Understanding Key Terms and Modalities for Private Sector Engagement in Development Co-operation

ABOUT

Members of the Organisation for Economic Co-operation and Development's (OECD) Development Assistance Committee (DAC) have recognised that there is a lack of shared terminology and understanding of modalities for private sector engagement in development co-operation. As part of the peer learning review on working with and through the private sector in development co-operation, DAC members requested the creation of a shared set of key terms and definitions, as well as a typology for classifying private sector engagements to facilitate the use of shared terminology and common understanding among DAC members.

This inventory provides a list of terms used in private sector engagements in development co-operation collected as part of the peer learning review. Unless otherwise stated, the definitions provided below are not official OECD definitions. Terms are presented thematically and cover a range of concepts relating to partnership, modalities for private sector engagement, business conduct, risk, leverage and additionality. The definitions draw directly or have been adapted from the OECD Glossary of Statistical Terms[1] where possible, as well as academic and policy literature (including from DAC members) on private sector engagement in development co-operation.

The inventory also includes a new typology of private sector engagement in development co-operation developed as part of the peer learning review. The typology aims to contribute to the development of shared understandings of modalities and mechanisms used in private sector engagements and establishes shared terminology for discussions among DAC members. The typology also provides a framework against which DAC members can review their private sector engagements, particularly in terms of identifying gaps in current approaches.

TERMS AND DEFINITIONS

Foundational concepts

Private sector: Organisations that engage in profit-seeking activities and have a majority private ownership (i.e. not owned or operated by a government). This term includes financial institutions and intermediaries, multinational companies, micro, small and medium-sized enterprises, co-operatives, individual entrepreneurs, and farmers who operate in the formal and informal sectors. It excludes actors with a non-profit focus, such as private foundations and civil society organisations (Crishna Morgado et al., forthcoming; Di Bella et al., 2013).

Private sector engagement: An activity that aims to engage the private sector for development results, which involve the active participation of the private sector. The definition is deliberately broad in order to capture all modalities for engaging the private sector in development co-operation from informal collaborations to more formalised partnerships. Given that the term applies to how development co-operation occurs, private sector engagement can occur in any sector or area (e.g. health, education, private sector development, renewable energy, governance, etc.). Through private sector engagement, the private sector and other participants can benefit from each other's assets, connections, creativity or expertise to achieve mutually beneficial outcomes (Crishna Morgado et al., forthcoming; Di Bella et al., 2013).

Private sector collaboration: A subset of private sector engagement, collaboration refers to engagement with the private sector that does not include a formal contractual relationship. Collaboration occurs when potential partners explore opportunities to address development challenges. This style of engagement is characterised by low levels of formality, obligation and risk (Commonwealth of Australia, 2015).

Private sector partnerships: A subset of private sector engagement, partnerships are characterised by more formal relationships (contract, memorandum of understanding, etc.) between parties and generally include higher levels of structure and obligation, including funding components (Commonwealth of Australia, 2015).

Public-private partnerships: A subset of private sector partnerships, according to the OECD Glossary of Statistical Terms, public-private partnerships are arrangements whereby the private sector provides infrastructure assets and services that traditionally have been provided by government, such as hospitals, schools, prisons, roads, bridges, tunnels, railways, and water and sanitation plants.

Private sector development: Activities carried out by governments and development organisations with the objective of promoting an enabling environment for the private sector in partner countries. Private sector development refers to the substantive nature of particular development activities (i.e. the sector targeted by development interventions). Activities include the creation of an adequate policy environment, addressing market imperfections (e.g. value chain development) and firm-level interventions (e.g. capacity building, access to finance and markets) (Crishna Morgado et al., forthcoming; Di Bella et al., 2013).

Modalities and mechanisms for private sector engagement

Modalities for private sector engagement: Modalities through which private sector engagement occurs. They include knowledge and information sharing, policy dialogue, technical co-operation, capacity development and finance (Di Bella et al., 2013).

- *Knowledge and information sharing:* This includes learning-oriented interactions that aim to identify and exchange experiences and best practices among organisations and firms. It also includes initiatives that aim to address information asymmetries in markets. Knowledge and information sharing is characterised by varying degrees of formalisation and institutionalisation.
- *Policy dialogue:* This includes policy-oriented discussions across sectors that aim to create or change policies or behaviour, including through the adoption of best practices and specific standards. Policy dialogue is characterised by varying degrees of formalisation and institutionalisation.
- *Technical assistance:* Mostly provided in the context of development finance, technical assistance includes the direct provision or funding for the provision of specialised advice and support to private sector actors.
- *Capacity development:* This includes efforts to enhance individual or organisational learning and develop the abilities of actors to perform functions, solve problems and achieve objectives.
- *Finance:* This includes transfers in cash, goods or services for which no repayment is required and transfers for which (re)payment is required to support specific projects, programmes or private sector entities. Finance includes private sector instruments.

Private sector instruments: The DAC considers all financial instruments that are used to engage the private sector in development co-operation to be private sector instruments. These instruments are associated with formal private sector partnerships and create contractual obligations when used. Private sector instruments include grants, reimbursable grants, debt instruments, equity, guarantees and other unfunded liabilities (OECD, 2015a; OECD, 2014b). Private sector instruments are a subset of the finance modality for private sector engagement.[2]

- *Grants:* These include transfers in cash or in kind for which no legal debt is incurred by recipients. In the context of private sector engagement, DAC members provide grants directly to companies, including through challenge or innovation funds, as well as other implementing partners, such as civil society organisations and multilateral organisations, to carry out activities in partnership with private sector partners. Under the Creditor Reporting System, grants include standard grants, interest subsidies and capital subscriptions on deposit and encashment basis.
- *Debt instruments:* These include transfers in cash or in kind for which recipients incur legal debt. Debt instruments include standard loans, bonds, asset-backed securities and reimbursable grants.
- *Mezzanine finance instruments:* Mezzanine finance can be structured as debt or preferred stock. It includes subordinated loans, preferred equity and other hybrid instruments.

- *Equity and shares in collective investment vehicles:* Refers to investment in a country on the DAC List of ODA Recipients that is not made to acquire a lasting interest. Includes common equity, shares in collective investment vehicles and reinvested earnings.
- *Guarantees and other unfunded liabilities:* A guarantee refers to a risk-sharing agreement under which the guarantor agrees to pay part or the entire amount due on a loan, equity or other instrument to the lender/investor in the event of non-payment by the borrower or loss of value in case of investment. Other unfunded contingent liabilities refer to other instruments that do not constitute a flow as such but may be also collected in future.

Innovative finance: Innovative financing is financing that deploys proven approaches to new markets (including new customers and segments), introduces novel approaches to established problems (including new asset types) or attracts new participants to the market (such as commercially oriented investors) (Guarnaschelli et al., 2014). This broad definition includes a variety of financial tools, including mechanisms that raise funds or stimulate actions in support of international development that go beyond traditional spending approaches by either the public or private sectors (Sandor et al., 2009). Examples include securities and derivatives (e.g. grants, guarantees, loans, bonds and notes), results, output- or performance-based mechanisms (e.g. advanced market commitments, challenge funds and development impact bonds), voluntary contributions (donations as part of consumer purchases) and compulsory charges such as taxes (Guarnaschelli et al., 2014).[3]

Blended finance: DAC members define blended finance as "the strategic use of official funds including concessional tools to mobilise additional capital flows (public and/or private) to emerging and frontier markets" (OECD, 2016b: 3). In their work on blended finance, the World Economic Forum and OECD (2015) note that blended finance has three characteristics: leverage, the use of development or philanthropic funds to attract capital into deals (i.e. concessional finance); impact, investments that drive social, environmental and economic progress; and returns, in line with market expectations based on real and perceived risks. Given that blended finance explicitly aims to attract new participants to markets, it can be seen as a form of innovative finance.

Impact investing: According to the Global Impact Investing Network (GIIN, n.d.), impact investments are investments made into companies, organisations and funds with the intention of generating social and environmental impacts alongside financial returns. Core characteristics include: intentionality (i.e. an investor intends to have a positive impact); return expectation on capital, or at a minimum, a return of capital; a range of return expectations and asset classes; and measurement of social and environmental impacts. The ambitions of impact investing are similar to blended finance in terms of supporting positive development results while realising financial returns. However, impact investing does not explicitly seek to mobilise additional private flows, as is the case with blended finance. Impact investing can be seen as a form of innovative finance. It introduces a novel approach to an established problem, particularly in that it moves beyond traditional spending profiles for the public and private sectors. Impact investing is sometimes referred to as social investing.

Business Conduct

Responsible business conduct: The OECD's "Policy Framework for Investment" notes that responsible business conduct entails compliance with laws, such as those on respecting human rights, environmental protection, labour relations and financial accountability, even in countries where these are poorly enforced (OECD, 2015b). Corporate social responsibility activities are also considered a part of responsible business conduct by the OECD. Responsible business conduct involves responding to societal expectations – in terms of environmental, social and economic outcomes – communicated by channels other than the law (e.g. by inter-governmental organisations, within the workplace, by local communities and trade unions, or via the press). The OECD has OECD Guidelines for Multinational Enterprises (OECD, 2014a)[4] on responsible business conduct and the United Nations has developed Guiding Principles on Business and Human Rights (UN, 2011).

Corporate social responsibility: Initiatives by companies to assess and take responsibility for effects on environmental and social well-being. The term is often used to describe activities that go beyond regulatory or legal requirements. The International Organization for Standardization has set out guidelines for companies to integrate corporate social responsibility into their operations (Investopedia, 2016).[5]

Inclusive business: Efforts by the private sector to target the poor and include them into supply chains as employees, producers and business partners or through the development of affordable goods and services needed by the poor. Inclusive business has a greater focus on the profit motive than corporate social responsibility activities (ADB, 2016; Gradl and Knobloch, 2010).

Risk

Financial risk: The possibility of financial loss as a result of an investment.

Reputational risk: The possibility of reputational damage as a result of being associated with a particular partner or investment.

Leverage and additionality

Leverage: The OECD Glossary of Statistical Terms defines leverage as having exposure to the full benefits arising from holding a position in a financial asset, without having to fully fund the position with own funds.

Catalytic: The role of development organisations or aid in stimulating actions on the part of other actors such as the private sector, national governments and civil society. The term is often used to refer to catalysing additional flows for development, but a broader understanding includes catalysing other types of change, such as behavioural change and systemic change.

Additionality: "In the context of reporting on private sector instruments in DAC statistics, [the OECD-DAC Secretariat proposes that] an official transaction be considered *additional* either because of its 'financial additionality' or 'value additionality' or both. Such a transaction is *financially additional* if it is extended to an entity that cannot obtain finance from local or international private capital markets with similar terms or quantities without official support, or if it mobilises investment from the private sector that would not have been otherwise invested. It is *additional in value* if the public sector offers to recipient entities or mobilises, alongside its investment, non-financial value that the private sector is not offering and which will lead to better development outcomes e.g. by providing or catalysing knowledge and expertise, promoting social or environmental standards or fostering good corporate governance" (OECD, 2016c).

Development additionality: In addition to financial and value additionality, the literature on additionality often refers to development additionality. This term refers to the development impacts that arise as a result of investment that otherwise would not have occurred. In this case, one of the main rationales for partnership is that it facilitates faster, larger or better development impacts than the public or private sector would be able to achieve working alone.

Other terms

Bankability: A project or proposal is considered bankable if investors are willing to finance it (EPEC, n.d.).

Base of the pyramid: The base of the pyramid (BoP, sometimes referred to as the bottom of the pyramid) refers to approximately four and a half billion people who live on less than USD 8 per day at the base of the global economic pyramid. The concept of addressing the needs of people at the BoP through business was introduced in 2006 by C.K. Prahalad. Often people at the BoP are excluded from formal markets, face a lack of competition and overpay for goods and services of low quality. Under the BoP theory, poor people can benefit through the application of disruptive new technologies and inclusive business models that provide access to basic needs. Activities include engaging people at the BoP as producers, consumers and entrepreneurs to improve livelihoods and drive economic growth for communities and the private sector (BoP Global Network, 2012; BoP Innovation Center, n.d.).

Shared value: The term refers to the result of policies and operating practices that enhance the competitiveness of a company while simultaneously advancing economic and social conditions in communities where it operates (Commonwealth of Australia, 2015).

A TYPOLOGY OF PRIVATE SECTOR ENGAGEMENT IN DEVELOPMENT CO-OPERATION

Drawing from and building on the existing typologies of private sector engagement (see Vaes and Huyse, 2015; Di Bella et al., 2013; Kindornay and Reilly-King, 2013; Smith, 2013; BMZ, 2011), the new typology presented below in Table 1 aims to consolidate private sector engagement modalities and mechanisms. The typology is not exhaustive of all possible forms of private sector engagement. It focuses on private sector engagement from the view of development co-operation providers – the categorisation is based on the modalities and mechanisms provided by DAC members as the starting point. It also includes the roles of the private sector in each modality.

Modalities and mechanisms

The typology is organised around broad modalities for private sector engagement and the mechanisms used therein. It is centred on five modalities for private sector engagement: knowledge and information sharing, policy dialogue, technical co-operation, capacity development and finance. Each modality is accompanied by a list of objectives and mechanisms typically associated with it, as well as illustrative examples, most of which are available online. Depending on how mechanisms are structured, they can draw on multiple engagement modalities (e.g. by including policy dialogue and financing under one mechanism). Within each modality, engagements occur at various levels of depth, ranging from private sector collaboration to more formal private sector partnerships.

Private sector role and risk

For each modality, the typology lists the roles of the private sector. Adapted from Vaes and Huyse (2015), it notes the private sector's role as a beneficiary, implementer, reformer, resource provider, participant or target. The private sector is a *beneficiary* when it benefits from development co-operation activities, including in terms of an enabling business environment, financial support, capacity development, technical assistance, information provision and knowledge sharing. The private sector serves as an *implementer* when companies implement new business models to realise development impacts in terms of social, economic or environmental sustainability. When companies reform existing business approaches to be more development-friendly in terms of social, economic or environmental sustainability, they serve as *reformers*. The private sector is a *resource provider* when it invests financial resources, expertise or other strategic resources, which include donations and investments (financial and non-financial) in projects or initiatives that have a development objective. The private sector is a *participant* when it participates in development-related initiatives such as policy dialogue, knowledge sharing and multi-stakeholder initiatives. Finally, the private sector is a *target* when it is targeted by government, civil society, other private sector stakeholders or multilateral organisations to change its business practices. These roles are not mutually exclusive – the private sector often plays multiple roles in particular private sector engagement activities. In addition to listing the roles of the private sector in different modalities, the typology outlines levels of private sector financial risk.

Table 1. **Typology of private sector engagement in development co-operation**

Modality	Objectives	Mechanisms	Examples	Roles of the private sector	Level of financial risk
Knowledge and information sharing	• Advance solutions by sharing new methods, tools and innovative approaches to addressing development challenges	• Multi-stakeholder networks • Learning platforms • Conferences, seminars, workshops and other events • Funding for research (specifically on private sector engagement in development co-operation)	• Aligned Capital in Impact Investing • Alliance for Integrity • PPPLab • Practitioner Hub for Inclusive Business	• Beneficiary • Participant • Resource provider	• Low
Policy dialogue	• Develop policy agendas and frameworks at international, national and local levels that reflect all parties' interests • Change behaviour such as through improvements in corporate practices and industry standard-setting	• Multi-stakeholder networks and platforms • Cross-sector roundtables • Specialised hubs or institutions • Institutionalised dialogues	• Dutch Post-2015 Charter Initiative • Inclusive Business Action Network • Swedish Leadership for Sustainable Development	• Beneficiary • Participant • Target	• Low
Technical assistance	• Enable private sector actors to effectively engage in development co-operation such as through support for project design • Improve private sector actors' operational capacities and effectiveness	• Business advisory services • Feasibility studies	• DEG financing opportunities • Service Point for the Private Sector and EZ-Scouts	• Beneficiary	• Moderate • Private sector beneficiaries typically contribute to costs
Capacity development	• Improve capacities of private sector actors to contribute to development results • Change or modify business operations	• Training activities and other forms of capacity development programming • Professional exchanges and secondments	• Chambers and Associations Partnership Programme (KVP) • Entrepreneurship promotion • Vocational Education and Training Partnership Programme (BBP)	• Beneficiary • Reformer • Target	• Low
Finance	• Leverage or raise private sector finance and investment promotion • Test innovation and scale success • Monetise development results (e.g. output-based mechanisms) • Support expansion of more and better business including through the promotion of business-to-business partnerships, inclusive business, responsible business conduct and corporate social responsibility • Harness private sector expertise and market-based solutions to development challenges	• Private sector instruments including grants, debt instruments, mezzanine finance instruments, equity and shares in collective investment vehicles, guarantees and other unfunded liabilities • Includes the range of instruments captured under innovative finance	• Africa Enterprise Challenge Fund • African Guarantee Fund • DEG financing opportunities • Development Credit Authority • Dutch Good Growth Fund • Global Development Alliances • Impact investing	• Beneficiary • Implementer • Reformer • Resource provider • Participant	• Moderate to high

Notes

1. See https://stats.oecd.org/glossary for access to the glossary of terms.
2. Definitions as provided in the 2016 Creditor Reporting System code list. See http://www.oecd.org/dac/stats/dacandcrscodelists.htm and OECD (2016a). For a review of some of the more complicated financial instruments used by donors, see Benn et al. (2016) and Bilal et al. (2014: 14).
3. The OECD Glossary of Statistical Terms does not define innovative finance. It does, however, define innovation co-operation as involving active participation in joint innovation projects with other organisations. These organisations may be either other enterprises or non-commercial organisations. The partners need not derive immediate commercial benefits from the venture. Pure contracting out of work, where there is no active collaboration, is not regarded as co-operation. Co-operation is distinct from open information sources and acquisition of knowledge and technology in that all parties take an active part in the work.
4. See mneguidelines.oecd.org for access to information, tools and resources relating to the promotion and implementation of the guidelines.
5. Under ISO 26000, social responsibility refers to the responsibility of an organisation for the impacts of its decisions and activities on society and the environment through transparent and ethical behaviour that contributes to sustainable development, takes into account the expectations of stakeholders, is in compliance with applicable law and consistent with international norms of behaviour, and is integrated throughout the organisation and practiced in its relationships (ISO, 2014).

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