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# Discussion Paper

## MOBILIZING PRIVATE FINANCE *for* SUSTAINABLE DEVELOPMENT

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## Discussion Paper

# Mobilizing Private Finance for Sustainable Development

## Abstract

The proactive engagement of the private sector was critical to accelerate the achievement of the Millennium Development Goals (MDGs). Inevitably, private finance will become even more central in the concerted effort to achieve the Sustainable Development Goals (SDGs) due to their ambition. Private investment decisions—in both the real economy and in the financial sector—should move the world towards the aspirations set out in the 2030 agenda. This means going far beyond philanthropy and voluntary corporate social responsibility, important though they are. It is a matter of steering the investment decisions that private actors make every day. In the context of the Financing for Development debate, this discussion paper reflects on the latest trends and makes recommendations to: 1. Establish an enabling regulatory environment for the private sector to invest in the SDGs; 2. Introduce “Smart” public incentives to fasten the realignment of private finance to the SDGs; and 3. Foster change in company and consumer behaviours to transition to inclusive and sustainable markets.

### Financing Solutions for Sustainable Development (online platform)

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See: [www.undp.org/content/sdfinance](http://www.undp.org/content/sdfinance).

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*Proactive engagement of the private sector was critical to the achievement of the Millennium Development Goals (MDGs). UNDP considers that the role of the private sector and private finance will become even more central in the concerted effort to achieve the Sustainable Development Goals (SDGs). Our organization works with companies—big or small—from a variety of sectors—water, energy, extractives, risk reduction, finance—to find common solutions to development challenges—from climate change adaptation to the response to Ebola—to facilitate public-private partnerships and to support on the ground the advent of an inclusive and vibrant private sector.*

## 1. PRIVATE FINANCE IS NEEDED FOR SUSTAINABLE DEVELOPMENT

Inevitably, the largest share of resources to fund the sustainable development agenda will come from the private sector. Given that the SDGs cannot be achieved through public finance alone, whether from domestic resources or Official Development Assistance (ODA), the challenge for governments will be to implement policies which serve to align larger amounts of these flows, from both public and private sector sources, with sustainable development aims. The challenge for the private sector is to move towards inclusive and sustainable business models without undermining profitability.

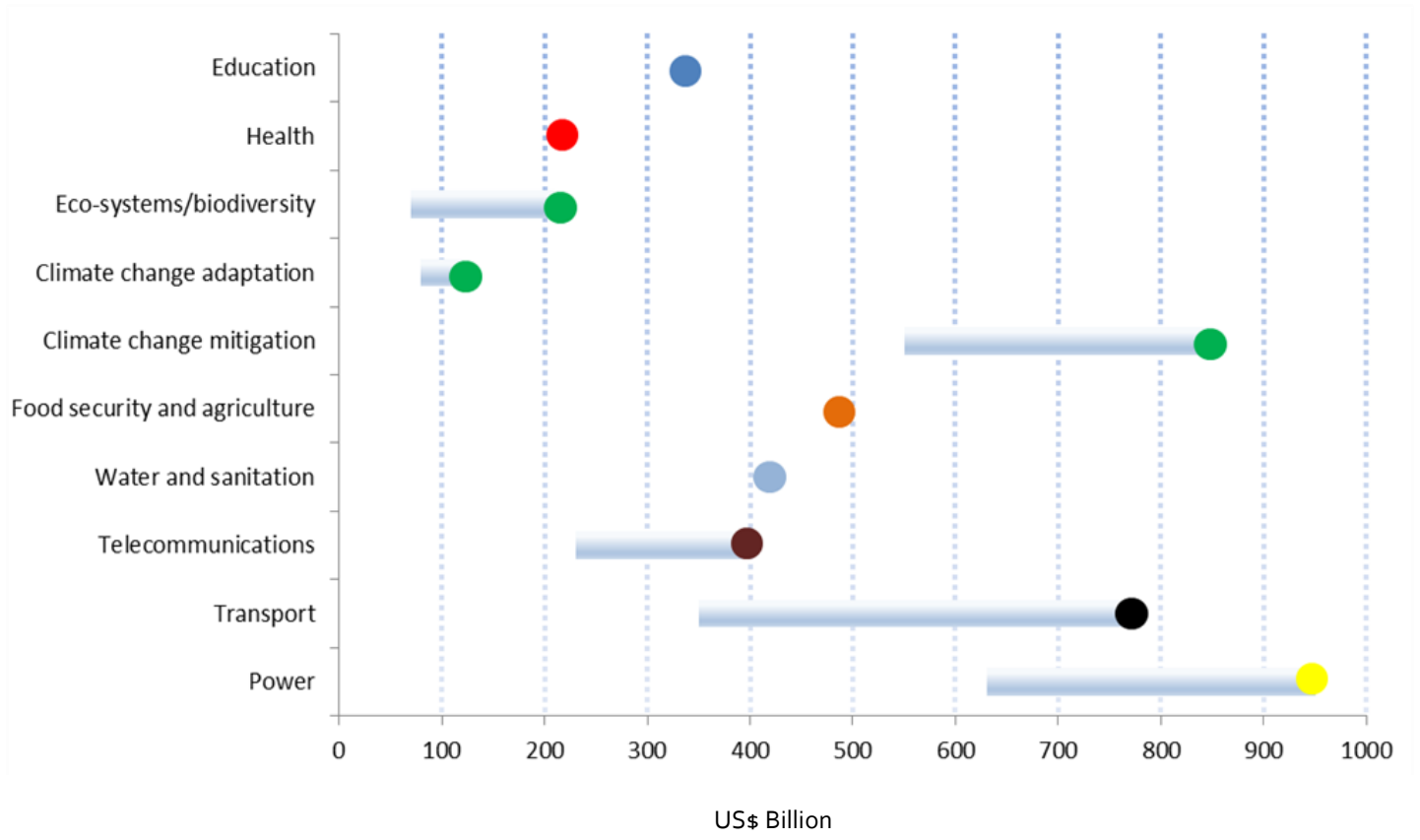
In the context of the Financing for Development debate, this paper reflects on the potential contribution of private finance—any financial means that could be made available by private individuals and corporations be it profit-making investments or donations to sustainable development. The 2030 agenda has been framed to tackle universal problems, from improvements in education and health, gender equality, to the fight against youth unemployment and the preservation of biodiversity, and attention is now focused on the means of implementation. This goes beyond identification of the sources of finance and encompasses broader issues such as policy choices at the national level and policy coherence at the regional and global levels, including on trade, tax and climate change. Policy trade-offs, capacities and technology are all important aspects of the current debate.

Developing countries will need support from the international community. UNCTAD estimates the midpoint of investment needs in developing countries at US\$3.9 trillion a year, with an annual investment gap of US\$2.5 trillion in sectors spanning education, health, biodiversity, climate change, food security and agriculture, water and sanitation, telecommunications, transport and power. These numbers point to the dimension of the challenge and dwarf levels of ODA, estimated only at US\$168 billion in 2013.

What is then the rationale for investing private resources in sustainable development? What is the business case for private sector engagement? What safeguards need to be put in place? We explore some of these issues. The next section will look at the sources, quality and direction of private finance. Section 3 will suggest an approach to align private finance with the SDGs and some recommendations will be featured in the conclusion.

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Figure 1: Estimates of investment required in SDG sectors in developing countries, 2015-2030 (US\$ billion)



Source: Author's calculations based on UNCTAD, *World Investment Report 2014: Investing in the SDGs: An Action Plan* (Geneva, 2014). Available from: [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf).

## 2. THE SOURCES, QUALITY AND DIRECTION OF PRIVATE FINANCE MATTER



Private financial flows to middle-income countries grew steadily over the past decade. Some low-income countries also attracted an increasingly diverse mix of flows, including from South-South partners and private aid providers. The emergence of new markets across all regions was driven by a rising middle class, technology innovations, trade and investment liberalization and the “search for yield”, in the context of prolonged low interest rates. These external flows have been outmatched in some instances by the growth of domestic investment, particularly in large middle-income markets.

### *There is no shortage of (private) capital across the world.*

There is a relative abundance of liquidity across the world. Global wealth (i.e. the accumulation of national savings over time) grew continually after the crisis, surpassing US\$250 trillion in 2014.<sup>1</sup> Between 2000 and 2010, domestic and foreign investments in developing countries quadrupled from US\$1.6 trillion, to US\$6.9 trillion, and, according to estimates, they could double again within the current decade. Outflows of resources from developing countries, both in the form of outward investment and repatriation of profits, also increased—to an estimated US\$0.7 trillion in 2012.<sup>2</sup> Volatility has also been amplified following the deeper integration of developing countries into the global economic system.

<sup>1</sup> Credit Suisse, Global Wealth Report 2014 (2014). Available from: <http://publications.credit-suisse.com/>.

<sup>2</sup> This sum excludes illicit financial flows (see Development Initiatives, 2015, Available from: <http://devinit.org/#/>).

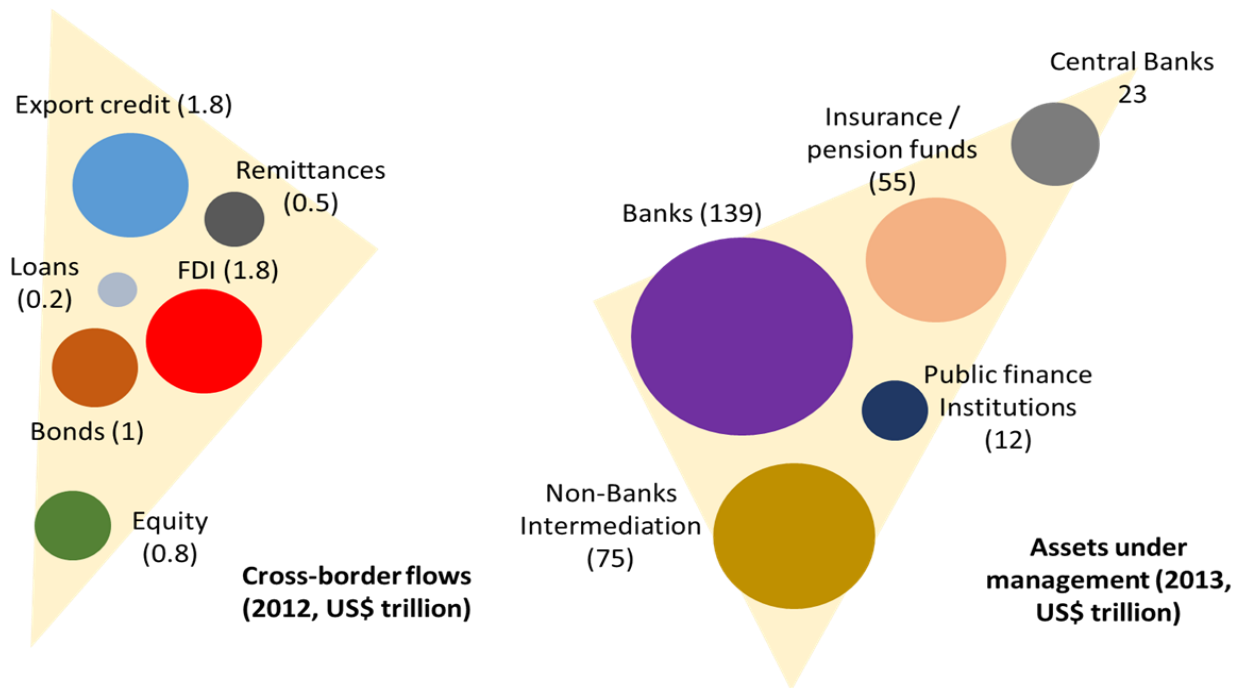
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National savings remain at the origin of wealth accumulation. Saving rates vary widely as a share of GDP depending on geographical and cultural factors, the rate of economic growth, financial deepening and the population pyramid. Before the nineties the savings rates in developing countries were lower than those in developed ones. This pattern changed in the nineties when high domestic savings in East Asian economies and oil-exporting countries in the Middle East brought developing countries' domestic savings rate (32 per cent in 2009) to a level double that of developed countries.

This accumulated wealth is still managed mostly by banks and non-banking financial intermediaries housed in developed countries and a few financial hubs in East Asia. Of the US\$68.3 trillion in assets under management by the world's top 500 asset management firms, the share of Asia—the largest emerging region—was only 9.7 per cent in 2012, of which about 92.5 per cent was managed by firms from Japan, Australia and South Korea.<sup>3</sup>

The distribution of wealth endowments reinforces the case for cross border flows. Figure 2 provides a snapshot of flows and assets held by the private sector. If insurance companies and pension funds are added, assets under management rise to an estimated US\$270 trillion while cross border flows are will be close to US\$9 trillion worldwide. Notably, the landscape is changing, with remittances quadrupling from 2000 and expected to surpass US\$500 billion by 2016.<sup>4</sup> Excluding China, the volume of remittances is already higher than Foreign Direct Investment (FDI) in developing countries. Crowdfunding could become a disruptive force, with an estimated US\$93 billion market by 2025.<sup>5</sup> Cross-border private aid (e.g. foundations, corporations, etc.) is estimated at US\$60-70 billion per year, while national philanthropy movements are growing rapidly in developing countries.<sup>6</sup>

**Figure 2: The landscape of private sector finance (flows and assets)**



*Note: export credit refers to new guarantee issuances.*

*Source: Author's calculations based on data from the Financial Stability Board, McKinsey and the Berne Union.*

<sup>3</sup> Rao, Vivek, [Developing the Financial Sector and Expanding Market Instruments to Support a Post-2015 Development Agenda in Asia and the Pacific](#), ADB Sustainable Development Working Paper Series No.36. (2015). Available from: [www.adb.org/sites/default/files/publication/155081/sdwp-036.pdf](http://www.adb.org/sites/default/files/publication/155081/sdwp-036.pdf).

<sup>4</sup> World Bank, Migration and Development Brief 25, Migration and Remittances, Recent Developments and Outlook, World Bank (2015). Available from: <http://pubdocs.worldbank.org/en/102761445353157305/MigrationandDevelopmentBrief25.pdf>.

<sup>5</sup> World Bank, [Crowdfunding's Potential for the Developing World](#) (2013). Available from: [www.infodev.org/infodev-files/wb\\_crowdfundingreport-v12.pdf](http://www.infodev.org/infodev-files/wb_crowdfundingreport-v12.pdf).

<sup>6</sup> UNDP, [Philanthropy as an Emerging Contributor to Development Cooperation](#) (2014). Available from: [www.undp.org/content/dam/undp/documents/partners/civil\\_society/UNDP-CSO-philanthropy.pdf](http://www.undp.org/content/dam/undp/documents/partners/civil_society/UNDP-CSO-philanthropy.pdf).

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The quality and typology of financial flows matter. In the quest to mobilize resources for development, it is not enough to focus only on the financial instruments that can raise more funds. Understanding where the investment gaps are, what the projects' capital requirements are and the business case that will allow profitable private sector engagement are crucial. Firms in developing countries, for example, need better instruments to (affordably) access private finance. The demand from Micro, Small, and Medium Enterprises (MSMEs) for early seed finance instruments is strong but unmet as only a few institutional and private investors are able to serve such a clientele with adequate products.

A move away from a focus on short-term capital returns to a greater emphasis on long-term profitability is also necessary.<sup>7</sup> Moreover, the shorter-term objectives of financial investors imply that many of the prevailing investment strategies are not well-suited to sustainable development. Given that banks, non-banking intermediation and institutional investors are managing the largest share of world resources, a debate on how to better balance the demand from developing countries with the supply is necessary. Reorienting a small share of the assets held by pension funds, insurance companies and large foundations' endowments—the latter in the USA alone is valued at US\$670 billion<sup>8</sup>—can help transform long-term finance in developing countries, as their investment objectives tend to be longer term. Pension funds in the North and the South can help address this gap, but they are held—justifiably—to provisions that limit their freedom to invest in riskier asset classes. Thus safeguards need to be put in place to reduce the financial risk profile of certain operations, particularly in infrastructure, to better match saving with investment opportunities.

Securing the mobilization and the prudent intermediation of private savings (including remittances) in developing countries will expand the frontier of available resources and will help to consolidate the financial sector in many developing countries where it still remains relatively small and undiversified. To this end, the establishment of investment vehicles, financial intermediaries and stock markets could be supported along with the capacity of market regulators. The emergence of project financing and venture capital in Africa should also be better studied to appreciate what needs to be done in frontier markets.

## *The direction of private finance is skewed to certain countries and sectors.*

For the first time global companies are investing more in emerging markets than in the USA, Europe and Japan.<sup>9</sup> A number of African economies, where development needs are the highest, are now considered among the fastest growing economies in the world. Any company with global ambition will have to invest in developing markets. Yet, private sector investment continues to be highly concentrated geographically and sectorally, mostly in resource-rich countries, extractive industries and capital regions.

Policymakers, development partners and investors interested in a larger role for private finance in development must recognize that it still predominantly flows towards higher and middle income countries and to bigger firms. UNCTAD estimates that only 1.9 per cent of global FDI reaches the Least Developed Countries (LDCs). In Africa, the resource-rich countries' share of total FDI—even if in decline—is estimated at 70 per cent.<sup>10</sup> The IFC's estimate is that only 15 per cent of MSMEs in the world have access to appropriate credit and other financial services.<sup>11</sup> There is no indication this pattern will change without regulatory reforms that can shift incentives for investors combined with an endogenous push within the global financial market.

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<sup>7</sup> Center for American Progress, [Report of the Commission on Inclusive Prosperity](#) (2015). Available from: [www.scribd.com/document/252423889/Report-of-the-Commission-on-Inclusive-Prosperity](http://www.scribd.com/document/252423889/Report-of-the-Commission-on-Inclusive-Prosperity).

<sup>8</sup> UNDP, [Philanthropy as an Emerging Contributor to Development Cooperation](#). Available from [http://www.undp.org/content/dam/undp/documents/partners/civil\\_society/UNDP-CSO-philanthropy.pdf](http://www.undp.org/content/dam/undp/documents/partners/civil_society/UNDP-CSO-philanthropy.pdf).

<sup>9</sup> Chakravorti, Bhaskar and others, [Growth for Good or Good for Growth?: How Sustainable and Inclusive Activities are Changing Business and Why Companies Aren't Changing Enough](#) (Citi Foundation 2014). Available from: [www.citifoundation.com/citi/foundation/pdf/1221365\\_Citi\\_Foundation\\_Sustainable\\_Inclusive\\_Business\\_Study\\_Web.pdf](http://www.citifoundation.com/citi/foundation/pdf/1221365_Citi_Foundation_Sustainable_Inclusive_Business_Study_Web.pdf).

<sup>10</sup> African Development Bank and others, [African Economic Outlook 2013](#) (African Development Bank, Organisation for Economic Co-operation and Development, United Nations Development Programme, Economic Commission for Africa 2013). Available from: [www.undp.org/content/dam/rba/docs/Reports/African%20Economic%20Outlook%202013%20En.pdf](http://www.undp.org/content/dam/rba/docs/Reports/African%20Economic%20Outlook%202013%20En.pdf).

<sup>11</sup> IFC and McKinsey, [Two trillion and counting](#), (2010). Available from: [www.ifc.org/wps/wcm/connect/3d5d09804a2d54f08c1a8f8969adcc27/Two+trillion+and+counting.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/3d5d09804a2d54f08c1a8f8969adcc27/Two+trillion+and+counting.pdf?MOD=AJPERES).



## 3. HOW TO ALIGN PRIVATE SECTOR FLOWS WITH SUSTAINABLE DEVELOPMENT



How can investment decisions be better aligned with the SDGs? Inevitably there will be trade-offs. While there are many complexities in pushing breakthroughs in financial markets, the logic is simple: private investment decisions should become more aligned with the aspirations set out in the post-2015 agenda. To that end, the debate on private finance ultimately becomes one about regulatory frameworks, smart incentives, and behavioural change, with the objective to achieve more inclusive and sustainable markets.

The needs and motivation of investors have to be clearly understood. There are several reasons why the private sector can outpace the public sector in investing in sustainable development. When there is a new market opportunity or a strong business case, investment will come, if the regulatory provisions allow it. The private sector can voluntarily embrace higher standards to anticipate or prevent the future impact of legislation as well as to enhance their brand's value. They can benefit from public incentives when the risks are too high and/or the returns are not in line with market expectations. Private investors can drive innovation and embrace social and environmental objectives—the defining characteristics of inclusive business<sup>12</sup>—in their day-to-day business, going beyond short-term profit considerations, as many pioneers have demonstrated. Lastly, companies, private households, and high-net worth individuals, can also extend philanthropic donations based on personal and societal moral and religious values.

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<sup>12</sup> Business that can significantly contribute to human development by including the poor in the value chain as consumers, producers, business owners or employees (“inclusive business models”), UNDP.

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The challenge appears when this realignment does not present a clear business case. In many cases a balance in the rewards-risk equation can be achieved from closer collaboration between the public and private sector. To realign investors' decisions with the SDGs and advance sustainable and inclusive markets a three-tier approach is suggested, made up of:

1. Sound design and enforcement of regulatory frameworks that prevent or mitigate the impact of harmful private investments and responsibly regulate the market where they can do good;
2. Smart public incentives that reduce the costs and/or re-profile the investment risk in the presence of market failures and accelerate the roll-out of private investment for sustainable development;
3. Changes in business practices and consumers' preferences that allow a better internalization of sustainable development objectives in daily operations of investors and the private sector.

## *BOX 1: Regulatory frameworks and private finance in renewable energy*

Climate finance underlines the role private finance already plays in achieving global goals. Private investors contribute about 60 per cent of the US\$331 billion recorded as climate finance in 2013. The large majority of private investment is allocated with an expectation of earning profit, being mostly investment in the mitigation category and particularly in the energy sector.

Public interventions can play a critical role in bridging viability gaps, reducing and transferring the investment risks that private actors are unable or unwilling to bear. With its de-risking methodology, UNDP is helping countries to quantitatively compare the cost-effectiveness of different public measures to promote investment in renewable energy. Research in Tunisia found that financing costs of renewables were high due to a wide range of investment risks. The "power market risk" category—i.e. power market regulation and the need for well-functioning, transparent contractual and pricing mechanisms for electricity—was identified as the biggest contributor to the higher costs of renewables. UNDP estimates for example that for wind energy, a package of public de-risking measures could result in wind energy's generation cost falling 23 per cent. UNDP is now supporting Tunisia in implementing these public interventions, with a focus on the regulatory framework.

Sources: Buchner, B. and others, *The Global Landscape of Climate Finance 2014*, (Climate Policy Initiative, 2015). Available from: <https://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2014/>. Information on UNDP's de-risking approach can be found at [www.undp.org/DREI](http://www.undp.org/DREI).

## *Regulatory frameworks.*

The call to mobilize private sector finance to achieve the SDGs should not be seen as (or become) an additional burden that makes doing business more difficult. Changes in regulations can also generate new business opportunities. An example is the establishment of protected areas and the business potential they create for tourism. Early estimates suggest terrestrial protected areas receive roughly 8 billion visits a year, of which more than 80 per cent are in Europe and North America, generating approximately US\$600 billion a year in direct in-country expenditure and US\$250 billion a year in consumer surplus. This is a market with high growth potential in developing countries.<sup>13</sup> This example shows how regulatory frameworks, e.g. the establishment of protected areas, can allow sustainable business to grow.

Regulatory coordination beyond national boundaries will be necessary to prevent a race to the bottom. The Montreal Protocol is a good example of how international law can successfully address global challenges. In 1989-2013, in addition to its main objective of halting ozone

<sup>13</sup> Balmford, A. and others, "Walk on the Wild Side: Estimating the Global Magnitude of Visits to Protected Areas", *PLoS Biol*, 13(2) (February 2015). Available from: <https://www.cbd.int/financial/values/global-tourism-pa.pdf>.

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depletion, the Montreal Protocol helped reduce cumulative CO<sub>2</sub> eq. emissions by 135 billion tons. This was achieved by encouraging private conglomerates in the refrigeration equipment sector to upgrade their technology and processes via new regulations and standards at the national level.

Similarly, increased cooperation on taxation could unleash resources for the SDGs. It is estimated that approximately 8–15 per cent of the net financial wealth of households is hosted in tax havens, with an estimated loss of US\$66–84 billion a year in public revenue in developing countries alone. In addition, owing to “transfer pricing” by multinational corporations, developing countries may be losing an additional US\$160 billion per year.<sup>14</sup> Closing these loopholes through better regulations and more meaningful cooperation with the private sector can free much-needed resources, which could be reinvested in SDGs sectors and tax abatements.

## *“Smart” public incentives.*

The “do no harm” principle, pursued mainly through regulations and standards, is not sufficient. Neither are business-friendly regulations. Enterprises might not have the resources to climb the technological ladder or they might do so at the expense of labour and quality of employment. To gain additional speed, regulatory provisions can be enhanced with smart public incentives aimed at correcting market failures and reducing the costs of compliance and investment risks connected to investing in the SDGs. ODA can support the poorest countries in the design and delivery of these incentives and in building the required management capacity in public authorities.

### *BOX 2: Reforming harmful energy subsidies is possible*

Reforming energy subsidies is a policy-charged exercise with multiple impacts across a country’s population. While not all attempts were successful, the literature suggests that unfavorable outcomes are more connected to the design of the subsidy reform than to its intrinsic merits. The IMF investigated 28 cases of subsidy reforms in developing countries for which sufficient evidence was available: 12 were considered successful, 11 partially successful and five unsuccessful.

Most recently, India has undertaken to reform its complex patchwork of energy subsidies. Taxes on petrol, diesel and coal are being progressively increased. While releasing the Economic Survey 2015, the flagship document of the Ministry of Finance, the minister affirmed that price subsidies were regressive and not benefiting the poor.

Sources: IMF, *Energy Subsidy Reform: Lessons and Implications* (2013). Available from: [www.elibrary.imf.org/page/120](http://www.elibrary.imf.org/page/120); GSI and IICSD, *India Energy Subsidy Briefing* (2015). Available from: [www.iisd.org/gsi/sites/default/files/GSI\\_NEWSLETTER\\_MARCH\\_WEB.pdf](http://www.iisd.org/gsi/sites/default/files/GSI_NEWSLETTER_MARCH_WEB.pdf).

The word “smart” stands to indicate that the experience with public incentives has been mixed and that caution is due in the design to prevent resistance and rent-seeking. Sometimes public incentives are in place, but they can work against the SDGs. Close to US\$500 billion is spent on harmful energy subsidies each year,<sup>15</sup> a share of which is transferred to private operators as direct or indirect transfers. Poorly-regulated tax incentives in Thailand have exacerbated the impact of the 2011 floods by favouring relocation of foreign investment in areas prone to flooding. Gradually reforming these schemes does not require new expenditures in the national budget, but the correction of distortions and a better incorporation of risks. The savings could instead be used to support tax reductions and other incentives for the private sector.

As private finance is intrinsically not structured to finance projects where social benefits exceed private returns, monetary and non-monetary incentives might be required to stimulate private investment. Direct subsidies in the form of tax credits or performance-based transfers can be disbursed in situations where social outcomes outperform profits. While these operations are common in developed

<sup>14</sup> UNCTAD, *World Investment Report 2014: Investing in the SDGs: An Action Plan* (Geneva, 2014). Available from: [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf).

<sup>15</sup> IMF, *Energy Subsidy Reform: Lessons and Implications* (2013). Available from: <http://www.elibrary.imf.org/page/120>.

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countries, extra diligence is necessary to guarantee fair conditions for all parties in developing countries, given that not all countries have equal capacities.

Governments can thus play multiple roles in incentivizing private finance: first, they can influence the direction of private finance through monetary and non-monetary incentives. The provision of services to MSMEs such as free and easily accessible information on prices and potential markets has proved its value.

## *BOX 3: Spreading agriculture market information in Ethiopia*

Accessing market information, a key element in running any business, is a significant challenge for firms in many African countries. Agriculture is a critical sector of an economy such as the one of Ethiopia. Though agriculture contributes 45 per cent of GDP, commodity sellers often go to the market with little or no information on prices. The lack of information and of functioning trading floors has traditionally impeded investments in agriculture. To address this challenge, the Ethiopian Commodity Exchange disseminates up-to-date, real-time market information to all market actors. With 17 delivery centres, 57 warehouses and traded volumes of 601,000 tons of commodities such as coffee, sesame, maize, wheat and pea beans, it generated a combined value of US\$ 5 billion in its first five years of operations. UNDP, USAID, DfID and IFC helped the commodity exchange to take off. Furthermore, UNDP is working with farmers and national associations to introduce more sustainable practices in the production of the coffee that is traded by the Exchange.

Sources: UNDP, *Private Sector Success Stories from UNDP Country Offices in Africa (2014)*. Available from: [www.undp.org/content/undp/en/home/librarypage/poverty-reduction/private\\_sector/private-sector-success-stories-from-undp-country-offices-in-afri.html](http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/private_sector/private-sector-success-stories-from-undp-country-offices-in-afri.html); UNDP, *Green Commodities Programme–Ethiopia National Coffee Platform*. Available from: [www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Green%20Commodities%20Programme/Ethiopia%20factsheet%20pdf.pdf](http://www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Green%20Commodities%20Programme/Ethiopia%20factsheet%20pdf.pdf)

Guarantees extended by the public sector—another category of public incentives—can help in a situation where investment risks cannot be properly assessed or absorbed by the market. The public sector, International Financial Institutions (IFIs) and Export Credit Agencies can extend guarantees and credit enhancement services to allow a broader set of investors to enter and compete in developing countries' markets. For example, the Multilateral Investment Guarantee Agency (MIGA) aims to attract more and better investors and private insurers into difficult environments. However, the MIGA's 2013 issuance portfolio of US\$2.8 billion is only a drop in the ocean. Most guarantees are extended over short-term export credit contracts. Export credit agencies issued new guarantees worth close to US\$2 trillion in 2013, but only 5 per cent of these cover investment deals (versus 86 per cent in short-term transactions).<sup>16</sup>

Second, the government can invest in combination with the private sector. While private capital is theoretically available for infrastructure investments, it might not be affordable and/or available at maturities that would sustain the required longer-term horizon. The need is well documented: spending on infrastructure in developing countries has to increase to US\$1.8-2.3 trillion each year by 2020. National budgets and ODA will not be sufficient to finance such an undertaking, but different investors can be called upon depending on their profile. In the early stages of infrastructure development, investment risks are higher and the role played by the government or IFIs to lower them is central, while further along, mature infrastructure projects can target institutional investors such as pension funds with long investment horizons.

Finally, over the last decade, there has been a proliferation in initiatives labelled as “innovative finance for development”, often taking the form of public-private partnerships that blend public and private capital. Research by UNDP identified case studies where the leverage ratio

<sup>16</sup> [Berne Union](http://www.berneunion.org/about-the-berne-union/) (2015). Available from: <http://www.berneunion.org/about-the-berne-union/>.

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of blended ODA/private investment can range from 57:1 to as much as 2,500:1.<sup>17</sup> Many have made valuable contributions to development, particularly in the health sector, but they remain small in scale and have failed substantially to increase the resource envelope for development. Additional research, capacity and political backing is required for scaling up.

## *BOX 4: Innovative finance*

Innovative finance has spurred new forms of public-private partnerships that has leveraged private sector resources. Given the relative scarcity of public funds, best practices and innovations on ways in which public and private finance can be blended should be researched and up-scaled. These include for example, the International Finance Facility for Immunization and the GAVI Matching Fund, debt swaps, crowdfunding, challenge and innovation funds, [social impact bonds](#), and [diaspora bonds](#). A few examples from UNDP's portfolio are profiled below:

- The Malawi Innovation Challenge Fund is a US\$8 million competitive mechanism that allocates grants to innovative projects proposed by private companies active in Malawi's agricultural and manufacturing sectors. Supported by the UNDP and UK Aid, the fund delivers social and environmental protection outcomes by blending ODA with private sector commitments to sustainable business practices.
- Project CAMbio works with over 20 financial institutions in Central America that to date have placed US\$41 million of credit to small companies and farmers. These credits have permitted soil conservation through planting and waste recycling, as well as through forest cover conservation and water source conservation. The project is led by the Central American Bank for Economic Integration with support from UNDP and the Global Environment Facility.
- Indonesia, the world's largest palm oil producer, is rolling out a UNDP-supported nationwide certification process to smallholder farmers, who produce about 40 per cent of the country's palm oil. The overarching objective is to improve agricultural practices through greater access to training and extension services, and protect the country's unique biodiversity.
- In collaboration with the Zoological Society of London, Social Finance and United for Wildlife, UNDP is designing a development impact bond which aims to secure much needed long-term finance to help protect rhinos from extinction.
- Established by UNEP, UNDP, and UNFPA, the UN Social Enterprise Facility is a second-stage social impact investment fund that will provide finance for social enterprises in Asia-Pacific that have a high-potential to scale. Beneficiaries will access a combination of incubation advisory and access to debt equity or grants.

Sources and additional information: [Malawi Innovation Challenge Fund \(www.micf.mw\)](http://www.micf.mw); [CAMbio \(http://arc-www.bcie.org/?cat=1006&title=Project%20CAMBIO&lang=en\)](http://arc-www.bcie.org/?cat=1006&title=Project%20CAMBIO&lang=en); [Indonesia \(Indonesia\)](#) and [Rhino bonds \(www.biodiversityfinance.net/sites/default/files/uploads/documents/5d\\_zsl\\_rhino\\_impact\\_bond\\_overview\\_cbd\\_16.10.14.pptx\)](#).

For more information on innovation and enterprise challenge funds visit:

[www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html](http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html).

For more information on social impact bonds visit: [www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html](http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html).

For more information on diaspora bonds and remittances visit: [www.undp.org/content/sdfinance/en/home/solutions/remittances.html](http://www.undp.org/content/sdfinance/en/home/solutions/remittances.html).

<sup>17</sup> UNDP, [Catalysing Ocean Finance](#) (2012). Available from: [http://www.undp.org/content/undp/en/home/librarypage/environment-energy/water\\_governance/ocean\\_and\\_coastalareagovernance/catalysing-ocean-finance.html](http://www.undp.org/content/undp/en/home/librarypage/environment-energy/water_governance/ocean_and_coastalareagovernance/catalysing-ocean-finance.html).

# MOBILIZING PRIVATE FINANCE

## *Behavioural change.*

Behavioural change in consumers and businesses is needed to transition to a more sustainable financial market that can allocate resources more equitably, effectively and efficiently.<sup>18</sup> If the objective is to improve housing conditions in a fast-growing metropolis, the construction industry might need to adhere to stricter building codes so that new buildings can, for example, better withstand fire hazards. This behavioural change is driven by the use of regulatory power. However, large parts of the population will still live in buildings that are not up to standard. Firms and households could be encouraged to invest in their properties to adjust to the new code with tax deductions for upgrades. This time a financial incentive is added to influence investors' behaviour, in this case property owners. One step further, an investor could capitalize a local enterprise researching a low-cost solution to the problem. In the latter example, the change is driven by a business on its own account. While a combination of the three is often necessary, the latter could be the game changer.

### **BOX 5: Business Call to Action (BCtA)**

Launched in 2008, BCtA aims to develop inclusive business models that promise both commercial success and development impact. Worldwide, 104 companies have already committed to improve the lives and livelihoods of millions through commercially-viable business ventures that engage low-income people as consumers, producers, suppliers, and distributors of goods and services. BCtA member initiatives include pledges to provide access to financial services for more than 57 million people, promote improved health outcomes for 50 million people, and enhance access to energy for 89 million low-income households.

*Source: BCtA is supported by Australia, the Netherlands, Sweden, the UK, the USA, and the UN Global Compact. It is hosted in UNDP. See UNDP, [Breaking Through: Inclusive Business and the Business Call to Action Today \(2014\)](http://www.businesscalltoaction.org/wp-content/uploads/2014/09/BCtAImpactReport_BreakingThrough.pdf). Available from: [www.businesscalltoaction.org/wp-content/uploads/2014/09/BCtAImpactReport\\_BreakingThrough.pdf](http://www.businesscalltoaction.org/wp-content/uploads/2014/09/BCtAImpactReport_BreakingThrough.pdf).*

On the supply side business pioneers and visionary leaders can set examples. L'Occitane en Provence sources shea butter from 15,000 women in Burkina Faso, exemplifying how a company that explicitly addresses low-income people's needs can bolster its own commercial success.<sup>19</sup> Google has invested over US\$1.5 billion in clean energy to balance the pollution generated from millions of users clicking on search links every day. Its "Googleplex" headquarters will run 100 per cent on renewable energy. Not to be outdone, Apple has announced an investment of US\$848 million on a solar farm to power all its operations in California.<sup>20</sup>

On the demand side, consumer education, media, trend-setters and civil society can play an even larger role by pushing the business sector to change in order to adapt to clients' demands. The campaign against tobacco, which only to a certain extent relied on regulations, enforcement and incentives, is an example where a behavioural change in consumers' preference was critical in achieving a public goal. The expansion of organic and fair trade is another good example. Consumer preferences and accepted behaviours can strongly influence markets and be a driving force for the alignment of private finance with the SDGs.

The objective is thus to shift business practices and market preferences to achieve a gradual internalization of the SDGs. While this shift should be accompanied by an enabling regulatory environment and—where possible—fiscal incentives, the private sector must play a leading role. Businesses and financial investors should not be seen only as providers of capital or as a "tax base", but as agents of change. Pioneers among large multinationals and smaller firms have demonstrated how profit and sustainable development can work together.

<sup>18</sup> Behavioural economics offers a scientific landscape of the drivers of behavioural change, building upon three decades of research from psychologists, economists, and market specialists.

<sup>19</sup> UNDP, [Realizing African Wealth](http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/realizing-africa-s-wealth--building-inclusive-businesses-for-sha.html) (2013). Available from: <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/realizing-africa-s-wealth--building-inclusive-businesses-for-sha.html>.

<sup>20</sup> See <http://www.greenbiz.com/article/google-inc-apple-inc-wind-solar-fossil-fuels-renewable-energy-economics>.

## *BOX 6: Impact Investment in Africa*

As a non-profit, Acumen transforms charitable donations into long-term debt or equity investments. The company finances work in traditional SDGs sectors such as agriculture, education, energy, healthcare, and housing. A to Z was Acumen's prime candidate to make long-lasting insecticide-treated bed nets for malaria prevention. Instead of a grant, Acumen provided a three-year loan with a 6 per cent annual interest rate. The initial contract also stipulated a royalty-free technology transfer of the nets from Sumitomo Chemical, and helped A to Z purchase new, specialized bed-net weaving machines. Once the viability of the market distribution strategy was validated, Sumitomo Chemical and A to Z each invested US\$ 7.5 million in follow-on financing to start a joint venture. In 2013, A to Z produced 30 million nets a year. Its staff of 7,000, who are mostly women, has made the company one of the largest employers in Tanzania. The report "Impact Investing in Africa: Trends, Constraints and Opportunities" by UNDP's African Facility for Inclusive Markets, profiles more examples and recommendations to advance impact investment in Africa.

Source: UNDP, *Impact Investment in Africa* (2015). Available from:

[www.undp.org/content/dam/undp/library/corporate/Partnerships/Private%20Sector/Impact%20Investment%20in%20Africa/.mpact%20Investment%20in%20Africa\\_Trends,%20Constraints%20and%20Opportunities.pdf](http://www.undp.org/content/dam/undp/library/corporate/Partnerships/Private%20Sector/Impact%20Investment%20in%20Africa/.mpact%20Investment%20in%20Africa_Trends,%20Constraints%20and%20Opportunities.pdf). For more information on impact investment visit: [www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html](http://www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html).

The number of socially and environmentally aware investors is growing, despite lack of incentives and limited regulatory provisions. During the 2014 Climate Summit investors committed for the first time to decarbonize US\$100 billion in investments. Institutional investors, including Europe's largest asset managers and pension funds, announced a partnership with the United Nations to reduce the carbon footprint of US\$100 billion of institutional investments worldwide and disclose the carbon footprint of investments worth US\$500 billion.<sup>21</sup>

Despite early-success stories, it is important to generate awareness of new business models that demonstrate the long-term profitability of working in ways that align business results with poverty reduction and environmental sustainability. Impact investment, i.e. an investment made with the intention of generating measurable social and environmental impacts in addition to financial returns<sup>22</sup>, offers one solution for the financial sector. In 2011, an assessment identified over 2,200 impact investments,<sup>23</sup> while fund managers reported a growing US\$46 billion worth of impact investment in 2013.<sup>24</sup> Furthermore, benevolent investors and foundations can help break new ground. Philanthropy has the potential to play a key supporting role when it invests in under-resourced sectors and innovation.

<sup>21</sup> See <http://www.un.org/climatechange/summit/wp-content/uploads/sites/2/2014/05/FINANCING-PR-REVISED.pdf>.

<sup>22</sup> [Definition by the Global Impact Investing Network](#).

<sup>23</sup> E.T. Jackson and Associates Ltd. Accelerating Impact, [Achievements, Challenges and What's Next in Building the Impact Investing Industry](#) (Rockefeller Foundation, 2012). Available from: [www.rockefellerfoundation.org/app/uploads/Accelerating-Impact-Full-Summary.pdf](http://www.rockefellerfoundation.org/app/uploads/Accelerating-Impact-Full-Summary.pdf).

<sup>24</sup> Saltuk, Yasemin and others, [Spotlight on the Market - The Impact Investor Survey](#) (J.P Morgan Chase &Co and the GIIN 2014). Available from: <https://thegiin.org/assets/documents/pub/2014MarketSpotlight.PDF>.

## *BOX 7: Global Islamic Finance and Impact Investing Platform*

The Global Islamic Finance and Impact Investing Platform (GIFIIP), established by the Islamic Development Bank and UNDP's Istanbul International Center for Private Sector in Development (IICPSD) is an example of an innovative financial partnerships for the Sustainable Development Goals. GIFIIP endeavors to position Islamic finance and impact investing as a leading enabler of SDG implementation globally through private sector engagement. The global platform aims to mobilize and blend the resources of Islamic finance and the private sector to drive forward business solutions to sustainable development challenges in a fair, transparent, quantifiable and verifiable manner.

The platform serves as a knowledge hub for peer-learning and experience sharing, a forum for policy dialogue and advocacy, and a marketplace where Islamic financiers can meet impact investors and social impact enterprises, and agree on commercially-viable financial solutions that are intended to result in positive social and environmental outcomes.

Source: [UNDP, Global Islamic Finance and Impact Investing Platform](http://www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance_BroWEB.pdf). Available from: [www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance\\_BroWEB.pdf](http://www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance_BroWEB.pdf).



## 4. CONCLUSION



Private investment decisions—in both the real economy and in the financial sector—should move the world towards the aspirations set out in the 2030 agenda. However, this means going far beyond philanthropy and voluntary corporate social responsibility, important though they are. It should be concerned with steering investment decisions that private actors make every day. These decisions are primarily made in the real economy, by companies small and large, as well as by a broad range of actors in the financial sector such as banks, pension companies, and hedge funds. Governments, community leaders, academia, media and consumers can reinforce this pattern.

The inclusive business approach, intended to realign and make new investments that are profitable and at the same time sustainably lift people out of poverty, is being applied more broadly. Scaling-up and replicability are now required. A supportive regulatory environment and smart public incentives are necessary ingredients to guarantee results at scale. Building on the need to realign investments and market practices to the SDGs, the aim is to reach a better balancing of market opportunities, risks, and social and environmental impacts. A number of concrete actions can be taken, including the following:

### *Establish an enabling regulatory environment for the private sector to invest in the SDGs*

- Review the compatibility of regulatory provisions governing the private sector's role in the SDGs and establish a sound methodology for the same; regulatory provisions should gradually govern the phase-out of investments that harm the achievement of the SDGs;

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- Introduce mandatory accounting principles, for example compulsory reporting on sustainability by enterprises over a certain size and/or regulatory provisions for the pricing of externalities that are not incorporated in balance sheets, such as biodiversity loss and/or harmful emissions;
- Design an enabling environment for sustainable and inclusive business models that addresses legislative gaps preventing, for example, impact investment from expanding;
- Introduce regulatory provisions for an increased mobilization and prudent intermediation of savings and remittances;
- Review mandatory provisions for prudential safeguards in pension and insurance funds to better estimate risks related to investing in the SDGs with an initial focus on sustainable infrastructure;
- Reinforce regulatory provisions and international cooperation on tax and transfer pricing to reduce illicit financial flows;
- Build capacity in integrated planning and public spending, supporting public authorities to better cost and finance national sustainable development strategies that include provisions for the mobilization of private finance.

## *Introduce "Smart" public incentives to fasten the realignment of private finance to the SDGs*

- Review the compatibility of current public incentives with the SDGs and gradually introduce reforms for a better alignment of the same, for example, by phasing out harmful energy subsidies;
- Support the collection and dissemination of economic, financial, market and regulatory data to lower the costs associated with the assessment of investment risks and the setting-up of a business;
- In the presence of market failures, provide incentives or public capital for the establishment of financial intermediaries, including development and infrastructure banks that can help to responsibly catalyse private investment and blend public and private resources;
- In the presence of market failures, introduce incentives in the form of equity, concessional lending, risk sharing/pooling to increase the speed of the realignment, for example by extending public guarantees to lending facilities for MSMEs;
- Invest in innovative public-private mechanisms that can catalyse private finance for the SDGs, for example social impact bonds, and innovation and challenge funds.

## *Foster change in company and consumer behaviours to help transition to inclusive and sustainable markets*

- Better align investment decisions by philanthropists and foundations with the SDGs, for example by agreeing on voluntary targets for foundations and philanthropies to allocate a common share of their balance sheets to investments compatible with the SDGs;
- Reinforce the reputation, dissemination and use of sustainable indexes by institutional investors and market authorities;
- Include in educational curricula at all levels courses on financial literacy and ethics in finance and foster teaching and research on inclusive and sustainable business models in business universities;
- Advance a new culture of corporate governance that favours long-term profitability over short-term returns, including the revision of the performance-based systems of senior management to reward longer term investment and take into account the social and environmental results of approved investments;
- Support the emergence of global alliances on sustainable infrastructure investment, starting from early attempts by IFIs to establish these alliances;
- Design and implement consumer awareness campaigns and new labels and certifications that promote, encourage and reward business that better aligns with the SDGs;
- Support global initiatives and alliances that promote inclusive and sustainable markets such as the Sustainable Stock Exchange, and the Global Impact Investing Network, and disseminate global standards such as the Global Compact, the Principles for Responsible Investment and the Equator principles.

## Financing Solutions for Sustainable Development (online platform)

For more information on possible financing solutions the private sector might adopt to advance sustainable development visit our online repository of financing solutions that describes their potential, advantages, disadvantages, risks and characteristics. It profiles case studies and refers to multiple external sources, including e-learning and advanced guidance material, where available.

See: [www.undp.org/content/sdfinance](http://www.undp.org/content/sdfinance).

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