UNDP-Spain MDG Achievement Fund

Terms of Reference for Thematic Window on

<u>Development and the Private Sector</u>

This document provides policy guidance to UN Country Teams applying for funding under the UNDP-Spain MDG Achievement Fund (MDG-F) Thematic Window for **Development and the Private Sector**. The framework elaborated below sets out the policy goals of the Fund in this area and illustrates the types of interventions the Fund will support. This guidance will also be applied by the technical assessment process that will review applications. These Terms of Reference should be read in conjunction with the Fund's **Framework Document** which sets out the overarching strategy for the MDG-F and the **Concept Note Format** which provides the format for submissions. These can be viewed at the Fund's home page at Hwww.undp.org/mdgfH. Kindly note that MDG-F Thematic Windows will only accept applications from UN Resident Coordinators in eligible countries, applying on behalf of their UN Country Team

1. Background and Rationale

It is widely acknowledged that the private sector has a central role to play in poverty reduction and the achievement of the MDGs,. Private enterprises and functioning markets contribute to poverty reduction directly, through the creation of jobs and the supply of goods and services that the poor need, and indirectly through their contribution to aggregate economic growth and tax revenues. The private sector can also play an important role through strategic social investments that reinforce local, national and global development priorities, engaging in policy dialogue and advocacy around key development issues and ensuring that business activities are aligned with key sustainability principles.

The contribution of the private sector to poverty reduction is by no means assured however. In many UN program countries the 'indigenous' business sector is characterized by a relatively small number of inefficient and uncompetitive large enterprises, and a large number of micro and small enterprises that operate on a subsistence basis in the informal sector. Such enterprises typically have limited growth potential and contribute minimally to the creation of productive and decent work. Meanwhile markets for goods and services that the poor rely upon for their livelihoods and consumption are often highly distorted or non-existent. Largely because of these weaknesses, the private sector is often not engaged as a partner in broader development processes.

As a consequence the full transformative potential of the private sector cannot be realized. 'Eco-systems' of enterprises and inter-enterprise linkages that offer the potential for rapid growth and decent work creation fail to materialize, and the poor, where they have access to markets at all, pay significantly inflated prices (so called ‘poverty premiums’) for goods and services that are often sub-standard.

Addressing these problems, ensuring that private sector development contributes directly to pro-poor growth and strengthening its role in broader development processes are the main objectives of the ‘Thematic Window on Development and the Private Sector’ (TWDPS). Consistent with the human development paradigm, the TWDPS is intended to encourage the development and implementation of UN agency projects that result in one or more of the following: decent and productive work for the poor, expanded consumer choices for the poor and / or mechanisms that enable the private sector to become a stronger partner in development. Such projects should draw on the unique strengths of the participating UN agencies and have the potential to leverage systemic change or (in the case of pilot or demonstration projects) to be scaled up.

Activities undertaken under the TWDPS will make a significant contribution to the broader goals of the UNDP-Spain MDG Achievement Fund and will both contribute to, and benefit from, activities pursued under the Windows on Youth, Employment and Migration, Democratic Economic Governance, Environment and Climate Change and Gender Equality and Women’s Empowerment. In particular, activities aimed at promoting entrepreneurship and investment, increasing productivity, harnessing business linkages and improving market access and functioning will significant enhance employment prospects in participating countries and complement labor supply-side issues addressed through the Window on Youth Employment and Migration. Activities aimed at creating an enabling environment for increased private sector engagement in development processes will strengthen specific measures to promote public private partnerships in service delivery promoted through the Window on Democratic Economic Governance.

2. Key Challenges and Opportunities

The key challenges to be addressed by the TWDPS are the following[1]:

i. **Creating incentives for entrepreneurship and investment** - In the majority of TWDPS program countries entrepreneurship and investment lag considerably behind equivalent OECD rates. Addressing this problem requires policies that provide greater access to productive resources (including real property and financial capital), encourage entrepreneurship and employment-intensive investment, and reduce the costs and risks of doing business. Particular attention needs to be paid to economic sectors in which the poor are strongly represented as producers and consumers. Robust and transparent institutions are required to implement these

[1] See OECD DAC ‘Accelerating Pro-Poor Growth through Support for Private Sector Development – An Analytical Framework’ 2004

policies, to enforce contracts and to ensure a level playing field for the poor at local and national levels.

ii. **Increasing productivity through competition, innovation, networking and decent working conditions** - In order to ensure that the poor can compete successfully in an increasingly globalised economy, pro-poor growth also requires measures to promote increased productivity and improved working conditions. Such measures include investments in human capital and new technologies (especially value-adding ICTs), clustering or cooperative initiatives that enable small scale producers to enjoy lower transactions costs and / or economies of scale, access to know-how and business development services, competition policies, strategies to promote research and development, respect for workers' rights and, the adoption of workplace practices that increase competitiveness and increase workers' incomes.

iii. **Harnessing economic linkages** - For poor producers to contribute to and benefit from growth, steps need to be taken to address the significant inequalities of opportunity that they face in integrating into domestic and international supply chains. In addition to policies that promote entrepreneurship, investment and increased productivity, measures are typically required to overcome information constraints, promote inclusive standards and encourage supply chain upgrading by lead firms (including the upgrading of SME suppliers).

iv. **Improving market access and functioning** - Meeting the above challenges may help to ensure pro-poor growth, but for the poor to benefit to the fullest extent from it, attention needs to be paid to the mechanisms through which they participate in and benefit from markets for productive resources and the goods and services that they rely on for their livelihood and consumption needs. Improving market access and functioning for poor producers requires *inter alia* measures to increase competition in value chain functions that capture the highest proportion of total value added. For poor consumers it requires measures to promote competitive supply markets and encourage innovative new 'bottom of the pyramid' business models.

v. **Reducing risk and vulnerability** - Pro-poor private sector development requires that the poor have the means to mitigate risks from various shocks (man-made and natural) that impact on them disproportionately, undermining the benefits they might otherwise derive from growth. Many of these risks can and should be offset by sound public policies and the provision of public services, but in most participating countries public provision is weak or non-existent and markets for private risk mitigation, including savings and specialist risk products to underwrite productive resources have yet to develop.

vi. **Engaging the private sector in the broader development process -** The voice and resources that the private sector can bring to bear in terms of its knowledge, expertise, physical, technological and financial resources, innovative solutions, business models etc, are also not always well heard or understood. These capacities, combined with those of governments and civil society actors, can be effective in addressing issues ranging from education, health, energy access and environmental concerns to social cohesion and corruption, to mention a few. The effective delivery of basic services is vital not only for poverty alleviation and MDG achievement but is also indispensable for functioning of markets and the private sector itself. There is a lack of capacity (in the public as well as private sectors) and mechanisms that can allow for innovative and more systematic public-private partnerships to take place. These challenges are highly interlinked. If one is not in place it will act as a brake on growth or make the outcomes associated with growth and private sector activities less pro-poor. It is also essential that private sector actors, including organizations representing small enterprises, are given the opportunity to participate actively in shaping reforms of the policy and regulatory environment for business.

3. Illustrative Interventions

The TWDPS seeks to facilitate the achievement of the MDGs through interventions that promote the development of private sector, through enabling policy frameworks, the growth of inclusive markets and the establishment of pro-poor public-private partnerships that create and sustain decent and productive employment. Taking into account the challenges outlined above, preference will be given to applications that contribute demonstrably to one or preferably more of the following outcomes.

For poor producers:

i. Enhanced access to productive resources
ii. Reduced costs and risks of doing business
iii. Enhanced productivity and improved working conditions
iv. Integration into (domestic and international) supply chains
v. Increased value-added and returns on investment

For poor consumers:

vi. Increased affordability / expanded choice of goods and services
vii. Effective and affordable mechanisms for mitigating risks

More broadly:

viii. Improvements in the efficiency and effectiveness of development policies and processes resulting for the engagement of the private sector as a partner

In order to achieve these outcomes, proposals are encouraged to identify the most appropriate entry points for intervention, bearing in mind the potential for leveraging systemic and sustainable change. Potential entry points could include key line ministries and local authorities, foreign and domestic investors, lead companies, business representative organizations, financial services providers, business development service providers and MSMEs.

Illustrative interventions under each of the above outcomes are provided below.

i. Enhanced access to productive resources

- Technical assistance for property reforms and conflict resolution mechanisms, including property titling and capacity building for local cadastral and planning authorities
- Support for inclusive finance programs that promote the development of vibrant national and local markets for MSME finance, including microcredit, cooperative finance, leasing, factoring, loan guarantees and private equity
- Institutional strengthening for local financial services providers including microfinance institutions, credit unions and cooperatives, mutual guarantee associations etc.
- Institutional strengthening of technical and business services providers including technical resource centres, business counselors, testing laboratories (including measures to secure their long-term sustainability).
- Entrepreneurship development programs, especially those that target disadvantaged and vulnerable groups (i.e. long-term unemployed, women, IDPs, ethnic minorities). N.B. Entrepreneurship development for youth, and other labour supply-side measures should be submitted under the Thematic Window for Youth, Employment and Migration

ii. Reduced costs and risks of doing business

- Technical assistance for the formulation and implementation of business environment reform programs, including capacity building for national and local regulatory and enforcement authorities
- One-stop-shops that reduce the costs of regulatory compliance
- Institutional strengthening for business associations and workers' organizations that represent the interests of poor producers and employees, and the promotion of mechanisms for ensuring meaningful participation in national and local decision making processes
- Targeted programs (entailing elements of the above) that remove barriers and create incentives for informal sector businesses to join the formal economy

iii. Enhanced productivity and improved working conditions

- Support for legal and regulatory reforms that facilitate the formation and growth of enterprises, with a particular focus on small enterprises including those that have the potential to move from the informal to formal economy. This will include the promotion of cooperatives, purchaser and producer associations and other forms of collective private enterprise, enabling small scale producers to benefit from scale economies and increase investment in value-adding technologies and processes.
- Programs that increase productivity through improvements in working conditions, the adoption of sound workplace practices, the respect of rights at work and the skills development of the workforce

- Clustering and linkages initiatives, including support to inter-firm linkages and the development of an appropriate institutional environment for promoting efficiency and joint action
- Initiatives that facilitate the transfer and diffusion of affordable productivity enhancing technologies, especially ICTs

iv. Integration into (domestic and international) supply chains

- Technical assistance for the development and implementation of public procurement initiatives that create a ‘level playing field’ for poor producers / suppliers at national and municipal/local level
- Capacity building measures to strengthen the ability of poor producers / suppliers to compete successfully for public tenders
- Support the development of inclusive standards and capacity building measures to assist poor producers / suppliers to attain them
- Supplier development and exchange schemes
- Partnerships with lead firms to promote socially and environmentally responsible investments in local content and supply chain upgrading
- Upgrade SME competencies in socially and environmentally responsible business practices to increase their access to international value chains.

v. Increased value-added and returns on investment

- Technical support for the mapping of employment elasticities and the identification of employment intensive sectors and value-chains with the potential for productivity growth
- Value chain diagnostic initiatives and the identification of binding constraints to value chain integration
- Comprehensive value chain programs that increase value addition and returns on investment for poor producers

vi. Increased affordability / expanded choice of good and services

- Advocacy and technical support for initiatives that encourage innovation in ‘bottom of the pyramid’ goods and services and pro-poor business models
- Strategic partnerships with lead firms and investors in respect of the above
- Technical support for investments and regulatory reforms that result in increased competition and de-concentration in key factor markets and markets for pro-poor goods and services, including health and social welfare services and consumer financial services (see also below)

- Technical support for the creation of enabling legal and regulatory environments for financially sustainable social enterprises that address the needs of the poor and socially excluded

NB. Public private partnership initiatives to improve the efficiency, access and affordability of utilities should be submitted under the Thematic Window on Democratic Economic Governance.

vii. Effective and affordable mechanisms for mitigating risks

- Support for credit risk management initiatives that reduce the risk of lending to poor producers / suppliers without introducing significant 'moral hazards.'
- Technical assistance and institutional strengthening support for the development of national and local financial services initiatives that increase access to consumer financial services for the poor (savings, consumer credit, money transfers, micro-insurance and pensions)

viii. Increased engagement of the private sector as a partner in development

- Establishment of mechanisms that allow for more systematic and informed interaction and collaboration between the public sector, the private sector and other actors in addressing key development issues.
- Initiatives that integrate private sector and development measures into national or sub-national policy and planning frameworks (PRSPs, national development strategies, national economic development plans, and regional and local development plans) including associated capacity building measures.
- Support to specific and strategic public private partnerships at national or local levels that address one or more MDGs, including in particular access to basic services, such as health, education, energy or the fight against hunger.
- Initiatives that aim to build capacity and disseminate good practices in public-private collaboration for local public and private actors.

4. Measuring Impact

Programmes financed by the MDG-F in this window will be expected to demonstrate credible, measurable results. Applications to the Fund will therefore be required to identify baseline key indicators, as well as performance and results indicators that can be used to measure and monitor the success of the programme.

Indicators will be linked wherever possible to the direct outputs and outcomes of projects and to any indirect beneficiaries. Special efforts should be taken to disaggregate findings with respect to gender and socially excluded groups. Indicators should include quantitative as well as qualitative measures of progress and impact.

All proposals from UN Country Teams must justify their interventions based on a prior formulation of a diagnosis identifying the general issues and constraints. The formulation of ex ante evaluations of the impact of the proposal on poverty reduction will be welcomed, following, for example, the methodologies of the World Bank’s Poverty and Social Impact Analysis (PSIA), or the ex-ante Poverty Impact Analysis (PIA) from OECD DAC.