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SECO – Economic Cooperation and Development

SECO Approach to Partnering with the Private Sector





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Introduction

■ The international community is increasingly looking to the private sector as a partner in achieving development objectives. Scarce public financial resources, complex development challenges and entrenched poverty has led to the realisation that private actors may play a greater role. Important international milestones include the Fourth High Level Forum on Aid Effectiveness (2011), which recommended broadening the partnership between donors and the business sector. More recently, the reports of the High-Level Panel and of the Open Working Group on Sustainable Development Goals (post-2015) recognised that complex global problems will be better addressed through partnerships involving governments, civil society, the business community, academia and private philanthropy.

SECO¹ has long recognised the critical role of the private sector in ensuring a sustainable development path. In the mid-1990s, the FOFEA (today SECO) launched the first pilot projects to support the private sector and experimented with new guarantee instruments and new procedures to construct and operate infrastructure projects. The fifth credit facility of 1996 brought a sweeping new direction for economic and trade-policy measures, especially with the creation of organisations such as SIPPO enshrining a close collaboration with the private sector. This allowed SECO to test innovative solutions and build its unique expertise. The recent 2013-2016 Message on Switzerland's International Cooperation focuses on the need to build on this expertise and scale up innovative partnering modalities with the private sector.

This positioning paper clarifies SECO's position in partnering with the private sector. It outlines SECO's objectives as well as the principles governing these collaborative arrangements. Following a description of SECO's experience, it proposes some ways to be further explored to harness the opportunities of such partnering.

Definition

There is no internationally agreed definition of partnering with the private sector, nor even clear agreement on the term itself. **For SECO, partnering with the private sector is a collaborative arrangement between public-sector and private-sector actors, with a common objective and shared costs or risks.**² The private sector is understood to mean private companies or business associations. A collaborative arrangement can range from a Memorandum of Understanding to a commercial contract.

Public-private partnerships (PPPs) have been used since the 1990s to cover contractual agreements under which the private sector delivers an infrastructure product or service and bears certain risks. Such contracts fall under the definition of partnering with the private sector.

It should be noted that:

- Partnering with the **private sector is different from private sector development (PSD)**, which is a thematic focus of SECO. PSD focuses on supporting the local private sector by improving the framework conditions for business or strengthening entrepreneurial skills in partner countries.
- Partnering with the private sector does not cover contractual arrangements under which a **private firm is contracted to implement a development project** on behalf of a donor agency without sharing any costs or risks.

¹ In this paper, "SECO" is used to refer to the Economic Cooperation and Development Division (WE) of SECO.

² The SDC defines partnerships with the private sector or PPDP (Private Public Development Partnerships) as an alliance with a private actor that establishes mutual obligations. Each partner defends its specific interests while sharing a set of agreed values. Such alliances create a positive impact at the social, environmental and/or economic levels.



1. Why partnering with the private sector?

■ In line with the current international debate and based on its experience, SECO recognises the fundamental role played by the private sector in contributing to sustainable growth and the ultimate goal of poverty reduction. SECO is actively partnering with the private sector to better achieve its development objectives. In other words, **partnering is not an objective in itself but a means of reaching an end, i.e. sustainable growth leading to reduction of poverty and disparities.**

SECO's partnering with the private sector is motivated by several drivers:³

■ **Sharing of information and knowledge for joint solutions:** Large-scale global, regional or sectoral challenges may best be met by exchanging and disseminating ideas and solutions among aid agencies, private firms as well as NGOs, universities and others. The involvement of several actors allows the solutions to gain greater legitimacy than a partnership limited to public institutions and private companies. SECO plays a facilitator role, contributing to the effective organisation of such collective solutions.

■ **Influencing the behaviour of enterprises:** Through their activities, enterprises may impact upon people's lives and the delivery of public goods. By encouraging positive business practices, SECO aims to reduce negative externalities or to catalyse the positive effects of private-sector activities.



■ **Leveraging financial resources and mobilising know-how from the private sector:** A growing number of companies are realising that engaging on the sustainability agenda can bring short or longer-term benefits and are therefore willing to invest

some of their own resources. This provides opportunities for SECO to engage with private companies so as to either leverage additional financial resources or mobilise their specific expertise and know-how.

■ **Linking businesses:** Based on the assumption that companies lack the information or capacity to benefit from trade or investment opportunities, linking companies of developed and developing countries helps to promote economic growth. By supporting linkages between companies, SECO contributes to creating opportunities both in partner countries and at home.

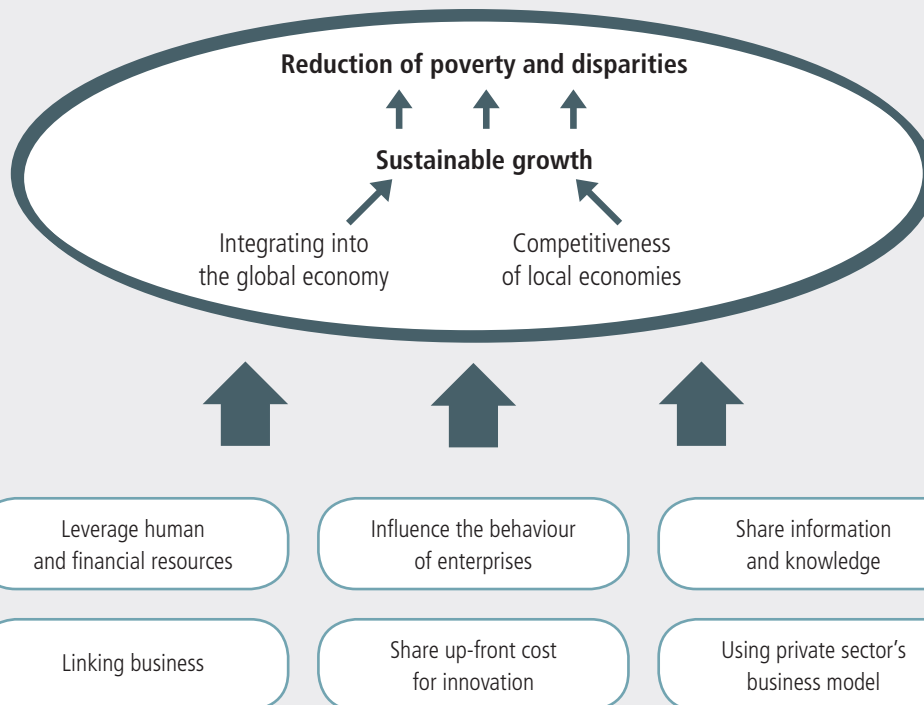
■ **Sharing investment costs for innovation:** SECO may bear some of the up-front costs to encourage companies to engage in or focus on activities that are likely to bring positive development outcomes, but that are riskier, have early high investment costs and a high risk of commercial failure, or are taking place in a difficult environment.

■ **Using the private sector's business model:** Private firms improve their own working practices and invest in new ideas or new approaches to maintain or conquer new markets. For SECO, working with private companies provides an opportunity to test new business models based on the comparative advantage of the private sector, e.g. flexibility, speed.



³ See W. Smith, *How donors engage with business*, ODI, July 2013, who describes some of these drivers as modalities.

Why is WE partnering with the private sector?



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Although much of the on-going international debate is focused on the private sector as a source of additional financial resources for development, SECO believes that partnering with the private sector goes further than that. Private partnerships bring more qualitative value by, for example, fostering innovation, encouraging the emergence of bottom-up solutions, contributing to technology transfer, demonstrating cutting-edge ways to do business, improving the competitiveness of local enter-

prises in partner countries or facilitating systematic market transformation. SECO is therefore actively seeking such partnerships to increase its effectiveness and outreach. SECO is also in dialogue with the Multilateral Development Banks (MDBs) and other international institutions on the benefits of this approach.



2. How do we work?

■ Over the years, SECO has developed several principles in working with the private sector:

■ **Subsidiarity:** SECO will only engage with the private sector when it does not substitute funding from other parties, including the company itself or commercial lenders. It also recognises that there are several stand-alone business initiatives or partnerships between private firms and NGOs that do not require contribution by public actors. In other words, SECO will not support projects that would anyway be undertaken or financed by the private sector.

■ **Additionality:** SECO expects its partnering with the private sector to make a significant contribution to the achievement of its development goals. The collaborative arrangement has to create more added value than would have been achieved anyway without the partnership, e.g. in terms of the project's scale, scope, quality or sustainability.

■ **Complementarity:** SECO aims to identify synergies between programmes or projects based on partnering with the private sector and other SECO activities. For example, strengthening the framework conditions (e.g. macroeconomic stability, investment climate) helps to exploit the opportunities raised by private partnering. Working with the private sector can also reinforce SECO's policy dialogue with governments on business conditions.

■ **Avoiding market distortion:** SECO is aware that partnering with a single firm may create an unfair competitive advantage. Therefore, SECO favours mechanisms that are based on an open application and selection process (e.g. matching funds) or an open procurement process to select individual firms. SECO enters into direct partnership when the opportunity costs of such a mechanism are too high (e.g. partnership limited in scope and time) or where such a mechanism is not relevant.

■ **Assessing environmental and social risks:** The assessment of environmental and social risks is a major component in the approval process of each SECO project or programme. A more in-depth analysis is being made for venture capital funds, including an extensive due diligence process.⁵ The objective is to ensure that the investments comply with all applicable laws and regulations, and beyond that, require that investments meet best practices with regard to international environmental, social and governance standards.



⁴ Some additional principles may exist for some specific types of partnerships (e.g. SIFEM).

⁵ See guidelines from the private company Obviam, which is tasked with managing SIFEM funds: *Responsible Investment Concept Document*, OBVIAM, <http://www.obviam.ch/investment-philosophy/investing-responsibly/>.

3. Who are SECO's partners?

■ SECO engages with various private partners, depending on the development goal that is being pursued.

Multinational or large companies have a comparative advantage in addressing global or sectoral development challenges, given their multi-country activities, large-scale resources or broad expertise. They are better placed to scale up and reach out to a large number of beneficiaries. They have well established networks and benefit from a higher visibility than smaller actors. The risks associated with entering into a partnership with multinational or large firms relate to their strong bargaining power and the reputational risks linked to their higher visibility. **SMEs** have a comparative advantage in tailoring specific solutions or piloting small-scale innovation adapted to the local context. Partnering with SMEs may entail higher transaction costs due to more limited resources to adapt to additional administrative requirements.

SECO may also decide to enter into a partnership with a **single firm**. In this case, the design of the partnership is simpler and the planned governance arrangements lighter. The partnership is limited in time and scope but may be used to test innovative approaches that could be scaled up at a later stage. The drawbacks of this approach include: (i) the risk of creating market distortion by giving one firm an advantage; (ii) the development results achieved with one private actor are more limited unless some scaling-up takes place. Some partnerships may involve **several private actors**. In such cases, the participation of several firms is actively sought; this facilitates the spreading of risks and costs and enables greater outreach for the project. **A multi-stakeholder approach** includes several private companies as well as other actors, such as trade associa-

tions, NGOs or private foundations that combine their resources and expertise to solve a more complex issue on a larger scale. Such a partnership is more complicated, given the variety of interests involved, but is more likely to provide a more comprehensive solution. Issues related to this approach include: (i) the complexity of designing and implementing such a partnership; (ii) the importance of governance arrangements that bring all the actors together.

SECO is engaged in many global partnerships which include **firms from all over the world**, including Switzerland. Direct partnerships with **Swiss firms** are mainly at partner-country level, especially to develop export capacities of local firms for sustainable trade. SECO also uses the modality of matching funds⁶ to specifically target the expertise of Swiss SMEs. Over the years, SECO has found several advantages in entering into partnerships with Swiss private companies, including: (i) the sophistication of the Swiss market, led by the innovative demand from Swiss customers (e.g. fair trade or organic products); (ii) specific expertise or positioning of the Swiss industry in a sector; (iii) the proximity of the companies facilitates the establishment of long-standing relations.

Partnerships with **local private actors** also offer potential for achieving SECO's development goal of sustainable growth. For example, private investors in venture capital funds are usually local banks or pension funds from partner countries. In other cases, SECO supports financing mechanisms that benefit local enterprises to support a transformational change.

⁶ A matching fund creates a mechanism to select individual firms that will receive a grant or a loan from the public sector to match their own contribution. It is based on clear criteria and a due diligence process and thereby ensures transparency in the selection of each firm.



4. What have we done?

■ SECO has pioneered partnerships with the private sector in many of its business lines, given that such collaborative arrangements were seen as necessary for reaching its development objectives. Sustainable trade and access to finance are the two business lines where this modality has been mostly used.

International trade supports a more efficient global division of labour, creates jobs and makes an important contribution to poverty reduction. Demand for more **sustainable trade** has increased over the years – more environmentally friendly production methods and better working conditions have been particularly emphasised. In response, several international or regional initiatives have brought together producers, traders, private companies or NGOs to define a set of agreed standards. SECO was a founder or an early participant of these global initiatives (e.g. Better Cotton initiative, roundtables on responsible soy, coffee, cocoa, sustainable biomaterials) and is continuing to launch new initiatives such as the Better Gold Initiative.



The Better Gold Initiative

The Better Gold Initiative (BGI) is a partnership between SECO and the Swiss Better Gold Association (SBGA) that aims to develop a market for gold from certified mines respecting internationally recognised sustainability standards. Gold from certified mines is assigned a premium, tied to better practices and continued improvements, and spent on sustainable development projects and community development. The BGI was started in 2013 in Peru, with the aim of replicating it in other countries in the near future. SECO has played a broker role in the initiative and is, for example, supporting small miners in producing better gold. Since inception (less than a year ago), over 150 kilos of “better gold” were imported to Switzerland, bringing an additional profit (premium) of CHF 100,000 to the Peruvian artisanal miners participating in the project.

SECO supplements this approach in sustainable trade with some country-level projects which help smallholders to implement the new standards set through these international initiatives or required by international buyers.

Scaling up organic and fair-trade cocoa in Ghana

The objective of the project is to support the scaling-up of the production of organic and fair-trade cocoa in three districts in Ghana and to support the sale of their produce via traceable value chains to market players in the Swiss chocolate sector. The project helps farmers improve their livelihoods in a sustainable way by adopting sustainable agroforestry-based cocoa production. A Swiss company is partner in this project. Max Felchlin AG has signed a purchase agreement for the next five years and has contributed with know-how for the post-harvest process.

Lack of **access to long-term investment capital** is a critical bottleneck for economic growth in developing countries, especially for SMEs. The Swiss Investment Fund for Emerging Markets (SIFEM AG), the Swiss development finance institution, provides long-term finance to venture capital funds and financial institutions in developing and emerging markets. SIFEM's primary focus is on institutions investing in the SME sector as well as other fast-growing companies. An independent evaluation of SIFEM showed that over four-fifths (82%) of SIFEM funds have private co-investors and 95% have public co-investors. Between 2003 and 2011, for every US dollar that SIFEM invested, private-sector investors invested USD 3.15. SECO is also directly involved in some structured investment vehicles or social investment funds to further support the financing of SMEs and has established a matching mechanism, the SECO Start-up Fund (SSF), for Swiss entrepreneurs that invest in projects in some frontier/emerging countries.

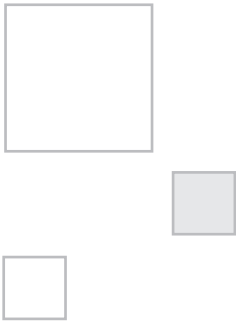
The importance of infrastructures in supporting the development of a competitive economy and contributing to poverty reduction is widely recognised. Governments from developing countries or traditional financing mechanisms by multilateral development banks or bilateral donors cannot respond to existing needs. SECO thus joined up with several other donors to create the Private Infrastructure Development Group (PIDG) to mobilise private investment. Between 2002 and 2013, PIDG leveraged US 28.71 billion in private financial resources. SECO also participates in the Interdepartmental REPIC Platform, which provides a central mechanism that allows Swiss private companies (but also other actors such as NGOs) to apply for matching grants to develop and pilot-test business models and technology adaptation in the area of renewable energies and energy efficiency in developing countries.

The SECO Start-up Fund (SSF)

The SECO Start-up Fund is a credit instrument that promotes private sector investment projects in countries with economies under development or in transition. The projects must be commercially viable and meet recognized environmental and social standards. An example of a project supported by the SSF concerns the production of high-quality milk in the Winnitska region in Ukraine. Two Swiss agronomists and their Ukrainian partner acquired old farm buildings and were supported by a loan from the SECO Start-up Fund (SSF) to co-finance the start-up phase. Today, the herd amounts to 230 cows producing 2.8 tonnes of milk a day. The project created a total of thirty jobs and the farm has been built around the Swiss Protection of Animals Act. The loan granted by SSF has been fully repaid and the business is continuing to grow steadily.

PIDG: Seacom Undersea Cable – Internet for Eastern and Southern Africa

Without adequate, affordable and high-quality bandwidth telecoms connections, Eastern and Southern Africa had to resort to expensive satellite technology, which delivered a limited service. The high-risk, long-term loan of USD 35 million made by the Emerging Africa Infrastructure Fund (PIDG) to Industrial Promotion Services (IPS) allowed IPS to invest this in turn as equity on an exceptional basis. This enabled the project to reach financial close. Finally, private sector investment in this project totalled USD 375 million. By March 2011, within two years of Seacom's commissioning, international and retail bandwidth costs had reduced by 83% and 67% respectively and, less than two years after Seacom went 'live', the number of Kenyan Internet users increased to 8.6 million from 3.6 million.



Finally, it should be stressed that partnering with the private sector is not limited to bilateral donors and that such partnerships also exists directly between multilateral development banks and private companies. For example, both Credit Suisse and SwissRe are investing directly in private equity funds managed by the Asian Development Bank. UBS was a B-lender for a USD 2 million line in 2010 for the Bank Sofisa Lending Facility (Inter-American Development Bank) in Brazil. Stadler Rail AG established a joint venture with the Minsk

Region Executive Committee (Belarus) for the construction of a production plant for passenger trains, trams and trolleybuses. The joint venture is supported by a senior loan from the European Bank for Reconstruction and Development. In a project co-financed by SECO in Indonesia, Holcim signed a memorandum with the International Finance Corporation (IFC) to provide technical assistance and construction materials to potential customers of microfinance institutions supported by IFC.



5. Moving forward

■ SECO is building on its vast experience in partnering with the private sector and exploring additional opportunities for further collaboration with the private sector. Preliminary reflections are looking at the forms of partnering as well as potential themes and include the following:

Forms of partnering

■ SECO is considering **new innovative financing instruments** such as Development Impact Bonds (DIB) by drawing on international experience and is looking at the preparation of some pilot projects.

■ **Matching fund** is a modality that is increasingly used by donor agencies as a means of leveraging resources and working with the private sector. SECO will review the experience of other donors and assess to what extent the SECO Start-up Fund, which provides loans to SMEs, should be expanded.

■ **Platform approaches** have the potential to address large-scale challenges such as climate change, urbanisation and infrastructure financing. SECO is scaling up the use of this modality for themes other than sustainable trade in commodities (e.g. hydropower energy or sustainable finance).

Themes

■ Tackling **climate change** requires not only financing but also new models and approaches. For example, SECO is further considering the potential of insurance-based instruments to support the mitigation of climate change effects, based on innovative programmes. The Southeastern and Central Europe Catastrophe Risk Insurance Facility is a dedicated catastrophe reinsurance pool to promote the catastrophe reinsurance market in Southeast Europe. Another exam-

ple is the cooperation established between the World Bank and private reinsurance companies, such as Swiss Re or Munich Re in the context of a SECO/World Bank partnership on financial risk management. The objective is to increase the financial resilience of middle-income countries to natural disasters.

■ SECO will continue to leverage private resources to support **infrastructure financing**. Developing regional or national financing mechanisms is another emerging approach that complements the PIDG. The EBRD/KfW/SECO Western Balkan Municipal Infrastructure Development Fund is an example of such a regional mechanism. This fund aims to leverage public funds with additional private capital to provide financing to utility companies and municipalities through local commercial banks in Albania, Bosnia, Kosovo, Macedonia and Serbia.

■ Addressing the challenges of **urbanisation** will require the use of different instruments and modalities as well as the involvement of many actors from the private sector, civil society and governments. Building on its experience with innovative financing mechanisms and platforms, SECO will assess how to build programmes that catalyse the resources and expertise of all these actors.

SECO's long experience shows that building partnerships with the private sector is the result of both systematic reflections and opportunistic moves. The key to success with such an approach is to continuously emphasise that partnering is a means of contributing to the achievement of development objectives.

⁷ A donor concludes a contract with a service provider in which it agrees to pay the provider only for the successful outcomes of its programme. Payment takes place after the donor has verified that pre-agreed outcomes have been achieved. Investors get their investment back with a premium in case of higher development outcomes.