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Overseas Development Institute

Policy brief

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The private sector and development

Key points

- The private sector drives the economic growth that is needed to alleviate poverty in developing countries
- More can be done to create the right incentives and policy framework for business to contribute to development
- With the right incentives, business will drive low carbon growth through green investments in developing countries

'New policy frameworks, incentives and business models are needed to maximise the contribution the private sector can make to development'

There is growing recognition that the potential contribution of the private sector to development far outstrips the potential impact of aid. Business itself is recognising its potential role, with growing demand for ethical and Fair Trade produce. But more could be done, through new tools to measure the impact of business on development and new business models to maximise the development contribution of the private sector, and a better policy framework governing business engagement.

New tools

Last year, ODI, DFID and Business Action for Africa ran a meeting series on business and development attended by many businesses, who wanted advice on improving and communicating their development impact. ODI is developing tools to help, such as a proposed new 'Good for Development' mark, which companies could use if they score highly enough against indicators linked to the Millennium Development Goals. Support from DFID could help ODI to pilot this initiative with business this year.

A Good for Development mark could provide commercial advantage to businesses that are making a significant and positive contribution to achieving the Millennium Development Goals through both their core business and corporate social responsibility activities. It would differ from other schemes by focusing on the positive contributions made to economic development, (e.g. through job creation and skills development) rather than simply meeting minimum labour standards or minimising environmental costs.

New policy frameworks

At the same time, the impact of business on development depends on the policy framework in which it operates in developing countries. ODI research confirms that a good investment climate and open and competitive markets

This policy brief draws on ODI's work on business and development:

http://www.odi.org.uk/themes/private-sector

can help to ensure a good development impact, but these are rare in developing countries. New approaches are needed to tackle market distortions created by vested interests who are opposed to pro-growth reforms. For example, ODI proposes new approaches to the mobilisation of business interests in favour of pro-growth reform, to offset vested interests who oppose reform.

Since the financial crisis, more emphasis has been placed on the role of the state in disciplining and managing the market. In developing countries there is a great deal of government intervention in the market, e.g. through industrial policies that often distort and that are damaging to markets. The time is ripe for a new kind of industrial policy. This would not be about picking winners, or providing subsidies or import protection. Instead, it would be about the intelligent and carefully prioritised use of government policy to encourage and facilitate private sector development in promising high growth sectors, and in a market friendly way.

Practical proposals

While the Washington Consensus has paralysed intelligent discussion of this issue, the crisis has reopened the debate. ODI has practical proposals on this middle way, based on extensive fieldwork:

- Consult business to identify growth sectors that could be transformative – enabling economies to move from low-skilled commodity-based industries, to sectors with more scope for technological progress and the building of human capital.
- Help these sectors grow by identifying, again in consultation with business, priorities for reform.
- Work with business to encourage business models that are pro-development.

The private sector also has a crucial role to play in low carbon growth in developing countries, but will only fulfill its potential when the right policies are in place. ODI has reviewed low carbon growth/climate change response strategies across a number of developing countries, and identified lessons for growth policy, e.g. the importance of being proactive in identifying and capitalising on new green growth opportunities. But we found that few provide enough certainty or information on future direction to enable the private sector to invest with confidence. ODI wants to facilitate dialogue between government and the private sector on this challenging issue, and would welcome support for this.

Access to finance is crucial for private sector development and for poverty reduction. ODI research shows that access to savings or credit helps people across all income groups to invest in education and microenterprises and to work their way out of poverty. While the focus of much donor effort has been on microfinance institutions, the banking sector also has an important role. We have also examined market-friendly policies that can stimulate wider provision of financial services by the banking sector, and our practical policy recommendations include:

- setting targets for the banking sector to widen access to services, and monitoring and publicising the results;
- facilitating linkages between the formal banking sector and semi-formal institutions that reach the poor more easily;
- supporting innovative cost-saving technologies and business models.

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