What Do We Know About the Effects of Private Sector Engagement?

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Veröffentlichungsversion / Published Version
Arbeitspapier / working paper

DEval
GERMAN INSTITUTE FOR DEVELOPMENT EVALUATION

DEval Policy Brief 3/2022

WHAT DO WE KNOW ABOUT THE EFFECTS OF PRIVATE SECTOR ENGAGEMENT?

Global challenges like poverty, climate change or health crises can only be overcome if state, civil society and economic actors pursue joint solutions. This is seen in the current effort to tackle the coronavirus pandemic: only the private sector's creativity and flexibility, along with close cooperation between private and public bodies, made it possible to develop and manufacture vaccines in record time.

The bulk of private investment flows to industrialised countries, while developing and emerging countries are often viewed as too risky. Development cooperation has therefore created a range of instruments to support (German, European and international) companies wishing to invest in partner countries whilst also pursuing development goals. These instruments are primarily expected to mobilise the additional funding needed to finance the Sustainable Development Goals (SDGs). But as to how far private sector engagement is achieving this and other objectives, until now the only research has taken the form of evaluations and academic studies on individual projects and instruments. In the evaluation synthesis by DEval (Habbel et al., 2021), the available evidence on private sector engagement is analysed systematically for the first time. The focus is principally on financial cooperation.

The evaluation synthesis differentiates between three private sector engagement approaches that are successful at mobilising private funding and achieving further positive effects in the partner countries. However, the analysis also points to some systematic weaknesses in the underlying evaluations and studies. First of all, development impacts are not sufficiently analysed or measured, but are only roughly estimated in most cases. Secondly, very few of the sources address the additionality of the development engagement – the strategically important question of whether the support really led to investment that would not have been mobilised without the public funding. The report therefore recommends that the responsible actors implement measures for the

- systematic and more accurate assessment of the additionality of private sector engagement projects and instruments, and
- improved measurement of development impacts

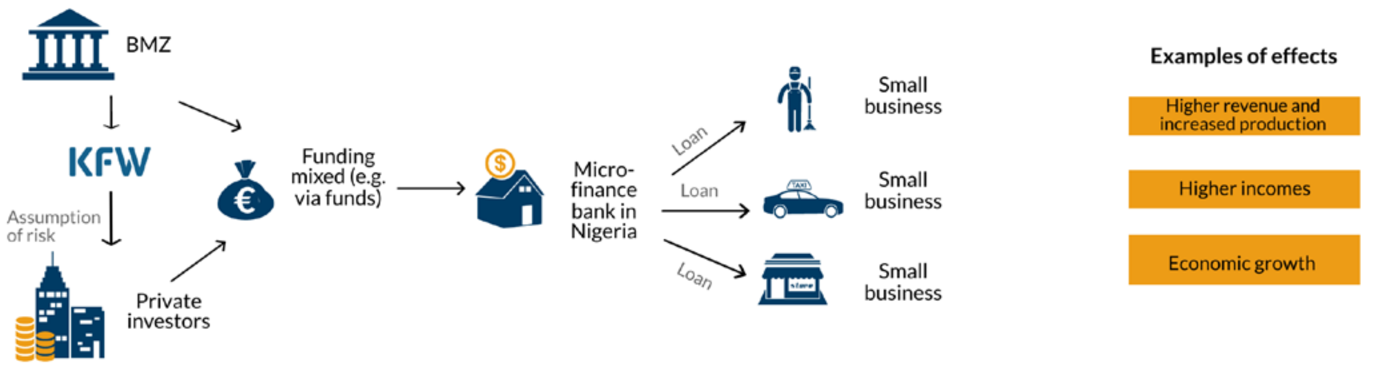
Methodological approach

The evaluation synthesis was conducted in line with procedures used for systematic reviews. Its object consisted of around 300 evaluations and academic studies on private sector engagement in German and international development cooperation, which were identified by means of an explicit search strategy and inclusion criteria. A sample was then drawn and quality-assessed with reference to nine indicators. The resultant 51 evaluations and studies reflect the evaluation practice of a variety of German development cooperation actors (including GIZ [Deutsche Gesellschaft für Internationale Zusammenarbeit] and KfW [KfW Development Bank]) as well as international bilateral and multilateral actors working in the field of private sector engagement.

Approaches for private sector engagement

Many investors perceive the risks of investing in developing and emerging countries to be very high, and therefore refrain from such investments. The evaluation synthesis differentiates between three approaches for private sector engagement which address these challenges in different ways. In "financing with companies", public funding is provided to reduce risk for private investors, as a buffer against potential losses from loan defaults, for instance. The aim of the approach is to free up additional private funding for the purpose of helping to achieve development goals. One way of doing so is to pass on the funding to

Figure 1 Illustrative example of "financing with companies"



Source: DEval

financial institutions in the partner countries so that they can finance micro-enterprises (see Figure 1).

The "financing of companies" is another format which makes use of financial incentives to mitigate the perceived high risk of entrepreneurial activity in the Global South. For example, companies from Germany or elsewhere in Europe can obtain grants or loans to embark on (additional) business activities in partner countries. The innovation and creativity of private sector actors are expected to generate positive effects in the partner country. An example of these are demonstration effects that result in more sustainable production and labour standards in the given sector (see Figure 2).

Finally, the "preparing for financing" format helps to facilitate the setting up of investable projects. For example, this can be done by providing technical support to intermediaries in partner countries or by brokering contacts between German companies and local ones. The contribution of this cooperation format to development impacts is largely indirect, in that it makes the financing of a company possible.

Findings of the evaluation synthesis: evidence for positive effects often weak

Mainly positive effects of private sector engagement reported

The evaluation synthesis confirms that additional private funding was indeed mobilised, as was expected on the basis of the literature. Further positive effects are reported in many different areas, such as: effects on knowledge and technology transfer at the intermediaries level, resulting from dialogue on standards between German and local companies in the partner country; environmental effects at the partner-country level by reducing emissions of greenhouse gases and other pollutants; and effects on the creation and safeguarding of employment with regard to target groups.

At the same time, cooperation between private sector and public actors gives rise to high transaction costs, especially in the initial phase of a project and when introducing a new instrument. Because public and private partners often have different goals and ways of working, and because of the pioneering nature of many projects, the planning, coordination and reporting of the joint activities usually involve time-consuming and complex processes. These costs fall over time or when activities are repeated, which should be taken into account in the conception of projects.

Little evidence of additionality and development impact

The predominantly positive picture of private sector engagement in the reports is relativised by their methodological deficits. Only rarely do the evaluations and studies examine unintended negative effects, for instance. In addition, while the sources examined report many (positive) effects, often these are only short- and medium-term effects such as the number of training courses delivered or the number of satisfied participants. In most cases, broader development impacts such as poverty reduction or signalling effects on foreign investors are only roughly estimated rather than explicitly measured.

Figure 2 **Illustrative example of "financing of companies"**

Source: DEval

Likewise, the sources only rarely analyse the risks associated with private sector engagement. Theoretically, the public funding can cause market distortions. This is the case, for example, when individual firms receive support and thereby gain an unfair advantage over competitors. Another danger is that private companies might use the assumptions of risk or provision of grants by public donors in order to make investments they would have made anyway (known as deadweight effects). Particularly in order to assess this risk, it would be necessary to examine additionality as a standard practice (see Box 1), which was only the case in a few evaluations and studies.

Assessing additionality

The Organisation for Economic Co-operation and Development (OECD) makes a distinction between financial and development additionality. An official investment is defined as financially additional when it supports a company that is unable, without public support, to obtain financing of a similar amount or on similar terms from local or international private capital markets; or when it mobilises investments from the private sector which would not otherwise have been invested (OECD, 2016).

Conclusions and recommendations

Even identifying relevant projects and instruments in this thematic field is difficult, because there is no consistent policy marker for private sector engagement that is used by all implementing organisations. For the same reason, is not possible to put a precise figure on the volume of funding allocated to this approach by the Federal Ministry for Economic Cooperation and Development (BMZ).

The available evidence describes a large number of positive effects of private sector engagement on investors and donors, intermediaries, target groups and the partner country. Nevertheless, its significance is limited: on the basis of the underlying evaluations and academic studies, clear answers cannot be given as to whether the projects and instruments considered achieve effects that would not have occurred without the public funding, and whether these are more than short-term effects.

To ensure that the public funding for private sector engagement is employed as efficiently as possible, there is a need for additional criteria in the conceptual design of projects and programmes in this area: the first is to apply the concept of additionality, and the second, to take account of the higher transaction costs arising due to the cooperation between the different partners. It should then be ensured that evaluations of these projects and instruments can identify not just short-and medium-term effects but also development impacts. Finally, a uniform means of identifying projects and instruments for private sector engagement would be important for the BMZ's portfolio management. Accordingly, the following recommendations are derived from the evaluation synthesis:

Examination of additionality and risks

During the conception, implementation and evaluation of projects and instruments for private sector engagement, bilateral and multilateral actors should systematically examine (financial and development) additionality as well as related assumptions and risks, since the evidence base is not sufficient as yet.

[1] *When they do, these most frequently affect the target groups in the partner countries – for example, in the form of price increases or dependency relationships.*

Conception and implementation

In the conception and implementation of projects and instruments for private sector engagement, bilateral and multilateral actors should ensure that private sector and development cooperation actors develop a reasonable joint understanding of objectives and continuously review related progress. The high transaction costs, which are incurred mainly during the initiation phase but also in the course of implementation, should be considered when conceptualising projects – for example, by striving for longer-term cooperation schemes between public and private sector actors.

Identification of private sector engagement

The BMZ should explore possibilities for unmistakably identifying projects and instruments for private sector engagement in German development cooperation, – for instance by using a uniform policy marker. This aims to increase transparency about the scale and role of private sector engagement and to simplify portfolio management and analysis on the part of the BMZ.

Measurement of impacts

GIZ, KfW and other bilateral and multilateral actors involved in private sector engagement should improve their assessment of development impacts. Especially in evaluations of high relevance, impacts should be measured and reported explicitly. Other evaluations may rely on theory-based approaches or estimation models, provided that these are presented transparently with a plausible, evidence-based impact hypothesis and relevant proxy indicators.

Sources

Habbel, V. et al. (2021), *Evaluation Synthesis: Private Sector Engagement,* German Institute for Development Evaluation (DEval), Bonn.

OECD (2016), *"Private Sector Peer Learning. Peer Inventory 1: Private Sector Engagement Terminology and Typology. Understanding Key Terms and Modalities for Private Sector Engagement in Development Co-operation",* Development Assistance Committee, Paris.

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The German Institute for Development Evaluation (DEval) is mandated by the German Federal Ministry for Economic Cooperation and Development (BMZ) to independently analyse and assess German development interventions. Evaluation reports contribute to the transparency of development results and provide policy-makers with evidence and lessons learned, based on which they can shape and improve their development policies.

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