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# Acronyms and abbreviations

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<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>BMZ</td>
<td>Federal Ministry for Economic Cooperation and Development</td>
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<td>CSR</td>
<td>Corporate social responsibility</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>DCED</td>
<td>Donor Committee for Enterprise Development</td>
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<td>DEG</td>
<td>Deutsche Investitions- und Entwicklungsgesellschaft</td>
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<td>GIZ</td>
<td>Deutsche Gesellschaft für Internationale Zusammenarbeit</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>MDG</td>
<td>Millennium Development Goals</td>
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<td>MSME</td>
<td>Micro, small and medium-sized enterprises</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PSD</td>
<td>Private Sector Development</td>
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<td>SME</td>
<td>Small and medium-sized enterprises</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>UNFPA</td>
<td>United Nations Population Fund</td>
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<td>UNIDO</td>
<td>United Nations Industrial Development Organization</td>
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Purpose and objectives of the sector strategy

This sector strategy lays out the development-policy directives of the Federal Ministry for Economic Cooperation and Development (BMZ) for German development cooperation in the field of private sector development. Private sector development is an area of core competency within the priority area ‘sustainable economic development’, which also embraces economic policy, financial systems development and vocational training.

The sector strategy aims to provide a guiding vision and framework for decisions on support measures. It underlines the importance of the private sector for the economic and social development process in partner countries and identifies typical challenges facing private businesses in this context. Building on the experience of development cooperation, it also presents private sector development approaches and instruments suited to achieving the desired results.

The sector strategy thus gives representatives of German development cooperation the tools they need to argue their case, and provides information for the general public. Specifically, it contains important directives for development policy that are relevant to decision-making. This applies to:

a. The identification, appraisal, design, implementation, steering and evaluation of sector-/issue-related programmes and modules. The strategy is binding for implementing organisations. It also provides guidance for the work of non-governmental organisations, the churches, foundations and private-sector actors.

b. The development of regional strategies and country strategies within bilateral development policy.

c. Positioning German development policy in the international debate and elaborating our inputs to multilateral/regional cooperation and to European development cooperation.

d. Communication with the general public in Germany, with the German Bundestag and with other federal ministries.

This sector strategy replaces the cross-sectoral concept on ‘Promotion of the private sector in the partner countries of the BMZ’ published in 1996.
**Summary**

There can be no self-sustaining economic development without a dynamic private sector. Productive private businesses generate employment and income, and the taxes they pay lay the foundations for a capable public sector. Equally, they help meet social and environmental challenges in areas important for development policy, including health, education and environmental protection. **Private sector development** is thus one of the most important **levers in achieving structural poverty reduction** and mobilising the potential of partner countries to free themselves from a state of dependence.

In many developing countries though, **unfavourable business conditions, low levels of investment** and the resulting **low levels of productivity and competitiveness** prevent companies from growing. The root causes can be found in unfavourable political, legal and administrative frameworks, in shortcomings in the institutional environment within which businesses operate, and in the limited capacities of the private sector to innovate. Further important causes are the difficulties businesses experience in accessing financial services, and deficits in infrastructure as well as low levels of education among employees.

The objective of **private sector development** is to strengthen the private sector in partner countries in the long term. The main target group comprises micro, small and medium-sized enterprises (MSMEs) in both the formal and informal sectors in developing countries. The support strategy of German development cooperation is geared to helping partner countries put in place an enabling political, legal and administrative environment for private investment and to establish competitive and sustainable economic structures. Since official development cooperation cannot achieve all these objectives on its own, German development cooperation is also increasingly working with the private sector to generate more sustainable investment and foster greater corporate social responsibility.

The focus of the support strategy varies depending on the development status and the context in each partner country, and takes its lead from the strategies and objectives of our partners. The strategy is then implemented using a combination of **Technical and Financial Cooperation, as well as partnerships with private businesses and civil society**.

This strategy enables German development cooperation to tackle major development challenges, facilitate increased investment and support the development of competitive, productive and sustainable businesses. It is implemented **in close conjunction with measures in the complementary areas of operation** of economic policy, financial systems development, vocational training, labour market support, infrastructure and good governance.
1. The importance of the private sector and scope of the area of operation

1.1 THE IMPORTANCE OF THE PRIVATE SECTOR FOR DEVELOPMENT POLICY

One quarter of the population of developing countries, about 1.4 billion people in total, live on less than 1.25 US dollars a day. In most of these countries there is a lack of productive employment that would give people the chance to take charge of their own lives and live in dignity. Some 200 million people around the globe are currently unemployed and more than 1.5 billion are employed under precarious conditions. It is estimated that about 39 per cent of all (self-)employed persons earn no more than 2 US dollars a day, meaning that they belong to the working poor.

Productive private businesses are the drivers of investment and economic growth. They create jobs and generate income. Since poor people often have only their labour as a means of earning a living, productive employment in a company or self-employment is a key precondition to improving their situation.

Private sector development is the basis for sustainable development in our partner countries. The jobs and income generated play a crucial part in reducing poverty and achieving Millennium Development Goal (MDG) 1 – eradicate extreme poverty and hunger. Over and above this, an increase in tax revenues is essential to enable governments to provide public goods and services, e.g. in the health and education sectors. In fragile contexts, in which conflict and poverty are mutually reinforcing, private sector development can also help stabilise the overall situation by generating income and reducing poverty.

At the same time, by developing innovative products and providing efficient services, private businesses offer a huge potential to solve problems in areas important for development policy, including environmental and climate protection, food security, health, social protection and rural development. For example, private companies develop technologies for improved climate change mitigation, offer insurance products providing coverage against ill health and mobile-phone-based information products for farmers. The private sector can thus also make a major contribution to achieving other MDGs as well as other international conventions and agreements.

In order to tap the potential offered by the private sector, Germany engages, through its programme of development cooperation, in private sector development. It has been active in this field for many years in a large number of countries and therefore has a good network of connections. This is useful for pursuing German interests in other policy areas (including environmental protection, peace and security, and external economic promotion).

1.2 SCOPE OF THE AREA OF OPERATION

The area of operation ‘private sector development (PSD)’ embraces development-policy measures aiming to create an enabling environment for investment and sustainable private-sector activity as well as enhancing the competitiveness and innovation capacities of businesses in partner countries.

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4. Ibid.
Private sector development is an area of core competence within the priority area 'sustainable economic development'. The success of private sector development is dependent on the success of, and a coherent interplay with, the other three complementary areas of core competency of this priority area: a well-functioning financial system, sound economic policy, and a demand-driven vocational training system along with a functioning labour market. Over and above this, a well-developed economic and social infrastructure (access to power, transport options, communication networks, education, health care and water), and good governance are key to achieving the intended results of private sector development. This sector strategy is thus closely linked to the BMZ strategies and position papers for these areas of operation.

Equally, direct cooperation with the local and international private sector in all areas of development cooperation plays an important part in private sector development in partner countries, since official development cooperation cannot hope to achieve its objectives without private sector involvement.


7 For more information on the forms of cooperation with the private sector see BMZ (2011): Forms of development cooperation involving the private sector, BMZ Strategy Paper 5/2011, Bonn.
2. The private sector in partner countries

2.1 THE CONTEXT

The private sector in many of our partner countries is marked by a comparatively low level of productivity in the majority of businesses, a low level of competitiveness and a lack of diversification. In most partner countries, the majority of private businesses are either small or micro enterprises that operate in the informal sector (excluding agriculture, the percentage of the workforce employed in the informal sector lies between about 40 per cent in countries like Uruguay and Thailand and 75 to 80 per cent in countries such as Bolivia and India). There is frequently a massive productivity gap between small and large enterprises. The gap is far wider than that seen in industrialised countries. It is typical for small and medium-sized enterprises (SMEs) to provide employment for a large percentage of the workforce, while generating a significantly lower share of value added. Formal-sector SMEs on average provide work for some 45 per cent of the workforce in developing countries, but generate only around 29 per cent of the country’s gross domestic product (GDP). Unlike businesses in industrialised countries, few small entrepreneurs ever manage to expand their businesses to become productive medium-sized or large companies (this is often termed the phenomenon of the missing middle). Small businesses do not grow automatically, indeed productivity gains are the exception rather than the rule.

2.2 CHALLENGES FACING PRIVATE SECTOR DEVELOPMENT

The root causes of the lack of competitiveness of the private sector in developing countries, and its low value creation, can be seen in the unfavourable political, legal and administrative environment (e.g. protracted processes within authorities), the lack of access to business development services (e.g. market information systems), and deficits in the institutional business environment and in the interaction between the public and the private sector (e.g. the lack of effective business membership organisations). Other major obstacles to private sector growth include lack of access to financial services, infrastructural shortcomings and poor education systems. As already stated in Section 1.2, these are problems that are addressed by Germany in its development cooperation support for other areas.

THE POLITICAL, LEGAL AND ADMINISTRATIVE ENVIRONMENT

International comparative studies, including the World Economic Forum’s ‘Global Competitiveness Report’ and the World Bank’s ‘Doing Business Report’, point to fundamental obstacles in the political, legal and administrative environment in developing countries. Many states still suffer from

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10 The informal sector is defined for the purposes of this strategy as the set of economic units that do not or do not fully comply with official regulation. Loayza, N.V. (1997), The Economics of the Informal Sector: A Simple Model and Some Empirical Evidence from Latin America, The World Bank, Washington, D.C.


12 For our purposes, SMEs are defined as businesses with a workforce of between 5 and 250.

unreliable and inefficient authorities, over-regulation, insecure property rights, a failure to uphold the rule of law, and corruption. Laws, regulations and administrative processes determine the costs and non-commercial risks of business activities and investment in the formal sector. Not only does a difficult legal and administrative environment block business activities, it also fails to give productive informal businesses any incentive to become part of the formal sector, which creates an obstacle to their growth\textsuperscript{14}.

Another challenge to achieving sustainable business in developing countries is the lack of sensible regulation that would oblige local and international businesses alike to comply with environmental, labour and social standards. As a result, many companies have little incentive to use future-oriented, environmentally sound technologies and to ensure decent working conditions.

In many cases, key factors behind national frameworks that constrain development include a lack of firmly established and effective state structures, and of development orientation. In other words they include a low level of governance and a lack of capacity on the part of (national and regional) state actors to develop coherent national private-sector strategies and policies.

At the level of global framework conditions, tariffs and non-tariff trade barriers persist, in spite of the increasing reach of globalisation processes. These barriers make it difficult for businesses in developing countries to become integrated in global value chains. The barriers include inefficient border-crossing procedures, unfavourable rules of origin, high logistics costs, and market distortions caused by export and other subsidies in industrialised countries. Over and above this, the increasingly stringent quality standards required and differing demands around the globe are becoming a technical barrier to trade where countries do not have an internationally recognised quality infrastructure, i.e. the infrastructure for mensuration, standardisation, testing, quality management, certification and accreditation. This makes it difficult for developing-country businesses to export and to access international markets.

\section*{Access to Business Development Services}

In many countries the quality and availability of business development services offered by state and private service providers are insufficient. As a result companies and employees alike have inadequate access to training, technology and market information.

Important factors behind the challenges outlined above include inadequate technical and institutional capacities of service providers, the limited ability of MSMEs to pay for services and/or a low level of willingness on the part of companies to pay, because they lack awareness of the benefits these services can deliver. Moreover, in some countries the existence of state- or donor-financed subsidies for business development services is blocking the development of high-quality commercial services in this sector\textsuperscript{15}.

\section*{Interplay Between the Public and the Private Sector}

Relations between the public and the private sector are complex and can take many different forms, depending on the industry and the specific issue at hand. The spectrum of positions at the outset ranges from shared interests, e.g. in increasing companies’ exports, to a conflict of interests, for instance


\textsuperscript{15} See also Section 3.3.
regarding the design of the tax system. Appropriate, development-oriented frameworks for the private sector can only emerge through an effective dialogue between the state and the private sector. By maintaining an ongoing dialogue and taking collective action with the private sector, a government can more effectively analyse the opportunities for private sector development, elaborate economic- and trade-policy strategies and prioritise the core obstacles to be removed, as well as mobilise the capital needed to finance economic infrastructure. Another important issue that must be part of the dialogue between the government and the private sector is the establishment of an enabling environment for collective bargaining negotiations. This same issue, which involves a democratic and market-driven mechanism for redistributing wealth, is also important for the dialogue between employers and their workforce.

While some large companies have a significant influence on government decisions, in many developing countries there is a lack of institutionalised dialogue that would involve small and medium-sized enterprises and disadvantaged sections of the population in political reform processes. Moreover, business membership organisations, such as chambers of commerce, chambers of skilled crafts or industrial associations often lack the skills and the organisational capacities to effectively represent the interests of members vis-à-vis the state. As a result, the needs of these businesses are not taken into account adequately in political reform processes and policy design, and no effective cooperation takes place between state and private-sector actors in the design of framework conditions and promotion policies.

2.3 OPPORTUNITIES FOR PRIVATE SECTOR DEVELOPMENT

The continued momentum of economic globalisation is creating numerous opportunities for the private sector in developing countries. The internationalisation of value chains and the steep decline in transport and communication costs mean that a product is no longer produced in one country alone; in fact, many countries are involved in the product cycle. This offers developing countries the opportunity to take on individual steps within the production process. They can thus access new markets and create more jobs in the export sector. As suppliers to global businesses, local enterprises can benefit from a transfer of knowledge and technology and can raise their own productive capacities. At the same time these processes of internationalisation, for instance in textiles, mean that consumers are looking increasingly critically at production conditions. Thus, compliance with quality, social and environmental standards is increasingly vital for businesses aiming to become involved in international value chains16.

It is not only global integration, but also regional economic integration that offers new opportunities. Countries with small domestic markets in particular can benefit from economies of scale and knowledge transfer by targeting regional markets. In some developing countries, however, demand is also rising on their domestic markets, thanks in particular to a growing middle class.

The private sector in developing countries can harness further potential for growth by leapfrogging stages of technological development and investing directly in state-of-the-art technologies (e.g. in resource-efficient production technologies). The continuing dissemination of information and

communication technologies (ICT) in partner countries, the increased use of ICT in companies and the access this affords to worldwide expertise can also significantly increase the competitiveness of companies in developing countries.

Demographic trends in many developing countries represent both an opportunity and a risk. The high percentage of individuals of working age carries the risk of high rates of youth unemployment with the concomitant danger of worsening social tensions and conflicts if demand for labour is too weak. At the same time, these young people represent an opportunity for the private sector. If they are given access to a demand-driven education and vocational training system and a properly functioning labour market, the private sector will gain access to a pool of effective workers.

Integrating women on equal terms in the private sector is another potential that developing countries can tap. Breaking down gender segregation in the labour market, i.e. the gender-based and unequal allocation of men and women to specific occupations, industries and levels of hierarchy, offers the chance of reducing inefficiencies caused by the inappropriate relegation of female workers to low-wage sectors. By strengthening women's participation in the economy, their entrepreneurial skills can be utilised and can contribute to private-sector growth.

\[\text{Cf. BMZ (2013): Information and communication technology. BMZ Strategy Paper 2/2013, Bonn (German only) and UNIDO (2008): Building e-competence: Enabling small business to access opportunities through Information and Communication Technology, UNIDO, Vienna.}\]
3. Guidelines for private sector development in partner countries

3.1 OBJECTIVES, TARGET GROUP AND ACTORS INVOLVED

The objective of Germany’s activities in private-sector promotion is to strengthen private businesses in partner countries, thus enabling them to make a significant contribution to inclusive growth and sustainable development.

Our vision of sustainable development is set out in the principles of the social and ecological market economy18. German development cooperation can draw on the successful German and European tradition of designing economic, trade, environmental and social policies. Also, the promotion of environmental and social standards (e.g. the core labour standards of the International Labour Organization (ILO)), sustainable production and consumption patterns and support to environmentally efficient business are important factors in translating our vision of sustainable development into practice.

The target group of private sector development consists of businesswomen and -men and their workforces in partner countries. The focus is on strengthening the operations of national private sector from the local to the global level. This includes not only formal businesses and self-employed persons, but also informal enterprises. There is a particular focus on micro, small and medium-sized enterprises (MSMEs). MSMEs provide work for the majority of the workforce, and thus ensure a living for the majority of the population in our partner countries. Yet they often lack the resources and capacities they would require in order to surmount obstacles to growth without external assistance. Some measures, including activities to put in place an enabling environment, also aim to improve investment conditions and thus attract foreign businesses, including German companies. This foreign direct investment can have a positive impact on the dynamics of domestic industry.

The key actors in private sector development can be found in both the public and the private sector. Firstly there are government institutions (chiefly ministries) and economic promotion institutions at national, international (e.g. regional organisations) and decentralised level as important partners of German development cooperation. Equally though, private-sector institutions (chambers of commerce or skilled trades and industrial associations), and organisations with links to businesses, including providers of business development services, research and certification institutes, trade unions and other organisations that represent workers, as well as non-governmental organisations, are important actors in private sector development. Finally, individual national and international businesses too are important partners for development cooperation, for instance when promoting value chains or sustainable corporate governance.

3.2 INTENDED RESULTS

Private sector development, as conducted by German development cooperation, aims to create productive employment opportunities, generate living wages and thus reduce poverty on a sustainable basis. An integrated approach is a particularly effective means of achieving this, with measures to promote competitive private industry closely coordinated with vocational training and upgrading programmes and activities to ensure that the labour market functions more efficiently 19.

Other intended results of private sector development include productivity gains, and more competitive businesses, which are prerequisite to achieving higher income and increased employment opportunities. Possible ways of achieving these results include:

→ improving products and processes within businesses (e.g. by enabling businesses to optimise operations or develop innovative and competitive products and services);

→ increasing investment activity by existing and/or newly founded local and international businesses;

→ founding innovative, growth-oriented businesses.

For these results to be achieved an enabling environment for sustainable private-sector growth must be established; private companies must also be effectively networked, and corporate governance must be established that is geared to stepping up competitiveness. As Figure 1 shows, this is where private sector development measures come in. They contribute toward:

→ ensuring that state policies and instruments foster the development of MSMEs while limiting their risks;

→ enabling private and/or state institutions to offer relevant business development services on a sustainable basis;

→ ensuring that the interests of businesses are represented vis-à-vis policymakers;

→ connecting business people both horizontally and vertically and ensuring that they have the managerial capacities to implement sustainable governance.

Private sector development can also achieve the following results:

→ Higher income – especially on the part of women – results in higher private spending on education and family health, which in the medium term helps reduce poverty 20.

→ Rising tax revenues – as private businesses pay more taxes – to finance public sector investment, for instance in the health and education sectors.

19 Cf. GIZ/BMZ (2010): Handbuch Beschäftigungsförderung in der Entwicklungszusammenarbeit zur Umsetzung der Millenniumsziele, especially Section 2.2. Wirksamere Beschäftigungsförderung durch den integrierten Ansatz realisieren (German only).

Higher employment and higher incomes provide a ‘peace dividend’ for the population at large and for the (former) conflict parties in fragile and conflict-affected states, thus fostering stabilisation, reconstruction and reconciliation.

Support for innovative inclusive business models helps generate entrepreneurial solutions to social and environmental problems.

The promotion of corporate social responsibility, innovative business models and environmentally sound technologies contributes to the development of a socially and environmentally sustainable private sector in partner countries.

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21 This figure illustrates the results framework in private sector development. Objectives and indicators of programme and project proposals in bilateral development cooperation still need to be transferred into the obligatory logframe matrix introduced by the BMZ on 01.02.2013.
3.3 EXPERIENCE AND PRINCIPLES

German development cooperation in the field of private sector development is based on the principles derived from the lessons learned in development cooperation and our guiding values. The experience, good practices and principles laid out below guide our actions in the field of private sector development:

SYSTEMIC APPROACH AND RESULTS ORIENTATION

→ German development cooperation pursues a systemic approach in private sector development, linking interventions at the level of individual institutions (meso level) and those at company level (micro level) with structure-building interventions at policy level (or macro level) and activities to build closer links between the different actors.

→ German development cooperation undertakes to uphold the international aid effectiveness agenda (Paris Declaration on Aid Effectiveness, Accra Agenda for Action). German development cooperation measures in the field of private sector development are thus geared to results and are implemented with a systematic results-based monitoring scheme.

→ Specifically, private sector development interventions are geared to maximising positive results with regard to poverty reduction and employment. Experience over recent decades indicates that the long-standing development paradigm which assumed that economic growth would automatically reduce poverty through trickle-down effects, does not work. The impact on poverty reduction depends in fact on the quality of growth and the number and quality of the jobs created, as well as the degree to which regions and sectors in which poor people live and work are taken into account. For German development cooperation this means, for instance, that when selecting sectors for promotion, the potential of the sector to generate jobs and raise income for poor sections of the population on a sustainable basis in the medium term is the decisive factor.

→ Private sector development approaches support the integration of productive parts of the informal sector in the formal economy. The large percentage of the total economy accounted for by the informal sector, and the high concentration of poverty in the informal sector, make it essential to address informal businesses as a target group. The approaches of German development cooperation focus (1) on overcoming obstacles to growth for formal and informal MSMEs and (2) on raising the degree of formalisation of the economy as a whole by reducing the costs of moving from the informal to the formal sector.

SUBSIDIARITY AND DEMAND ORIENTATION

→ Private sector development measures comply with the principle of subsidiarity. All German development cooperation interventions should establish whether or not support services of this sort are already being offered or could be offered by the private sector. Every effort should be made to avoid crowding out private service providers.
When promoting business development services, German development cooperation is demand-driven and market-oriented. This means that services are not provided directly by development cooperation. Commercial service providers are promoted, competition among service providers is increased and customers are required to finance some or all of the costs. Nevertheless it might be necessary to ensure permanent public subsidies for some services that can be seen more as public goods, in the fields of environment, innovation and network services in particular. The same applies to services that address target groups such as business start-ups and micro-entrepreneurs.

Like many other development interventions, private sector development measures risk distorting markets or provoking free-rider effects. To prevent this, companies to receive support should be selected on the basis of transparent, ideally competition-based criteria.

ECONOMIC, SOCIAL AND ENVIRONMENTAL SUSTAINABILITY

The sustainability of promotion approaches depends crucially on the ministries and authorities involved embracing good governance and on the development of capacities to design, adapt and implement policies at both individual and institutional level. If the services established are to be sustainable, it is vital to ensure they can operate so as to cover their costs in the long term without development assistance.

Special attention must be paid to the need to integrate women, young people and other disadvantaged groups in the economy. The equal involvement of all sections of the population, male and female, in economic activities makes it possible to realise the full economic potential of a national economy. This makes it an important factor in achieving competitiveness and thus an integral part of sustainable private sector development.

German development cooperation also promotes an environmentally sustainable private sector. Its private sector development activities contribute to environmentally sustainable growth processes and to environmental and climate protection. It aims to ensure compliance with environmental and social standards, to support the private sector in adapting to climate change and to promote growth among companies in 'green' sectors of the economy. An environmental and climate impact assessment is conducted for every bilateral official development cooperation project and programme in the field of private sector promotion.
4. Support strategy

To achieve the objectives of its private sector development support, Germany pursues, through its development cooperation programme, a strategy that brings together approaches in the following three areas:

1. **Creation of an appropriate political, legal and administrative environment**

2. **Establishment of competitive and sustainable economic structures**

3. **Cooperation with the private sector for sustainable investment**

The specific form of the strategy adopted in any one instance will depend on the development status of the partner country and the prevailing economic order.

In **low-income countries** the focus is on setting up the framework conditions for a market economy, on strengthening economically disadvantaged regions (for instance through local and regional economic promotion activities), on triggering inclusive growth processes in potentially competitive sectors, as well as on involving MSMEs in economic cycles, and thus helping create more productive employment as well as reducing poverty.

In **middle-income countries** it is particularly important to develop knowledge- and technology-based competitive advantages in order to achieve and maintain competitiveness on international markets. This can be achieved, for instance, by reinforcing innovation systems. Another focus is to reduce the negative impacts of rapid economic development and boost the environmental and social sustainability of the private sector. Private sector development can thus help make national economies environmentally sustainable (i.e. help them become green economies), especially in partner countries whose industry is already fairly well developed.

In **states affected by conflicts or natural disasters** the strategy focuses on job-creation measures, reducing the root causes of the conflict and on (re-)building market structures. Since conflicts often have their roots in socio-economic circumstances, special attention is paid in post-conflict situations to making measures conflict-sensitive (in line with the do-no-harm principle), to ensure that our interventions do not further aggravate existing conflicts. Depending on the context, short-term emergency aid measures to generate employment are implemented in countries whose economic structures have been destroyed, with a view to stabilising the situation, alongside medium-term economic promotion activities to support reconstruction and reintegration. The combination of emergency aid, reconstruction and economic development measures lays the foundation for increasingly structure-building economic promotion activities. Given that in the context of conflicts, state structures are frequently extremely weak, it is all the more important to strengthen private-sector actors and involve businesses as strategic partners in reconstruction.

4.1 **Creating an appropriate political, legal and administrative environment**

One of the core duties of a state is to put in place an enabling environment for private-sector activities. An appropriate political, legal and administrative environment is a necessary condition for investment, trade and growth, but not a sufficient one.

**Improving the national business and investment environment**

To establish a favourable business and investment environment at the national level, German development cooperation supports state actors in analysing the
opportunities for and obstacles to private sector development, in prioritising essential reforms and developing as well as in implementing **strategies to improve legislation, regulations and bureaucratic procedures** for businesses in cooperation with the private sector. This includes above all reducing regulatory and administrative obstacles, e.g. to registering businesses or issuing licenses. German development cooperation also helps strengthen the analytical and implementation capacities of state authorities as well as improving policy-design processes, for instance by establishing dialogue mechanisms that bring together the national government and the private sector.

**Improved environment for MSMEs in the Philippines**

In the Philippines, German development cooperation has provided support for the further development and implementation of the country’s **national MSME development strategy**. The aim of the strategy is to improve the framework conditions for MSMEs and to develop promotion strategies for sectors with growth potential. MSME development councils, which bring together representatives of both the public and private sectors, are responsible for implementing the MSME development strategy in the regions. Procedures for registration have already been simplified in a total of 124 districts and the costs of registration reduced. The number of newly registered MSMEs in the towns receiving support was some 20 per cent higher than in the previous year. Over and above this, active approaches for MSME development, including local and regional economic promotion measures and the promotion of value chains, have been disseminated nationwide.

At national, and indeed global level, there are both **potential synergies and conflicts of interest** between private sector activities and sustainable development. Due to market failures, for example incomplete information and negative externalities (affecting for instance global public goods such as financial stability, peace and security, an intact environment and a stable climate) some private companies engage in business practices that are detrimental to development. This must be taken into account in when designing framework conditions for the private sector.

When reforming regulatory frameworks, German development cooperation activities therefore foster **good regulation**, which embraces social and environmental values and standards. This must also be taken into account in approaches to improve the wider business and investment climate. German development cooperation in this field relies on a **neo-structural approach**, which assumes that to generate private sector growth it is not enough to cut red tape and ensure sufficient competition between companies. State actors are actively called on to compensate for market failures and to play a key part in the **strategic development of competitive advantages**, e.g. through sectoral economic promotion (see Section 4.2). In contrast to the neo-classical approach, German development cooperation does not put deregulation first, but rather emphasises the development of an enabling regulatory environment and the establishment of core institutions for the market economy, backed up by active support measures to harness competitive advantages²³.

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Improving the Environment for Foreign Investment and Trade

Reforms of the general framework conditions for the private sector also aim to facilitate cross-border economic activities. Entry points here include dismantling cross-border barriers to trade and investment, as well as simplifying and harmonising trade and investment regulations and standards. Strategically important factors for economic development are regulated in regional and multilateral trade and investment agreements, especially with a view to the influence of industrialised countries on economic activities in partner countries, e.g. their agricultural subsidies and trade policy. In the political dialogue and where conditions are attached to budget support and policy-based lending, rule of law, secure property rights, the reliability of the actions of the administration and steps to stamp out corruption all play an increasingly important part.

Within the scope of Aid for Trade the capacities of regional organisations (such as the Southern African Development Community and the East African Community) and of national governments are developed, and the bodies representing the interests of the private sector are strengthened. This enables partner countries to help shape international environments and terms of trade in the interests of their own private sector.

4.2 Putting in Place Competitive and Sustainable Economic Structures

To support the private sector in developing and expanding competitive advantages, structural changes will be needed in many partner countries. The most important approaches pursued by German development cooperation include (1) sectoral economic promotion/promotion of value chains, (2) local and regional economic development, (3) the promotion of environmentally sustainable growth, (4) strengthening innovation systems and (5) strengthening the institutional environment in which businesses operate, in terms of the services available and the bodies that represent their interests.

Sectoral Economic Promotion / Promotion of Value Chains

Within the framework of sectoral economic and value chain promotion, support is provided to develop those sectors of the economy that offer the best prospects in terms of growth, value added and employment. In many countries the expansion of non-traditional industries and the services sectors, in which demand is high on local, regional and international markets, is a precondition for structural change.

German development cooperation helps public and private sector actors (governments, industrial associations, chambers of commerce, chambers of skilled crafts, etc.) to devise and implement sector

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25 The value chain approach looks at the manufacture of, trade in, and processing and sales of a product (including export) as linked steps in a process. Within this process private-sector actors cooperate, with the support of state and private-sector service providers, in order to produce and sell products and services more efficiently or more effectively. Within the framework of development cooperation, other aspects such as product quality, income generation and poverty reduction are integrated in this approach. Cf. BMZ/GIZ (2011): Wirtschaft stärken – Armut reduzieren, Erfahrungen mit dem Wertschöpfungsketten-Ansatz im Entwicklungsdienst der GIZ (German only).
strategies geared to raising market shares, targeting new markets and niche markets, and raising productivity and value added. Typical entry points include establishing a market for specialised (strategic) services (e.g. in quality management or logistics) as an important precondition for product and process innovation, strengthening sectoral association and promotion structures, promoting the integration of MSMEs in value chains, and improving sector-specific regulations. Special attention is paid to integrating women as well as poor and disadvantaged sections of the population in value chains. This can take the form of promoting inclusive business models, in which poor people are served directly by businesses in their capacity as consumers or are addressed through their involvement in product manufacture or sales. Investments as part of inclusive business models or to increase productivity along the value chain are accompanied by various German development cooperation measures. In this context, it is particularly important to improve access to finance, which is addressed in the complementary core competence area of ‘financial systems development’.

LOCAL AND REGIONAL ECONOMIC DEVELOPMENT

Local and regional economic promotion approaches aim to improve the competitiveness of selected locations and economic areas. German development cooperation supports institutions and local actors from the realms of industry, politics, public administration and civil society in their efforts to identify the competitive advantages offered by a region and to draft, realise and finance regional and local economic and structural policy strategies and measures. The experience gained at regional level is communicated to national level, so that successful approaches can be scaled up nationwide.

PROMOTION OF AN ENVIRONMENTALLY SUSTAINABLE PRIVATE SECTOR

Specifically targeted ecological private sector development can help foster new employment options while also achieving environmental objectives such as reduction of greenhouse gases or adaptation to climate change. Environmental services for businesses but also the renewable energy sector, have the potential in many countries to become growth industries, with a significant positive impact on employment (‘green jobs’). Green growth potentials are harnessed with German development cooperation specifically providing support to environmentally relevant industries. At the same time, growth here helps to offset job losses in resource-intensive industries by offering new opportunities to those affected.

By making businesses more environmentally efficient and by adopting clean technologies, manufacture-related pollution is reduced and economic efficiency enhanced. For example, partners are supported in establishing incentive systems for business investment in resource efficiency and environmental management, or in providing financing for investments designed to enhance energy efficiency. Another major factor is the promotion of innovation systems, and technology transfer and dissemination. To support businesses in adapting to climate change, German development cooperation promotes measures that reduce the vulnerability of businesses to changing climate and weather conditions (including extremes of heat and cold, storms, flooding, drought and water scarcity).

PUTTING IN PLACE EFFECTIVE INNOVATION SYSTEMS

The productivity and competitiveness of the private sector, i.e. its ability to hold its own against competitors on local, national, regional and international markets and to generate a profit, is increasingly determined by knowledge, technology and innovation. National innovation systems, in which producers and users of innovations in the private sector, the public sector and the academic and research community interact, foster the ability of businesses to innovate. To strengthen innovation systems, German development cooperation advises partner-country governments on the development and implementation of innovation strategies and promotion programmes. The capacities of central institutions within the innovation system (e.g. research and development facilities with close links to industry, business start-up and skills transfer centres, quality infrastructure institutions) are expanded and networking between the relevant actors from the realms of the public sector, the academic and research community is strengthened. In addition to giving businesses a greater incentive to innovate through appropriate incentives systems, this helps encourage businesses to produce and use innovative products, processes and services, as well as adopting new business models.

More innovation in Tunisia’s SMEs

To foster innovation in the Tunisian economy and thus underpin the competitiveness of SMEs, German development cooperation is supporting Tunisia in developing and strengthening its existing national innovation system. The focus is on ensuring an improved range of advisory services for SMEs in the field of innovation and innovation management, on connecting the private sector with the academic and research community, and on financing mechanisms for innovation. Over and above this, German development cooperation advises the Ministry of Industry and the Ministry of Higher Education and Scientific Research on the design of innovation policy. The range of services available to businesses in the field of innovation has already been much expanded thanks to the intervention of German development cooperation, with some advisers getting together to establish a network. The innovative advisory approaches of the trained management consultants have been translated into practice directly in SMEs. These businesses are continuing to undertake new innovation projects after training measures are completed.

STRENGTHENING THE INSTITUTIONAL ENVIRONMENT FOR BUSINESS DEVELOPMENT SERVICES AND INTEREST REPRESENTATION

Access to economically relevant information and business development services improves the ability of private-sector initiatives to develop. This presupposes that private, parastatal or state institutions exist that are in a position to adapt the services to bring them in line with demand and offer them on a financially sustainable basis. German development cooperation thus supports providers of business development services in the (further) development of service products and the development of sustainable business models. Support is also provided to-

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27 Cf. Arbeitskreis Innovationssystemförderung (2010): Förderung von Innovationssystemen – Ein Förderansatz für die deutsche EZ, Eschborn (German only).
wards the establishment of a system for the provision of internationally recognised mensuration, standardisation testing and quality assurance services.

Business membership organisations, including chambers of commerce and skilled crafts, and industrial associations, play a crucial role in representing the interests of the private sector, over and above the services they provide. Another important entry point of German development cooperation is therefore to strengthen the skills and institutional capacities of these organisations, thus enabling them to effectively represent the interests of the private sector vis-à-vis the government and the political sphere. This approach can be supported by cooperation arrangements with partner institutions in Germany (e.g. German business associations). The establishment of effective institutional structures within the private sector and on the state side (public-private partnership (PPP) units) leads to more coherent frameworks and ensures that private businesses are involved to a greater extent in the provision of public services.

By encouraging dialogue between representatives of the private sector and state actors (public-private dialogue) at national, regional and local levels, or within specific sectors, the private sector is also enabled to better articulate its own interests and to play a part in shaping reform processes. Experience indicates that development cooperation can have a lasting positive impact on this process by designing pertinent multi-stakeholder dialogues.

4.3 COOPERATION WITH THE PRIVATE SECTOR FOR SUSTAINABLE INVESTMENT

In addition to the above promotional approaches, German development cooperation also addresses the company level directly, so as to harness the potential offered by the private sector for sustainable development. The BMZ sees itself as the partner of industry and advocates more values-based business activities and greater corporate social responsibility. This approach, i.e. working with private businesses, is part of the strategy pursued by German development cooperation. Cooperation tends to be with international, especially German companies and with medium-sized or large companies in partner countries. The key approaches taken include direct support for pro-development investments, the promotion of inclusive business models and activities to strengthen corporate social responsibility.

SUPPORT FOR PRO-DEVELOPMENT INVESTMENT

Support for sustainable, environmentally and socially sound investment projects of private businesses in partner countries, for instance as part of value chain promotion or trade promotion, complements the systemic approaches laid out in Sections 4.1. and 4.2. German development cooperation ensures compliance with the principles of sustainability, environmental and social soundness and good governance. In this way private funds can be mobilised for development and socially and environmentally sustainable business practices firmly anchored.

Cooperation with private businesses makes it possible to combine the innovative force of the private sector with the resources, knowledge and experience

28 Private sector development interventions usually do not involve investment in infrastructure projects.
of development cooperation. This results, among other things, in job creation, the transfer of expertise to local businesses, the tapping of markets, and enhanced value added in the partner country.

**PROMOTION OF INCLUSIVE BUSINESS MODELS**

Business approaches that specifically address social and environmental problems, can potentially offer financially sustainable solutions in the fields of development and poverty reduction that can be scaled up. Inclusive business models, for instance, integrate poor people in value chains, both as customers and as employees, producers and entrepreneurs. German development cooperation supports the dissemination of business models of this sort. As well as assisting individual companies, approaches in the field of financial systems development play a part, along with the provision of information, the scaling up of best practices and the establishment of networks.

**Inclusive business model: Solar power for rural regions of Mozambique**

Only 2 per cent of Mozambique’s rural population has access to the electricity grid. The medium-sized company Phaesun is an expert in off-grid power supplies using solar power. Within the framework of a development partnership, German development cooperation is supporting Phaesun in adopting an inclusive business model to provide autonomous power supply to poor households in isolated areas and offering local job-seekers the opportunity of setting up in business for themselves and becoming involved in sales and service. To this end Phaesun and a Mozambican company are initially establishing a network of traders for small-scale solar systems. The so-called PicoPV systems consist of a panel, a lamp with integrated battery and an adaptor for charging mobile phones. Most households currently spend up to 10 US dollars a month on kerosene or other fuel. A solar plant for domestic use costs around 100 US dollars – the investment is thus amortised within about a year. A classroom is being equipped for the practical training of students and solar plant traders. The project partners provide back-up services for the trained solar technicians as they establish their own businesses. One component on offer is commercial training.
**DISSEMINATING CORPORATE SOCIAL RESPONSIBILITY**

German development cooperation also aims to raise the awareness and increase the involvement of businesses in fields such as environmental protection, resource efficiency, labour rights, human rights, health, and training and upgrading, since broader awareness of corporate social responsibility will help make the globalisation process more socially and environmentally sound. Compliance with fundamental environmental and social standards and corporate social responsibility allows businesses to become more competitive. Productivity is boosted and they can tap into new potential markets.

Along the same lines as the promotion of inclusive business models, this can be achieved in cooperation with individual businesses or by supporting and building **CSR networks**. Companies will be more likely to adopt the tenets of corporate social responsibility if there is effective regulation by the state, and if mandatory minimum standards, such as the ILO’s core labour standards, are enforced by law. This reduces the costs to industry of self-regulation, and counters the possibility that companies infringing standards will gain an unfair competitive advantage.

Within the scope of CSR promotion activities, German development cooperation specifically supports the commitment and initiatives of businesses and private-sector organisations to **tackle corruption** in the form, for instance of anti-corruption codes, and the Business Anti-Corruption Portal, which provides detailed information on developing and emerging economies and offers useful instruments for realising anti-corruption measures.

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30 Cf. BMZ (2009): Unternehmerische Verantwortung aus entwicklungspolitischer Perspektive, BMZ Special 167, Bonn (German only).


32 For more information see also www.business-anti-corruption.de.
5. Instruments

German development cooperation has at its disposal a variety of instruments for private sector development. As a general rule, a combination of Technical and Financial Cooperation measures are used, along with cooperation arrangements with the private sector and civil society.

Technical Cooperation instruments in the field of private sector development comprise primarily (1) the assignment of experts, i.e. short- and long-term experts, development workers, integrated experts and German senior experts to deliver advisory services on policy-related, technical and organisational issues, which could involve, for instance, advising government organisations on how best to enhance the business environment; (2) human capacity development activities including training programmes, dialogue platforms e.g. to foster public-private dialogue or the establishment of platforms for training and networking, for instance in economic promotion institutions; (3) financial contributions and subsidies for qualified local bodies, such as chambers of commerce, chambers of skilled crafts and industrial associations, to improve the provision of services to businesses. Technical Cooperation services also include involvement in joint donor programmes. Private sector development advisory services in a partner country can, for instance, be financed from contributions previously paid into a dedicated fund by several donors. The Chambers and Associations Partnership Programme is another instrument that can be used by German Technical Cooperation to help build business membership organisations in partner countries.

The instruments at the disposal of Financial Cooperation include policy-based lending, including the concomitant political dialogue which aims to create more favourable framework conditions for the private sector at national level, and capacity development services for key actors in private sector development through training and qualification in accompanying measures for financial cooperation. The temporary secondment of experts to multilateral bodies and organisations (e.g. the Investment Climate Facility for Africa) can also be used as a form of Financial Cooperation to strengthen the analytical and implementation capacities of institutions involved in private sector development.

The range of Technical and Financial Cooperation instruments is used primarily to improve the framework conditions and to build sustainable private sector development institutions in partner countries.

Besides, direct cooperation with local and international businesses is an important way to foster sustainable private sector activities directly. The instruments relevant for private sector development include integrated and non-integrated development partnerships with the private sector (e.g. developPPP), strategic alliances between the public sector in partner countries, German development cooperation and international and local businesses, and the involvement of private businesses in traditional public-private partnerships, in particular for infrastructure projects. Development partnerships with the private sector mobilise private capital and expertise to achieve shared project objectives that contribute to sustainable development. In entrepreneurial development cooperation, private businesses in partner countries receive market-oriented investment financing and advisory services to help them

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33 Strategic alliances are partnerships that point the way forward, bringing together several partners, different countries and major investments. They aim to achieve structural improvements in partner countries that transcend the immediate environment of any one private company.

34 The terms ‘development partnership’ and ‘public-private partnership (PPP)’ were long used synonymously. Usage in German development cooperation has now been aligned with international norms; the term PPP is used to designate the performance of public duties in the field of economic and social infrastructure by private bodies (which was previously known in German development cooperation as ‘private sector participation’ or ‘private participation in infrastructure’).
invest in raising their productivity. The spectrum of entrepreneurial development cooperation embraces the provision of capital in the form of loans, equity, mezzanine finance and guarantees, as well as special programmes of development relevance.

German civil society cooperation provides advisory services, (advanced) training courses and support to fit out premises, thus making an important contribution to raising productivity, for instance among small craftspersons and micro crafts enterprises, and in the processing of agricultural products. It also strengthens cooperative structures to enable them to represent members’ interests as well as improving collective processing and marketing facilities. The work of non-governmental organisations thus specifically helps improve the earning potential of disadvantaged population groups in developing countries.

To complement bilateral measures, Germany through its development cooperation brings its positions, interests and values to bear at multilateral and international level in the design of international policies on and approaches to private sector development. Our work in international donor organisations, such as the DCED and membership of German implementing organisations, e.g. the association of European Development Finance Institutions (EDFI), help further refine development approaches as well as enhancing the coherence of the approaches and instruments adopted by various donors. In this way, successful German development cooperation approaches can be rolled out on a wider scale and help raise the effectiveness and efficiency of international development cooperation.

The Donor Committee for Enterprise Development (DCED)

Founded in 1979, the Donor Committee for Enterprise Development (DCED) brings together numerous donors and international organisations working in the field of private sector development. It offers a platform for donor coordination and the sharing of good practices in private sector development. The central outputs of the DCED include the publication ‘Supporting Business Environment Reforms: Practical Guidance for Development Agencies’ and the ‘DCED Standards for Results Measurement’.
Annex: Overview of approaches and instruments

The following table provides an overview of typical promotion approaches, instruments and services offered by development cooperation at the different levels of intervention. In practice several approaches and instruments are generally combined in a project or programme.

<table>
<thead>
<tr>
<th>Promotion approaches adopted by development cooperation</th>
<th>Typical services/promotion instruments offered by development cooperation</th>
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<tbody>
<tr>
<td><strong>IMPROVING THE POLITICAL, LEGAL AND ADMINISTRATIVE ENVIRONMENT</strong></td>
<td></td>
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<tr>
<td>→ Advising ministries and public authorities on the removal of regulatory and administrative obstacles to businesses (and on devising and putting into practice national economic promotion strategies)</td>
<td>— Advisory services delivered by long-term and short-term experts</td>
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<tr>
<td>→ Advising ministries and public authorities on the dismantling of cross-border barriers to trade and investment, harmonisation and simplification of trade- and investment-related regulations and standards</td>
<td>— Human capacity development (training programmes, dialogue platforms, establishment of networks)</td>
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<tr>
<td>→ Institutionalising processes to coordinate the activities of the public and the private sector (public-private dialogue)</td>
<td>— Policy-based lending</td>
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<td>— Conferences</td>
<td>— Provision of materials and equipment (to a small extent)</td>
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<tr>
<td><strong>ESTABLISHING COMPETITIVE AND SUSTAINABLE ECONOMIC STRUCTURES</strong></td>
<td></td>
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<tr>
<td>Sector promotion / value chain promotion</td>
<td>— Advisory services delivered by long-term and short-term experts</td>
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<tr>
<td>→ Advisory services on sector strategies and promotion programmes</td>
<td>— Human capacity development (training programmes, dialogue platforms, establishment of networks)</td>
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<tr>
<td>→ Establishing a sector-specific or value-chain-specific range of business development services</td>
<td>— Development partnerships with the private sector</td>
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<tr>
<td>→ Networking, building clusters and making them more professional</td>
<td>— Strategic alliances</td>
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</table>
Local and regional economic development

- Advisory services on the drafting and implementation of regional economic development strategies in dialogue with the local private sector

Promotion of environmentally sustainable growth

- Advisory services on incentives systems to promote investment in the field of resource efficiency and environmental management
- Support for the development of environmentally relevant industries, such as environmental technologies and environmental services
- Developing advisory instruments/services to help MSMEs adapt to climate change

Promotion of innovation systems

- Building, strengthening and connecting the institutions of the innovation system (research and development facilities with close links to industry, business start-up centres and skills transfer centres) with each other
- Advising ministries of research and economics on innovation policies

Strengthening the institutional environment for business development services and for representing the interests of the private sector

- Establishing and strengthening chambers and associations (sustainable organisational structure, range of services, representing interests of the private sector vis-à-vis politicians)

- Secondment of experts (development workers, senior experts, integrated experts)
- Local subsidies for institutions
- Chambers and Associations Partnership Programme
- Cooperation with civil society
- Provision of materials and equipment (to a small extent)
Establishing and strengthening private and state quality infrastructure institutions

Developing a market for business development services and strengthening private and/or state service providers:

- General MSME services, sector-specific services
- Services for specific target groups: women, business start-ups, micro businesses

**COOPERATION WITH THE PRIVATE SECTOR AND PRIVATE-SECTOR INSTITUTIONS**

- Financing investment projects and investment advice
- Promoting inclusive business models
- Supporting corporate social responsibility (CSR) initiatives and establishing CSR networks
- Supporting the anti-corruption initiatives of businesses

- Development partnerships with the private sector
- Strategic alliances
- Entrepreneurial development cooperation, e.g. long-term investment financing and investment consultancy
- Information provision and networking
- Dissemination of best practices/conferences