States, networks such as the Initiative for Global Development, the U.S. Leadership Council, the Modernizing Foreign Assistance Network and the Ad Council have brought together corporate leaders with their NGO counterparts to raise public awareness of development issues and/or to advocate for aid and trade reform in the U.S. government.

3. At the global level, the Fourth High-Level Dialogue on Aid Effectiveness in Seoul which will convene in the fall of 2011, offers an opportunity to engage the private sector more strategically. Business leadership coalitions and individual business leaders could be invited to share concrete examples on how companies are forming partnerships with donors to improve development outcomes and to make specific commitments for scaling business engagement in development. The Seoul dialogue will offer a platform to engage business leaders from Asia, Africa, Latin America and the Middle East, in addition to those from OECD-based multinationals.

Conclusion

Private-sector contributions and market-based approaches to development are by no means a panacea. Their potential can be undermined by governance gaps, market failures and bad business practices. Some of these obstacles can be overcome by collaboration with other development actors. Others call for regulatory oversight or vigilant nonprofit watchdogs and an open media. There will always be a need for governments, donors, philanthropists and NGOs to provide social services, cash transfers and safety nets to the poorest, most vulnerable communities.

At the same time, the private sector is an important part of efforts to improve development outcomes and stretch limited official development assistance and philanthropic dollars. Therefore, the donor community should collaborate more actively and closely with businesses at the operational and policy levels, both domestically and globally. There is great potential to jointly develop innovative new financing mechanisms, technologies and business models that will deliver more inclusive green growth in developing countries.

Editor's note: This brief is drawn from a forthcoming report: Jane Nelson, "Expanding Opportunity and Access: Approaches That Harness Markets and the Private Sector to Create Business Value and Development Impact," John F. Kennedy School of Government, Harvard University.