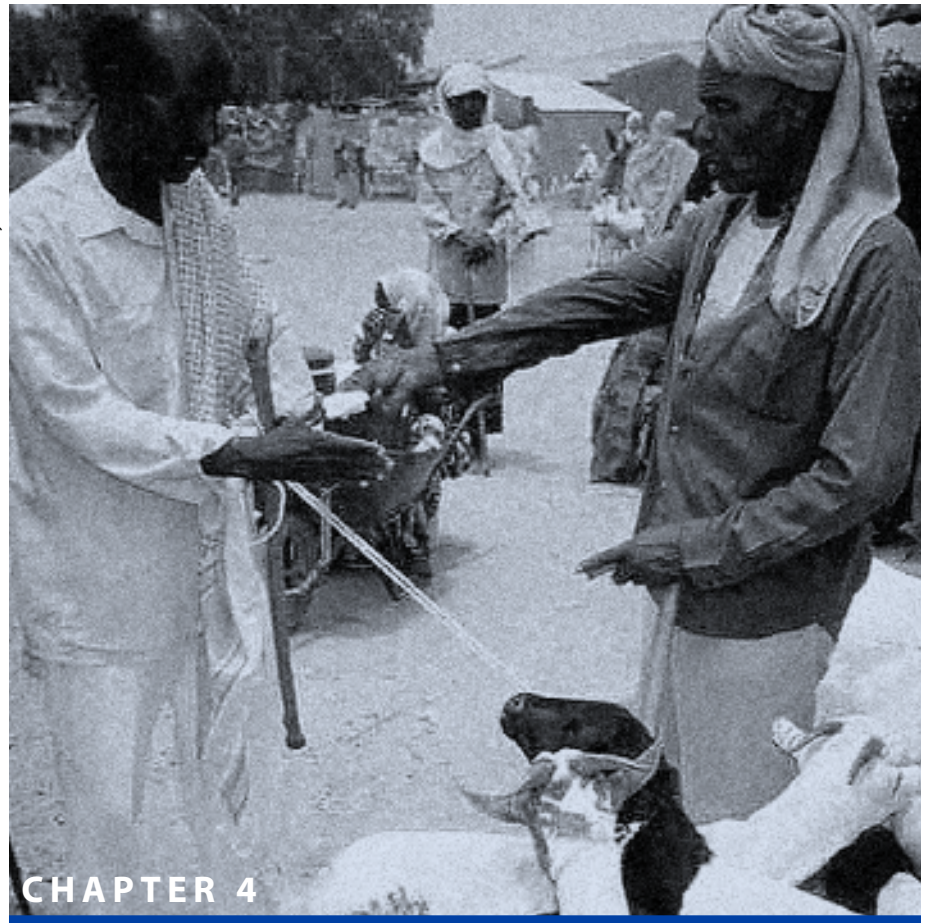


Photo: Sonya Laurence Green/UNDP, Somalia



## CHAPTER 4

## ENGAGING THE PRIVATE SECTOR IN DEVELOPMENT

**M**ost efforts to address the constraints to sustainable private sector development originate in governments and public development institutions. But the Commission believes that

to reach the needed level of change, it is essential to go farther and think about how better to engage the private sector in addressing the development challenge. Many critical resources for private sector development are under the radar screen of development, since they are not carried out by traditional development players and do not occur under the explicit label of development (box 4.1).

Private actions and public-private partnerships fall into two categories. They are commercial transactions driven by market incentives, developed as part of a corporation's evolving business and commercial strategy, which nonetheless have strong implications for development. Or they are specifically structured as innovative efforts to apply private sector principles and approaches to developmental problems (figure 4.1). From a different perspective, these innovative private sector activities are either purely private-private interactions or they fall more obviously into the area of public-private partnerships.

**BOX 4.1 RESOURCES UNDER THE RADAR SCREEN FOR PRIVATE SECTOR DEVELOPMENT**

Many private actors outside the traditional development community are addressing the challenges of development:

**Companies**

- Large corporations (both multinational and local) are leading private ecosystems that develop and strengthen the capabilities of local small and medium enterprises and microenterprises.
- Global financial institutions and emerging local financial institutions are developing innovative approaches and technologies to improve access to credit for the poor and for small and medium enterprises.
- Individual companies, generally multinational corporations but also some large local ones, are launching corporate social responsibility programmes to address specific development needs.
- Important local companies—alone or with domestic private sector associations—are broadening their strategy and reach from strictly lobbying for actions beneficial to the private sector to informing and influencing the development process.

**Associations and foundations**

- International private sector associations, such as the Council on Sustainable Development, International Chamber of Commerce, International Business Leaders Forum, World Economic Forum, International Organization of Employers and others at the regional level, such as the West African Business Network and the Commonwealth Business Forum, are focusing on various aspects of development. National business associations, such as the Confederation of Indian Industries and the Federation of Malaysian Manufacturers, have played a key role in national economic planning.
- Private foundations are engaging in the broader development process, with a focus on accountability and results.

**Academic institutions**

- Academic institutions (including management schools)—both in countries that are members of the Organisation for Economic Co-operation and Development and in some developing countries—are focusing more on private sector development and broader development issues.
- Leading business schools are working with African counterparts for the joint management training of local public officials and private sector leaders.

**Networks of individuals**

- Individuals are playing or wishing to play a bigger role in resolving global issues by contributing their know-how and services to various types of “developmental peace corps” organizations (retired senior executives, business administration students, financial sector experts).
- Expatriate executives of multinational corporations are mentoring local entrepreneurs or teaching business in schools where they are stationed.
- Diaspora members in North America and Europe are supporting entrepreneurs in their homelands with remittances, informal financing of small businesses, and business advice and mentorship. They are the mirror image of the brain drain discussed in chapter 2 and represent the potential brain bank that could play a bigger role as the changes in country policies discussed in chapter 3 begin to take hold.

**SERVING MARKETS AT THE BOTTOM OF THE ECONOMIC PYRAMID**

The vast emerging consumer market at the base of the pyramid—4 billion people with a per capita

income of less than \$1,500—provides multinationals and large local companies with an attractive market for their goods and services (box 4.2; see page 32). India has 700 million people in rural markets. China has a billion.

As today’s advanced economies become a shrinking part of the world economy, the accompanying shifts in spending could provide significant opportunities for global companies. Being invested and involved in the right markets—particularly the right emerging markets—may become a much more important strategic choice. Indeed, many companies are already serving the world’s poor in ways that generate strong revenues, lead to greater operating efficiencies and uncover new sources of innovation. For these companies—and for those following their lead—building businesses aimed at the bottom of the pyramid promises to provide competitive advantages as the 21st century unfolds. At the same time, it provides critical links to the marketplace for consumers at the bottom of the pyramid.

**FORMING ECOSYSTEMS AND BUILDING NETWORKS**

One of the most compelling ways to help firms succeed is by increasing the power of the linkages and networks they are part of. Many business ecosystems bypass weak regulatory environments by creating private capacity for regulation and enforcement within the network. This capacity can reduce asymmetries within networks and enhance the ability to enforce contracts, thus building trust in the system.

Networks can bring many benefits by:

- Enabling the transfer of skills, technology and quality.
- Ensuring that foreign direct investment has positive spillover effects.
- Bringing companies into the formal sector.

- Creating the capacity to govern transactions through commercial contracts.
- Opening markets and the supply of inputs to smaller firms through networks of larger partners.
- Improving the ability of small and medium enterprises in such networks to get financing on commercial terms.
- Increasing the wages, employment standards and productivity of local companies.
- Increasing the choice and lowering the prices for poor consumers by bringing a greater variety of goods to market.

These networks—which can include vertical supply-chain relationships and horizontal clustering—also have enormous potential. But so far their impact has been limited, concentrated in a few developing countries, such as Brazil, China, India and Malaysia. In Sub-Saharan African countries there are few commercial transactions between large multinationals and small local companies. A study of 5 foreign and 36 local companies in Kenya showed that none of the multinational affiliates engaged in local sourcing.

A good example of a business ecosystem at work is Hindustan Lever Ltd., a major producer of personal care and food products in India. Its ecosystem includes 80 manufacturing facilities, 150 small and medium enterprise suppliers employing up to 40,000 people, 7,250 exclusive stockists, 12,000 wholesalers and small retailers, 300,000 shop owners and 150,000 individual entrepreneurs in remote villages who sell its products, a number likely to grow to 1 million on current expectations.

FIGURE 4.1 PRIVATE SECTOR CONTRIBUTIONS TO PRIVATE SECTOR DEVELOPMENT		
	Targeted at public sector players	Targeted at private sector players
<b>Driven by private sector players</b> <ul style="list-style-type: none"> <li>■ Companies</li> <li>■ Civil society organizations</li> <li>■ Foundations</li> </ul>	<ul style="list-style-type: none"> <li>■ Setting broader standards (industry norms, sustainability, corporate governance)</li> <li>■ Lobbying for policy changes</li> <li>■ Promoting participatory processes through social dialogue</li> </ul>	<ul style="list-style-type: none"> <li>■ Business linkages and partnerships</li> <li>■ Investment, including foreign direct investment</li> <li>■ Mentorship for entrepreneurs</li> </ul>
<b>Driven by public sector players</b> <ul style="list-style-type: none"> <li>■ Local governments</li> <li>■ Donor governments</li> <li>■ Development agencies</li> </ul>	<ul style="list-style-type: none"> <li>■ Policy reform</li> <li>■ Policy advice</li> <li>■ Funding and delivering technical assistance for public sector reforms</li> <li>■ Financial transfers (aid, loans)</li> </ul>	<ul style="list-style-type: none"> <li>■ Public-private partnerships, for example, for basic service delivery</li> <li>■ Public-private consultative bodies</li> <li>■ Privatization or contracting</li> <li>■ Investment promotion</li> <li>■ Direct business development services</li> <li>■ Direct financing</li> </ul>

Working with women entrepreneurs, Hindustan Lever is leveraging the ecosystem to target the potential of more than 200 million consumers in rural areas. These business women learn about products, prices and returns and advise the customers in their villages about the products they sell. Hindustan Lever has the potential to reach customers it could not effectively reach otherwise through normal distribution channels. This market-based ecosystem is a means of informing the poor about the benefits of transparency in transactions and the need to respect contracts—be they explicit or implicit with the company. This connection with national and global business systems reduces reliance on local moneylenders and slumlords.

Another example is the \$2 billion garment export industry in Bangladesh, based on the power

of spreading innovation. In view of the limits on Korean textile and garment exports to the United States, Daewoo started a joint venture with a local Bangladeshi company to produce garments for export and trained local employees in the latest production techniques. Over time, however, as many as 115 of the first 130 Korean-trained managers left with the knowledge and networks they had acquired to set up their own companies. The industry has grown to more than \$2 billion in annual sales and accounts for more than half the country's exports.

Networks link entrepreneurs with potential sources of financing, human skills, partners, suppliers and information. Through such networks entrepreneurs share information and assessments of

## BOX 4.2 SHOWING WHAT'S POSSIBLE AT THE BOTTOM OF THE PYRAMID

**In the financial sector**

ICICI Bank-India is offering innovative ways to deliver financial services to the poor. It has developed two models:

- The direct-access–bank-led model promotes and nurtures self-help groups, to create a savings pool. Once a pool reaches a certain size (few hundred U.S. dollars), ICICI will consider making loans of \$5,000 with a distribution of \$250 per individual. Group pressure is the best collateral, and repayment rates are 99.9%.
- In the indirect channel ICICI partners with microfinance institutions drawing on the advantages of each. The microfinance institution draws on its skills to contribute the social intermediation aspects, while the bank carries out the financial intermediation and bears the credit risk. This can effectively leverage the risk capital that already exists with banks and can be a potential solution to the capital constraints of microfinance institutions. This model reduces the cost of intermediation without affecting the quality of the portfolio.

The strategy has both made good business sense and had significant development impact. For example, the number of self-help groups has increased to over 10,000, allowing ICICI to substantially increase its market share in rural areas. Villagers have had a surge in financing opportunities. Interestingly, a study conducted independently has shown a strong surge in self-confidence of members in self-help groups.

**In the retail sector**

Casas Bahia, the largest retailer in Brazil, focuses almost entirely on poor consumers. It uses a *carne*, or passbook, system of financing that allows poor customers to buy on credit. Casas Bahia uses a proprietary system that does credit checks and applies common-sense rules to determine whether to offer financing to those without credit history.

Casas Bahia has 4.2 billion reais in revenues, 330 stores, 10 million customers and 20,000 employees. Some 70% of its customers have no formal or consistent income and are primarily maids, cooks, independent street vendors and construction workers whose average monthly income is two times the minimum wage. The poor now have access to a much broader range of products and benefit from better credit schemes than they previously had.

**In the cement sector**

CEMEX, Mexico's largest and the world's third largest cement company, created two key programmes to tap the large poor population of Mexico, where 60% of the people survive on less than \$5 a day.

*Source: Prahalad (forthcoming)*

- *Patrimonio Hoy* targets the low income, do-it-yourself home-builder segment of the population. It is set up like a microcredit scheme, with small lending groups, but the savings are used to purchase cement and other building materials.
- *Construmex* is an innovative way of tapping the diaspora community so that money sent home for construction can be transferred directly to the cement company without paying financial intermediaries. The service allows Mexicans living in the United States to send their money and their orders directly to cement distributors in Mexico, who then deliver cement to the site of the person's future home or business.

CEMEX knew that a significant part of the \$10 billion in remittances to Mexico (about 10%) is used for construction of houses.

*Patrimonio Hoy* tripled the rate of cement consumed by its low income, do-it-yourself homebuilders. *Construmex* has reported \$2.5 million in sales since it started in July 2001, mostly from emigrants in Los Angeles. With its U.S. sales potential estimated at \$160 million a year, *Construmex* is planning to expand to other cities with large Mexican communities, including Chicago and Houston. Both programmes provide the poor with more cost-effective opportunities to build their homes and improve their livelihoods.

**In the cellular network sector**

GrameenPhone is the largest cellular operator in Bangladesh. Vodacom is a South African subsidiary of Vodafone and the largest operator in South Africa. Both companies work with local entrepreneurs who acquire cellular phones and resell phone services within their villages. GrameenPhone combines this activity with microcredit for entrepreneurs and focuses mostly on women.

GrameenPhone has built the largest cellular network in the country, with investments exceeding \$300 million and a subscriber base of more than 1 million. Its rural programme is already available in more than 35,000 villages, providing telephone access to more than 50 million people, while helping to create microentrepreneurs. The key to the success of the village phone has been a cadre of entrepreneurs, 95% of them women, who benefit from the opportunity to run their own microenterprises.

Vodacom provides more than 23,000 cellular lines at more than 4,400 locations throughout South Africa. The company has provided affordable communication services to millions of South Africans and empowered thousands of previously disadvantaged individuals with income-generating opportunities and lasting business skills. These accounts generate Vodacom's highest revenues.

markets and technology and lessons from their own experiences. They can also coalesce into groups to discuss issues of common interest and contribute more broadly to the communities they live in.

Informal entrepreneurial networks (often ethnic or religious in origin) predominate in developing countries. In the absence of clear legal enforcement of contractual obligations, these relationship-based networks—relying on trust, personal guarantees

and informal contract enforcement—facilitate cross-border trade and business transactions and provide a source of financing. Best known is the extensive network of Chinese overseas entrepreneurs with predominantly family-owned businesses, found among the 50 million-strong Chinese diaspora.

It has played a key role in the economic transformation of China and emerged as a business force in Southeast Asia. Official Chinese statistics reveal that overseas Chinese entrepreneurs account for 70% of China's foreign direct investment—more than \$50 billion recently.

The Indian diaspora has been less involved in direct investment back home than in making business connections between overseas investors and the local business community and in facilitating the faster development of private ecosystems.

With market development and the emergence of larger firms, informal ties based on personal ties are supplanted by formal networking organizations, such as chambers of commerce, alumni associations and incubators. These formal networking organizations have long been sources of mutual support in the developed world and are now providing the same in the developing world, playing a vital role in:

- Organizing and pooling resources to create shared institutions and capabilities.
- Creating relationships and levels of trust that make them more effective.
- Defining common standards.
- Conducting or facilitating collective action in procurement, information gathering and international marketing.
- Defining and communicating common beliefs and attitudes.
- Providing mechanisms to develop a common economic or regional agenda.

Business associations, especially trade and industry organizations, are representing the common interests of their members by coordinating activities, establishing self-regulatory standards, lobbying governments and providing direct services to members. Direct services include the promotion of linkages, training, information dissemination and access to markets. Business associations have taken the lead in improving the competitiveness of their members by:

- Lowering the costs of information.
- Establishing horizontal coordination (quota allocation, capacity reduction) and vertical coordination (upstream-downstream).
- Setting standards and upgrading quality.

### **FOSTERING PUBLIC-PRIVATE PARTNERSHIPS FOR SUSTAINABLE DEVELOPMENT**

Important benefits can be obtained by fostering more effective public-private partnerships, particularly in the selective provision of such services as energy and water. Energy production and basic water supply projects can use the most effective ownership structure necessary, including public ownership. But final delivery to the rural customer or to the informal sector can often be managed by smaller domestic companies. Decentralized power production, through distributed energy of various kinds, can also be contracted to the private sector

through agreements with the public sector grid. Solar power and small run-of-the-river hydro plants are examples.

Public-private partnerships are also effective in implementing sustainable development objectives. Noteworthy here are the United Nations' Global Compact—a voluntary corporate commitment to environmental, human rights and labour standards—and the International Finance Corporation's Equator Principles, an agreement by leading international financial institutions to observe global standards in environmental and social policies in all large projects they finance, regardless of whether these are jointly financed with public institutions that observe the same rigorous standards.

Similar public-private partnerships in corporate governance and transparency are attempting to influence private sector behaviour. The "Publish What You Pay" campaign aims to help citizens of resource-rich developing countries hold their governments accountable for how revenues from the oil, gas and mining industries are managed and distributed.

The campaign, backed by a worldwide coalition of more than 170 nongovernmental and civil society organizations, was founded by Global Witness, George Soros's Open Society Institute, CAFOD, Oxfam, Save the Children U.K. and Transparency International U.K.

The coalition calls for international regulation on the disclosure of net taxes, fees, royalties and other payments made by companies to developing country governments in all countries where they operate.

Because individual companies might be put at a disadvantage by disclosing information others fail to reveal, expecting voluntary disclosure might not be a viable option. Yet all companies and the investment community would benefit from a level playing field if regulators required disclosure. The importance of this approach is also reflected in the Extractive Industries Transparency Initiative developed by the U.K. government and recently endorsed by the World Bank.

In addition to setting standards for the private sector, a small but growing number of companies are driving standards higher themselves—to be the pacesetters for measuring other private companies. These newer trends provide a valuable complement to the traditional approach of a regulated private sector and a regulating government agency. Infosys in India is not only paving the way in this field but also engaging directly with governments to influence the broader reform and developmental agenda in its state of operations and in the country. This kind of role for the private sector is vital to the development effort.

## IMPROVING CORPORATE GOVERNANCE

Corporate governance is a focal point in creating safeguards against corruption and mismanagement, limiting insider dealing and cronyism while promoting the values of a market economy in a democratic society. The values include accountability, transparency and the rule of law—as well as fairness, responsibility and ownership and protection for minority shareholders.

The benefits of committing to corporate governance mechanisms are less corruption, a healthier private sector, fairer markets and greater institutional development—all supporting a growing economy. Separate from corporate governance, which at its heart is the protection of shareholders rights, is the growing interest in corporate social responsibility. Companies are not only pressured by government, which adopts corporate governance regulations forcing codes of conduct on businesses, but also by public opinion galvanized by civil society and labour organizations. Self-regulating or voluntary codes of corporate behaviour prove that companies are willing to be good corporate citizens.

It is important for the public and private sectors to work together to develop a set of rules binding for all, establishing the ways companies have to govern themselves. Business associations, such as chambers of commerce and industry groups, should try encouraging their members to develop standards of corporate

governance to protect shareholders and other constituents—and standards of social responsibility to respond to external stakeholders. Private sector task forces promoting corporate governance and business associations developing codes of corporate governance for its members are promising starting points.

## ADVANCING RESPONSIBLE BUSINESS PRACTICES AND CORPORATE SOCIAL RESPONSIBILITY STANDARDS

To some extent the mainstreaming of what is now commonly referred to as “the triple bottom line”—reconciling respect for the environment, social equity and financial profitability—is good news for business. The triple bottom line focuses corporations not just on the economic value they add, but also on the environmental and social value they add—and destroy. The term captures the values, issues and processes that companies must address to minimize any harm from their activities and to create economic, social and environmental value. This involves being clear about the company’s purpose and taking into consideration the needs of all the company’s stakeholders—shareholders, customers, employees, business partners, governments, local communities and the public.

The possibilities of such an alignment, between social and commercial interests, remain largely untapped. The majority of companies that have taken an enlightened approach to sustainable development have been pushed and pulled in that direction: pushed by

changing societal expectations and stakeholder demands, and pulled towards emerging markets by greater competition for market share in the mature markets of the developed world.

Most of the efforts have been concentrated in traditional philanthropic or charitable models: building schools and health clinics or supporting cultural and artistic organizations. Though valuable and perhaps necessary, this model is more window-dressing than a substantive or sustainable contribution to the lives of the poor. Because it lies outside the traditional business model, the benefits are measured in intangibles—such as reputation, risk reduction and license to operate—rather than the bottom line. It represents mainly short term, unquantifiable and unaccountable financial contributions. And commitments can come and go with changes in the business climate or management.

In the last decade there has been a growing body of evidence that pioneering companies that actively manage their impacts on sustainable development have better financial performance. Companies have been pushed by advocates, labour unions, the media and even shareholders to take the positive and negative impacts of their activities into far more consideration than they did before. They are building human rights, core labour standards and sustainable development into their corporate commitments. They are slowly learning to implement them through management systems and broader accounting standards. And they are reporting their successes and failures along the way to the

public, using sophisticated corporate social responsibility reports.

Global partnerships to define standards in different sectors of industry have also facilitated private sector leadership and corporate governance attributes that reflect changing corporate behaviour. These include Responsible Care in the chemical industry, the Sustainable Forest Initiative, Sustainable Fisheries, and the Global Mining Initiative launched in 1998 by nine mining companies from around the world.

The global mining industry sought to redefine its role by demonstrating corporate commitments to stakeholder dialogue and sustainable development. The initiative led to an independent research project on mining, minerals and sustainable development and a multistakeholder conference in May 2002. The partnerships and research efforts that flowed from these initiatives continue through the International Council on Mining and Metals, the World Business Council for Sustainable Development and other industry associations and companies that share experience in promoting local growth through sustainability principles and standards.

The partnerships reflect the evolution of new voluntary standards for judging corporations. Some critics will point to these partnerships as corporate ways of avoiding binding regulations. Others see them as direct evidence of corporate commitment and understanding of the importance of taking a leadership role on sustainable

development. Among the new standards are: AA1000 (developed by the Institute for Social and Ethical Accountability), ISO14001 (International Organization for Standardization) and Project Sigma (a sustainability management standard under development by the British Standards Institution, Forum for the Future and others).

The development and improvement of indicators for development by international development agencies, such as the International Finance Corporation's Sustainability Framework, and by corporations, such as the Global Reporting Initiative, present unique opportunities to track private sector contributions to sustainable development. So does the scoring of corporate efforts to pursue the Millennium Development Goals, published through the World Economic Forum's Global Governance Initiative. Such quantitative tools will allow corporations to move beyond qualitative stories associated with traditional philanthropy towards strategic social investments with short, medium and long targets. Being able to budget and report on results will have the benefit of quantifying private sector contributions to international poverty reduction targets while simultaneously creating incentives for more proactive approaches to sustainable development. Standard indicators based on existing international frameworks

also provide the tools for cost-benefit analysis of investments and the identification of effective models.



The Commission sees a distinct need for accelerating the dissemination of information on successful models, creating new ones or adapting existing ones to new environments, replicating them across geographies and scaling them up rapidly.

The private sector, particularly the management of large local and multinational companies, needs

to make a much more serious commitment to capturing the opportunities—by researching bottom-of-the-pyramid markets, by advancing standards of sustainability and public trust and by thinking creatively about linking with other businesses locally or abroad for mutual benefit. Governments, from both developing and developed countries, can facilitate this, and international development institutions can assist them.