Summary of the discussions

Innovative financing mechanisms for sustainable development Wednesday 2 April 2014, SDC, Bern

Annette Detken, head of division – KfW Development Bank (Kreditanstalt für Wiederaufbau)

Susanne Grossmann, managing partner – BTS Investment Advisors (private equity fund)

Owen Barder, senior fellow – Centre for Global Development (think tank)

Introduction by **Martin Dahinden**, director-general of the SDC

Moderator: **Susanne Brunner**, SRF – Schweizer Radio und Fernsehen

---

The panel of experts addressed opportunities and risks related to innovative financing mechanisms (IFM), output and outcomes of private finance leverage and necessary framework conditions: Donors aim to **leverage additional (private) finance** for development through IFMs, such as funds, public-private partnerships or instruments including loans, guarantees and equity finance. Structured funds have drawn in private investors by piloting and building up a track record of investment opportunities, and by **mitigating risks.** Nevertheless, the experts' opinions differed on whether IFMs merely **allocate existing aid money or whether they leverage new funding**. There was also disagreement on whether public support might give rise to new commercial activities. On the one hand, some felt that private investors may be in a better place to assess commercial opportunities, while costly public funding can distort markets. On the other hand, there were those that believed the public sector can play a pilot role. The panellists did however agree that additional funding is just one of several objectives and that risk mitigation is not the only incentive for private contribution.

Indeed, private investors need to make a profit and they look for a return on the risks they take. However, in the area of public goods or social sectors there are barriers other than commercial interests. While many energy-efficiency projects for instance yield good results by themselves, other obstacles prevail, such as a lack of technological expertise, a shortfall in management capacity or missing information for risk assessments. Therefore, apart from providing capital, a public agency should continue to deliver **technical assistance and capacity building**. Feasibility studies, information sharing and favourable business environments remain important for private investors to enter the market.

IFMs are about new business models rather than leveraging, as one panellist stressed. Development impact bonds **reward positive development outcomes** rather than funding inputs and processes. Their cooperation structures make the most of different actors' strengths and incentives: investors manage risks and fund suitable projects while service providers deliver local and effective solutions. The public donor only rewards the achievement of development results. On a related note, **job creation** as an often used proxy to **measure development impact** may be misleading. Initially, thanks to efficiency and productivity gains, job numbers might decrease, while in the long run a healthy company can offer long-term jobs. The risk that donor-led mechanisms can crowd out the emergence of innovative (local) businesses was also mentioned.

The success or failure of IFMs depends on operational contexts. Grant financing is better suited to the poorest "bottom of the pyramid" in order to provide people with access to basic services. IFMs, such as equity finance in fast-growing small and medium companies, are more appropriate for **people not in extreme poverty** but still below the empowerment line. Their purchasing power can meet some needs, such as food or energy, but they lack access to social infrastructure such as hospitals and schools. Here, beyond job creation, private firms can pursue effective innovative local solutions. By internalising costs, loans in contrast to grants can **incentivise** the private sector to be more than a passive source of money.

A shift in focus from inflows to outflows of resources from developing countries draws attention to the importance of **illicit financial flows,** which have a key impact on development and the amounts of which exceed aid budgets by far. During the discussion, the importance of setting framework conditions for Switzerland and other countries to minimize these outflows was also stressed.

A last point relates to development funds being predominantly domiciled in offshore financial centres. Funds are often not based in the targeted developing countries because of burdensome administrative systems for investments and transfer of funds. For the time being, Switzerland is not attractive to private partners either, owing to taxation and a complex funds authorisation process. The full potential of **Switzerland to become a hub for sustainable investment** remains to be tapped.