Business Environment Reform Facility

Investment Climate Policy Refresh

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About this Study

This report has been commissioned under the Business Environment Reform Facility (BERF). BERF is funded by the UK Department for International Development (DFID) under the Business Environment for Economic Development (BEED) Programme. BERF is a central facility responding to demand from DFID's priority Country Offices and stakeholders to initiate, improve and scale up business environment reform (BER) programmes. We provide expert advice, analysis of lessons learned, policy research about what works and what does not, and develop innovative new approaches to involving businesses and consumers in IC reform.

BERF has a strong emphasis on strengthening the Business Environment for women and girls, as well as for young adults more generally. It is also aiming to improve the relationship between business and the physical environment including, where relevant, linkage to climate change analysis. BERF recognises the need for appropriate political economy analysis in order to underpin Business Environment Reform processes and interventions.

BERF is managed by a consortium led by KPMG LLP. This study presents the research of seven experts conducted over the period August to October, 2018. Carl Aaron (Research Leader produced the main report) working with John Burton. Volume 2 case studies were produced by Kato Kimbugwe (Rwanda), Alfred Kombudo (Kenya), and Brian Stones (South Africa).

Disclaimer

Acronyms and Abbreviations

AGOA	Africa Growth and Opportunity Act
AIMM	Anticipated Impact Measurement and Monitoring
BEED	Business Environment for Economic Development
BER	Business Environment Reforms
BERF	Business Environment Reform Facility
BICF	Bangladesh Investment Climate Fund
BMO	Business Membership Organisation
CDC	Commonwealth Development Corporation
CMP	Cut-Make-Package
CSR	Corporate Social Responsibility
COMESA	Common Market for East and Southern Africa
CPSD	Country Private Sector Diagnostics
DB	Doing Business
DBI	Doing Business Indicators
DFI	Development Finance Institution
DFID	U.K. Department for International Development
EAC	East African Community
EATI	East Africa Tea Initiative
EBA	Everything But Arms
EBRD	European Bank for Reconstruction and Development
FCAS	Fragile and Conflict-Affected States
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FOB	Free On Board
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GRD	Growth and Resilience Department (DFID)
GSP	Generalised System of Preferences
GVC	Global Value Chain
IBRD	International Bank for Reconstruction and Development
ICSS	Investment Climate Support Spectrum
IEG	Independent Evaluation Group
IFC	International Finance Corporation
ILO	International Labour Organisations
IPA	Investment Promotion Agency
LIC	Low Income Country
MENA	Middle East and North Africa
MFA	Multi Fibre Agreement
MGMA	Myanmar Garment Manufacturers Association
MICE	Meetings, Incentives, Conferencing, Exhibitions
MIGA	Multilateral Investment Guarantee Agency
MDA	Multi Donor Account (EBRD)
MNC	Multi National Corporation
MSME	Micro Small and Medium Enterprise
NAFTA	North American Free Trade Area
NGO	Non-Governmental Organisation
NTB	Non-Tariff Barrier
OECD	Organisation for Economic Cooperation and Development

OPIC	Overseas Private Investment Corporation
PIDG	Private Infrastructure Development Group
PPP	Public Private Partnership
PSD	Private Sector Development
RDB	Regional Development Bank
SADC	Southern Africa Development Community
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SUED	Sustainable Urban Economic Development (DFID Kenya)
TA	Technical Assistance
TAF	Technical Assistance Facility
TMEA	Trade Mark East Africa
VC	Venture Capital
WB	World Bank
WBG	World Bank Group

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1. Executive Summary

The key objective of this study is to articulate a new approach to Business Environment Reform for DFID that synthesises a "rules and regulation" approach vs. a "deals" (or investment facilitation) approach. We look also at how potentially transformative sectors are identified by countries and donor organisations, and how transformation happens. Our third objective is to look at the impact of different types of business transaction covering foreign direct investment (FDI), global value chain (GVC) linked business transactions, and the export of productive capital goods. All three types can be part of transformative sectors; and better rules and regulations can benefit all three.

We researched three country case studies in order to illustrate this Investment Climate (IC) – investment nexus: Kenya, as a large "moderately fragile" country, Rwanda, as a "neighbouring" fragile state, and South Africa (Western Cape), as an upper middle income non-aid dependent sub-national region. Rwanda and Kenya have made significant strides in shifting IC activities to be more investment-focused, coming up with creative interventions to make investments more viable, with greater development impact. Western Cape combines investments with regulatory support from government agencies, without facilitating donor interventions.

Traditional IC programmes are evolving or being de-emphasised in favour of 'hybrid' options (developmental approaches, involving complementary technical assistance or capacity building investments). There remains a role for 'traditional' IC programmes where core institutions and rules are weak. But programmes are increasingly more sector-specific, or incorporating a market systems approach, essentially seeking to better link IC programming with private sector development (PSD). DFID country offices often have a portfolio that includes an evolved IC programme alongside 'hybrid' options, including venture capital (VC) type investment activities.

There is a spectrum of interventions ranging from 'traditional' IC activities to 'pure' FDI. We present an IC Support Spectrum (ICSS) that recognises how evolution and innovations from both ends of the spectrum, from IC facilitation to deals support, offer a range of PSD interventions. Donor organisations deploy an increasing range of intervention options, that they use creatively, tailored to the country context.

Table 1: Investment Climate Support Spectrum (ICSS)

Type	Detail	Example	Comment
1. 'Traditional' Investment Climate	Interventions focused purely on rules and regulations, often with some evolution towards a sectoral focus.	e.g. Rwanda IC Reform Programme III	Sustained impact with government officials; developmental/inclusive focus; essential foundational reforms ideally paired with deal-focused interventions; DB ranking visibility; opportunities for subnational/sectoral extension
2. Transaction Facilitation Trade Advisory Sectoral targeting	Transaction advice to prepare for investments, or to facilitate trade-related rules.	e.g. Trade Mark East Africa transaction advice (with some public goods investment)	Particularly relevant for setting up infrastructure/logistics and soft market interventions to complement existing investments (as well as new investments); strong market enabling/access aspect. Sectoral strengthening TA

Type	Detail	Example	Comment
3. 'Hybrid' De-risking	Investments accompanied by parallel de-risking activity such as an advisory facility or government relations function	e.g. EBRD style: investments with bolt-ons; AIF Rwanda; Agricultural service companies to complement investments	Helps strengthen sectoral ecosystems and sectoral value chains; cluster strengthening. Supports complementary public goods investments for major investments; also has a strong inclusion aspect.
4. Public Private Partnerships (PPPs)	Large PPP-type investments in infrastructure often involve some regulatory restructuring.	E.g. Green Energy projects requiring regulatory changes or power purchase agreement design. PIDG	Interventions to support interest of major specific infrastructure sponsors; ministry capacity building; public infrastructure management; bid document preparation
5. Venture Capital / IFC type with specific TA	VC funds work with investees over time and may give various technical / gov't relations support	Thematic funds e.g. green energy, many examples, GroFin	DevCap contributions to VC funds – sector-focused or agnostic to develop new business areas and strengthen vibrant SME ecosystem; also TA to deepen sector and strengthen regulatory environment; possibly also firm-level assistance
6. 'Pure' FDI	Purely commercial decisions with no IC or other support up front.	e.g. VW Rwanda; CDC ARM Kenya	DevCap for FDI that invests without support other than incentives and support offered by host country governments.

Better coordination between these two approaches to private sector strengthening is needed. Currently, IC reform and investment are generally done by different development organisations: DFID and CDC; IFC and World Bank (IBRD). Some coordination of advisory services and investment strategy exists within the World Bank Group (e.g. through FIAS). The organic link, whereby investments help directly upgrade the IC, or investment can be directly tracked to IC reforms, however, is weak. IFC, for example, has recently developed an 'IFC 3.0 Strategy' for delivery of joint advisory services (with the World Bank), in combination with a market systems and sectoral approach. Better coordination would also increase DFID and CDC programme effectiveness.

Whilst traditional IC programmes are being deemphasised, they nevertheless remain effective in some contexts. Traditional IC programmes are valuable where they are inclusive, empowering and demonstrate legitimacy: land reform (e.g. in Rwanda) is a good example. Subnational support programmes in less dynamic, or up-and-coming areas, are another appropriate context for traditional IC programmes (e.g. DFID Kenya programme). IC programmes focused on formalisation and micro-entrepreneurs are relatively scarce, but could be effective in the right context. Informal enterprises are constrained from growing into more sophisticated ventures generating tax revenues and employment, and generally remain informal in order to avoid predatory regulations, or because there is no net benefit to formalisation. Strengthening microbusiness and transforming elements of the informal sector into formal SMEs is important, because dynamic SMEs generate employment and upgrading needed by developing countries.

IC activities around transaction advice have become more mainstream in donor programmes. FDI is promoted with a traditional array of incentives, but is increasingly accompanied by a variety of supporting interventions that enhance investment viability or development impact. There is a debate about the extent to which countries benefit from providing non-discretionary investment incentives, but there is a growing consensus that investment facilitation and aftercare are potentially more effective than financial and fiscal incentives. Technical advice, and in some cases complementary investments to support infrastructure investments, is particularly valuable, along with PPP interventions. Some investments in particular sectors have been creatively supported by public goods investments and capacity building to support development impact.

VC funds have a valuable demonstration effect, and fund managers offer significant firm level advice as part of the package. Funds can be either sector agnostic or thematic (e.g. green energy), with the latter offering opportunities for linking with supporting sectoral IC interventions. CDC, for example, is involved in both direct equity (hitherto taking more of a pure FDI approach), and intermediate funds (i.e. VC), but increasingly creating a technical assistance facility (TAF) to complement investments.

Recommendations

1. **Continue funding for World Bank IC programmes** through BEED or similar. FIAS and other IC advisory areas of the World Bank are focused on better integrating investment and IC interventions. DFID can participate in these efforts and debates. It could work, in particular, with IFC 3.0 and the sectoral agenda. In this framework, one idea is for a multilateral rapid response TAF. Using an Investment Committee model, and multi-donor funding, it could specifically target and help develop this 'middle ground' of hybrid interventions, and the linking of IC and investment interventions.[1]
2. **Continue to play a role in influencing the World Bank Group (WBG) to link investment and IC work.** DFID should actively seek to influence WBG's move towards a market systems sectoral model. IFC is attempting to link IC work much more explicitly with investment. This has not always been successful, but it needs to be done. DFID can play an important role at that table holding IFC to account, a function that is much valued by other bilateral donors.
3. **Explore how better to measure IC programme success, especially centrally-managed programmes (CMPs).** Historically this has proven difficult, focusing mainly on inputs and a few outputs, and little on impacts.

- There is an opportunity to be more creative as IC programmes evolve: e.g. sectoral, subnational and investment-oriented programmes.
- IFC is also grappling with the metrics of how to measure IC programme success, and DFID should collaborate, including around the Anticipated Impact Measurement and Monitoring (AIMM) agenda. This is a work in progress, and would benefit from donor perspectives and expertise, in particular ensuring that it strengthens accountability.
- DFID and partners could learn from the metrics used by investment-side interventions (see recommendation below), and these should be considered as DFID works towards improved IC programme monitoring.

[1] Under and Investment Committee model, support assignments are decided by an IFC/WB committee, but that committee reports to the assembled bilateral donor representatives every six months with information about what is being funded, performance and so forth.

- DFID should be proactive in bringing new monitoring and evaluation approaches to CMPs in particular, and in urging key partners such as WBG to be experimental but rigorous.

4. **Make (additional) contributions to the EBRD MDAs and similar vehicles.** The EBRD MDA is an investment side TAF that has proven very effective, grafting IC TA onto viable investments. HMG has supported two EBRD MDAs to date: MENA, managed by FCO; and Ukraine, managed by DFID. It is a good model that could be replicated in other regions.

5. **At the country level, deliver a country-appropriate mix of investment and IC interventions.**

- Continue to work with WBG where appropriate. DFID can seek to ensure that the relevant technical capacity exists within the WB country office. Otherwise sustained reform impact will be difficult to achieve. Programmes should be designed to address informality, and promote simplified, transparent regulations that encourage the informal sector to formalise.

- Consider supporting thematic programmes such as Rwanda Land Reform, or Access to Finance programmes[2]. The right thematic programmes get IC close to the people, and demonstrate legitimacy.

- Work at the subnational level. DFID Kenya is recently doing this. If proactive subnational regions can be identified, and political will harnessed, subnational programmes can be very effective. Donors can help to develop a toolkit of reforms and ideas for the subnational level, including how to engage with national level institutions – both in the capital city, and at field offices. They can also help develop a subnational scorecard programme, ideally including WBG and other donors. Involving a respected local think tank / analysis group as partner is sensible. It is important not to make the methodology over-complicated and the role should be handed over to be sustained.

- Support creative programmes that provide ongoing support to businesses/sectors/investors. Foreign investors frequently bemoan the absence of aftercare in investment promotion. Local companies would also benefit from that ongoing help. IPA or Small Business Agency officials need to be incentivised to have continuous engagement with businesses. Programmes that build the capacity of, or set up, accountable dynamic business support agencies are needed.

- Engage with Investment Promotion Agencies (IPAs) advising on investment generation, investment facilitation and incentives. The agenda, if feasible, should include encouraging transparency, and monitoring developments in government to government deals.

6. **Develop a rapid response TA Facility jointly or in coordination with CDC**. "CDC Plus" has been initiated but is yet to be rolled out fully, and its parameters are not yet fully clear.3

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[2] See IEG (2015) for IFC's detailed analysis of what thematic programmes have worked best, and why, over several decades.

[3] CDC Plus is a new facility with funding from DFID that will support potential and current investees, and can also be used to address wider challenges within CDC's investment markets. The CDC Plus facility will provide technical assistance and grants to support investee companies reach commercial sustainability, scale and deliver greater impact. Beyond investee companies, the facility will provide grants to work with industry stakeholders and partners on programmes and projects that address critical

As well as firm level support, a TAF should ideally be able to address systemic government-side or business-side issues identified by either CDC or DFID. There are models for managing this, but it is important that the consortium selected has access to business professionals: e.g. people who have worked with businesses solving customs issues, as well as customs specialists that have guided customs bureaux through change management. Work on systemic IC challenges that CDC learns about through direct equity or debt investments should be shared with DFID. CDC Plus seems to be a good innovation, although the criteria for supporting add-on interventions are not yet clear. The oversight and monitoring function needs to be rigorous.[4]

7. **Strengthen mechanisms for CDC to discuss business and IC issues with DFID** ideally in the field. When systemic business side or IC issues emerge from an investee, a mechanism is required to discuss that with DFID. IFC and IBRD staff are able to do this within the WBG, even if not always effectively. This has not happened systematically between CDC and DFID.
8. **Continue to move towards supporting country Seed Capital funds** through allowable mechanisms (e.g. accountable grants, non-returnable capital)[5]. This should be seen as a central part of DFID's IC / PSD portfolio.
9. **Invest in identification of metrics for investment activities**, through engaging with some leading VC Funds and Foundations. DFID invests in identifying logframe indicators, especially ones that will capture development impact and investment generation success (in IC programmes) or performance (in investment programmes). Discussions with IFC around jobs and other indicators are often detailed. Some of CDC's current fund investees have developed quite simple and useful indicators that could be considered/deployed.
10. **Promote entrepreneurship competitions**, and the use of social media to encourage entrepreneurship and IC reform. A 'Dragon's Den' type approach can help develop an entrepreneurial mind-set, and be used to highlight conducive business environments at the same time. There can be a suite of activities that resonate with the social media / active youth. Online business competitions can lead to physical business 'boot camps', which can lead to investee competitions, with globally/regionally renowned entrepreneurs as judges. Partnerships with local or national governments could be brought in to highlight progress and challenges in particular sectors. The latter aspect is underdeveloped, but especially in subnational programmes could be effective.[6] Partnering with a proactive, business-friendly subnational leader, for example, could have significant impact.

challenges within target markets with the objective of unlocking additional developmental value. See: https://www.cdcgroup.com/en/how-we-invest/how-we-partner-with-businesses/adding-value/

[4] CDC Plus and coordinated/parallel DFID TA should have a standard Assistance Request Form, which uses the PSD Support Matrix tick boxes. Measurable success criteria should be in place for both.

[5] Part of DFID Kenya's new SUED programme is a case in point. This part of SUED was tendered out to Coffey International and has a Seed Capital component and a TA component.

[6] In Tunisia, for example, the UK-sponsored Minbar project reached entrepreneurs in challenging regions through social media and business competitions in order to generate entrepreneurial interest and by the end of its short one year programme had linked up with microfinance institutions and banks. See: https://www.affinislabs.com/copy-of-fund-ecosystem

2. Introduction

The primary objective of this study is to articulate a new approach to Investment Climate (IC) policy for DFID that synthesises a "rules and regulation" approach, and a "deals" or investment facilitation approach. The UK has tended to support both, but independently. The UK has supported high level IC work, often along *Doing Business* lines, for many years, with some success, through in-house and World Bank Group (WBG) programming. Meanwhile, UK "deals" have happened commercially through UK firms simply investing (potentially with some corporate social responsibility mixed in), or through CDC with its private investment development mandate. UK sponsored work has recently begun to expand, with lots of new ideas and initiatives being tried. Our purpose here is to capture the main trends and innovations, and offer options to incorporate in future programming. In particular:

- IC activities, increasingly linked to sectoral (e.g. agriculture), thematic (e.g. land reform), or subnational programmes, amongst others, are on the rise. Between this evolution of IC interventions, and a variety of investment-inspired interventions, IC policy and programming has the potential to be much more closely linked to actual investment and job generation, and to inclusive development outcomes. Some research literature is sceptical about the impact of IC work, and so posits that "deals" are the way forward.[7] [8]
- IC programming has evolved towards becoming more investment-related, and investments have sought to become more viable and/or developmental through the addition of technical assistance or other add-on support. There is an emerging spectrum of intervention options between traditional IC programmes and pure FDI.
- Deals: There are different understandings of "deals".
    - In the context of investment there are "special deals", the non-transparent backroom deals. The question of special deals is often raised in the context of government-government (G2G) deals between China and partner African countries.
    - There are also "deals" in the sense of non-discretionary investment incentives. In other words, it is not about a friendly IC or simplified rules, but about tax rates and other incentives.
    - There are also "deals" in the sense of an investment package that more broadly acknowledges that in Low Income Country (LICs) or Fragile and Conflict Affected States (FCASs), investment does not often happen on a commercial basis, even if the key rules and regulations are in place.

[7] Pritchett finds, for example that there is little correlation between *Doing Business* rankings, and what enterprises actually report about the IC in surveys. Mary Hallward Driemeier and Lant Pritchett. 2015. "How Business is done in the Developing World: Deals versus Rules." *Journal of Economic Perspectives* 29(3). Summer.

[8] Pritchett and his colleagues also look at eight country case studies to see whether deals or improvements in the regulatory regime were key to fuelling growth episodes. Lant Pritchett et al (Eds). 2017. *Deals and Development: The Political Dynamics of Growth Episodes.* Oxford: OUP.

- "Investment facilitation" is also to be understood relatively broadly. We use it to mean making investments more viable and sustainable. In the context of IPAs, investment facilitation is about the hand-holding of investors considering an investment in a country before and after they have made the decision to invest. Development organisations want to make investments viable and developmental, thereby helping to improve opportunities and reduce poverty on the one hand, and make the investment economically viable, on the other.

A second objective is to investigate how sectors with transformative potential can be better identified, and supported through IC reforms or investment facilitation. This is a way in which IC work has been more investment-relevant. IFC, for example, has focused on tourism and agriculture, and IFC's 3.0 Strategy seeks to forge a stronger link between this sectoral IC work, and investment generation. DFID has also been doing this.

The third objective is to understand the development impact of different types of business transaction. This is important because if DFID is to be involved in facilitating engagement by businesses, it needs to understand the development impact of the different types of investment. It is also relevant because the UK seeks to ensure that UK companies benefit together with beneficiaries in the UK's partner countries. Some high level conclusions include:

- **Targeting the broader development impact of investments is critical**: for example, the extent to which health, extension and infrastructure services reach large numbers of beneficiaries. Complementary interventions to an investment will make the investment more viable, but should also strengthen the developmental impact. Development organisations should be targeting SME investment as well as larger scale FDI. SMEs will be the principal creator of the income opportunities and the jobs that will be needed to absorb the vast numbers of new labour market entrants in LICs and FCAS. Countries aspire to create higher skilled jobs, and enhanced income opportunities for poorer rural populations. Empowering smallholders, for example, is extremely important.
- **Measuring the success of IC programmes, and of investments is challenging**. Donor organisations continue to grapple with this issue, and it is not the focus of this report. It is relatively easy to measure outputs (like regulations introduced) but more difficult to measure the impact on private investment, which is the desired outcome. IFC has often included "leveraged investments" as an outcome indicator of business environment programmes. However, investment units operate independently of advisory units, so there is no direct link, and these investment outcome indicators have often underperformed.[9] The IFC 3.0 strategy is IFC's latest attempt to systematically link advisory and investment services, but mainly by elaborating the Theory of Change, and expected longer term sectoral impacts more carefully. Investment success should certainly be measured by

[9] For example, the IFC-implemented Education for Employment advisory programme in North Africa (2012-16) intended to leverage significant IFC investments in the education sector, but managed only a small proportion of the target in the early years. See: https://devtracker.dfid.gov.uk/projects/GB-1-203235/documents. Also, the Rwanda IC Reform Programme (RICRP) III had investment targets in the logframe linked to the advisory work, but IFC had difficulty tracking these figures, or more likely attributing results. See (although the latest Annual Review has not been published as of November 2018 but should be available): https://devtracker.dfid.gov.uk/projects/GB-1-204486/documents

deal flow, but there are two additional dimensions: developmental impact; and the economic / sectoral impact of the investment. The former is hard to measure and both may be long term in nature. The Anticipated Impact Measurement and Monitoring (AIMM) system is IFC 3.0's approach to doing this by ex ante attempting to forecast an investment's impact on its sector and the economy. Some VC and Patient Capital Funds, strongly encouraged by donor organisations, have developed rigorous beneficiary monitoring and tracking systems, proving that it can be done at the grass roots level.

In order to address these objectives, we have undertaken a review of existing literature and case studies, and conducted field research in three countries / subnational regions. The field case studies have informed the main narrative, and been a source of examples. They include Rwanda, Kenya, and Western Cape (South Africa). The case studies are contained in Volume Two, and a summary is provided as Annex 4: Field Case Study Summaries and Lessons. The structure of the remainder of the report is as follows:

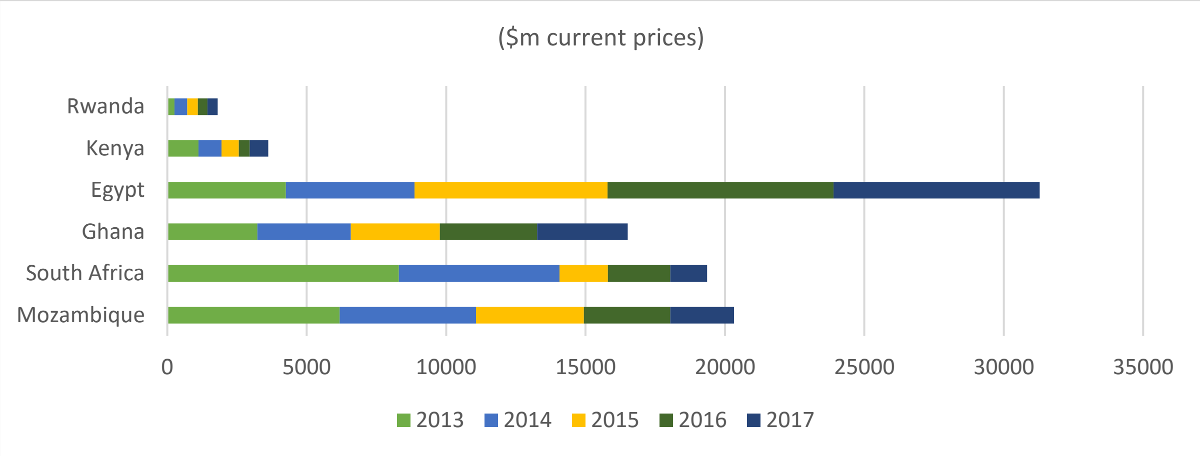
- Section 3 offers an overview of measures of domestic and foreign investment in our focus countries, and some comparators. It also looks at some measures of the business environment, and observes that there is not much correlation between the IC and the overall levels of investment.
- Section 4 looks at the range of traditional and newer IC programming on the one hand; and at a wide variety of investment interventions. It makes recommendations for future programming.
- Section 5**Error! Reference source not found.** looks at how transformative sectors are identified, by different donor organisations, and at how transformation happens on the ground.
- Section 6 looks at the role of market access and regional markets.

3. Background - Investment and Investment Climate Data

3.1 Overview of Private (Foreign) Investment

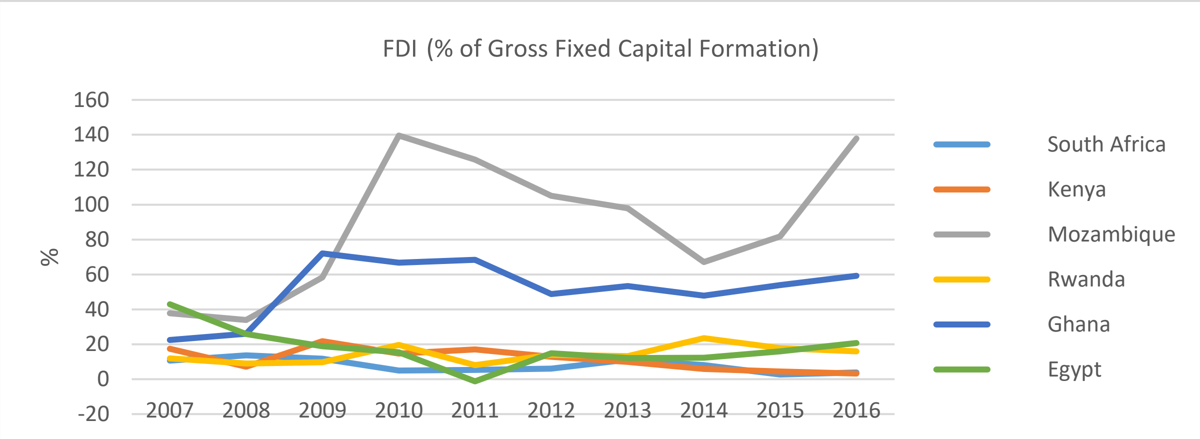
FDI inflows to our case study countries of Kenya Rwanda and South Africa have been rather weak both in absolute terms, and as a proportion of total investment and GDP. As a percentage of total investment, Mozambique and Ghana have relatively high levels of FDI, whilst Kenya, Rwanda, and South Africa have more modest shares for FDI despite their superior ICs (See 3.2).

Figure 1: FDI Inward Flow, Selected African Countries



Source: World Investment Report 2018

Figure 2: FDI inflow, Share of Total Investment, Selected African Countries



Source: World Investment Report 2018

3.2 Investment Climate Indicators

Rwanda, Kenya, and South Africa perform well on IC reforms, in particular *Doing Business,* where they rank 2nd, 3rd and 4th in Africa respectively (after Mauritius). Kenya was one of the global top reformers in recent years. In the World Economic Forum's (WEF) *Global Competitiveness Index* (an annual measure of country competitiveness based on the opinions of selected executives that determines the level of productivity of a country published by the World Economic Forum) Kenya and Rwanda perform relatively poorly, ranked lower than in *Doing Business*. Whilst good *DB* rankings are generally correlated with greater investment flows[10] and good *DB* rankings do put countries on the investment location radar, clearly there is more to achieving high levels of FDI than getting the rules and regulations right.

Table 2: Doing Business - selected indicators and African economies

Starting a business	South Africa	Rwanda	Kenya	Sub-Saharan Africa
Ease of doing business ranking (190 countries)	82nd	29th	61st	142nd
Starting a business (190 countries)	134th	51st	126th	125th
Number of procedures	7	5	7	7.4
Time (days)	40	4	23	23.3
Cost (% of income per capita)	0.2%	14.8%	24.9k%	44.4%
Min. capital (% of income per capita)	0%	0%	0%	10.0%

Source: Doing Business 2019

SMEs, however, face challenges not necessarily captured in these indicators. *Doing Business* purports to take the case of a typical SME (although the assumptions made are quite large for the vast majority of local investors), whilst WEF rankings are very FDI-focused. Small businesses in Rwanda, for example, have commented that once businesses reach a certain size there is pressure to make the government a stakeholder, and this dissuades expansion. It may also be that small companies operating outside the capital city (the focus of DB and WEF rankings) engage with local governments far less capable or facilitation-minded than in the capital city. However, this can cut both ways, and the subnational *Doing Business in Kenya 2016* finds there are four counties more business-friendly than Nairobi, with very proactive leaders in some cases.

Table 3: Selected Global Competitiveness Index indicators

	Indicator	Kenya	Rwanda	Mozambique	Ghana	Egypt
1.09	Global Competitiveness Index Ranking out of 137	91st	58th	136th	111th	100th
1.11	Efficiency of legal framework in challenging regulations	3.7	5.0	3.5	3.9	3.4
1.12	Transparency of government policymaking	4.5	5.8	3.2	3.9	3
1.21	Strength of investor protection 0-10 (best)	5.3	5.2	4.3	5.3	4.8
6.04	Effect of taxation on incentives to invest	3.6	4.3	3.5	3.5	3.7
6.12	Business impact of rules on FDI	4.5	5.4	4.2	4.6	3.4

Source: The Global Competitiveness Report 2017/18

[10] (World Bank, 2012)

4. Rules and Regulations versus Deals

4.1 Overview

There has been active debate about whether *Doing Business* rankings and indicators reflect the true experience of investors (foreign and local).[11] The suggestion is that at least they do not tell the complete story, and that IC work and PSD support need to be much more coordinated. Looking at the challenge from the investment side, does investment come of its own accord, without encouragement, in pursuit of market or other opportunities; and if not, how is it to be encouraged?

The traditional approach to investment promotion has been to provide a better IC, as well as to improve incentives or infrastructure to attract (primarily foreign) investment. IPAs have sought to facilitate investment, and development agencies such as DFID have helped them build that capacity, and when successful attract big anchor investments. There is a role for such pure investment promotion or deal facilitation work.

The approach to the "deal" landscape is moving beyond simply helping target, attract and support investors. The *Doing Business* approach to promoting PSD does not capture everything that countries and their supporters (i.e. donor organisations) are trying to achieve. This was a headline finding of the World Bank's 2015 Independent Evaluation Group (IEG) report on the effectiveness of IC reform interventions.[12] It finds that:

- The impact of WBG IC support on investment, jobs, business formation and growth is more complicated (than just measuring regulatory reforms), and is either not well measured, or possibly not happening that well; and
- Inclusion and shared prosperity impacts are limited and not well measured.

All investment types need to be encouraged – FDI, local SME investment and the informal sector. A sector-focused PSD strategy is useful, and is developing traction amongst development agencies, in particular the World Bank.[13] Donors and investors (VC firms and others) are providing additional assistance involving firm-level support, sectoral assistance, human capital support, along-side support for IC improvements.

Debate about the continuing role of IC support centres, and what they should be delivering beyond viable investments. This extends to issues such as inclusion, systemic change and impact. Systemic change might for example include formalisation of the informal

[11] See, for example, Hallward-Driemeier and Pritchett, 2015.

[12] See Independent Evaluation Group, 2015, World Bank Group. IC Reforms, Chapter 1 http://ieg.worldbankgroup.org/Data/reports/chapters/investment_climate_final.pdf, p.xi.

[13] IFC's Country Private Sector Diagnostics (CPSD) and the Overseas Development Institute's (ODI) Sectoral Economic Transformation (SET) methodologies both seek to identify potentially transformative sectors. They aim to be systematic rigorous processes, not least in order to avoid the accusation of the much discredited approach of trying to "pick winners". Because of the obvious inclusion and job creation benefits IFC has looked in detail at Tourism and Agribusiness, and these appear regularly in sectoral competitiveness strategies. See for example the CPSD for Ghana which has a strategy for attracting anchor investors, supporting promising SMEs, IC and business environment reform. See World Bank, 2017 Creating Markets in Ghana, Country Private Sector Diagnostic. It is early days for assessing whether this systemic approach by donors works. However, the history of industrial zones targeting a particular manufacturing sector – such as electronics in China, or garments in Bangladesh – suggests value in standardizing an approach.

economy, sector transformation, and undertaking IC interventions linked to actual economy wide impacts. IC work is moving from traditional approaches to be more directly relevant to investment, and private investment has embraced various 'hybrid' or developmental approaches, involving complementary technical assistance or capacity building investments.

4.2 Traditional Approaches to Investment Promotion

The role of development organisations was traditionally seen as helping strengthen the environment for investment, assuming investment would naturally follow – both FDI and domestic investment. IC interventions are defined as: "support for policy, legal, and institutional reforms intended to improve the functioning of markets and reduce transaction costs and risks associated with starting, operating, and closing a business". Advice was often given in three areas:

- Traditional business environment rules and regulations – investment laws and regulations, tax regulations and so on. This approach focused primarily on FDI was championed by the Foreign Investment Advisory Service (FIAS), founded in 1985 to provide advice requested by China. After 2002, the Doing Business (DB) approach became popular, with its global coverage, ranking system (which began in 2006), and relevance to both FDI and local SMEs. Although it received criticism at various stages, it has been extremely influential: it has spurred numerous reforms, and many donor-supported and domestic reform programmes have been crafted around its findings and recommendations. [14]
- Provision of fiscal incentives. The main thrust was that for healthy private sector development, incentives should be transparent and therefore non-discretionary, and to the extent possible be incorporated in tax codes. In reality, countries compete extensively, and find ways of offering tailored discretionary incentives to key investors.[15]
- Provision or facilitation of infrastructure. FIAS and others provided much advice on the improved infrastructure as a form of incentive. The use of industrial zones, in particular, given their successful use in China and elsewhere, to kick start development became a focus of advice worldwide.[16] A key point and recommendation is that successful zones are

[14] For an overview of FIAS, see: http://www.worldbank.org/en/topic/competitiveness/brief/facility-for-investment-climate-advisory-services-fias The Wikipedia article (accessed 13/10/2018) gives a good summary of the Doing Business tool and its evolution: https://en.wikipedia.org/wiki/Ease_of_doing_business_index#History It also includes discussion of criticisms including that "many countries may find it easier to change their ranking in *Doing Business* than to change the underlying business environment".

For a selection of Doing Business reform success stories, see: Penelope Brook *et al.* 2008. *Celebrating reform 2008 - doing business case studies (English).* Washington, DC: World Bank. Located at: http://documents.worldbank.org/curated/en/513161468156260541/Celebrating-reform-2008-doing-business-case-studies

[15] A good summary of the state of tax incentives in developing countries (summarizing and updating previous studies) was published by Tuomi See Krista Tuomi. 2012 (June). International Growth Centre Working Paper Series. "Review of Investment Incentives: Best Practice in Attracting Investment". F-41003-ZMB-1. https://www.theigc.org/project/review-of-investment-incentives-best-practice-application/

[16] Zeng provides a good summary of the different types of zone and their benefits, as well of the particular challenges of creating successful zones in low income countries. See Douglas Zhenhua Zeng. 2016. *Private Enterprise Development in Low Income Countries (PEDL) Synthesis Paper Series.* "Special Economic Zones: Lessons from the Global Experience". https://assets.publishing.service.gov.uk/media/586f9727e5274a130700012d/PEDL_Synthesis_Paper_Piece_No_1.pdf

a microcosm of the larger economy with efficient regulatory systems, good infrastructure and often some preferential incentives. Aid agencies and advisors from successful zones continue to support zone development.

Investment targeting was often absent from the traditional approach. The specific investment was allowed happen naturally in response to regulatory improvements, incentives and conducive infrastructure. Investment targeting did happen, and was supported, but it was often found that investment targeting was ineffective if the IC was unattractive, and advice reverted to some variation of the above three issues. Incidentally, often the most successful zones were those whose management was fully delegated to experienced zone operators from countries with lots of potential investors.

There has been a gradual recognition that domestic PSD is also critical, especially of SMEs in economies dominated by state-owned enterprises (SOEs). IFC, for example, began to establish Project Development Facilities such as Mekong Private Sector Development Facility (1996-2013, three phases) that sought to support SMEs, primarily through firm and industry level support, but also with some support for business environment reform.[17] Although FDI can kick-start PSD and generate much needed foreign exchange, domestic private sector development is critical and should be supported early on.

4.3 Levels of FDI and Investment

In the LICs and FCASs in which DFID (and CDC increasingly) operates, investment is not coming in the quantity or quality needed. The IC is one problem, and investment is not coming without some form of inducement, or "de-risking" (i.e. provision of complementary support which improves the expected return of the investor).

Most countries offer fiscal and financial incentives for investment, and have been increasing them over the past decade even though there is evidence that they are not cost effective.[18] Where there is clear economy-wide or developmental impact[19] then a de-risking approach is justified, with creative use of public goods supporting interventions. There is a considerable amount of development capital flowing into Africa, and other developing countries. Deals may justify and require 'de-risking', the case increasing with the development impact.

It has been argued that a focus on investment environment is misplaced. A comparison of *Doing Business* rankings and *Enterprise Survey* results across countries concluded that the actual burden of doing business in a country is not accurately captured in *Doing Business*.[20]

[17] Nevertheless, in 2018, a report commissioned by the Vietnam *Provincial Competitiveness Index* concluded that: Vietnamese SMEs "are beset by obstacles, including limited access to resources for business (land, policy in-formation, laws, and capital), burdens of informal charges, the poor quality of business support services and misguided support policies as well as greater burdens of administrative procedures and inspections from local authorities". See: Vu Tien LOC. 2017. *Business Environment for Vietnam's Small and Medium-Sized Enterprises.* Vietnam Chamber of Commerce and Industry (VCCI) and USAid: Hanoi, Vietnam. http://orgeng.pcivietnam.vn/uploads/85874-SME%20REPORT%20EN%20WEBSITE%20FINAL.pdf

[18] World Bank, 2017b, pp. 73-99

[19] (e.g. Luxmi / Unilever investment in the Rwanda case study)

[20] Pritchett argues that *de jure* regulations are not really how business is done, and that out of the 'chaos' of dealing for construction and other permits comes a world of "ordered deals" where business associations and other creative mediation of

An investigation of incentives, also notes, for example, that Rwanda is legally allowed to offer discretionary incentives, although this is largely denied by government officials, and not disclosed by investors[21]. Across countries there may well be other factors that determine location rather than differences in DB ranking. Enterprise surveys or business satisfaction surveys are a useful addition. These should be designed and implemented in partnership with local think tanks, and handed over to build sustainable capacity.

There is nevertheless a case to efficiently manage licensing systems and get other parts of the business environment right, including productive dialogue with business associations. The point is that better investment can be attracted at lower cost with a better IC; and investments can be arranged or upgraded in various ways to enhance developmental impact. Traditional IC programmes to lay the regulatory foundations for PSD remain useful in some LIC and FCAS countries, such as Liberia, Sierra Leone and Kenya. Strong institution-building support is needed alongside the provision of advice. Firms need ongoing support once operations are underway, as the sector grows. Thus, managers of IC programmes should continue to identify sectoral needs, which may emerge over time.

Countries ranked higher on DB perform better on lists compiled by investment location advisory firms. A country that has adapted policy in response to DB rankings and associated recommendations tends to be regarded as a collaborative responsive country that investors can work with constructively. In our case studies, Rwanda's strong ranking contributed to VW making a market-testing investment, for example. This responsiveness is important, because most countries seeking FDI offer similar incentives, which often do not differentiate countries sufficiently.

Established presence of IC advice is beneficial. This can take the form of a significant core of technical advisors, where the World Bank Group generally has an advantage because country offices are well established. Another effective approach has been the establishment of IFC-managed multi-donor facilities such as the Bangladesh Investment Climate Fund (BICF).[22]

4.4 Evolution of Investment Climate Interventions

Traditional types of "investment climate" programming remain important in some circumstances and countries. The World Bank's Independent Evaluation Group (IEG) commissioned a comprehensive review of the WBG's entire historical IC portfolio, reviewing 809 programmes.[23] Many IBRD programmes were traditional, focused on institutional and

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the public-private business interface is what makes for dynamic PSD. Hallward-Driemeier and Pritchett (2015) compare *de* jure (*Doing Business)* and *de facto* (Enterprise Surveys) data for various indicators like construction permits, and find not *de facto* costs and time are far less than DB would predict. So firms are getting around rules; so what's the point in focusing on them in developing countries where the divergence is huge? Some have written extensively on this subject. Most recently: Lant Pritchett et al. 2017. *Deals and Development: The Political Dynamics of Growth Episodes.* Oxford: OUP. Also,

[21] Tuomi, 2012, p.11

[22] Importantly, Facilities like BICF have a mandate that extends to broader systemic business environment mandate including, for example, public private dialogue (PPD) and support for Business Membership Organisations (BMOs), precisely the sort of public-private interfaces that Pritchett argues are important in a "deals"-based world.

[23] IEG World Bank. 2015.

regulatory reform, and not linked with investment. IFC programmes were more PSD-focused, and generally more creative when operating through a facility of some kind, such as the BICF. Key recommendations were for greater systematic coordination, noting mainly that WB/IFC coordination had generally been *ad hoc* in nature. The report also noted that thematic IC reform programmes – notably in land and finance – were amongst the most effective.[24] The report notes that the main debate in FCAS and LICs has been around the sequencing of reforms – the balance between rules and regulations, and "deal-based" interventions[25] – and suggests that most commentators argue for a hybrid approach. The Review also notes that a significant proportion of the WBG's sector-focused IC activities have included agriculture and tourism, but that this has not necessarily been reflected in IFC's investment activities.

Traditional IC programmes also remain relevant in some FCAS countries, and where the informal sector dominates. World Bank IC programmes in Cote d'Ivoire, Burkina Faso, Kenya, Mozambique, Liberia and Sierra Leone, and a few other places, would fall into this category. IC reforms in FCAS focus on putting the basic rules, regulations, institutions and policies in place. In parallel, deals and investments are used to leverage reforms.[26] In the most difficult FCAS countries, BE reform is challenging. Here, a careful political economy analysis, a careful country-specific sequencing of reforms, and an initial focus on programmes that establish popular legitimacy (e.g. land reform), can be effective.[27]

Box 1: Kenya Investment Climate Programme

The three stages of the World Bank's IC Programme in Kenya (funded by DFID) are a good example of both the persistence of "pure" IC work, and programme evolution towards a more sectoral approach. Kenya is pleased to have jumped almost 20 places in the Doing Business 2019 rankings (information as of 1 June 2018) from 80th to 61st. The World Bank also has a large office in country with resident experts in different fields, thereby increasing reform traction.

Meanwhile, the IC Reform programme in Rwanda will probably wind down, because as the second ranked economy in Africa (after Mauritius) there are diminishing returns to high level IC reform efforts, and these are giving way to a focus on facilitating actual investments. The 2nd and 3rd iterations of the WB's IC Programme in Kenya have focused much more on sectoral support, and on market systems approaches. The UK's new Growth Programme in Kenya will continue some support for the WB Programme, but also channel funds to providing seed capital for start-ups, and to support to selected subnational regions.

A subnational focus for IC reform is increasingly important from both an inclusion perspective, and because DB was being "gamed" with some improvements limited to capital cities in a way that boosts DB rankings but produces fewer economy-wide benefits. The WB

[24] DFID's Rwanda Land Reform program (see Case Study Summary in Appendix 3, and in full in Vol 2) is a good example. See also, BERF 2016

[25] The IEG report uses "deals" in the investment deals sense.

[26] Under FCAS we include "neighbouring" FCAS (e.g. Rwanda); moderate FCAS (e.g. Kenya). According to the IEG report (2015, p.77) traditional IC programmes in pure FCAS (these were Guinea, Liberia, Lao PDR, Mali Nepal, South Sudan, Sudan, and Yemen) had mixed success in achieving programme objectives: "effectiveness was contingent on….the complexity of the interventions and whether the reforms were politically feasible, institutional capacity building and implementation assistance, government ownership of IC reform, and the fragile political economy." These caveats seem very important, and should guide IC programming in any country, especially FCAS.

[27] BERF, 2017, Chap 2, pp.11-21

and others are increasingly using Subnational Doing Business and Municipal Scorecards to try and achieve economy wide IC improvement. In Kenya, for example, Nairobi was ranked fourth out of 11 Kenyan counties investigated in 2016.[28]. Within countries, there are often proactive subnational leaders who are keen to make the difference at the local level. Kenya (IFC) is undertaking a subnational Doing Business of some 11 counties, and this is a useful way of stimulating healthy competition.

IC programmes have frequently evolved towards a focus on sectors and market systems approaches. The second iteration of the World Bank's IC programme in Kenya included a much stronger sectoral focus, for example (Box 1). Both DFID and IFC have championed a market systems approach to sectors, combining IC, sectoral, upstream and downstream work in programmes that both prepare for investment (local and foreign) and provide ongoing support to the sector.[29] For example, the interventions supported by DFID in commercial agriculture can be characterised as a sectoral approach (**Box 2**). Over time, as the potential for longer term investment increases, IC work should make the investment link explicit. One approach is to pursue a sectoral and market systems approach. Another (well implemented by the EBRD)[30] is to graft IC support onto specific investment projects (e.g. in infrastructure sectors). A market systems approach that goes beyond IC constraints to look at other business environment issues such as labour supply and skills can be useful. This could look at trading arrangements and Non-Tariff Barriers (NTBs) affecting the sector, as well as regulations.

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[28] See Subnational Doing Business – Kenya. http://www.doingbusiness.org/en/rankings/kenya

[29] IEG, 2015, IC Reforms, Chapter 1; and IFC, 2018, Strategy and Business Outlook Update FYY19-FY21: Implementing IFC 3.0.

[30] The European Bank for Reconstruction and Development's (EBRD) approach has been effective, and is reviewed within Annex 3: Development Finance Institutions.

Box 2: Commercial Agriculture in Rwanda

Donor De-Risking

Agriculture is likely to remain the main driver of poverty reduction in Rwanda given that over 80% of the population depend on it for their livelihoods. Commercialising agriculture provides the greatest opportunity to transform the economy, create jobs, increase incomes, reduce poverty, and deliver more inclusive economic growth. Additionally, GoR recognises that Rwanda's growing trade deficit can only be addressed by increasing agriculture's contribution to the economy through commercialisation. De-risking agriculture investments is critical if the twin goals of economic transformation and stimulating the rural economy are to be achieved. However, a number of constraints in the market system in Rwanda – such as poor access to finance or patient capital and technology; lack of access to inputs such as seeds or fertilisers, and difficult logistical systems – currently limit or prevent the effective commercialisation of agriculture, and prevent the poor from benefiting from agricultural opportunities. Rwanda's agri-business firms are few and small. As a result, only 20% of agricultural produce has any significant value added to it.

Lack of access to affordable finance constrains growth and limits the flow of FDI to the agriculture sector, reducing companies' access to technology and innovation, and limiting their ability to add value to products and invest in new areas of business. Productivity, investment and job creation are significantly lower in firms citing access to finance as a constraint. The type of financing available in Rwanda is also a major constraint. Returns on agricultural investments often take time to be realised. There is a need, therefore, for a wider range of financial services, including equity stakes, guarantees, and loans, which together can provide support to high risk, high return investments over a longer time period. Whilst figures for equity investments are not available, this market in Rwanda is known to be very underdeveloped, and the Rwanda capital market offers limited products compared to other EAC countries. The overarching constraint is the availability of patient capital to de-risk small holder agriculture. Given the population density and land constraints, patient capital is required to de-risk both supply-side and demand-side constraints in Rwandan agricultural value chains to ensure inclusive and impactful development of the agricultural sector.

How DFID programmes have helped de-risk FDI in Rwandan agriculture

DFID Rwanda's SILTPR has supported the de-risking of small holder farmer (SHF) in the tea sector to enable $75m in FDI from Unilever and Luxmi to build tea factories on greenfield sites. To address the SHF risk, the Outgrower Service Company (OSC) model was deployed. The OSC provides services to build capacity and capability of the SHFs to produce high quality tea, and patient capital to finance SHF uptake of services. Without patient capital investments and the link to an offtaker of their tea, most SHF would not be able to sustain the upfront costs associated with growing tea. DFID is providing £11.8m to The Wood Foundation Africa responsible for managing the OSC. Both the FDI investors (Unilever and Luxmi) made contributions to financing the OSC.

DFID Rwanda IMSAR has provided patient capital deployed by AgDevCo. AgDevCo targets value addition, export potential and agro-processing businesses producing quality supply for local and regional markets, as well as businesses that have strong links to smallholders and can be viable on small land areas. $450,000 was invested in Kigali Farms for a modern button mushroom facility, and the scaling up of production. AgDevCo will continue to play an active role in advising the business on its marketing and export strategy into the East Africa region as well as provide support for its smallholder oyster mushroom programme. In Uzima Chicks, the Government has leased its Rubirizi National Hatchery to Flow Equity, an American firm, for 25 years. A $3m investment is for revamping the facilities to increase productivity and reduce the imports of chickens and eggs. AgDevCo's investment gives Uzima the operational funding to grow rapidly as a domestic producer of day old chicks for local smallholder farmers, and eventually for export to the region.

A significant proportion of the WBG's sector-focused IC activities have included agriculture and tourism, although this has not necessarily been reflected in IFC investment performance. Section 5 below looks further at how sectoral transformation has happened, and how transformative sectors have been identified.

Approaches that target specific themes have in some cases also proven to be transformative[31] such as Land Reform and Financial Sector Deepening.[32] Thus, for example, a Land Reform programme has the benefit of inventorying and assigning parcels of land (which can then be used as collateral or sold, and so on), and allow confidence in industrial development. The Rwanda Land Programme was extremely successful in this regard, and has begun to realise the hidden assets of poor people[33]. An IFC survey of numerous IC programmes implemented by the WB identifies certain types of programme that have been particularly effective. Prominent amongst them are Land and Finance Reform. DFID is well aware of the benefit of such programmes, and this is a good area to continue. The Rwanda Land Programme shows what can be done. In a large country, donors may focus on a subset of proactive sub-national governments to leverage political will and provide role models for others. As with all IC reforms senior political buy-in is critical.

An Investment Climate Support Spectrum (ICSS) is a useful framework for analysing the scope of interventions to support investment. Table 1**Error! Reference source not found.** presented the ICSS, a categorisation of interventions. Interventions may not neatly fit into one category, and many will have evolved over time. Each country and situation will use and need a different set of interventions. Between the two extremes of traditional IC technical assistance, and targeted investment support for pure FDI, various 'hybrid' approaches have emerged – combinations of technical assistance alongside investment activity, and various types of facilitating or developmental support to commercial investments. It is not a question of where to work on the spectrum. Rather the different types of interventions can be included in a PSD support strategy for a country. A country review can be undertaken to see what is feasible and needed; a judgment is then made on the balance of traditional IC support and investment/deal-linked interventions that is most suitable. Traditional IC support might be appropriate to energise subnational regions or create more opportunities for women entrepreneurs; whist hybrid interventions might be appropriate for sectoral development, improving market access, or supporting an SME VC programme.

PSD remains an important framework for underpinning investment promotion efforts, including FDI. The PSD Support Matrix (Table 4**Error! Reference source not found.**) shows three aspects of technical assistance support.

- Level of support: firm level assistance such as might be provided to VC investees or through SME capacity building and training;[34] broader business environment/sectoral TA to build the SME/business ecosystem, such as skills training, sectoral market access TA, support for BMOs; and IC TA to governments and regulatory agencies.

[31] IEG, 2015

[32] Other themes effective for inclusion programming around gender include: registering property, tax regulations. See IEG, 2015, p.72. More generally, business registration and regulations, and trade, showed the greatest before and after impact, whilst all thematic interventions – with the exception of Investment Promotion – produced positive outcomes (IEG, 2015, p.81).

[33] De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else.* London: Black Swan

[34] Investment-specific support can include financial management, succession planning, or training of poor smallholders in rural communities.

- Objectives of support. Supporting interventions can work either to increase the viability of investments, or to increase their developmental / inclusion impact. Spreading the benefits (first column of Table 4 below) is about getting more firms and people involved in productive activity as entrepreneurs or employees or beneficiaries, and building the ecosystem for local SMEs to foster new income-generating activity. A vast quantity of income opportunities and new entrepreneurial activity is required to absorb the numbers of new labour market entrants in the future.[35] Viability (second column) is about making private investments more likely to succeed. Thus, the availability of firm level support as part of a VC package, may determine whether the investment happens at all. Similarly, a market systems or IFC 3.0 approach to identifying sectors, and addressing the sectoral IC or institutional issues[36] may turn a single investment into a sectoral success story.
- Both traditional IC programming and pure investment activity have evolved to embrace different levels of TA: IC work now gets involved in the broader business environment and, for example, in the holistic strengthening of a sector. Investments are now made more viable and developmental through the addition of firm-level advice, sectoral capacity building, or even government relations. Engagement of a single investor in the regulatory regime can be benign (e.g. helping to develop power offtake agreement templates that will benefit subsequent power investments), but can also be anticompetitive.[37]

[35] (e.g. 200,000 per annum in Rwanda or 700,000 per annum in Egypt).

[36] (e.g. negotiating industry wide labour standards such as for the ILO's Better Factories programme)

[37] Incidentally, there are also occasions where IC / rules and regulatory add-ons to specific investments can be detrimental to the broader private sector, by distorting the fair playing field. An interesting example is that as a result of the new Nairobi-Mombasa Railway investment it appears that a combination of regulations effectively requires all transport between the two cities, to be by rail, such that any transport to/from further inland requires subsequent transhipment, rather than a single truck journey.

Table 4: PSD Support Matrix - Illustrative Interventions

	Spreading the Benefits / Preparing the PSD Landscape	Generating and supporting viable investment
Country Level	1. **Business Environment Reform** • Land registration reforms giving more people access to "dead capital" • Legislation allowing access to finance	2. **Investment Climate** • Addressing NTBs affecting a target sector • Upstream sector identification, or market systems analysis and draw down support
Sector Level	3. **Broader Business Strengthening** • Entrepreneurial development. • Professional qualification standards • Support to women and excluded populations.	4. **Sectoral skills training** • Support for BMOs in sector • Sectoral skills training and qualifications standards
Firm Level	5. **Complementary programmes to investments** • Train excluded groups • Extend service provision to poor communities • Upskill smallholders • Provide succession training	6**. Training** • Financial management training • Technical training • International marketing advice • Government relations support.

An additional dimension/consideration regards <u>when</u> to provide support in the investment cycle, whether before or during an investment. Is the supporting intervention (whether from the investment- or IC-side) provided to prepare for the investment[38], or to support it during operation?[39] The absence of investor aftercare, for example, is regularly cited by foreign investors as unsatisfactory, and should be supported; much "new" investment is expansion by existing investors, and so the tracking and management of existing clients is critical.[40] In Kenya, also, we found this function underdeveloped as investment officers targeted new investments. The introduction of Customer Relationship Management (CRM) software (whether sophisticated or simple) is one possible approach.[41]

4.5 Investment Side Interventions – Beyond Traditional FDI

A range of institutions promote direct investments. For large donors or DFIs, an important challenge is to find the right intermediaries to deliver hybrid investment solutions on the ground; donors or DFIs cannot be in the business of overseeing small or medium size local investments. The main actors on the investment-side that have worked to make investment happen, or to make it more developmental, include DFIs, VCs, and various Foundations[42]. All provide investment in addition to advice, often at the firm level, but sometimes also at the

[38] (e.g. transaction advice or ensuring a supply of technical skills)

[39] (e.g. ongoing training for young employees, or support to address sectoral NTBs in a regional market)

[40] (Killen and Ghimire, 2016, p.51 onwards).

[41] (Ortega and Griffin, 2009).

[42] (e.g. Acumen)

industry level. DFIs in particular may get involved in IC issues both for the sake of viability and to spread the benefits. Annex 3 provides an overview of some of the main DFIs and their approaches to offering supporting interventions. We summarize the variety of supporting interventions that have emerged in Table 5 below, and then offer some recommendations derived from these investment-side activities that can be incorporated into a refreshed IC approach by DFID.

Technical Assistance Facilities or Multi Donor Accounts are an effective way for donors to set aside and provide funds to support the viability or development impact of investments.[43] Donor organisation, including DFID, have also set up facilities to provide deal-side transaction or technical support.[44] Funds should be available for preparatory (including sectoral and IC) work, and ongoing support. Typically, such support funds can cover the full range of PSD support activities in the matrix earlier.[45] The European Bank for Reconstruction and Development's (EBRD) technical advisory work is delivered around viable investments, and field offices tend to be run by investment professionals. It is more like a partnership with a capable investor to make developmental investments happen; then the technical support needed to make it viable and development is identified and delivered.

A VC approach is also extremely valuable in a developing country environment. VC Funds are increasingly popular, whether country-focused or thematic. Those in LICs are often funded by DFIs who recognise the need for technical assistance, and for funds that do not need to maximise return, but prioritise developmental impact. Firm level assistance is typically provided by the fund out of management fees, but the funder may well have creative ways of rewarding the manager for delivering the extra advisory needs, and donor organisations could establish TAFs to support technical advice above the firm-level on a draw-down basis. Good VCs will spend time identifying good partners in a business area with strong development potential. They will then work with the business to grow through multiple funding rounds, typically providing firm-level support as part of the service. However, making this part of a sectoral growth and IC strategy, with donor organisations establishing a complementary sectoral TAF, for example, has significant potential.

Hybrid de-risking solutions can be very successful. De-risking approaches have been used in Africa and elsewhere to make investments viable and more developmental.[46] In the agricultural sector in Rwanda, for example, tea sector investments have been de-risked by the provision of bridging loans to farmers, investments in quality upgrading, and provision of management training and investment in the tea management company. That example

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[43] (A separate facility approach- such as BICF and TMEA – was considered from the IC-side above, but a recommendation of this research is that tools on the IC-side and those on the investment side constitute a full spectrum of available add-on options to promote private investment and PSD.)

[44] Private Infrastructure Development Group (PIDG) companies, and Trade Mark East Africa (TMEA) are examples.

[45] (e.g. CDC's Impact Fund TAF or EBRD's MDA)

[46] Girvetz, E. (2018) De-risking agricultural investment in Africa. Financial Times [Online]. 14 August. [Accessed 10 November 2018] at: https://www.ft.com/content/4ee682ec-9fd6-11e8-85da-eeb7a9ce36e4

combined de-risking of the commercial investment with significant developmental impact. It depended upon the involvement of investor, DFID, and a foundation.[47]

Large investors may provide their own investment-specific and government relations advice, and sometimes even sector wide support if it serves their interest. Small firms find this more difficult, whilst domestic SMEs have generally had to live with the prevailing regulatory regime. Many large companies have over time begun to pursue a Triple Bottom Line or Balanced Scorecard approach,[48] and if resources and partnership are available from development organisations such as the World Bank, so much the better. An early example was Intel's investment in Costa Rica:[49] Intel actively brought the national and local community into its core business, boosting technological training through the sharing of staff, and voluntarily contributing royalties to its host community, for example. The World Bank (MIGA and FIAS) actively supported this partnership, and propagated the good practice worldwide.

Metrics and accountability are important. Quantitative measures of inclusion and jobs for example have proven difficult to capture. And yet VC and Patient Capital funds have managed to develop strong systems at the grass roots level. Half of the battle is to get investment bankers, for example, to focus on such granularity, when they are already preparing for the next deal; but the point is that it is possible. Meanwhile, the Anticipated Impact Measurement and Monitoring (AIMM) approach is IFC 3.0's attempt to improve ex ante measurement of development impact, given the difficulty of capturing meaningful results over short time horizons. VC or Patient Capital organisations such as Novastar, and its many sisters, or The Acumen Fund, have developed very good qualitative (e.g. tracer or case studies) and quantitative (e.g. beneficiary numbers) metrics through which they can be held to account.

[47] Such solutions often require an open mind, and the ability to be inspired by, and combine, partial solutions from other locations. Creating competitions for such hybrid investment solutions, along with ensuring the ability to assess viability, and a readiness to fail are essential.

[48] See, for example: "Triple Bottom Line". *The Economist*, 17 November 2009.

[49] See MIGA. 2006. *Investing in Development Series.* "The Impact of Intel in Costa Rica: Nine Years After the Decision to Invest". World Bank: Washington, D.C.

Table 5: Investment-Side Intervention Options

Type of DF Intervention	Description	Example
Venture Capital Funds	• Often receive contributions from multiple bilateral and multilateral DFIs • A typical fund might be thematic or nationally-focused, and have 10-15 early stage SMEs / regional investors under funding and management at any time. • Multiple financing waves anticipated, so VC doesn't commit all funds up front. • VC managers provide firm-level assistance; broader investment-focused assistance (sectoral or gov't relations) or developmental advice may access other TA funding. • Exit typically assumed by buy-out	GroFin (MENA, SSA regional); DFID, Shell Foundation and other funding; proof of concept focus with investments in middle class consumption type activities with developmental impact: www.grofin.com NovaStar Ventures (Kenya, Ethiopia, expanding regionally.) Early stage investors; ongoing management advice; focused on bottom of pyramid, maximizing beneficiaries, and developmental impact. TA primarily firm-focused, but can be gov't relations IC work. CDC, FMO and other DFI funders: www.novastarventures.com Kukula Capital (Zambia): VC, debt and private equity; Zambia exclusive; six investments one exit as of 2018; modest management fees with equity options; Danish and Zambian funders http://kukulacapital.com/
Grass Roots Patient Capital Funds	• Provide patient capital at the bottom of the pyramid with technical and management advice; • Typically between microfinance and VC; • Includes mentoring and leadership training; • Often receive contributions from multiple bilateral and multilateral DFIs	Acumen (primarily numerous family foundations and local/int'l corporate funders):)patient capital; early stage investments (100+ companies, $100+mn invested); expertise and post-investment support; and mentoring/leadership training; originally microfinance in Rwanda but grown: www.acumen.org Grassroots Business Fund: Founded by former IFC director; takes a blended investment (hybrid) approach combining debt, equity and investment advisory services (firm-level); for-profit component funded by DFIs, aid agencies and individuals/foundations; non-profit advisory side funded by DFIs and corporate foundations; invests in high-impact businesses affecting large numbers of people in vulnerable communities : www.gbfund.org
Other Mkt Testing and B2G Traditional FDI variation	• Various examples of FDI that have a Business to Gov't (B2G) deal dimension • Can be anti-competitive or necessary to re-energize an entire sector • Can be market-testing in order to develop a new market.	VW Investment in Rwanda ($20mn): Target production in vehicles; partnership w gov't to test ride sharing and other transport services: https://www.reuters.com/article/us-volkswagen-rwanda/volkswagen-opens-rwandas-first-car-plant-idUSKBN1JN0NF Zipline investment in Rwanda: PPP type investment in drone delivery services for rural communities; Gov't collaboration in regulatory reform and service pricing: www.flyzipline.com

Type of DF Intervention	Description	Example
Infrastructure PPPs	• Project Finance aspect is paramount in larger examples, typically on a commercial basis; • Transaction related advice required; also full range of 6 types of supporting intervention possible • Smaller infrastructure PPPs more systemic, focusing on e.g. waste management and housing; clear focus on societal developmental impact	EBRD Jordan Water Sector: EBRD with partners 2018. Wide ranging deal to provide infrastructure investment combine with deal facilitating technical assistance, in particular IC for whole sector including developmental impact.[50] https://www.ebrd.com/jordan-data.html Private Infrastructure Development Group (PIDG) (Aid agencies, DFIs): loans, equity and guarantees: innovative public infrastructure programmes maximizing beneficiaries and developmental impact. In Burkina Faso[51] PIDG's Technical Assistance Facility (TAF) funded key advisory work to establish bankability of the country's first private sector infrastructure/ solar IPP operation: https://www.pidg.org/
Hybrid and de-risking investment activities.	• This is a general category of investment activity accompanied by some mixture of de-risking activities, advice, parallel social or facilitating investment or grants. • Advisory de-risking can include technical advice to government on new sectors. • Parallel investments/grants may focus on a service facility to train workers or upskill smallholders • Often deployed in the context of agricultural and manufacturing investments, and therefore well suited to market systems type approaches – crucially these interventions are designed in concert with actual investments, and not upstream (though a market systems approach can have upstream IC-led TA, and downstream investment-driven de-risking interventions). • Guarantees (e.g. PIDG's GuarantCo) also fall under this category	EBRD retail mall investment Jordan: EBRD provided start-up funds and TA to the Abdali Mall Recruitment and Training Centre (AMRTC) a retail training institute in Jordan to ensure supply of trained staff to its investment, but also supplied the broader retail industry: https://www.ebrd.com/news/2016/ebrd-supports-creating-job-opportunities-for-jordanian-youth.html Wood Foundation and Unilever, Rwanda: Unilever invested in the Mulindi tea factory in Rwanda, but the investment was only viable with an upgrading of the quality of smallholder tea leaf supply; Wood Foundation, DFID and Unilever established a service company to support several thousand smallholders and their families, thereby achieving viability and developmental impact : https://www.thewoodfoundation.org.uk/making-markets-work-for-the-poor/rwanda/kibeho-munini/

[50] Coverage of this PPP programme in Jordan from 10/5/2018: http://www.jordantimes.com/news/local/ebrd-offers-1-billion-finance-infrastructure-projects-jordan

[51] See case study: https://www.pidg.org/impact/case-studies/burkina-faso-windiga-zina-solar-ipp

5. Sectoral Transformation

The World Bank and others have looked for tools to identify transformative sectors as a way of extending and making IC work more effective. Asian Tiger and Tiger Cub[52] countries in particular, and others, have shown that it is possible to break into new sectors and make growth sustainable. Some governments have been good at identifying transformative sectors. Transformative sector identification by governments has often taken the form of industrial policy or grand industrial plans[53], or through the vision of a political leader that has been translated into a plan.[54] When more specific individual sectors have been identified[55], it has often been disparaged as "picking winners", whether successful[56] or not.[57]

Donor partners and investors can provide a variety of support. They can finance the experiment, (although on large infrastructure investments the debt burden can be large[58] and be dangerous in the long run).[59] Donors can assist with technical tools to analyse sectors, and draw up market systems plans, or they can support Master Plans that may have been drawn up without them. Where sectoral or master plans are prepared, donors together or separately can establish a technical assistance fund for a wide range of activity from IC to broader business environment.

5.1 Examples of Sectoral Transformation

With good coordination and investment, governments and their donor organisation supporters can kick-start a relatively new sector through hard and soft infrastructure investment. Box 3 presents some case studies of industrial transformation. Agriculture and tourism are always good candidates for economic transformation, and it is often a question of "how" or "which sub-sector", rather than "whether". There are several potentially transformative examples from Rwanda that emerged from our case study presented in Box 4

[52] The Four Asian Tiger Economies were: South Korea, Taiwan, Hong Kong, and Singapore. The Tiger Cubs are: Indonesia, Malaysia, Thailand, Vietnam and the Philippines.

[53] (e.g. Malaysia, Japan)

[54] (e.g. Singapore, and in Africa, perhaps, Rwanda)

[55] (e.g. aircraft manufacturing)

[56] (e.g. Embraer, Brazil)

[57] (e.g. Indonesia)

[58] Himbara, David (2018) Kagame is Drowning Rwanda in Debt. Medium [Online] 1 August. https://growthlab.cid.harvard.edu/files/growthlab/files/128.pdf

[59] As in Sri Lanka's port investment. Abi-Habib, Maria (2018) How China Got Sri Lanka to Cough Up a Port. The New York Times [Online]. 25 June. [Accessed 15 October 2018] at: https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html

Box 3: Sectoral Transformation in Diverse Environnements

Garment Sector in Bangladesh: The readymade garment (RMG) sector in Bangladesh was insignificant until the 1970s when a private investor from Korea arrived and trained some 130 Bangladeshi entrepreneurs, many of whom were women. "This industry seems to have grown rapidly for three decades through a virtuous circle involving continuous learning from abroad and active investment [by the industry itself], which strengthen each other's positive effect. In our view, the creation of the virtuous circle was facilitated by the massive entry of wealthy and highly educated entrepreneurs to the industry, which followed the initial intensive technology transfer from Korea."[60] The Government of Bangladesh did offer incentives to the industry in the 1980s (duty free machinery imports, cash incentives and bonded warehouse facilities). Because of the industry's rapid growth as a result of Korean investment it was brought under Multi Fibre Agreement (MFA) quota arrangements in 1986. These were phased out by 2005, but the industry's investment and efficiency and low wage costs meant that exports continued to increase both during and after the MFA, with exports of $28bn in 2015. The industry has suffered many tragic factory disasters, but has worked hard in response to improve working conditions, and remain competitive.

Garment Sector in Ethiopia:[61] Ethiopia is a newcomer, and textile and garment industry exports in 2015 were a modest $115mn compared to Bangladesh's $28bn, but FDI in the sector led by China reached some $1.3bn in FY16/17. The garments industry had been identified as a potential growth sector since 1995, but performance was mediocre until the implementation of the Growth and Transformation Plan in 2010, which included an array of incentives. The government has also invested significant sums in transport infrastructure to reduce transit times, and in industrial parks. It is early days, but low costs and massive investment in infrastructure could make the country globally competitive in this sector, and offer the country an alternative to its difficult agrarian economy.

Intel and Medical Devices in Costa Rica: Intel's decision to invest in a wafer facility in Costa Rica in 1996 was a significant achievement for the country. At its peak Intel accounted for 20 percent of Costa Rica's exports, and six percent of GDP. There was comprehensive collaboration across government, the IPA (CINDE), utility companies and training establishments. Regulations and incentives were improved, but then available to all investors. Infrastructure and human capital were upgraded. Intel has since disinvested, but in 2017 exports under another electronic category – medical devices – reached $2.9bn or 27 percent of exports. This shows how the Intel – Costa Rica collaboration to improve human capital in electronic engineering, and infrastructure has transformed the sector, and led to lasting economy-wide benefits.

Car Manufacturing in Northeast England:[62] Nissan's 1986 decision to invest in Sunderland shocked competing locations. It received a standard package of incentives for high unemployment areas, and access to the European market, but most importantly beyond that elicited intense collaboration at all levels of government, utilities, landowners and unions in a way that persuaded Nissan to invest. Like Intel in Costa Rica, Nissan's investment was transformational, leading to a regeneration of the regional economy, and the growth of numerous auto-related and high-tech companies.

Pharmaceutical Sector, Kenya: The development of Kenya's pharmaceutical industry began with import substitution policies deployed before and after independence. Although IS policies (such as a requirement on MNCs to form parastatal joint ventures) helped lay some limited foundations, Kenya's membership of regional trade blocs (COMESA and EAC) and the establishment of industrial zones provided market access and allowed

[60] Mottaleb and Sonobe, 2011. This paper gives the most informative summary of the transformative growth of the garment industry in Bangladesh. Mottaleb, K. and Sonobe, T. (2011) An Inquiry into the Rapid Growth of the Garment Industry in Bangladesh. *GRIPS Discussion Paper,* 11-10.

[61] Maasho, Aaron (2017) Ethiopia bets on clothes to fashion industrial future. Reuters [Online]. 21 November. [Accessed 15 October 2018] https://uk.reuters.com/article/us-ethiopia-textiles/ethiopia-bets-on-clothes-to-fashion-industrial-future-idUKKBN1DL1VU

[62] Conn, David (2018) Will Nissan stay once Britain leaves? How one factory explains the Brexit business dilemma. Guardian [Online]. 4 October. [Accessed 15 October 2018] https://www.theguardian.com/news/2018/oct/04/will-nissan-stay-once-britain-leaves-sunderland-brexit-business-dilemma.

strong firms to adapt to international competition. From 2007-2013 local production of non-parenteral medicines climbed from $34mn to $154mn, the vast majority through local company production, with only one foreign manufacturer left by 2014. Kenya is now the largest producer of pharmaceutical products in COMESA supplying 50 percent of the regional market. The sector is part of the Kenyan industrial masterplan, but the government does not yet seem to have taken a proactive role in leading the sector. Various reports suggest technical training could be of higher quality, and that margins allowed on medicines are too high. In sum, the Kenyan pharmaceutical sector is still small, but a strong sectoral policy covering qualifications, technology upgrading, and attention to the sectoral regulatory regime can transform it. One commentator concludes: "With a little extra help at the government level, Kenya might soon be a leading African nation in the field."[63]

Box 4: Transforming Sectors in Rwanda

Meetings, Incentives, Conferencing, Exhibitions (MICE) Sector, Rwanda:[64] President Kagame has championed a series of major infrastructure projects that will benefit the economy more broadly, despite significant debt accumulation, and stimulate the MICE sector. The Kigali Convention Center is the flagship investment, which ran into numerous difficulties, but opened in 2017, and has buoyant demand. Other projects include the Bugasera International Airport, and investment in RwandaAir to make it a cross-Africa carrier. It is a gamble but the President is able to guarantee the collaboration across all relevant ministries and agencies to get things done. Challenges remain – including the enormous debt overhang, and the need/opportunity to intensify hospitality training – but the sector has every chance of being transformed and becoming an engine of growth. Industry revenues grew from $42mn in 2016 to $74mn in 2017.

Market-testing Transformative Investments – Zipline:[65] Zipline is a drone delivery service dispatching emergency blood and other medicines to remote rural areas with a total investment as of 2016 of $42m. The service can now offer access to all 11 million citizens. It is a collaboration between Zipline and the Government of Rwanda (GoR) in what is termed a market-testing investment. The collaboration required changes to the regulations covering air traffic control, professional licensing, along with the development of pay-per-use user agreements with clinics and government. Zipline now has a workable model to expand elsewhere in Africa, and it represents a new business area for Rwanda. In a similar mode, VW's investment in Rwanda in car production is intended to test the market for car sharing and other services, as a pilot for the rest of Africa.

Mulindi Tea Factory and Tea Service Company, Rwanda:[66] Another example in Rwanda is the Unilever and Luxmi tea factory investments in Rwanda, which have been accompanied by investment with DFID and the Wood Foundation in a tea service company to manage and train tea plant smallholders. This deal structure has brought about a step change in the quality of tea inputs, and can be widely replicated to increase tea quality and incomes across the entire sector in Rwanda. It is not a new industry, but this investor and donor initiative has led to a qualitative change in the prospects for the industry.

[63] Simonetti, Roberto et al. (2016) Pharmaceuticals in Kenya: The Evolution of Technological Capabilities. In Mackintosh, M. et al (eds.) M*aking Medicines in Africa: The Political Economy of Industrializing for Local Health.* Palgrave Macmillan, pp.25-44.

[64] Himbara, David (2018)

[65] Kolodny, Lora (2016) Zipline raises $25 million to deliver medical supplies by drone. TechCrunch [Online]. 9 November. [Accessed 15 October 2018] at https://techcrunch.com/2016/11/09/zipline-raises-25-million-to-deliver-medical-supplies-by-drone/

[66] Majumdar, Arkamoy (2017) Assam's Luxmi Tea to develop 4,500 hectare plantation in Rwanda. LiveMint [Online]. 21 July. [Accessed 15 October 2018] at https://www.livemint.com/Companies/7I9XA4LCTHVNRnAeNY95NJ/Assams-Luxmi-Tea-to-develop-4500-hectare-plantation-in-Rwa.html

5.3 Diagnostic Tool Analysis

International organisations and aid agencies have sought to understand how transformation happens, and how to identify sectors with potential, without straying into "picking winners". Success is tied up with many factors, but a realistic outlook and political support are both necessary. Here we look briefly at three approaches to identifying transformative sectors: the IFC's Country Private Sector Diagnostics (CPSD); ODI's Supporting Economic Transformation (SET) methodology[67], and the "Product Space" concept developed by Hausmann, summarised in Box 5 and also Annex 2. Backed up by a political economy analysis (PEA) these tools can be extremely useful, although ultimately leaders need to take a gamble, which sometimes works and sometimes does not. Tourism and agriculture are often identified as sectors with transformative potential largely because of their job creation and inclusion potential.

Transformation can be about a qualitative change within a sector (such as tourism or agriculture), or about industrial upgrading into new sectors, such as from manufacturing to services. Successful transformation is not accidental, and above all requires political will at the sectoral and national level, and the ability to collaborate amongst stakeholders. Industrial upgrading or transformative sectoral development does not need to be large scale at the outset.[68]

Box 5: Diagnostic Tools to Identify Transformative Sectors (See Annex 2).

Ricardo Hausmann's Product Space approach is primarily focused on revealed comparative advantage, and the propensity to export new products thereby promoting growth and development. In contrast to CPSD the developmental impact of the transformation comes through growth. The approach is therefore less comprehensive than the CPSD. The methodology focuses on evolution in the sophistication of exports. The speed of transformation from simpler to more sophisticated exports is determined by "density" of product space i.e. how close the new products are to the existing products. Distance between pairs of products is measured by the probability of a country exporting both products. Examination of product density depends on data around product exports currently, and products which have high density to existing products, which indicates a direction of travel for transformation into new products. The approach is therefore relatively amenable to analysis from published export data. It is relatively objective and helps to identify which countries are likely to progress more rapidly into new sectors and technologies from their current base. This can change over the longer term however, so the methodology is probably more useful in a shorter time frame. It is also worth considering that dimensions of scale are important. So, a country can scale up without transformation into advanced technologies, as well as expand by moving up the value chain. Whilst the latter may add more value, the former strategy can be important in terms of generating jobs.

Overseas Development Institute (ODI) has been commissioned to implement a Supporting Economic Transformation (SET) programme. This facility is providing economic transformation advice to a variety of developing country partners on a call-down basis. It has also reviewed historical transformations in order to draw lessons. As a tool to design and implement industrial upgrading strategies it focuses primarily on data analysis, and historical comparators. It considers the rate of growth within and between sectors, and the productivity of firms. It takes a similar revealed comparative advantage approach to Hausmann's Product Space, but is concerned also with domestic transformation. Both the Product Space and the SET approaches are data-

[67] Under the SET methodology McMillan et al[67] look at a broader range of sectors and countries covering services and manufacturing, showing that with the right policies there is transformative potential across a variety of sectors.

[68] Thus, Rwanda is experimenting with market-testing investment in ride-hailing and drone delivery services (Box 4).

analytical (and probably relatively inexpensive as a result), and focus primarily on value-adding / export sectors. They are more akin to analytical tools for particular ideas rather than an integrated approach to industrial upgrading.

IFC's Country Private Sector Diagnostic (CPSD) methodology seeks to identify sectors where private sector solutions can create or expand markets and make substantial contributions to development impact. To that end, it looks for investment solutions, including de-risking and other hybrid opportunities, as well as at IC reforms, and sectoral strengthening interventions.

IFC carried out two pilots of the new Country Private Sector Diagnostic (CPSD) in Kazakhstan and Ghana in 2017. The diagnostics were completed quite quickly, mainly during 2017, and the report has been widely circulated. IFC's intention is to share the methodology in order to promote collaboration with other donors who may wish to support the ensuing recommendations and reforms. The costs of the exercise are not known, but based on the significant work and staff involvement and consultation each may have cost several hundred thousand dollars or more. Not least given the likely costs of the exercise, partner consultation and buy-in are critical to the success of the CPSD and the recommendations that come from it. The report and process show extensive consultation in addition to data analysis. Indeed, the Ministry of Finance in Ghana had already included spending on recommendations before the report was formally launched. The CPSD is a thorough and pragmatic methodology using a variety of analytical methods including trade data, sectoral performance and so forth. Interviews with existing businesses however small to understand sector potential and binding constraints were particularly impressive. The CPSD is a phased process looking at all sectors, but quickly focusing in on 7 sectors (in the case of Ghana) and then three for deep dive analysis. Agriculture and tourism are likely to be near the top of the short list of most countries due to their large potential developmental impact. The presentation of the report is succinct and clear, importantly making it accessible to the wide audience that will need to buy into and use it. Recommendations are comprehensive and cover both IC and investment recommendations.

CPSD is an impressive and transparent methodology with excellent consultation and pragmatic presentation, providing recommendations and supporting financial, IC and investment interventions. Importantly, the World Bank Group (in partnership with bilateral donors) has the capacity and resources to support implementation of many of these recommendations in partnership with the host government.

5.4 How Sectoral Transformation Happens

Successful transformation is purposeful, and often involves government direction or coordination, the convening power to get different stakeholders around a table and working with each other. In other cases, a proactive investor, followed by a proactive private sector can make it happen, accompanied by incentives (including infrastructure) for the industry.[69]

[69] McMillan et al (2017) provides a variety of country and sector transformation case studies, whilst this report's case study of the Rwandan MICE sector is a good example.

6. Trade and Regional Markets

Regional markets and preferential trade agreements are important for attracting much foreign investment and especially GVC activity to countries, notably LICs and FCAS. The absence of intraregional trade in North Africa continues to hamper development there, for example. In Sub-Saharan Africa, particularly relevant to our countries, and because they are extremely strong trading blocs, are the East African Community (EAC) (Box 6) and the Southern African Development Community (SADC). Trading agreements with advanced countries/blocs stimulate growth, and attract investment.[70] The SADC-EU Economic Partnership Agreement (EPA) was the first regional EPA to be fully operational in 2015. The EU-EAC EPA is still pending ratification by some of the EAC members, but when implemented may have a positive impact on trade for members, which could increase further after a programme of systematically addressing non-tariff barriers (NTBs), and other positive knock

Box 6: **The East African Community (EAC)**

EAC membership is now six countries (Kenya, Tanzania, Uganda, Rwanda, Burundi, and South Sudan), of which four are landlocked, creating a single market with access to the sea (with a combined population of 150 million, and a combined market of $146 billion) in place of the otherwise fragmented national economies. Following a treaty amongst 3 founding countries (Kenya, Tanzania, and Uganda) in 1999, important milestones include the accession of new members (Rwanda and Burundi in 2007 and South Sudan in 2016), the launch of the common market (2009), and the agreement of a protocol for the establishment of a monetary union (2013). The EAC has also provided a basis for negotiation of outward facing trade agreements, such as the European Partnership Agreement (EPA), and the tripartite agreement with COMESA and SADC, representing an important stepping stone towards the Continental Free Trade Area (which in 2018 was approved by 44 African nations, not including Nigeria and South Africa). Intra EAC trade grew from $1.5 billion in 2005 to $5.8 billion in 2013, falling back however to $4.4 bn in 2016. Intra-regional trade constitutes 9.4 per cent of the total trade of the bloc, which suggests considerable scope for expansion.

on effects.[71]

Many investments and business interactions are positively influenced by the size and integration of the regional market, and, importantly by the ability of goods and people to move freely between those national markets. Harmonised standards, and for instance mutual recognition of qualifications, are critical to the integrity of the market. In EAC, as an example, there remain many NTBs and rules and regulations that could be harmonised.

Some of the most valuable IC assistance that can be offered by donor organisations is regional, including firm/industry work on improving the integrity of the common market. The common market in East Africa provides an incentive for GVC-type trading relationships, and for attracting market-seeking FDI. Given the public goods nature of regional integration and market access, and the harmonised rules and regulations that support it, this area is ripe for

[70] E.g. Trade agreements with the EU, including Everything But Arms (EBA) agreements, and the Africa Growth and Opportunity Act (AGOA)

[71] European Commission (2017) *The Economic Impact of the Economic Partnership agreement between the EU and the East African Community: An analysis prepared by the European Commission's Directorate General for Trade.* Brussels: European Commission.
http://trade.ec.europa.eu/doclib/docs/2017/february/tradoc_155363.02%20Economic%20Impact%20of%20the%20EU%20-%20EAC%20EPA.pdf

technical support. This can come in the form of a technical facility for trade issues[72]; as well as in the form of assistance to individual firms and industries where specific investments are being supported.

Counter-productive trade policies can effectively shrink the addressable market for investors such as export processing regulations. Currently, such policies in the EAC require investors in EPZs receiving duty remission incentives to export 80 percent of their goods outside the customs union. More generally, unfair countervailing measures are sometimes imposed on exports within the EAC where disputes arise in the calculation of value-add in the manufacturing process.

There may be opportunities to incentivise countries to fall into line with the required common standards, or legal and regulatory alignment. One idea that could usefully be implemented systematically is the *East African Common Market Scorecard,* so far undertaken only once in 2014. This approach calls out those not performing to agreed standards.[73] It is similar in some ways to the *Doing Business* ranking system. The Common Market Scorecard approach, like *Doing Business,* should be repeated regularly, and out of each iteration should come an action agenda that is made public, and progress should be assessed for each country/ministry/organisation at the subsequent review.

Figure 3: East African Common Market Scorecard Methodology

Freedom of movement	Operations/Sectors Covered	Issues Considered
Capital	• Securities Operations • Credit Operations • Direct Investment • Personal Capital Transactions	• Ceilings on value of transactions for non-residents/citizens • Discriminatory requirements for approvals of transactions • Prohibition of non-residents to participate in investments • Mandatory deposit requirements by Central Banks • Incentives extended only to domestic investors • Discriminatory tax treatment • Restrictions on ownership of firms • Restrictions on transfer of securities • Limitations on credit obtainable from domestic transactions. • Restrictions on outward investment
Services	• Legal • Accounting • Architecture • Engineering • Retail • Wholesale • Telecommunications • Road Transport	• Nationality Requirements • Residency Requirements • Licensing and qualification requirements • Registration Requirements • Authorisation Requirements • Technology Transfer/Training/Requirements
Goods	• Tariffs and equivalent measures on Intra-regional trade • Non-tariff barriers • Application of the Common External Tariff • Sanitary and Phytosanitary Standards and technical barriers to trade	• Application of charges of equivalent effect to tariffs • Sanitary and Phytosanitary measures • Technical Barriers to Trade • Non-recognition of rules of origin certificates • Perforation of the Common External Tariff • Temporary adjustments to the Common External Tariff

[72] Like the East Africa Trade and Investment Hub that already exists, and should be maintained

[73] See World Bank Group (2014), *East African Common Market Scorecard.*

7. Conclusion

Based on a review of literature and three case studies in Africa, this research has reviewed the state of IC interventions, and their effectiveness. Traditional IC programmes, focused on reform of rules and regulations and institutions, are being reconsidered. These interventions, by DFID and others, have been evolving to be more investment relevant, including a greater focus on sectors, market systems, subnational regions, and in other ways.

At the same time, investment activities by donor organisations in developing countries have also been increasing, and evolving to include more technical assistance, not only to firms but to sectors, and the business environment more generally. DFID has supported some of the DFIs through contributions to technical assistance funds (TAFs), and this approach should be continued.

All in all, it is clear that donor organisations are engaged in a range of PSD interventions ranging from traditional IC activities to direct investments and VC activities. There is an increasing variety of hybrid and de-risking interventions and transaction-focused technical assistance models and options.

DFID is experimenting with a combination of various interventions in partner countries, and when designing country portfolios it should consider the full range of options, and how to combine them. This should be based on a Country Private Sector Diagnostic (CPSD), Political Economy Analysis (PEA) or similar tool.

It is also recommended that coordination between DFID and CDC should increase, something the parallel institutions of IFC and WB are also working on. DFID can play a role in the World Bank Group's efforts through support to FIAS and other groups through future IC programming, but should also do so between itself and CDC.

This research has focused on DFID, and makes recommendations for the evolution of its IC interventions, but it has also revealed needs for other research and reviews. First, a deeper review of how investment activities by patient capital funds, VCs and DFIs are supported, and used to improve the broader investment climate, is much needed. Second, a review of the development impact of different types of investments and business transactions is needed to see how they benefit both PSD and broader development in recipient countries.

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Annex 1: Development Impact

This Annex looks briefly at how different business transactions have development impact. IC reforms can guide how that impact happens.[74] Here we take a different perspective and consider the development impact of different types of business transaction: FDI; value chain sourcing transactions; and export of high technology or capital goods, and associated "solutions".

The development impact of a business transaction is about how the benefits of the transactions build on and go beyond the company's corporate interests. The development impact of business transactions is relevant for several reasons:

- Business transactions can have overall negative as well as positive impacts,[75] so investment approvals and activities need to have safeguards against negative impacts. Technical support to governments to help guard against negative investment impacts is a good use of development aid.
- Development impacts can come from the beneficial direct impacts of investments and from indirect impacts, like linkages with suppliers and employment at them, development of clusters or sectors around large investments, improved market access that benefits smaller indigenous companies also, or general upgrading of technical ability. Development organisations can provide technical assistance to upgrade firm capabilities, industry capabilities[76] or the IC through, for example, the deployment of technical assistance funds, or direct programming.[77]
- Investments (and other business transactions) can also have impacts on the broader social economy. Ideally broader societal benefits overlap to the extent possible with the core business activities of the firm. Aid organisations can support firms, governments, and other stakeholders in the business environment to enhance positive developmental impacts, and mitigate negative ones.[78]

Alongside positive impacts, there are some potential negative impacts of different types of business transaction that IC reforms can seek to mitigate. The possible negative impacts of FDI include the crowding out of local business, environmental impacts[79], effects on

[74] E.g. facilitating entry, encouraging the growth of sectors, making it easier to employ people, or making it more inclusive

[75] See Klein, Aaron and Hadjimichael (2001) for a typology and analysis of the direct and indirect impacts of FDI and its impact on poverty reduction, which remains a good overview. Another good collection of evidence on the topic is Moura and Forte (2009).

[76] E.g. services to BMOs or technical training)

[77] This is the right-hand column of the PSD Support Matrix presented in Table 4.

[78] Agricultural and natural resource investments, for example, can have negative impacts on rural communities, whether through pollution or deforestation.

[79] E.g. plantation investments and logging

rural communities[80] (FAO, 2012) [81], monopolising the labour market for talented workers, and so on. IC reforms can help mitigate these impacts, if done properly, and indeed use the presence of investors to increase opportunities and standards for all businesses. Value Chain transactions will generally raise standards in supplier countries to meet the standards of more advanced markets. However, potential negative environmental impacts of natural resource activities such as logging and agriculture underline the need for appropriate developing country standards, and partnerships with sourcing companies.[82]

FDI Development Impact

There is a vast literature on the development impacts of FDI[83], which can be summarised into a manageable range of key issues. For the purpose of providing a summary Table 6 lists six main types of FDI sectors, and some important direct development impacts. The impact of FDI in a particular sector on any of the impact areas is obviously firm-dependent: one manufacturing investor could be a 'race-to-the-bottom' polluter, another might introduce 'best-in-world' environmental standards. FDI in most sectors has the potential to be enormously developmental: it depends on the quality of the investor, and how the host government supports and handles it. The table is therefore a checklist that can be expanded as needed to assess the desirability, form a development impact perspective, of a particular investment (or indeed other business transaction). That in turn can guide what supporting interventions might be appropriate or add value. This could be technical assistance to increase viability, or spread the benefits, as laid out in the PSD Support Matrix in Table 4. It may also take the form of complementary public goods investments or grants. These and other categories could be scored 1-10, for example.

Quantifying the development impact of FDI is a broad and often contentious subject, and could benefit from updated review. As noted in this report, FDI can benefit the sector and economy directly (measured by direct jobs or export impact, for example), but also through broader development impacts. The latter are particularly interesting, but also difficult to capture. The World Bank and others have long struggled with capturing the indirect job and beneficiary impact of FDI, for example. Impacts on subnational development, skills upgrading, higher standards, entrepreneurial mind set, empowerment of women, are also important. An updated review of what is important, and how well impact can be quantified, would be useful.

The host government or the supporting donor organisation should ask what it wants, or is able to achieve, from an investment. Is it to achieve more PSD (e.g. technical production advice, or an SME supplier upgrading programme)? Or is the objective social /

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[80] E.g. through large scale agriculture

[81] This FAO report underlines that there are particular dangers of large scale agricultural investment relating in particular to large scale land acquisition and impacts on local communities. The report underlines the concomitant important role for IC support to reduce these risks.

[82] E.g. Forest Stewardship Council)

[83] For an overview of the impacts of FDI generally in developing countries, see: OECD, 2002. For an exhaustive review of FDI impacts in agriculture in developing countries, but with extensive case studies, see: FAO, 2012.

development impact (e.g. a mentoring/entrepreneurship programme to spread business expertise more widely, or extending rural electrification to additional villages)?

Table 6: Development Impact Checklist for Different FDI Sectors

	Direct Jobs	Indirect Jobs	Beneficiaries	Tech. Upgrade	Value Chain / Cluster Impact	Inclusion: Women Youth	Environment	Rural Impact	Training / Human Capital
Tourism									
Commercial Agric.									
Manufacturing									
Infrastructure									
Services (IT/Health/Ed.)									
Natural Resources									

Box 7: Luxmi and East Africa Tea Investments (EATI) (Rwanda)

There are several interrelated tea investments in Rwanda that involve Unilever, Luxmi Tea (Assam), The Wood Foundation, DFID and large numbers of owner tea farmers. In a first phase, the Wood Foundation through its investment vehicle, East Africa Tea Investments (EATI)[84] made a patient capital investment in the Mulindi Tea Factory, and one other factory. EATI holds 55 percent of the shares, and will run the factory for 7 years in order to build capacity and recover capital. Smallholders / local cooperatives own the remaining 45 percent, and the 55 percent will be handed back in 7 years. In parallel, EATI has been carrying out significant smallholder support activities including running nurseries, providing seedlings, organizing leaf transport, training, and so on. [85]

This patient capital approach has opened the way for two serious commercial investments of €55mn by Unilever, and $30mn by Luxmi in recently auctioned tea plantations of several thousand hectares each. Unilever made its first new plantings in 2017, and Luxmi in 2018, and their crops will become commercially productive in four years. Ahead of then, both companies will build tea factories.[86] DFID has committed roughly $9mn to EATI, and Luxmi also $3.5mn. Neither Unilever nor Luxmi would have made the commercial investment commitments without the existence of EATI's smallholder services and transformative quality improvement programme. The value of that contribution was clear to investors from the commercial and development impact of the "pilot" programme around Mulindi, which was in turn based upon EATI's first programme launched in Tanzania in 2009.

The development impact of this patient capital FDI, and associated commercial investments, is substantial. It is substantially upgrading productivity and performance of the tea industry feeding a virtuous cycle of industry expansion. The broader impacts on community resilience and human capacity improvement are substantial.

- Tea prices have over doubled since 2012 from FRW100/kg in 2012 to FRW211/kg on average as of 2017, due in large part to quality improvements, and with a direct effect on family incomes. Farm productivity has increased by 30-40 percent

[84] The Gatsby Foundation is the other partner in EATI.

[85] MINAGRI (2017) *Mulindi Tea Farmers Upbeat as they celebrate their achievements with Wood Foundation* [Online]. There are actually two factory investments and smallholder support programmes in Gicumbi District (Mulindi Tea Factory), and Rusizi District (Shagasha Tea Factory); this mini case study visited the Mulindi Tea Factory.

[86] Restored bushes (that have been neglected) take 4 years to commercialisation; new plantings take seven years.

- Some 5000 smallholders farm the 2000 hectares of tea plantation, supporting households of roughly five persons each. DFID also assumes there is also a 100 percent indirect jobs effect for the 25,000 smallholders/beneficiaries.
- Some of the suppliers to the tea factory are taking up multi-cropping for the first time with new tea bushes, which will lead to greater livelihood security.
- The significant quality improvements and price premium from new tea growing and processing practices result in a significant income boost to the local economy.
- Smallholder families have been able to afford housing and schooling for children, which was previously beyond their reach.

Box 8: Intel (Costa Rica)

Intel made the decision to invest in a $300mn wafer fabrication plant in Costa Rica in 1996.[87] It was a major investment promotion success, and the country worked hard and apparently reasonably successfully to use it to transform and upgrade the economy.[88] Twenty or so years after Intel's decision to invest in Costa Rica, Costa Rica remains a major exporter of technology products, notably medical devices, despite Intel's withdrawal in 2014.[89] Costa Rica embraced Intel and used it to train a new category of human capital and cultivate a new technology industry. The challenge of a dual economy is still there – before Intel its main exports were coffee and bananas – but Costa Rica has created a skilled workforce component that should be attractive to other high tech employers.[90]

The development impact of Intel worked mainly through a feedback loop involving human capital upgrading, and how the export revenues were reinvested.

- Intel's $300mn investment was a great success for the IPA, CINDE, which made great efforts to link it with the local economy. For example, Intel provided training to its own staff, who were encouraged to devote some of their time to training at local university faculties, thereby upgrading the broader workforce.
- Intel worked with the education establishment to redesign curricula, which benefitted human capital generally, and there remains a strong, and now more diversified, flow of high tech companies into Costa Rica.
- Transport infrastructure and incentives regulations were also upgraded in a way that benefitted all subsequent investors.
- Both with a view to, and after, Intel's investment, CINDE and the government worked to improve regulations, the incentives law, and infrastructure.

[87] See Spar, Debora (1998) Attracting high technology investment: Intel's Costa Rican plant. *Foreign Investment Advisory Service Occasional Paper* No. 11. Washington D.C.: World Bank. http://documents.worldbank.org/curated/en/949541468770676701/Attracting-high-technology-investment-Intels-Costa-Rican-plant for a review of the successful investment promotion coup.

[88] See MIGA (2006) for a review of the impact of Intel's investment 9 years after investment but before withdrawal.

[89] Intel is relocating that production to China, Malaysia and Vietnam, but it was also seen as a function of Intel having fallen behind in the mobile phone chipset marketplace. But the lesson for Costa Rica and other countries is that such leapfrogging investments need to be quickly embedded in, and linked to, the local economy. Workforce needs to be upskilled beyond the actual investment, home-grown companies encouraged, the regional marketplace developed for derivative manufactured products, and more importantly services. Even if Intel or other high tech companies leave, people will still use the products and need "solutions".

[90] See Aguilera, R. (2014) Costa Rica: Life after Intel. Huffington Post [Online]. 5 January, updated 6 December 2017. [Accessed 15 October 2018] https://www.huffingtonpost.com/rodrigo-aguilera/costa-rica-life-after-int_b_5246788.html

- Costa Rica so far seems to have been able to run with a more "niche" high tech industry in the form of medical devices, which accounted for 27 percent of total exports in 2017, or $2.9bn, a threefold increase over 2007.

A proactive approach is essential when promoting transformative investments with real development impact. Thus, incentives may be involved (as in Costa Rica), but (a) they may not be sufficient to make the investment sustainable and integrated, and (b) they may need to be adapted with a view to being transparent and to attracting other companies on the same terms. CINDE received advice from the World Bank and Irish Free Zone advisors; Mulindi had a patient capital foundation with world class technical advisors and a strong partnership with government through the Rwanda Development Board (RDB) and relevant ministries. In particular, both investments were positioned to leverage broader development impact.

Global Value Chain (GVC)

For GVC linkages between Europe, especially the UK, and Africa, agricultural and garment sectors predominate. A "value chain" describes the full range of activities required to bring a product or service from conception, through the different phases of production involving a combination of physical transformation and the input of various producer services, to delivery to final consumers, and final disposal after use[91]. The UK's imports from Africa are only two percent of total UK imports, and this trade is dominated by fuel, precious stones, and fresh fruit and vegetables.[92] The main (agricultural) value chain import to the UK from Kenya is green beans (Box 9).

Box 9: Green Beans from Kenya[93]

Kenya produced an estimated 62,000 tons of green beans in 2017 on an estimated 7,500 hectares of land. Over 34,000 tons were exported, primarily to the UK. Supermarkets and wholesalers in the UK are the buyers. Sixty percent of production comes from smallholder farms of under 10 hectares, and mainly under two hectares. The green bean value chain supports the livelihoods of around 52,000 smallholder farmers and their families, approximately 200,000 people (given a family size of over four). One estimate of the employment multiplier for agriculture, especially where smallholders dominate is two, but it is also estimated that the sector uses 40,000 – 70,000 temporary workers in factories and fields. Therefore, a rough estimate of direct and indirect jobs could be 150,000, with an additional 200,000 family member beneficiaries.[94]

Green beans are a good source of foreign exchange earnings for the country, and well organised smallholders can make a reasonable profit. The sector has a strong development impact:

[91] Kaplinsky, R. and Morris, M. (2001) *A Handbook for Value Chain Analysis.* Ottawa: International Development Research Centre. http://asiandrivers.open.ac.uk/documents/Value_chain_Handbook_RKMM_Nov_2001.pdf

[92] See Romei, V. and Cocco, F. (2018) Can UK trade with Africa start to fill gap left by Brexit? *Financial Times* [Online] 29 August. [Accessed 15 October 2018] https://www.ft.com/content/600603dc-aaac-11e8-94bd-cba20d67390c

[93] See European Commission (2018) Green beans value chain analysis in Kenya. *Value Chain Analysis for Development* No.4. Brussels: European Commission. https://europa.eu/capacity4dev/value-chain-analysis-for-development-vca4d-/documents/vca4d-brief-4-kenya-green-beans and SNV – Netherlands Development Organisation (2012) The Beans Value Chain in Kenya. August. Amsterdam: SNV. http://www.fao.org/3/a-at264e.pdf for excellent summaries of the value chain and its development impact.

[94] Temporary work income would not be sufficient income for an individual; also most smallholders multicrop with green beans being a valuable cash crop primarily for export.

- There are two main groups of industry beneficiaries: (1) Small scale producers who grow relatively small amounts of high quality bean, some 60 percent of production, and primarily for export, and (2) an informal and casual workforce that supports the labour intensive production in this sector.
- Women benefit from employment as they carry out most production and processing activity, and constitute roughly 80 percent of the workforce, giving them a degree of financial independence.
- Returns from small scale rural production (as with tea in Rwanda) benefit the local economy, and are typically invested in children's education, health care, housing and small businesses around the farm (not least because women are the primary workers/earners in the sector).

There are some risks to the value chain. First, there is a need to control the use of pesticides since the key end markets are sensitive to this. Second, there is a slight trend towards larger scale production, even though the best beans are produced on small farms, and those farms have a strong development impact.

The green bean sector and value chain is important economically for Kenya as an exchange earner, but also for its significant development impact. Supporting interventions would be useful to:

- promote communication on, and compliance with, destination market food safety regulations;
- invest in outgrower schemes, and to help smallholders work together through cooperatives, for example, to achieve more efficient collection and distribution, and so capture extra value added.

Box 10: Garments from Myanmar[95]

The Myanmar garment sector has expanded rapidly since sanctions were lifted in 2013, and sector exports have grown from $340mn in 2010 (primarily to Japan) to $1.6bn in 2016. The Myanmar Garment Manufacturers Association (MGMA) says the industry has a mixture of around 420 domestic, joint venture and foreign-owned firms employing around 300,000 workers, 91 percent of whom are female. MGMA confidently assumes that, with the reinstallation of US's Generalised System of Preferences (GSP) and other preferential trading arrangements, by 2020 exports will grow to $12bn with sector employment of 1.5 million workers. The potential development impact is significant.

Myanmar is wage-competitive at a $80 monthly average wage in 2016, higher than Bangladesh but lower than Vietnam, Cambodia or China. The problem with the garment value chain is that it is often tightly controlled by "transnational agents", mainly of mainland Chinese origin, who lock locally owned firms into the most basic manufacturing niche – Cut-Make-Package (CMP). Agents have full control of the value chain, with little incentive to pass on much information to local producers beyond the sample provided to replicate. Supply linkages mostly happen outside of Myanmar, limiting spillover impacts. That said, Chinese agents do help local firms achieve the working conditions and social upgrading required by Western lead firms. Local owners do not normally have direct interaction with international buyers except through the occasional donor-sponsored programme. Foreign-owned or JV companies have a slightly more advanced manufacturing model, capturing slightly more of the value chain, and with greater prospects for firms' process upgrading.

The current development impact of the garment sector is large, and could be enormous.

- Current employment of 300,000 (91 percent female), potentially rising to 1.5 million by 2020.
- Significant remittances to rural areas from workers at factories in urban areas
- Transmission of higher social, labour and environmental standards to the extent that firms can link into European and American markets (e.g. H&M, C&A, Adidas, Gap, Marks and Spencer, Primark), which demand better working standards and higher social and environmental compliance than Asian counterparts.

[95] See El Shahat, S. and di Canossa, Violante (2018) Opportunities for Sustainable Development in Global Value Chains: A Case Study of the Myanmar Garment Sector. *Inclusive Economic Transformation.* January. https://www.ictsd.org/sites/default/files/research/sustainable_development_in_global_value_chains-myanmer_garments.pdf for an excellent investigation of Myanmar's garment sector, on which this case study draws.

- EU buyers can contribute to functional upgrading moving from CMP to FOB, thereby upgrading industry skills.
- Female employment is significant and extends up into senior management positions.

In view of the sector's potential economic contribution and development impact, the sector will benefit from:

- Consolidating preferential trading arrangements, and receiving technical assistance to meet social and environmental compliance standards;
- Further integration into value chains especially with European buyers; donor programmes can play a role in this;
- Participants in Value Chain need to engage and dialogue more; industry level technical and design capacity enhancement is needed
- Improvement of soft and hard infrastructure, including some laws and regulations and infrastructure. A GVC-focused three level (firm, industry and IC) reform and technical assistance offering along the lines of the proposed PSD Support Matrix (Chapter 4) would work well.

Capital Goods Export

Exporting capital goods to developing countries without investing in the developing country is another way of achieving development impact, and can build strong bonds between the exporting and receiving country. The export of typically higher tech capital goods, such as wind turbines or solar power equipment is often accompanied by installation, maintenance or other contracts. The UK has a vibrant renewable energy sector exporting to other developed as well as developing countries. Two UK solar power companies are achieving development impact in Africa in different ways (Box 11: Two UK Solar Power Companies).

Box 11: Two UK Solar Power Companies

Northumbria Energy accompanied the UK Prime Minister on her August 2018 tour of Africa. The company from Newcastle provides a turn-key smart mini grid solution, and has partnered with a South African firm, Smart Grid Networks, to distribute and install the product in South Africa and SSA. It provides hardware, software, and payment solutions to create off grid energy generation, storage and distribution networks. Most recently they have also partnered in setting up an Energy Skills Academy in South Africa (with UK Government Prosperity Fund funding), which will train students to support the emerging "smart energy" sector covering smart metering, smart mini grids, and energy storage systems.[96]

The potential development impact is enormous, with the company envisaging a production roll out from South Africa, and the ability to train South African engineers, and in due course installation and maintenance teams from around the continent.

BBOXX is a UK-based solar power company started in 2010 to provide grass roots solar power solutions.[97] It produces solar kits for families and individuals, and larger installations for small communities. Products are designed and engineered in the UK, manufactured in Guangzhou (China), and distributed in Africa. BBOXX owns subsidiaries in Kenya, Rwanda, Sierra Leone and Uganda, which sells products directly to consumers through a branch network. Most sales are of individual solar kits to families of 5 people. The development impact is substantial and delivered at the grass roots level.

[96] See Wayman (2018). Also, www.northumbria-energy.com

[97] See BBOXX corporate brochure: BBOXX (2014). http://www.bboxx.co.uk/wp-content/uploads/2014/10/NEW-COMPANY-BROCHURE-website.pdf

- As of September 2018 over 150,000 systems had been delivered, primarily on payment plans, and had benefitted over 700,000 people, and operations continue to expand rapidly.98
- A study commissioned in Uganda found customers achieved 2 extra hours of lighting per day on average, thereby increasing business or study productivity.
- A key part of the solution is the payment plan system. Average savings of $17 per month from using the BBOXX solarkit easily supported the payment plan on offer, before additional productivity benefits were considered.
- Seventy-one percent of surveyed households benefitted from additional income averaging $49 per month, money that is typically spend on food, healthcare or education.

The key to BBOXX's success and development impact is the solution on offer. It is designed to be affordable based on household payment plans, and a grass roots retail distribution system has been put in place. The development impact on rural communities is substantial.

Summary

All three forms of business transaction with developing countries can have substantial development impact. The case studies selected here offer some important lessons.

- Host government proactivity is normally essential to attract beneficial investments and avoid others, as is aftercare to make sure investments survive and prosper.
- Donor organisations can support direct investments and value chains through, for example, helping to establish training facilities alongside investments, offering good practice on qualifications / standards, or helping with the upskilling of tea smallholders.
- Donor organisations can play an important role in opening their own country markets, or by strengthening or facilitating regional markets. Thus, technical advice in agricultural markets helps to ensure health and safety standards, and regional/international market access, thereby ensuring growth and sustainability for hundreds of thousands of smallholders.
- Donor organisations can work to identify developmental investors, and work with them to expand in new countries.
- DFID could also sponsor competitions for innovative capital goods or solutions exporters. Indeed, it is the "solutions" that are often more important than the product.
- Donor organisations need to work closely with business to work out how to invest and partner overseas with both commercial viability and development impact in mind. DFID already does this with many companies, but looking to smaller companies, perhaps in the context of trade advice, and partnering with them to identify and realise multiple new opportunities, has significant potential.

[98] See BBOXX blog post of 25 September 2018: BBOXX and GE partner to provide energy access in the Democratic Republic of Congo. http://www.bboxx.co.uk/2379-2/

Annex 2: Tools for Diagnostics

	IFC WB CPSD	Hausmann Product Space	ODI Transformation
Key Reference	Creating Markets in Ghana, Country Private Sector Diagnostic November 2017	Structural Transformation and Patterns of Comparative Advantage in the Product Space, August 2016.	Supporting Economic Transformation, March 2017
Summary of methodology	Scan of sectors to assess their "desirability" (potential impact on development) and their "feasibility" for rapid growth now and within 5 years. "Deep dive" analysis of sectors which score highly.	Focuses on the evolution in the sophistication of exports. Speed of transformation from simpler to more sophisticated exports is determined by "density" of product space i.e. how close the new products are to the existing products. Distance between pairs of products is measured by the probability of a country exporting both products.	'Economic transformation' comprises structural change – moving from low productivity sectors to high productivity sectors; and productivity growth within sectors is due to technology and organisational improvements. This is measured through 1. Economy wide changes in labour productivity; 2. Firm-level changes in productivity; and 3. Export diversification, value chains and value addition.
Key inputs into the Analysis	• Definition of sectors • Scoring for desirability and feasibility factors from 1 – 5 • Weighting applied to the 6 indicators of desirability • Social accounting matrix based multiplier models to assess forward and backward linkages of a sector	• Examination of product density depends on data around product exports currently, and products which have high density to existing products which indicates a direction of travel for transformation into new products.	• National accounts data by sector • Employment data by sector • Productivity by sector • Rates of productivity growth within and between sectors • Firm level data on productivity • Export domestic value added • Export composition
Analytical Frameworks Used	• Desirability analysis to identify the potential development impact of sectors. • Assessment of current sector performance • Feasibility analysis to identify scope for progress in the short and medium term • Product complexity analysis to help assess likely sector contribution to a country's complexity	• Measurement of "distance" between products based on the probability of a country exporting both products • Revealed comparative advantage probability analysis based on proximity analysis • Prediction of pace of structural transformation based on density of potential new goods in relation to current exports	• Value added/productivity • Sectoral transformation • Export diversification, value chains and value addition • Revealed comparative advantage in export products • Likely product space diversification • Domestic content (value addition) of exports

	IFC WB CPSD	Hausmann Product Space	ODI Transformation
	• Social Accounting Matrix-based multiplier models to assess likely forward and backward linkages from a sector • Binding constraints analysis/benchmarking to understand sectoral constraints.	• Analysis of country performance over time can suggest whether growth is above or below expectation given the density of the product space in a country.	• Haussmann Product Space analysis of exports
Objectivity in the analysis	• Scoring matrix for desirability is based on objective measures of country performance based on IFC databases of country performance. • Cross country benchmarking helps to identify binding constraints for particular sectors in a more objective way. • Methodology leads to a common basis to identify sectoral priorities.	• Distance between products is measured objectively.	• Methodology includes quantitative analysis based on national accounts and enterprise surveys, as well as export basket composition.

Annex 3: Development Finance Institutions

There are 17 bilateral DFIs, and seven multilateral ones according to OECD monitoring and research.[99]

- Bilateral DFIs have often sought to promote investments by national companies in developing countries, and for many that is still the main focus – for example Denmark's IFU. Bilateral DFI activity is largely separate from the country's Development Agency work.
- Multilateral DFIs had a much clearer development mandate, but this is largely expressed as having no national bias for the foreign investors they supported. They began with concessional loans to multinationals that might not have invested otherwise in developing countries, and then moved into equity. Many countries had local ownership requirements and local partners often had to be involved for that reason, but multilateral DFI stakes were notionally considered "local", and so their involvement was frequently sought. Local development impact was largely assumed rather than being the subject of specific technical support.

A brief overview of the approaches of four DFIs is instructive, and provides some ideas for future investment support involving DFIs.[100]

International Finance Corporation (IFC), a member of the World Bank Group, was established in 1956, and has seen its role evolve. It has been at the leading edge of innovation on the investment side, but as noted in the IEG IC report,[101] its collaboration with the IC work of the IBRD has been ad hoc. IFC provided loans for Korean development in the 1970s, and in 1976 it funded its first SME finance project for $2mn in Kenya.

As IFC moved into IC work, there was a tendency for the investment activities to have limited coordination with investment advisory activities. For IFC/WBG, advisory work was often the entry point, but it aspired to leverage investment. However, investment teams acted independently, and sourced only deals they considered viable. Under IFC 3.0's market systems approach from 2018, investment and advisory services are intended to be much more integrated: advisory services will be guided by IFC's strategy, which is investment driven, and IFC will "systematically coordinate advisory with investment and policy advice to create the upstream conditions for market creation, while also building a near-term investment pipeline and improving client performance".[102]

EBRD has taken a different approach, which is investment-driven, drawing increasingly on advisory services to improve viability in fragile contexts, or to spread the benefits of investment. EBRD was founded in 1991 as an investment bank for the reconstruction of

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[99] See: http://www.oecd.org/dac/stats/development-finance-institutions-private-sector-development.htm

[100] More information on the full range of DFIs can be obtained from the OECD website, and from the individual DFIs listed there.

[101] IEG 2015.

[102] IFC 3.0, pp.9-10

Eastern Europe and the Former Soviet Union. Gradually it evolved into a more recognisable development bank with an emphasis on environmental and other safeguarding issues as part of project implementation. From around 2011 it strengthened its credentials as a full DFI, setting up a variety of advisory facilities funded both from bilateral donor contributions and internal shareholder funds.

- For example, the EBRD's South Eastern Mediterranean[103] Multi Donor Account was established in 2012 to finance activities in priority sectors in the MENA region. These included pre-investment capability assessments for the water sector in Jordan, bid document assistance for major infrastructure projects, and skills training and inclusion activities for projects once invested (with benefits to the wider sector).[104]
- The EBRD's Ukraine Stabilisation and Sustainable Growth Multi-Donor Account was set up in 2014 to help Ukraine reform its economy, improve its business climate, and restore sustainable growth.[105] Flagship supporting interventions include: the Business Ombudsman, Ukraine Reforms Architecture, and the ProZorro Public e-Procurement system.

The fundamental principle of EBRD's advisory work is that it is delivered around a viable investment, or to render a target investment viable. Field offices are typically managed by investment professionals, who work to identify or create viable deals. In the early days of EBRD's emergence as a full DFI it was often difficult to get field offices to focus on developmental outcomes, but that quickly changed. The Multi Donor Accounts (MDAs) deliver the full range of support interventions from the individual firm level to the national business environment, and focus both on target investment viability, and spreading the benefits. Both DFID and FCO are contributors to these MDAs. This approach has proven very successful.

<u>CDC</u> was established in 1948 to "do good without losing money". The balance of CDC's portfolio has shifted across debt, direct equity and intermediated equity (VC funds) over the years. In 2012, CDC reengaged in direct equity, and in 2017 its portfolio was 52 percent intermediated equity, 38 percent direct equity and only ten percent debt.[106] The portfolio remains very Asia heavy (India and China together are 40 percent of the portfolio). However, 2018 has seen a new strategy of geographical shift and major recapitalisation, primarily towards Africa, and a new vision to become "the most developmental DFI: tackling market failures that hold back development such as access to medicines … supporting women's economic empowerment…"[107] As part of its new strategy, CDC has set up an Impact Fund

[103] SEMED is EBRD's term for the MENA Region, where its countries of operation are currently: Morocco. Tunisia, Egypt, Jordan and Lebanon.

[104] https://www.ebrd.com/news/2018/ebrd-helps-boost-tourism-and-hospitality-sector-in-jordan.html

[105] https://www.ebrd.com/who-we-are/our-donors/multi-donor-funds.html#semed

[106] https://www.cdcgroup.com/en/our-investments/key-data/

[107] See https://www.cdcgroup.com/en/about/our-history/

and an associated technical assistance facility (TAF), and now "CDC Plus" in its latest manifestation.. The Impact Fund TA facility with £40 million available, and a quarterly technical oversight committee, sought to provide TA to cover what standard fund management fees cannot cover.[108] CDC's TA activity should focus on enhancing the viability of investments, or spreading the benefits, ranging from firm-level support to strategic system-wide initiatives. CDC and others can take lessons from the EBRD model, but strengthen the active oversight and strategy dimension.[109] As of 2018, CDC has also begun setting up a network of field offices, along similar lines to EBRD.

DFID is committed to using CDC as part of its investment-side, development capital strategy, using intermediated and direct equity, and debt. CDC is active in Kenya[110] in both forms of equity, for example. Its recent direct equity investment in ARM Cement has run into significant difficulties,[111] although CDC and IFC (the main co-investor) are committed to a successful outcome. Meanwhile, CDC is also invested in VC Funds in Kenya[112] such as Novastar Ventures, where it was an anchor investor of around $15 million in the first Fund (2014) of $80mn, and again in the second fund soft closing in October 2018. Novastar is firmly focused on socio-economic equity and maximizing developmental impact, and in turn provides firm-level financial and technical assistance to investees.

Overseas Private Investment Corporation (OPIC) (USA) is another bilateral DFI, which is reviewing and expanding its mandate.[113] Originally set up to provide primarily debt finance to overseas investments with a US shareholder, it has been criticised for cherry-picking profitable investments that might have happened anyway, and not being "additional". The latest 2018 reorganisation of US development finance means that the new OPIC can provide guarantees, invest in equity as well as debt, and no longer requires a US shareholder. It is moving from the bilateral fold to the multilateral fold, rather like CDC. There will also be pressure to do more developmental investments in due course, perhaps, and competition for more viable projects in low income and fragile countries can only increase. There will be a greater need for technical assistance, both at the firm level and to support industries and sectoral markets, as well as to spread the benefits of private investment.

[108] See: http://www.theimpactprogramme.org.uk/the-impact-programme/

[109] The EBRD's MDA technical assistance strategy has generally been demand driven, but since 2017 a few specialty windows (e.g. gender and inclusion) have started to make the MDA's interventions more strategic.

[110] CDC made early investments in Kenya in the 1970s, and also provided technical assistance in 1976 to IFC's first investment in Kenya, a $2mn load to the Kenya Commercial Bank to support SMEs.

[111] See, "Failed Kenya Investment Throws Doubt on Aid Strategy", *Financial Times,* 23 August 2018.

[112] See http://www.theimpactprogramme.org.uk/investments-dfid-impact-fund/

[113] See, https://fas.org/sgp/crs/row/R45180.pdf for a Congressional Research Service review from 2018 on the proposed reorganisation of US development finance, and a review of other bilateral and multilateral DFI arrangements.

Annex 4: Field Case Study Summaries and Lessons

Rwanda

Overview

Rwanda is a fast growing landlocked member of the East Africa Community with a population of 12 million. From 2000-14, GDP per capita increased from $242 to $730 and poverty has declined from 60.3% of the population to 39.1%. Rwanda's IC is ranked 2nd in Africa after Mauritius according to the World Bank's *Doing Business.* FDI inflows rose from $103m in 2008 to $342m in 2016. The Government of Rwanda recognises the need to transition away from the state-driven model of development that was essential in the post-Genocide chaos. The IC is now strong, and it is time to begin more proactive facilitation of investments, and support subsequent operations.

IC and Investment Activity

IC Major IC reforms have been undertaken, including the establishment and mainstreaming (to cabinet status) of the Rwanda Development Board (RDB), upgrading the Investment Code (2015), reforms to promote new sectors (including MICE - Meetings, Incentives, Conventions, Exhibitions, and ICT), rapid expansion of industrial / export processing zones, and land reform, in particular. Agricultural input programmes were particularly important (funded by DFID, and implemented by IFC).

Investment Activity. Turnkey infrastructure investments based on loans have been substantial, but also privatisations. PPPs have been used, but more are needed, along with the transaction advice to support them. There are many examples of de-risking or hybrid investment activities. PIDG's role in de-risking[114] the KivuWatt Lake Kivu methane power investment was catalytic. Also, in the agriculture sector, the establishment of a service company to run a factory and do extensive smallholder capacity building was essential to realise Rwanda's two biggest commercial agriculture investments in the tea sector - €55m by Unilever, which in turn leveraged another $27m investment by Luxmi Tea from India. Major investments and sector expansion have been seen in broadcasting and banking.

Inclusion Benefits: Women, youth, rural development, and MSMEs have all benefitted substantially from both IC and hybrid / de-risking investment activity.

Sector Examples

MICE (Meetings, Incentives, Conferences, and Exhibitions): Tourism was identified early as a key sector, but Rwanda needed to diversify beyond gorilla tourism. MICE (conference-type tourism) was selected, and pursued with mega projects such as the Kigali Convention Center, Rwandair Privatization, and a new international airport at Bugesera. The IFC Governance for Competitiveness project, and WB TA to Tourism and Conservation provided significant support. Kigali now ranks as the 5th ranked MICE city in Africa, with rapidly expanding revenues. Although a relatively new part of the overall Rwandan economy, MICE

[114] "De-risking" means reducing the risk to the investor by providing finance, technical advice, information, or other support to the investor.

can be significant in terms of the growth the tourism sector itself, taking it up-market and reducing the risks faced by the sector. This can generate foreign exchange and jobs.

Policy Implications

Donors should shift away from stand-alone IC programmes. Rwanda should graduate from business environment reforms, transaction support, packaging of bankable projects, towards investor tracking, and aftercare, (where Rwanda has the advantage of good intra-governmental coordination).

Rwanda recognises that its FDI strategy has to shift to focus on packaging and de-risking investment opportunities. On the investment side, project de-risking and patient capital are much needed, and have a track record: e.g. tea factories and PIDG KivuWatt engagement, where the PIDG TAF was able to provide viability gap funding to reduce up-front costs. More focus on MSME enterprises is needed, and on de-risking agricultural investments.

Kenya

Overview

Kenya is the leading member of the East African Community, with a population of 50 million, where per capita GDP has risen from $404 to $1335 over 2000-14. Kenya's IC has improved rapidly in recent years, ranking 3rd in Africa and 61st globally in Doing Business 2019. FDI flows have fluctuated considerably but recovered to $672m in 2017.

IC and Investment Activity

IC. Kenya has undertaken significant reforms in recent years, as lauded by *Doing Business* reviews, including in financial services, rules of origin and certification, and competitiveness. Kenya benefits from a variety of bilateral assistance programmes, including the major KCEP competitiveness programme of the World Bank (significantly funded by DFID). There is a variety of transaction support / facilitation through the multi-donor Trade Mark East Africa (TMEA) and others. The USAID-funded East Africa Trade and Investment Hub provides regional market and trade-related advice. Kenya's move to an investment focus is paying dividends with, for example, Bangladesh Square Pharma investing $75m in one of Kenya's Export Processing Zones supported by the WB's investment policy and SEZ work. Incentive packages purport to be non-discretionary, and are mainly SEZ focused, but power generation offtake prices for new energy projects are typically negotiated.

Investment Activity. Kenya's FDI inflows have been relatively small compared with other countries and the size of the economic opportunity. FDI declined from a peak of $1.45bn in 2011, down to less than a third of this sum five years later ($393m). This increased in 2017 with $672m in receipts, attributable to buoyant domestic demand and inflows into ICT industries. Kenya's FDI performance remains underwhelming compared to regional peers. Even though overall FDI has been on the decline, the private equity segment is growing. Kenya is benefiting from a renewed interest by investors into the East African region. Europe and North America continue to lead as sources of funds raised for PE investing in East Africa. Pension funds are an increasing source of investment.

Inclusion Benefits: Much activity is Nairobi focused, but WB's sub-national *DB,* and DFID's new focus on 11 counties are changing this. Meanwhile, VC / patient capital activity has a strong inclusion focus in areas such as sanitation, health, green energy and education (e.g. Bridge International and other investments through Novastar Ventures).

Sector Example

Textiles and Garments. Textiles and garments are major sectors in Kenya. The milling part of the value chain operates at low capacity (45 percent). There are an estimated 74,000 micro and small companies, and 170 medium and large companies in the textiles and garment sectors. Over 40,000 people are employed in garment operations just in the EPZs. Efficient border compliance procedures are seen as an advantage.

Policy Implications

In the Kenya context, there should be a stronger focus on crowding in private finance for development objectives. DFID can explore supporting this approach by working with the private and public sectors.

Improving the quality of competition policy and practice becomes important when DFIs trend towards providing investor-specific facilitation. This is important as a safe-guard to ensure firm rivalry, an important aspect of country competitiveness.

Investor aftercare should be a core part of investor facilitation. Aftercare services and systems are needed for domestic and foreign firms. PPP capacity building is needed via Ministry of Finance, but also in line ministries, and county governments.

South Africa – Western Cape

Overview

South Africa has a population of 57.7m with a national GDP for 2016 of $209bn, or $3,622 per capita. The Western Cape has a 6.6m population, and is more prosperous than the national average, with a regional GDP of $29.3bn for 2016 (14 percent of national total), for a per capita GDP of $4,439. South Africa has a *Doing Business* 2019 ranking of fourth in Africa, and 81nd globally, but is behind Kenya and Rwanda on many sub-indicators. Perceptions and rankings by *DB* and others have been declining in recent years. South Africa has an unemployment rate of 28 percent and poverty incidence of 40 percent. The South African economy has moved into recession in 2018. FDI showed a net outflow of $12.5bn over the 2014-17 period. The Western Cape is the second province after Gauteng for FDI, with significant infrastructure advantages, like major ports and airports. Investment inflows and project numbers, however, have been declining since 2013. In the Western Cape, the key target growth sectors are tourism, oil and gas, agro-processing and green economy.

IC and Investment Activity

IC. Businesses see the regulatory environment as difficult, and the broader business climate as weak in education and skills, inefficient state-owned enterprises (SoEs), limited competition, and corruption. Although Western Cape has an above average income, it suffers from the national trends in IC issues, and declining FDI and broader investment performance.

The IC has been weakening according to *DB* and other indicators: unreliable energy supply, fluctuating exchange rates, security risks, political instability and drought. Issues are reported to national government for handling through the One Stop Shop based at Wesgro (the regional IPA), although issues such as electricity connections and construction permissions are dealt with by municipal authorities and regional government.

Investment Activity. Wesgro focuses on facilitating deals through FDI, rather than reforming regulations. Wesgro secured 18 investment projects in 2017/18, creating 2,426 jobs. Manufacturing was the largest sector for FDI followed by agribusiness and the green economy. Agribusiness created the largest number of jobs (1,412) followed by manufacturing (395).

Inclusion Benefits: Inclusive growth has been largely elusive - South Africa has a very unequal society. Wesgro provides facilitation support and aftercare to prospective and existing investors, who in turn have initiated social improvement programmes within their local communities. The Western Cape Government funds skills development and SME development programmes with a strong inclusion theme e.g. aimed at previously disadvantaged groups. Most of these programmes are aimed at businesses in general rather than at foreign investors.

Sector Examples

There is no explicit role for Wesgro (the Western Cape's investment promotion agency) in sectoral transformation, although **agro-processing, oil and gas, tourism** and **green energy** are priority sectors because of their historical importance as contributors to job creation and regional GDP (agriculture, tourism) or their growth prospects (oil and gas, green energy). Secondary sectors for support are business process outsourcing, film production, ICT, manufacturing and private healthcare. These priority sectors will "change the trajectory of economic growth and job creation in the Province."

Policy Implications

A contextual 'hybrid' investment policy – combining deals facilitation with Business Environment Reform is appropriate when the business environment is severely constrained and risk mitigation is a major component of the investment decision. Wesgro seeks to facilitate investments in focus sectors, but otherwise relies on national level incentive provisions. Wesgro's focus is on speed from investment approach to start up.

A successful approach to investment promotion does not necessarily involve transformative sectors, but is likely to engage with specific sectors which offer particular advantages. Wesgro has identified growth sectors but there is little evidence of cross-sector fertilisation and no explicit recognition of the agency's role in transformation.

HMG could play a role in arguing the case for engaging with full-scale monitoring and evaluation in order to create a development impact balanced scorecard with critical metrics across the inward investment landscape. There is a recognition by Wesgro and the Western Cape Government that impact measures such as female and youth employment and skills development are important political factors, but detailed intervention data is not currently being monitored and systematically reported.

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