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Evaluation Department



Norad



Towards Private Sector Led Growth: Lessons of Experience Executive Summary



AFRICAN DEVELOPMENT BANK GROUP

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Executive Summary

Introduction

This document outlines the key findings of a synthesis of 33 evaluations carried out by various development institutions on private sector development (PSD). Both multilateral and bilateral institutions have carried out a number of evaluations on support to the private sector and/or various segments of the private sector [microfinance, private equity, public private partnerships, small and medium enterprises (SMEs)], which contain a wealth of evaluative evidence. The synthesis aims to inform the strategic direction as well as the design and implementation of future private sector development interventions in order to maximize the private sector's role in spurring economic growth and advancing development effectiveness in Africa. The objective of the synthesis is twofold: 1) to mine evaluative knowledge on the relevance, efficiency, effectiveness, sustainability, and management of private sector interventions; and, 2) to identify key lessons based on what worked and what did not work and why.

Key Findings

PSD Constraints and Challenges

There was broad agreement on the main constraints to PSD. The importance of these constraints varied by firm size, country context, and donor. Most donors used in-country consultations, and to a lesser extent formal diagnostic tools as the mechanisms for identifying PSD constraints.

The main constraints to PSD included inadequate access to electricity, lack of access to finance, corruption, high tax rates, political instability, competition from the informal sector, and inadequate worker and management skills. These constraints

were often acknowledged in international financial institution (IFI)'s reports. However, in identifying what a PSD program may cover, the importance of each constraint differed by development partner and country. While donors made use of formal diagnostic tools, in-country consultations were the most prevalent mechanism for identifying constraints. Indeed, many donors engaged with the private sector, both local and international, to better understand the practical constraints to growth of enterprises.

Development Effectiveness of PSD Interventions

Relevance

Overall, donor strategies were aligned with national PSD strategies. However, relevance was weakened by a lack of selectivity, an unclear underlying rationale (theory of change), insufficient diagnostics and poor selection of beneficiaries.

The key findings are as follows:

- There was broad alignment between national PSD strategies and donor support strategies, but selectivity remained challenging due to the broad range of private sector entities that can be supported.

Maximizing sustainable PSD results through design

Key Lesson: The donor community needs to invest more significantly in the research agenda to develop alternative theories of change and establish linkages between PSD interventions and poverty reduction.

- The relevance of PSD programs' objectives in supporting poverty reduction (the overall goal of many donor programs) failed to be clearly demonstrated.
- Policy and regulatory reforms were necessary but not sufficient conditions for PSD.

Institutional Capacity is key

Key Lesson: *Changing laws and regulations can be a promising start to improving the business environment, especially when there is broad consensus among government and the private sector on the changes needed. However, it is important to build the capacity of public sector entities that deliver critical services to the private sector.*

- Financial instruments respond to a real need due to the fact that access to finance consistently appears in the top PSD constraints across almost all countries; they are also part of most countries' PSD programs.
- The relevance of non-financing support was found to be weak in several evaluations due to poor diagnostics and beneficiary selection.
- Interventions supporting only SMEs and micro-entrepreneurs are common. They are characterized by an unclear underlying rationale, a lack of definitional clarity, and often end up supporting larger or smaller firms than targeted.
- Bearing in mind that most of the poor lived in rural areas, many countries target agriculture and agribusiness as priorities. Donor PSD programs in agriculture and agribusiness are well aligned with national programs. Agricultural PSD interventions are found to be relevant even when donor support reaches the poor indirectly (for example, through the use of their labor or through increasing food security).

Effectiveness

PSD interventions effectiveness varied based on the type of intervention (for example, economy-wide, sector-specific and firm-specific). There is a broad consensus around the benefits of economy-wide policy reform measures, particularly for improving the business environment and ensuring the availability of infrastructure. Findings are more mixed regarding the effectiveness of different financial and non-financial instruments.

The key findings are as follows:

- Effectiveness of business environment reforms was not conclusive with donors presenting different opinions on the existing capacity of the public sector.
- Financing support was assessed as mixed. It was judged as more effective when coupled with technical assistance and capacity building for both the private sector and the financial intermediaries. The effectiveness of financial support to enterprises can be impacted by other factors. These include: 1) technical assistance, and 2) the intermediary's participation in the corporate governance of the enterprise. Most equity funds have representatives on the company boards in which they invest.

Maximizing sustainable PSD results through design

Key Lesson: *Designing financing support through intermediaries requires attention to the intermediary's existing strategy, the bundling of other services with financing (for example, paying attention to governance oversight provided by equity funds), and to the technical assistance needs of the intermediary itself.*

- In terms of non-financial support, achievement of output was high, but outcomes' achievement (job creation, poverty reduction) suffered from lack of evidence.
- Effectiveness of SME support was hampered by the lack of results data. The evaluations found that support to SMEs through intermediaries is effective only when the latter are already heavily focused on SME clients and have an existing SME strategy and portfolio.
- Effectiveness of micro-enterprises varied depending on whether investments were made in public or private sector institutions and whether the investment was in a standalone projects or a part of a program.
- Sectoral targeted interventions – particularly in agriculture – have proved effective.
- Efficiency was rated higher with donors' in-country presence but was hampered by capacity challenges, particularly related to retaining suitable numbers of staff with the right mix of skills and experience.
- Delivery of PSD donor support through financial intermediaries was more efficient than delivery through public sector institutions.
- The efficiency of business environment reforms was negatively affected by both design and implementation challenges.
- For financing support instruments, evaluations found that financial rates of return were found to be low when strategic choices are made to invest in riskier countries and sectors. Furthermore, process delays were found to be mixed among some evaluations reviewed.
- Evaluations noted delays in deploying non-financing support instruments.
- The efficiency of SME support was reported as mixed.
- The efficiency of interventions targeting micro-enterprises and micro-finance received limited coverage in evaluations. Evaluations that addressed this issue rated it as weak.

Institutional Capacity is key

Key Lesson: *Targeting is a widely used approach even though programs targeting firms based on size (SMEs or micro-enterprises) have demonstrated limited results. Programs with a sectoral focus – particularly agriculture/agribusiness – have been more successful.*

- Infrastructure and private participation in infrastructure though extremely important received limited coverage in PSD evaluations (only 2 out of 33 evaluations). Public-private partnership in the infrastructure sector was rated as effective but coverage by the evaluations was still relatively modest.

Efficiency

Efficiency was found to vary depending on a number of factors, such as donors' field presence, institutional capacity, level of investment and the use of public sector institutions. The key findings are as follows:

Institutional Capacity is key

Key Lesson: *Donors need to ensure that they have the appropriate institutional capacity (in terms of staff and systems) to effectively deliver PSD interventions.*

Sustainability

Overall, sustainability was found to be a weak area, mainly due to the fact that it was not always considered at the outset of the program design. When reflected, it tended to focus on financial rather than

institutional sustainability. The ratings given to sustainability varied with the type of intervention (financing, non-financing, reforms).

The key findings are as follows:

- Sustainability is rarely treated as a primary focus during program design. In addition, reviews of the sustainability of activities at best focuses on the continued financial sustainability of implementing agencies instead of focusing more broadly on institutional sustainability.
- Sustainability of products and services delivered through donor programs was particularly challenging where subsidies reduced prices during the program period.
- Financing interventions were generally more sustainable than non-financing support; in particular, private equity funds continued to remain sustainable after program implementation.
- Donor supported business environment reform programs face sustainability challenges. These spring from the needs to ensure that regulatory standards are kept up to date and institutional knowledge in support organizations is appropriately maintained. Projects supporting technology for business development, business development services, and some value chain programs were particularly prone to the lowest ratings in terms of sustainability.
- Sustainability of Micro-Enterprises and Micro-Finance targeted interventions remained an issue although there were some positive expectations for private sector entities.

Managing Private Sector Development Interventions

Design and Delivery

Donor PSD program design was complex due to a multitude of factors, including: 1) the choice

of constraints to be addressed with particular attention paid to binding constraints; 2) the diversity of instruments – policy reform, financing support, and non-financial support; and 3) the multiplicity of implementing agencies (public and private) and partnerships with individual private sector firms and associations. This complexity results in implementation challenges with regards to institutional coordination and sequencing.

Institutional Capacity is key

Key Lesson: PSD interventions require a country-specific diagnostic of constraints, needs and absorptive capacity of the private and public sectors. This should be based on in-depth consultations with the full range of stakeholders to better address the needs of the private sector and to take into account the benefits for wider society.

Most country PSD programs used a mix of interventions (national policy and regulatory reforms, support to key sectors and firm level support), tailored to address country specific PSD challenges. In light of the multiplicity of constraints, effective support to PSD placed the onus on tackling several constraints simultaneously, most notably those that were binding. Donor support to PSD used a mix of interventions and a diversity of implementation agencies to address country specific binding constraints. Donor programs often focused on three areas: (1) improving access to financial services, (2) an emphasis on particular instruments which may not be directly related to the final beneficiaries (for example, infrastructure such as transport) but may still be important to the program, and (3) improving the business environment. Additional areas included access to markets, support to organizations (for example, export promotion agencies) and focused on market development.

Evaluations noted that while “gap filling” is not a successful strategy, donors continue to pursue it. Most evaluations found that donor interventions should focus on additionality and catalytic impact

rather than “gap filling”. Evaluations reported that donors should minimize the distortions resulting from the subsidies that are often embedded in donor support. After all, the level of donor support will never be sufficiently large to address needs. Evaluations noted that donors think that gap filling will solve the problem. This was especially observed in smaller African economies where the financing gap may appear more amenable to filling through donor support. Evaluations highlighted the need to focus donor support on transforming the market structure or changing private sector behavior in the long-term as opposed to the direct outcome of gap-filling. They stressed the need to pay attention to the additionality of programs and instruments as well as to the risk of market distortions.

Maximizing sustainable PSD results through design

Key Lesson: *Given that the volume of donor PSD support will always be modest compared to the significant needs of the private sector, additionality and catalytic effects must be at the heart of PSD program design (for example, through helping to develop local currency financing products). Therefore, the focus should shift from “gap filling” support to changing market structure or behavior (through demonstration effects).*

Financing support was largely provided through intermediaries. The choice of intermediaries – taking into account their capacity and development focus – was an important determinant of success. Financing support was provided primarily through financial intermediaries (banks and private equity funds), as well as microfinance institutions, and, to a more limited extent, it was provided directly to private sector enterprises. Technical assistance and capacity building are provided in conjunction with financial support by some donors so as to enhance the capacity of financial intermediaries.

Non-financing (knowledge) support was also largely provided through intermediaries. But unlike the financial sector, these intermediaries were often weak or indeed non-existent. Utilizing existing public sector intermediaries was found to be a more expedient approach. However, adopting such an approach limited the development of a private sector led market for business services. Non-financial instruments aimed to improve the productivity of firms, which suffered from market failures in many developing countries. However, each instrument had a specific focus ranging from stimulating the demand for knowledge services (by providing targeted funding),

Maximizing sustainable PSD results through design

Key Lesson: *The choice of implementing institution(s) and building capacity in the selected institution(s) are key issues to be addressed during PSD program design*

to developing the supply side for such services (either through strengthening domestic public or private providers or through partnerships with overseas enterprises). Interventions that utilized new private sector intermediaries faced delays while the latter were being developed. The evaluations noted the concern of continuing to work only with public sector providers and not developing the market for private providers of business and professional services. Given the relatively smaller size of the African private sector, this is an area of particular interest.

Coordination

While donors recognize the importance of providing support in a coordinated manner, there is little evidence of coordination at country level beyond the exchange of information. Donors do, however, participate actively in global and regional multi-donor partnerships and often co-invest in the same private and financial sector intermediaries. Evaluations found that donors do not coordinate their PSD support at

Maximizing sustainable PSD results through design

Key Lesson: *The impact and sustainability of results of non-financing (knowledge support) interventions is heavily influenced by the choice of intermediary (public or private), the attention given to building capacity in the intermediary, and the demand for services once subsidies are phased out.*

country level apart from exchanging information. This pattern occurred even where the partnership was an explicit goal of the original donor strategy. Yet evaluations reported that an indirect approach of donor coordination is through providing funding to the same financial or private sector intermediary. This type of collaboration is often seen in the case of financial intermediaries and non-financial business service providers. The most common example is the case of private equity funds, which usually receive simultaneous funding from several IFIs and development finance institutions. Lastly, donors do participate actively in global and regional multi-donor partnerships and associated trust funds.

Achieving more by working together

Key Lesson: *Donor cooperation beyond information exchange is critical to enhance the effectiveness and efficiency of donor programs.*

Monitoring & Evaluation

Evaluations identified a number of weaknesses in the area of monitoring and evaluation, including the following points: 1) a difficulty in assessing the impact of programs which try to influence and change private sector behaviors; 2) a focus on outputs rather than outcomes; 3) a lack of baseline data; and 4) challenges with attributing outcomes to donor support.

Job creation was rarely a direct objective and was not properly monitored. Moreover, when it was monitored the indicators were not meaningful. Programs that sought to monitor job creation focused on direct job creation; the impact was either low or very costly. Some programs attempted to establish a relationship between PSD and job creation at the country level but this was difficult to measure. There was a lack of national data on enterprise and employment creation. Furthermore, since job creation was generated by private firms, it was difficult to attribute observed changes in firms' behaviors to a specific intervention (for example, with respect to recruitment). Where direct impacts were identified, these assumptions were often not verified. Several evaluations pointed to the fact that non-financial results were not properly monitored. Hence, they were difficult to evaluate.

Gender Mainstreaming in PSD Interventions

Coverage of gender specific issues among the evaluations was surprisingly limited, especially in light of the attention shown to this agenda by donors in recent years. Indeed, it is possible that this emphasis may deepen in future years as gender focused initiatives near completion. Evaluations stressed that many broader PSD interventions – particularly those focused on improving the business enabling environment – can significantly benefit smaller and less advantaged firms, typically owned by women entrepreneurs. However, evaluations did not present gender-segregated data. Nonetheless, the evaluations pointed out that country diagnostic work periodically focused on women entrepreneurs.

What does not get measured does not get achieved

Key Lesson: *A rigorous monitoring and evaluation system that focuses on outcomes and that is integrated throughout the life cycle of PSD interventions (design, implementation, completion and post completion) is critical to demonstrate its anticipated impact on poverty reduction.*



About this Evaluation

This evaluation synthesis report is a joint work between the evaluation departments of the Norwegian Agency for Development Cooperation (Norad) and the African Development Bank (AfDB). It serves to mine and synthesize the evaluative evidence from 33 evaluations undertaken by multilateral and bilateral institutions on support to the private sector and/or various segments in the private sector. The evaluation synthesis aims to inform the strategic direction, design and implementation of future private sector development initiatives by drawing lessons on what works, what does not work, and why.

About the African Development Bank Group (AfDB)

The overarching objective of the African Development Bank Group is to spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction. The Bank Group achieves this objective by mobilizing and allocating resources for investment in RMCs; and providing policy advice and technical assistance to support development efforts.

The mission of **Independent Development Evaluation (IDEV)** is to enhance the development effectiveness of AfDB initiatives in its regional member countries through independent and instrumental evaluations and partnerships for sharing knowledge.

About Norad

Norad is a directorate under the Norwegian Ministry of Foreign Affairs. In matters regarding Norway's International Climate and Forest Initiative (NICFI), Norad reports to the Norwegian Ministry of Climate and Environment. Norad's functions are laid down in the agency's terms of reference and annual letters of allocation issued by the Ministry of Foreign Affairs and the Ministry of Climate and Environment. Norad's main purpose is to ensure that Norwegian development aid funds are spent in the best possible way, and to report on what works and what does not work.

The **Evaluation Department**, located in Norad, is mandated to initiate and carry out independent evaluations of any activity financed by the Norwegian aid budget. The Evaluation Department is governed under a separate mandate for evaluating the Norwegian Development Aid Administration and reports directly to the Secretaries General of the Norwegian Ministry of Foreign Affairs and the Ministry of Climate and Development.



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