Focus Report

Different perspectives – joint success?

Private sector engagement in development cooperation

DEval
GERMAN INSTITUTE FOR DEVELOPMENT EVALUATION

Contents

Abbreviations and acronyms

AWE	Agency for Business and Economic Development *Agentur für Wirtschaft und Entwicklung*
BMZ	German Federal Ministry for Economic Cooperation and Development *Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung*
DAC	Development Assistance Committee, Organisation for Economic Co-operation and Development
DC	Development cooperation
DEG	German Investment Corporation *Deutsche Investitions- und Entwicklungsgesellschaft*
DERa	Development effectiveness rating
DEval	German Institute for Development Evaluation *Deutsches Evaluierungsinstitut der Entwicklungszusammenarbeit*
DFI	Development finance institution
DID	Difference-in-differences (analytical approach)
DSAA e.V.	Digital Skills Accelerator Africa e.V.
ESG standards	Environmental, social and governance standards
EU	European Union
FC	Financial cooperation
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GPEDC	Global Partnership for Effective Development Cooperation
KfW	KfW Development Bank *Kreditanstalt für Wiederaufbau Entwicklungsbank*
MFI	Microfinance institution
MSME	Micro, small and medium-sized enterprises
NGO	non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PSE	Private sector engagement
SDG	Sustainable Development Goal
Sida	Swedish International Development Cooperation Agency
TC	Technical cooperation
UN	United Nations

Foreword

Prof. Dr Jörg Faust
Director of DEval

Dear readers,

In affluent societies, market-driven competition is able to unleash its beneficial macro-economic dynamics such as innovation, imitation, consumer focus and allocation efficiency. At the same time, a competent state in such societies knows how to prevent failures of competition – by wisely regulating the financial markets, enforcing vigorous competition laws and applying effective environmental, labour-market and social policies. The resulting balancing act between the free market on the one hand and state intervention motivated by regulatory policy on the other presents a highly relevant, multifaceted conflict of goals in the context of development cooperation (DC), too, and one that is often the object of political controversy.

In view of the financial power and cross-industry, welfare-promoting strengths of private sector actors, it is no wonder that state DC has been focusing increasingly on private sector engagement (PSE) – whether with the financial sector, the production industries investing in the Global South or businesses pursuing foreign trade. Yet, private sector actors have their own perspectives of their investments in the Global South and prioritise objectives different to those of state DC; they do not focus primarily on collective concerns and benefits like state DC does.

This is illustrated for instance by the efforts to mobilise private capital for development policy purposes which, internationally, has so far fallen well short of expectations. It is therefore all the more important to systematically analyse when and to what extent PSE can succeed from a development policy perspective, and what obstacles need to be overcome to achieve this end.

Ideally, independent research and evaluation support evidence-based rationale which, though basically unable (and not intended) to resolve fundamental conflicts of interest, fosters better policies in the long term. Hence, this summarises and defines the aspiration of this focus report on private sector engagement in DC by the German Institute for Development Evaluation (Deutsches Evaluierungsinstitut der Entwicklungszusammenarbeit, DEval): by synthesising our empirical analyses and evaluations in this thematic area and supplementing them with the opinions of external experts, we have prepared our findings for a broad expert audience with the intent of contributing to an objective dialogue and more evidence-based decision-making.

Not least, we also advocate in this report for strengthening efforts to measure impacts. For a start, analysis is needed to determine whether and when PSE needs support from the state, and whether such engagement would indeed come about even without state support. Secondly, a well-informed, objective debate can reduce the polarisation of positions regarding DC.

In this spirit, I wish you informative, insightful reading.
Jörg Faust

1. What does “private sector engagement” mean?

What is private sector engagement?

What is it supposed to achieve?

Who is involved?

What financial means are used?

1.1 The role of the private sector in development cooperation

Achieving the 17 Sustainable Development Goals (SDGs) of the United Nations' (UN) 2030 Agenda for Sustainable Development will take enormous joint efforts by both public and private actors in the Global North and South. When the SDGs were adopted in 2015, it was already understood: they cannot be achieved in the Global South by DC alone. It will take broader engagement and additional investments. The United Nations Conference on Trade and Development (UNCTAD, 2023) estimates that the annual financing gap for implementing the SDGs in the Global South currently amounts to 3.8 billion US dollars at minimum.

The private sector is being increasingly integrated into DC with the aim of mobilising additional funding and know-how for implementing the 2030 Agenda. Considering the total global privately managed capital and investment volume of 382 billion US dollars (OECD, 2022), one thing is clear: if efforts could succeed in getting only about one per cent of this amount invested in development interventions, a broad range of economic and development needs could be covered. A 2024 study published by the Overseas Development Institute (ODI) also refers to the substantial investment potential of European pension and insurance funds in countries of the Global South, estimated to amount to some 120 billion US dollars over the next five years (Attridge et al., 2024).

However, mobilising additional capital from the private sector for DC does not automatically lead to implementation of the SDGs. After all, the prerequisites decisive to enabling private-sector development to unleash positive development effects are the framework conditions and in particular the functionality of the markets. Political instability, protectionism, inadequate regulatory frameworks and unilaterally dominated trade relations all stand in the way of effectively combating poverty. What is needed first and foremost to eliminate these dysfunctionalities and distortions is not money, but rather political change. Nevertheless, businesses can play a part in improving the economic framework conditions and generating contributions to development. For instance, the German Federal Ministry for Economic Cooperation and Development (Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung, BMZ) attributes private companies with "playing a pivotal role in shaping working, production and consumption conditions" in countries (BMZ, 2023) through their know-how, the application of new technologies, their efficiency and innovative strength.

The important role of the private sector in DC began gaining increasing recognition internationally and in Germany already in the 1990s in the context of the liberalisation of the markets (Habbel et al., 2021). In 1995, the BMZ's Scientific Advisory Board recommended that the private sector be integrated more into DC to enable transfer of capital and expert know-how, and to reduce the task burden shouldered by the BMZ (Kaplan et al., 2018). In subsequent years, further mention was made of the private sector in a series of international accords such as the final declaration of the Fourth High Level Forum on Aid Effectiveness held in Busan, South Korea in 2011, the Paris Agreement arising from the 2015 United Nations Climate Change Conference, and the Kampala Principles for Effective Private Sector Engagement in Development Cooperation formulated in 2019 (see Section 3.1).

In Germany, the Federal Government of the 17th legislative session of the German Bundestag took up the topic of PSE for the first time in 2009 in a coalition agreement, and the BMZ developed a series of strategies and initiatives aimed at specifically promoting PSE. Examples include the Marshall Plan with Africa (BMZ, 2020), the Compact with Africa (BMF, 2022) and the "Development Policy 2030" strategy (BMZ, 2018).

Other donors in the Global North have also been collaborating increasingly with the private sector on development activities since the 1990s. Their approaches differ only slightly from those of German DC, depending on the given governmental policies in force. The United Kingdom, the United States and Sweden place particular emphasis on partnerships between companies based in the Global North and South. These are geared to promoting growth and reducing poverty while simultaneously also conserving or leveraging their own resources. Australia, Austria and the Netherlands apply PSE in the context of their given development objective of creating cross-intervention coherence (Kindornay and Reilly-King, 2013). Few countries utilise PSE to pursue their own commercial interests.

Germany's strategies and instruments encompass every sort of motive for PSE described above. However, the pursuit of commercial interests – i.e. promoting foreign trade – is distinctly separate from PSE in the German context, as it falls within the scope of responsibility of the German Federal Ministry for Economic Affairs and Climate Action (Bundesministerium für Wirtschaft und Klimaschutz, BMWK). Yet, in practice, these areas of policymaking often move closely hand in hand. The instruments of promoting foreign trade include not only advisory services from Germany Trade and Invest (GTAI) and Germany's chambers of foreign trade but also guarantees for German companies. These are intended to secure investment activities in countries of the Global South which can consequently also generate effects to the benefit of development policy.

For the policy fields of both PSE and foreign trade promotion, there is a shared contact and liaison structure for companies to engage them with instruments of both ministries. Moreover, the two approaches are to be more closely coordinated in their application. However, civil society actors warn that PSE activities will not lead to poverty-oriented development financing, but rather, if anything, to conventional business promotion financed by development funding (Morazán, 2017; VENRO, 2010).

Even though instruments of PSE have always been used over the years in Germany by the various governments in power, the positions among the political parties regarding this approach differ in part considerably (German Bundestag, 2022c; Zapf, 2021). Germany's conservative parliamentary group comprising the Christian Democratic Union (Christlich Demokratische Union Deutschlands, CDU) and Christian Social Union (Christlich-Soziale Union in Bayern, CSU) views PSE to be an effective means of combating poverty and the causes of the flight of refugees by which Germany companies stand to benefit as well. By contrast, the Social Democratic Party of Germany (Sozialdemokratische Partei Deutschlands, SPD) emphasises that PSE should serve to improve people's working conditions – in particular for women and vulnerable segments of society – by supporting labour unions. The green political party Alliance 90/The Greens (Bündnis 90/Die Grünen) emphasises increasing the participation of women in the labour market, and points out that PSE plays an important role in qualifying skilled workers and supplementing the public funding aimed at DC. They furthermore underscore the potential environmental additionality that can be generated for example by qualifying workers in key technologies relevant for Germany's ongoing transition to renewable energy (Bündnis 90/Die Grünen Parliamentary Group, 2022). The liberal Free Democratic Party (Freie Demokratische Partei, FDP) believes it is necessary to integrate private companies into DC in order to sustainably achieve the long-term goals of development policy. However, the FDP and der German Council for Sustainable Development (Rat für Nachhaltige Entwicklung, RNE) both warn of the bureaucratic implications and reporting duties arising from Germany's Act on Corporate Due Diligence in Supply Chains (Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten) (RNE and BMWK, 2024) and other requirements.

The debate surrounding the German and, ultimately, the European Supply Chain Act reflect the diverse political points of view towards the role of private sector actors in countries of the Global South. It is also plainly evident that labour unions in particular welcome the potential of supply chain legislation for improving the human rights situation along supply chains (Beile and Vitols, 2024), whereas business associations express themselves more reservedly in this regard. Among others speaking out on this issue is the Federation of German Industries (Bundesverband der Deutschen Industrie, BDI), a stakeholder which has come forward with a position paper on German development policy. The obligations and expected costs for ensuring human rights and other aspects of due diligence are interpreted in their position paper as a risk for corporate engagement in the Global South. Instead, "DC should empower the companies of the Global South to comply with the regulations governing the EU single market" (BDI, 2024).

What does the general public in Germany think of PSE?

A 2023 representative survey of the German populace commissioned by DEval shows that the general public does not perceive the private sector to be a prominent DC actor. Only 27 per cent of the population believe that engaging private sector companies contributes to any sustainable economic development in the Global South. However, a similar opinion prevails regarding engagement by the German Federal Government and non-governmental organisations (NGOs), to which only 35 per cent of survey respondents attribute any sustainable effects in the Global South. Nevertheless, most Germans consider the objectives "to enable people [...] access to training or to acquire skills" and "to create jobs and support the economy" as important goals that DC should contribute to implementing. Both goals count among the core objectives of PSE.

The majority of survey respondents indicated that these two objectives should be given greater priority in DC, and the private sector should play a greater role as an actor in DC. They singled out the European Union (EU) and the UN as the two most important DC actors. While German companies are not perceived by any voter group to be particularly important actors in DC, 24 per cent of SPD voters (and thus the largest group within the SPD's electorate) are of the opinion that German companies are important actors in DC. 23 per cent of CDU/CSU voters believe the same, as do 20 per cent of the Bündnis 90/Die Grünen electorate. Surprisingly, only 14 per cent of FDP voters share this view.

Contrary to this, FDP voters are most frequently of the opinion that DC should contribute mainly to creating jobs and supporting the economy (30 per cent), followed closely by voters for Bündnis 90/Die Grünen (27 per cent) and the SPD (27 per cent). While SPD voters are likewise most frequently of the opinion (31 per cent) that German companies could most readily contribute to combatting poverty in the partner countries, voters supporting the far-right Alternative for Germany (Alternative für Deutschland, AfD) show the lowest approval rating in this regard (22 per cent). Only about ten per cent of the population are convinced that Germany should engage in DC for the purpose of benefiting from it economically.

Data basis: DEval Tracking, conducted by Repondi/Bilendi in January 2023, n = 2,000.

1.2 What is PSE – and what is it not?

PSE is a complex, multi-tiered undertaking in terms of the participating actors, their roles and the utilised DC instruments. Consequently, a private company in the Global North participating in a development intervention may perhaps have a different understanding of the role of PSE in DC than a financial intermediary active in the Global South (see also Section 1.3).

Moreover, many different instruments are used. Hence, the generally recognised definition formulated by the Organisation for Economic Co-operation and Development (OECD, 2016) is comparatively comprehensive. It describes PSE as "cooperation between state/public actors in DC on the one hand and private sector partners on the other hand to achieve development goals". The OECD explains that the various forms of PSE – which is also known as private sector for development (PS4D) – can have varying degrees of formalisation ranging from more informal multi-stakeholder partnerships and dialogues to strictly formalised cooperation arrangements in the form of contractual agreements with financing modalities.

In contrast to PSE, the OECD (2016) defines private sector development (PSD) as activities by governments and development organisations aimed at promoting a favourable enabling environment for the private sector in partner countries. Such activities may include regulations, addressing market defects, and interventions at the individual company level. PSE and private sector development can therefore link with or supplement one another, or overlap.

DEval's analyses include a geographical perspective in its definitions of PSE and private sector development (see Byiers and Rosengren, 2012): in pursuing PSE, DC actors collaborate primarily with German, European and international companies to achieve development effects in their partner countries. Exceptions to this include consulting firms and construction companies whose core business consists of supporting German DC or implementing infrastructure projects on behalf of German DC. By contrast, DC efforts in pursuit of private sector development mainly involve collaboration with governments, organisations and companies in the partner countries.

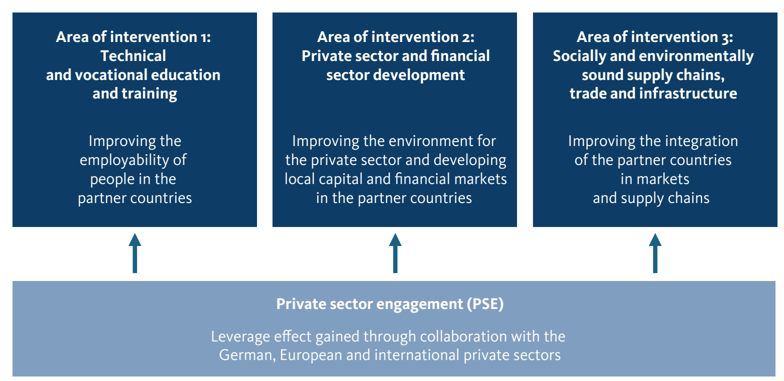
> **DC actors collaborate primarily with German, European and international companies to achieve development effects in their partner countries.**

This geographical focus makes sense in order to be able to define and analyse more closely the various actors and their differing roles and tasks. For instance, where has private capital been mobilised? What effect has it had on the participating companies in Germany or the given partner country?

The BMZ identifies three areas of intervention in its strategy paper "Sustainable Economic Development, Training and Employment" published in 2023: "private sector and financial sector development", "technical and vocational education and training" and "socially and environmentally sound supply chains, trade and infrastructure" (BMZ, 2023). The potentials for PSE in these three areas of intervention should be leveraged wherever possible. The two latter areas of intervention are geared to integrating markets in the Global South – by improving the infrastructure, fostering trade, implementing socially and environmentally sound supply chains and promoting technical and vocational education and training as well as good working conditions in the partner countries.

These areas of intervention overlap in many activities and influence one another through their interaction: for example, the vocational training and education of skilled workers by local institutions and German companies seeking to establish production sites in the partner countries lead to private sector development in the field. The cooperation with European companies in combination with political reforms and investments on the part of the partner countries can contribute to a more socially and environmentally sound configuration of global supply chains as well as to sustainable infrastructure.

PSE in the BMZ strategy "Sustainable Economic Development, Training and Employment"



Source: DEval, own presentation, based on the areas of intervention defined in the BMZ strategy paper „Sustainable Economic Development, Training and Employment" (BMZ, 2023).

1.3 Who are the actors involved in PSE?

Public actors in German DC, notably the governmental implementing organisations, collaborate on PSE with private sector actors and business organisations as well as with civil society stakeholders and NGOs.

The public sector actors who cooperate with the private sector in German DC mainly include the KfW Development Bank (KfW), the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, the German Investment Corporation (Deutsche Investitions- und Entwicklungsgesellschaft, DEG) and its subsidiaries DEG Impulse and DEG Impact GmbH, sequa gGmbH and the National Metrology Institute of Germany (Physikalisch-Technische Bundesanstalt, PTB). While the KfW and DEG are primarily involved in finance operations as actors in financial cooperation (FC), the other organisations focus on technical cooperation (TC) activities such as advisory services, capacity development and enabling the exchange of ideas and information.

The private sector actors involved are essentially cooperation partners or recipients of the FC or TC. Taking centre stage are the companies that undertake the financial and personnel-related investments in the partner countries, train their local employees and, with their activity in the Global North, exercise influence on markets and companies in the partner countries.

The financial intermediaries include German, European and development finance institutions, banks and corporations as well as (institutional) investors, impact investors and funds. Financial intermediaries administer the capital placed at their disposal by their clients and invest it in the most profitable ways. Possible institutional investors include, for example, pension funds, insurers and state or investment funds who bundle and invest the collected capital in capital markets (bpb, 2017). In contrast, impact investing seeks to make the most sustainable capital investment possible that achieves financial growth while complying with environmental and social standards and also pursuing the aim of measuring the relevant impacts (BII, 2024). Impact investors such as the Bill & Melinda Gates Foundation or the Bertelsmann Stiftung can call on socially impactful real estate projects or green bonds, for example.

For investors, the bankability of projects – i.e. their economic viability – is decisive. This factor poses one of the biggest bottlenecks to mobilising private capital for development purposes (Rana, 2017) and has a direct effect on the risk appetite of investors. One of the key aspects considered in assessing a project's bankability is the probability of successfully achieving the defined objectives, which in countries of the Global South is frequently assessed as low due to unstable regulatory, political or economic factors. Investors compare this risk against the expected returns on investment. They will oftentimes hesitate to engage in uncertain markets that fail to promise a high return on investment which impedes PSE considerably.

Furthermore, business organisations such as chambers of industry and commerce and business associations are important actors in PSE. They inform companies of new developments regarding legislation and public funding conditions and offer them vocational training and education as well as advisory services (see page 16). Besides public and private sector actors, NGOs and labour unions also contribute to PSE, for example through vocational training and education and by taking part in policy dialogues within the framework of multi-stakeholder partnerships.

1.4 What key challenges does PSE address?

In conventional economic and trade theory, various conditions apply for markets characterised by allocative efficiency. The model of perfect competition (according to Drewello et al., 2021, p. 39) and the concept of perfect competition are characterised by all market participants having free access to the market, and complete transparency prevails. A large number of sellers (polypolistic competition) and buyers allows market actors to perform efficiently and to maximise their profits or their welfare. It is furthermore postulated that property rights to all goods are clearly distributed and enforced. As a result, the prices of all goods reflect their total production costs (Stiglitz, 2009). Technologies are freely available, and trading of goods is done by those countries which, owing to their specific working and capital assets, are capable of producing these goods in the most cost-efficient way.

In reality however, these assumptions do not hold true (Stiglitz, 2009), and market failures and distortions occur regularly on global and national markets.

The main governmental and private actors in PSE

Actors	Activities
Governmental implementing organisations and companies	
Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH	• Capacity development • Advisory services and matchmaking activities • Policy dialogue
Deutsche Entwicklungs- und Investitionsgesellschaft (DEG) DEG Impulse	• Advisory services • Financing of companies
KfW Development Bank	• Financing of and with companies
Physikalisch-Technische Bundesanstalt (PTB) (National Metrology Institute)	• Policy dialogue
sequa gGmbH	• Capacity development • Advisory services and matchmaking activities
Private sector actors	
Intermediaries: German, European and international companies from diverse sectors (including the information technology, energy and agricultural sectors and the manufacturing industry, among others)	• Vocational training and education • Technology transfer • Improving employment relationships • Sustainable production • Provision of capital
Intermediaries: banks, insurers and other financial institutions	• Provision of capital • Investment management
Chambers of industry and commerce and German Chambers of Commerce Abroad	• Capacity development • Advisory services and matchmaking activities
Chambers of skilled crafts and trade associations such as the German Confederation of Skilled Crafts (Zentralverband des Deutschen Handwerks, ZDH) and the German Cooperative and Raiffeisen Confederation (Deutscher Genossenschafts- und Raiffeisenverband, DGRV)	
Foundations (for example the German Sparkassenstiftung for International Cooperation (Deutsche Sparkassenstiftung für internationale Kooperation e.V., DSIK), the German Economic Foundation (Stiftung der Deutschen Wirtschaft, SDW), and the Senior Expert Service (SES)	

Source: DEval, own presentation.

Market failures and distortions occur regularly on global and national markets. From a governmental perspective, such conditions legitimise not only regulatory intervention, but also the use of PSE instruments.

From a governmental perspective, such conditions legitimise not only regulatory intervention, but also the use of PSE instruments. The challenges facing development policy can be explained with the aid of scholarly schools of thought such as neoclassical theory and institutional economics as well as welfare economics and environmental economics that support state interventions in the economy under certain circumstances (Acemoglu et al., 2001, 2005; Frank, 1967; Krugman, 1987; Mazzucato, 2016; North, 1994; Ostrom, 2009; Prebisch, 1962; Sen, 1995, 2001; Stiglitz, 2009; Stiglitz and Weiss, 1981).

The necessity for state intervention is generally justified when a market failure occurs and, in particular, if its intention is to (1) eliminate or mitigate inefficiencies in markets, (2) create new markets, and (3) implement social and environmental goals in existing or new markets. Building on this basic economic theory, specific interrelated key challenges for DC can be derived in the countries of the Global South. DC seeks to counter these challenges with the extensive set of instruments that PSE offers, and certain instruments are better suited than others, depending on the given context.

Market failure is a key challenge and reason for DC, occuring in various forms in the partner countries of German DC. Where monopolistic or oligopolistic markets arise, for example in national economies dominated by the extraction of raw materials, competition between companies is either distorted or non-existent.

Market participants incur high transaction costs and losses due to inefficiencies brought about by information asymmetries, a lack of regulatory framework and dysfunctional political institutions. Ultimately, uncertainties of the behaviour of other market participants, difficult investment conditions and the tax burden that companies expect (Cunningham, 2011) all pose risks that stand in the way of taking part in the competition.

A wide range of market distortions occur in the Global North as well, in particular when companies externalise social and environmental costs. Externalising the costs that arise from producing and using fossil fuels is a classic example of such practice that requires public regulation and/or subsidies.

Moreover, PSE is aimed at supporting efforts to create new markets that contribute to sustainable economic development in the partner countries and the countries of the Global North. This also includes, for instance, advancing the introduction of new sustainable technologies for supplying electric power and other forms of energy (IEG, 2019; Mazzucato, 2016). Furthermore, the procurement of energy and resources in the Global South can be understood as "environmental structural policy" and – as noted by the German Institute of Development and Sustainability (IDOS) – as an important component and essential feature of German DC (Altenburg et al., 2022).

The many various crises ongoing around the world and the growing globalisation in recent decades pose problems for the economic systems in the DC partner countries, and the means and skills of private companies are aimed at helping to solve those problems. Moreover, there is growing awareness that many of the key challenges for DC in the partner countries also need to be

Key challenges that PSE is addressing

Access to finance: One of the reasons for limited access to finance in the partner countries of DC is that domestic and foreign investors in many cases assess the political and financial risk to be (too) high in comparison to the expected return on investment. This is also due to the fact that domestic companies lack financial securities (due for example to inadequate property rights) or are unable to produce reliable financial information. This constrains efforts to develop local capital markets, mobilise private capital and include marginalised segments of society in finance undertakings.

Market-related information and knowledge: Information asymmetries between market actors in the partner countries and those in the Global North as well as between market actors and governmental authorities impede action by companies and development finance institutions in the Global North and South. Firstly, there is often a lack of transparency with regard to existing regulatory requirements, the competition situation and market prices. Secondly, deficits exist in the partner countries in terms of technical know-how, digitalisation and access to training and education – especially for disadvantaged segments of society. This hampers innovation, imitation and scaling in production, services and trade.

In addition, many companies in the Global North and South are simply unaware of the potential offered by cooperation and business with development impact, and of the opportunities available for supporting DC. As a result, available potential for creating jobs and producing high-quality, inexpensive products and services for consumers remains unused.

Production conditions: Companies frequently externalise environmental costs to the general public, as consumers respond in price-sensitive ways. There is often a lack of state or corporate incentives to invest in climate-neutral and resource-conserving production and thereby internalise environmental costs. The Global South is often hampered additionally by a lack of knowledge needed to implement sustainable technologies.

This situation is exacerbated by the pressure from international competition, resulting in direct or indirect negative effects that impact climate change, biodiversity and a generally healthy environment.

Working conditions: Companies that operate in the Global South often lack the awareness, capacities and incentives to implement corporate due diligence obligations concerning human rights and international labour standards. This applies in particular to aspects such as occupational health and safety, fair wages, gender equality, inequality and discrimination of marginalised segments of the population, including business models and, in a broader sense, good governance and compliance with the rules of governance.

Regulation and framework conditions: International companies still consider the markets in many partner countries of DC to be intransparent and inefficiently regulated. The reasons for this include the high debt in the DC partner countries as well as deficits there in good governance in terms of democracy, legal certainty and effective control of corruption. Due to monopolistic and oligopolistic market structures and a lack of or inadequate regulation, the investment risk facing companies is rising, and resultant economic inefficiencies pose negative consequences for consumers.

> **There is growing awareness that many of the key challenges for DC in the partner countries also need to be addressed at least in part in the Global North.**

addressed at least in part in the Global North. That applies for instance to establishing environmentally oriented supply chains and increasing the demand for fair trade products.

1.5 How is PSE intended to work?

Due to the oftentimes inadequately regulated markets in the Global South, private sector engagement and capital do not reach the DC partner countries on a scale that would be desired from an economic and development policy perspective to achieve the SDGs. PSE is intended to contribute to solving the key challenges described on page 18, as illustrated in the theory of change outlined on page 20 and 21. Section 3 describes by what means and instruments PSE is concretely implemented, and addresses the question of whether PSE can meet the expectations placed on it.

The following theory of change presents the effects and causal pathways that are expected from PSE. More specifically, individual instruments and inputs of PSE achieve certain outputs which are then expected to result in for example behavioural changes among actors in the Global North and South. These should, in turn, bring about direct effects (outcomes) among the given target groups – ranging from the partner government right down to individual households. In their entirety, these outcomes are aimed at contributing to achieving the impacts of development policy that stand for societal changes in the context of sustainable development.

Target groups

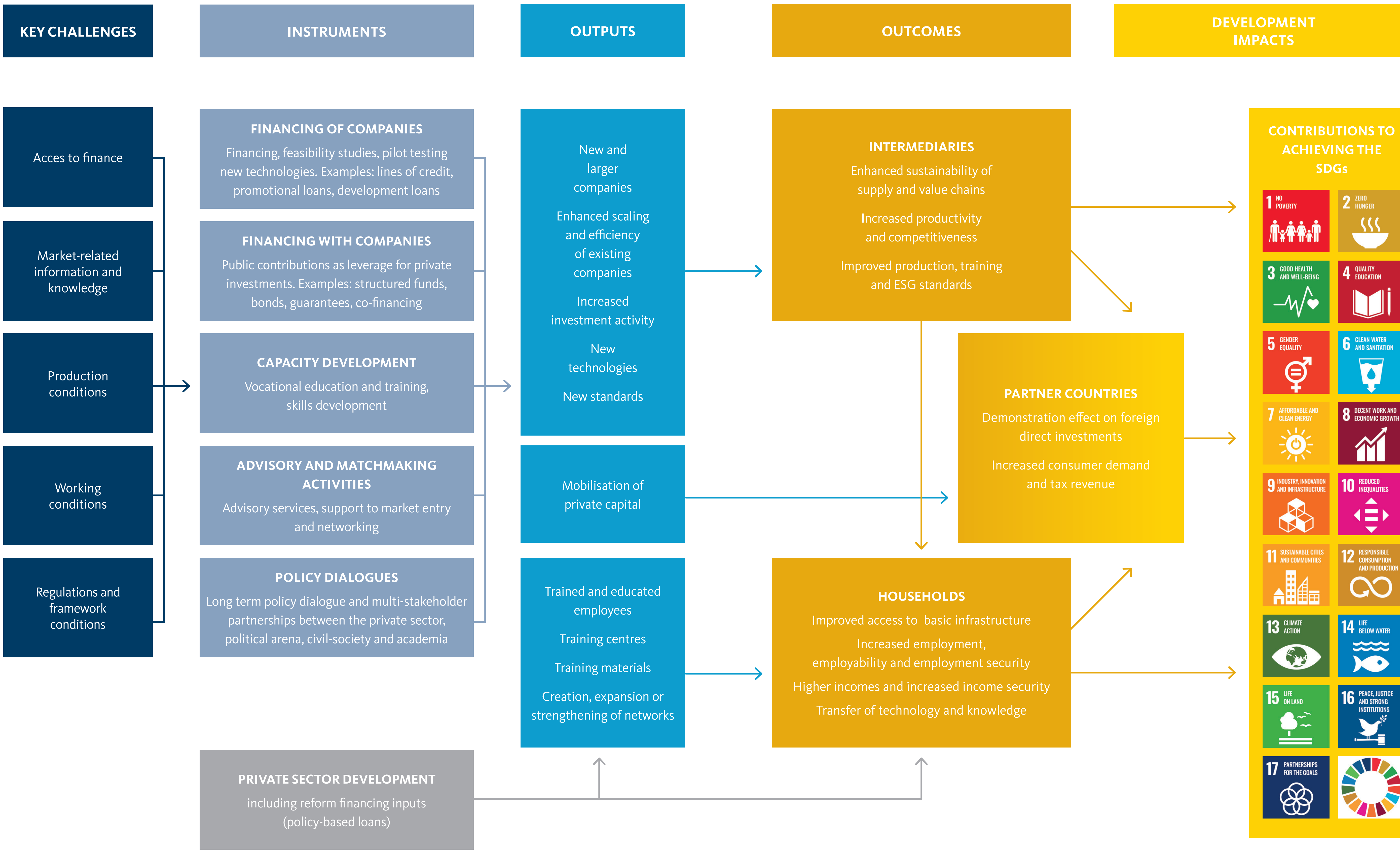
The intended outcomes are meant to be reached for the target groups in the partner country. This includes, in particular, intermediaries in the sense of financing organisations and companies as well as households and employees. For intermediaries who invest in building their supply chain or subsidiaries in the partner country, outcomes can consist, for example, of creating jobs or introducing environmental standards.

Households as a target group comprise (economic) entities consisting of one or more persons, such as smallholder farmers. They are either self-employed or active in informal or formal employment relationships. Moreover, they consume products and make use of services. For instance, households can benefit from the additional jobs, better education and training, higher income and improved working conditions that come about over the course of PSE activities.

In addition, potential impacts can be observed at the partner country level in the transition from the target groups to an aggregated economic and social level and for the country's government, for example in the form of increased consumer demand, growing tax income, increased investments or improved environmental protection.

Taken as a whole, PSE is intended to contribute to sustainable economic and social development in the partner country. The individual impact pathways lead via the assumed poverty reduction (SDG 1) to broad-scale economic growth and higher employment (SDG 8), promotion of innovation (SDG 9) or to environmentally sustainable production and consumption practices (SDG 12) and thus also to combating climate change in the form of inputs for adapting to and mitigating its impacts (SDG 13).

Theory of change from the key challenges for DC to the impacts of PSE



Source: DEval, own presentation.

Results and impacts at the target group and company levels are expected primarily in the Global South. Some of the intended effects, however, could also impact the Global North, such as the mobilisation of private capital, introduction of new standards or increased investment activity.

Classic DC interventions for private sector development can supplement PSE in meaningful ways. For example, as part of reform financing inputs (policy-based loans), the government in the partner country may be granted a loan that is linked to reforms aimed at regulating the economy. Such reform is intended to lead to improved legal certainty for investments and thereby to a mobilisation of additional private capital from domestic or international investors.

However, as so often happens, the theory and reality of PSE can diverge considerably. Hence, one of the underlying assumptions of the theory of change is that the given groups of actors are able to pursue their corporate and development objectives without their respective goals conflicting with one another. However, this is not necessarily the case in actual practice. One typical example is the corporate goal of minimising costs, whereas the development policy agenda pursues fair payment of employees and the creation of decent jobs. Hence, in these and other cases there is concern that public promotion of investments by the private sector leads to deadweight effects, i.e. that companies would have made the investment anyway without public support, so the public support induces no additional development effects (see Section 3, in particular regarding the review of additionality).

Public funding for PSE

The BMZ budget (Detailed Plan 23) does not contain any one item that fully collates all funding expended for PSE. Instead, funding for this approach stems from multiple budget items. In its position statement in response to the DEval Evaluation Synthesis of PSE, the BMZ declared in 2021 that, since 2017, the funding expended for PSE had risen to 267 million euros, and had thus more than doubled in that time span (BMZ, 2022). This amount represents roughly 2.6 per cent of the BMZ's total budget in 2021 of 10.2 billion euros. Although the BMZ ascribes an important role to (private) companies in its development policy agenda (BMZ, 2023), there has been no continuation of the reported growth since that point in time. The volumes of almost all budget items relevant to PSE decreased year on year from 2023 to 2024 – as did the BMZ's overall budget funding (BMZ, 2024).

A more exact overview of all funding used for PSE is not possible because many budget items are expended primarily for PSE (Items 687 01 and 896 34, for example), while others only in part. For example, budget item "FC with regions" (FC-R, 896 01) – besides other expenditures within its scope not earmarked for PSE – finances holdings of KfW in funds used to mobilise additional capital from German and European investors (AfricaGrow).

Approaches to PSE are also financed in part under Section 2302 (Civil society, community and economic engagement) of the BMZ budget. This also includes the partnerships with the private sector that essentially comprise the develoPPP programme. While in this case the entire amount may most likely be dedicated to PSE, individual interventions may under certain circumstances be (co-)funded from other budget items.

Development of BMZ budget items relevant to PSE

Budget item	Designation	2021	2022	2023	2024
		Amount in millions of euro			
866 11	FC loans	311	263	344	293
896 11	FC grants	2,120	1,975	1,997	1,779
896 01	FC with regions	579	170	162	157
687 01	Development partnerships with the private sector	267	190	189	167
685 01	Vocational training and education	61	61	61	60
896 34	Special initiative "Good Employment for Socially Just Change"	180	155	155	126

Source: German Bundestag, 2020; 2022a; 2022b; 2024.

These amounts were taken from the Detailed Plan 23 for the years 2021, 2022, 2023 and 2024 of the Germany Federal Budget, and correspond to the target amount for each budget item per year. Only those budget items are presented that contain large shares of funding for PSE approaches.

If, for example, a develoPPP intervention is focused primarily on promoting employment, funding from the budget item for the special initiative "Good Employment for Socially Just Change" is used for its purposes.

The ability to unequivocally correlate the individual budget items and inputs to the PSE approach would require a uniform overarching identification code, for example in the form of a PSE identifier. This would also serve to standardise definitions and markers that the implementing organisations have individually specified at the intervention level (see Sections 3.1 and 3.6).

Furthermore, KfW and DEG deploy their own capital or market capital for PSE inputs which they mix in part with BMZ-provided budget items. The volumes of market funding for PSE may be higher than those from the budget funding. However, more precise statements in this regard are hampered by the differing definitions and policy markers applied to PSE inputs.

Amélie zu Eulenburg
DEval Head of Department

Marian Wittenberg
DEval Evaluator (until 01/2024)

From the perspective of the KfW Development Bank:

“Government and the private sector must act in concert”

In order to close the financing gap to achieve the SDGs and the goals of the Paris Agreement, many DC actors, in particular development banks such as KfW, consider the mobilisation of private capital to be one of their most urgent tasks. Investments in developing countries and emerging economies are challenging for foreign private investors because the lack of knowledge of these markets makes it difficult for them to assess the risks involved, and they sense the risks are too high compared to the expected return on investment. This gives rise to fears regarding the risks entailed with the investment, for example in the form of transfer, currency, trade and default risks.

Mitigating risks and promoting positive effects on the environment and society

How risks in the local financial markets of developing countries and emerging economies are perceived is precisely where KfW can bring its weight to bear to design more secure framework conditions for private investment. The FC projects of KfW are geared accordingly to improve (1) statutory frameworks by way of policy-based financing, (2) physical framework conditions by investing in infrastructure, and (3) systemic framework conditions, for example by developing the finance system. In concrete terms, these FC efforts can reduce the risks of loss facing private investments for example by way of structured funds by assuming first-loss tranches, guarantees or insurances.

Besides a certain minimum return on investment and level of certainty that commercial investors view to be a basic condition for their financial engagement, growing importance is also placed on achieving positive environmental and societal impacts, in particular among philanthropic investors and impact investors. This is why FC builds directly on such investment objectives and designs incentives for private investments among areas and target groups worthy of promotion, such as female entrepreneurs or environmentally relevant start-ups.

Participating in financial funds and development platforms

The Partech Africa II Fund provides an example of mobilising private capital on the African continent. The fund makes start-up capital available to young tech companies with strong growth potential, and so far has mobilised 245 million euros from investors. The investment from KfW of over 45 million euros has contributed a decisive share. With a further five million euros, KfW financed the BMZ order Partech Accelerator Chapter 54 which, within the framework of a mentoring programme featuring distinguished players, prepares European start-ups for their internationalisation to encompass Africa.

The Microfinance Enhancement Facility, an FC fund that KfW and the International Finance Corporation jointly launched in 2009, distributes loans to microfinance banks. As of 2024 it began focusing on the financial inclusion of women, and since then has been active on the market as the Global Gender-Smart Fund (GGSF). In 2023, 78 per cent of its loans were granted to women. An FC flanking measure has been newly introduced with the aim of supporting partner banks’ efforts to promote the financial inclusion of women. A fund volume of some 650 million US dollars is envisaged in the long term.

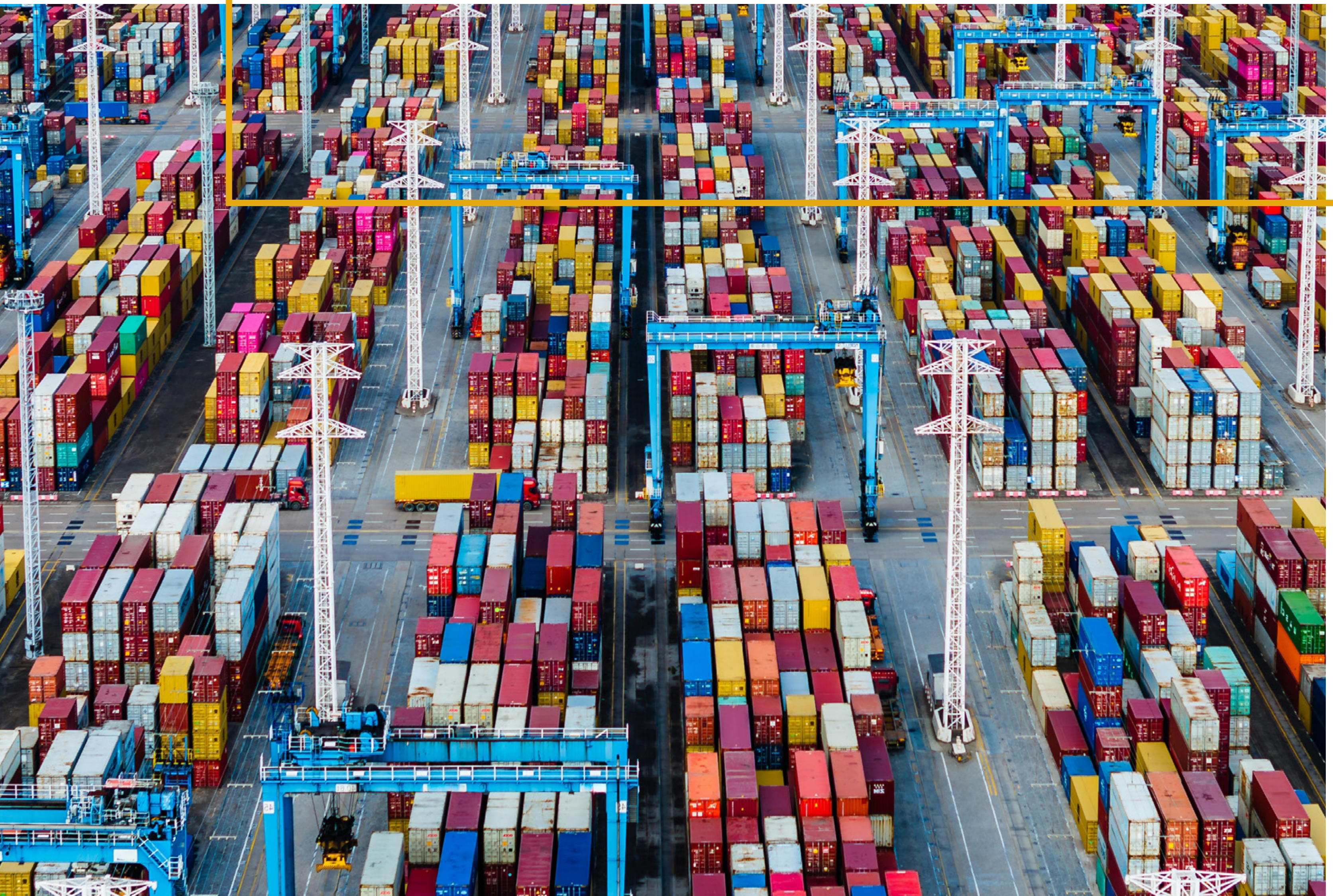
The advantages of development platforms

In supplement to supporting individual funds, KfW seeks with the aid of development platforms to bring investors together with development projects and to reduce obstacles that impede investment. Platforms can decrease the transaction costs for investors that arise from efforts to identify and vet investment opportunities. Depending on the design and selection of interventions, platforms can be used for philanthropic investors, impact investors or commercial investors. FC is currently working on various approaches such as the Power-to-X (PtX) platform for promoting green hydrogen technologies.

Track records to date have demonstrated that mobilising private capital to achieve development goals is not a task that can be solved easily and quickly. Governments and the private sector must learn how to jointly develop marketable and scalable financing instruments. The aim must be to steer the required funding not only into individual success models, but rather on a major scale via capital markets into developing countries and emerging economies. KfW plays an essential role in these efforts as an enabling transformational bank.

> **Many DC actors, in particular development banks such as KfW, consider the mobilisation of private capital to be one of their most urgent tasks.**

Christian Krämer
Member of the Management Committee, KfW Development Bank



2. How does development cooperation engage with the private sector?

What types of cooperation and what instruments are used in PSE?

How are they implemented in the actual practice of development policy?

What concepts are they based on?

PSE is implemented by way of numerous financing modalities, instruments and forms of cooperation, and can be systematised along the following approaches:

1. **The goals and intended results of engagement**
   Example: Reducing poverty by establishing sustainable value chains (Callan and Davies, 2013; Pérez-Pineda and Wehrmann, 2021; Smith, 2013);

2. **The actors involved and their roles**
   Examples: Public banks that decrease the risk for private investors so that private investors provide capital for development policy purposes, as well as companies who collaborate with chambers of commerce to engage in vocational education and training (Heinrich, 2013);

3. **Instruments**
   Examples: Exchange platforms and financial grants for companies (Di Bella et al., 2013);

4. **Intervention levels**
   a. **Macro level**
      Example: Establishing favourable framework conditions for the private sector
   b. **Meso level**
      Example: Focusing on market distortions and inefficiencies in partner countries, and
   c. **Micro level**
      Example: Promoting development of the private sector by supporting MSME financing and targeted development of employee skills.

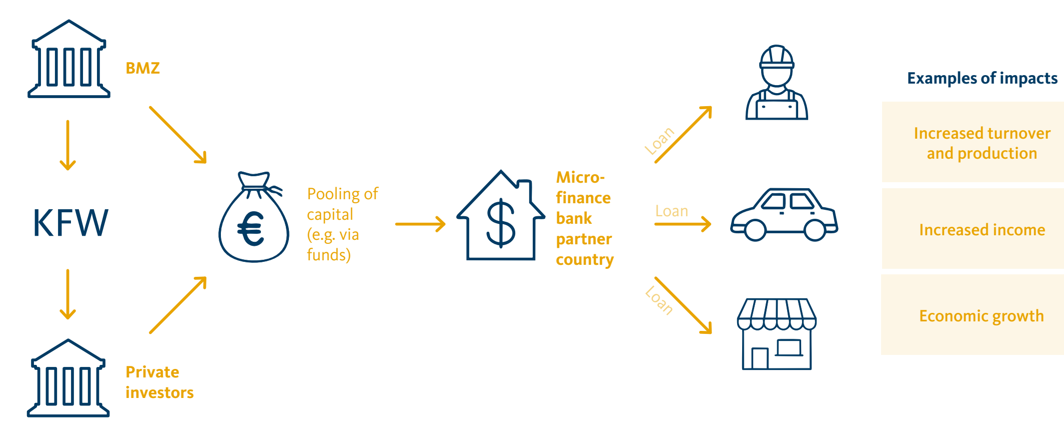
By setting these approaches (Bilal et al., 2014; Kindornay and Reilly-King, 2013) in direct correlation to the key challenges for DC presented in Section 1, the five categories of PSE previously identified in the theory of change shown on page 20 can be derived. These are:
1. Financing with companies,
2. Financing of companies,
3. Advisory services and matchmaking activities,
4. Capacity development, and
5. Policy dialogue.

2.1 Financing with companies

When participating in public-private financing activities, private partners usually assume the role of financiers, and do not act as implementing parties, albeit in some cases they may also assume the role of investment manager. This means that the German and European private investors bring about indirect development impacts, whereas the financed companies in the partner countries achieve direct development outcomes.

The financing with companies may be done by providing co-financing, bonds, guarantees, grants and funds (König et al., 2020). One typical example is the provision of blended finance when private investors invest in development interventions via legally independent investment funds. These funds combine public funding from the German Federal Government, KfW's and/or other development finance institutions' own resources with investment capital from private investors. In order to reduce the investment risks, which are often considered to be too high, the funds' capital is usually structured into different tranches.

Example: Financing with companies



Source: DEval, own presentation.

The high-risk tranches at one end serve as risk buffers for investors in low-risk tranches at the other. The public agents typically participate in the high-risk tranche and thereby assume a major portion of the investment risk, allowing, for instance, potential losses due to loan defaults to be accommodated.

Financing with companies is implemented in German DC with the aid, for example, of the AfricaGrow Fund, the InsuResilience Investment Fund and the eco.business Fund, which are administered by companies such as Allianz, BlueOrchard or Finance in Motion. These funds mix private and public capital which KfW administers on behalf of the BMZ. This provides a way of mobilising additional capital from German and European investors for achieving development policy goals. The funds invest the capital in regional funds and local development finance institutions in the Global South that possess the know-how and capacities for investing in local companies and thereby for creating jobs and promoting sustainable and inclusive business models. Such investments also grow the liquidity among the regional and local development finance institutions such as banks or FinTechs, which in turn provide insurance policies and loans to sub-borrowers in the partner countries and thereby contribute to improving the financial services available to micro enterprises.

Even though private sector actors are generally characterised by a common interest in minimising risk (for example by means of guarantees), they do not constitute a homogenous group. Instead, companies, financial intermediaries and trade associations oftentimes have differing interests resulting from their respective institutional perspectives. Financial intermediaries and fund managers explain on page 66 what these perspectives look like exactly, why and how fund managers and investors rely on structured funds, and where they see the greatest potential for such engagement. Three of these four asset managers represent their own financial intermediaries, while one represents KfW. They all invest in partner countries of German DC with the aid of structured funds, including inputs aimed at achieving development policy outcomes.

2.2 Financing of companies

There are many instruments by which companies receive financing aid directly. In German DC, such instruments include the develoPPP and ImpactConnect programmes. The companies taking part enter into a partnership with GIZ or DEG. The determining factor for receiving funding is what objectives the recipient company is pursuing with the inputs. In such programmes, German DC promotes activities in particular by German and European companies who are already active in developing countries or emerging economies or wish to become active there. This support can be implemented in the form of equity and debt financing such as loans or through the purchase of company shares. Basically, guarantees can be granted in these cases, too, for any losses incurred by private investors if a company eligible for support defaults due to insolvency. In essence, the intent is for companies to receive incentives to develop new business models and to improve and expand their cooperation and investments in the markets of the DC partner countries in order to foster development policy impacts.

These financing efforts are aimed at contributing to sustainable development through participation in international trade, global supply chains and business activities geared towards social and ecological sustainability. For example, a German company can be granted a loan to build a production site for sustainable packaging materials in a partner country, or to supply one of the company's locations in the Global South with renewable energy, or to finance environmentally compatible agricultural machinery. When financing stands to exclusively benefit companies in the partner countries, the activity is usually classed as private sector development as described in Section 1, and not as PSE.

Example: Financing of companies

Source: DEval, own presentation.

2.3 Advisory services and matchmaking activities

This form of cooperation does not serve to finance interventions, rather it is dedicated to providing professional advice, communicating market-specific information and referring points of contact to companies in the Global South. It is geared to enhancing the transparency of markets in the partner countries for private sector actors based in the Global North, and to expanding their knowledge of these markets so they can successfully engage with partners there. Advisory services for companies are implemented via the Agency for Business and Economic Development (Agentur für Wirtschaft und Entwicklung, AWE), which also includes the Business Scouts for Development. This agency is active among trade and industry associations, business umbrella organisations and congresses, chambers of commerce and labour unions in Germany and abroad. They advise on promotion, financing and cooperation proposals for DC. They also aim to facilitate companies' access to networks and support the development of projects. Their areas of focus include economic cooperation aimed at promoting climate neutrality and decarbonisation in business and industry, and efforts to establish sustainable and resilient supply and value chains.

Among other tasks, the AWE supports the HelpDesk on Business and Human Rights, from whom companies can obtain advice for example on implementing corporate due diligence obligations for human rights along their supply chain.

Matchmaking platforms, too, belong to this approach, such as the Import Promotion Desk of sequa and the GIZ's platform leverist.de, by which importers and exporters in the Global South and North network with one another, and companies build supply chains and find new trading partners and clients. In addition, the AGYLE African Leader Programme is geared to enabling young decision-makers in African and German companies to network with one another to initiate joint projects. Finally, the Lab of Tomorrow seeks to unite advisory services with project development by having companies, NGOs, self-employed entrepreneurs and state organisations from the Global South and North jointly develop business ideas in multi-day workshops which then can be supported by instruments of PSE as a next step.

Example: The Helpdesk on Business and Human Rights

In the context of Germany's Supply Chain Act (Lieferkettensorgfaltspflichtengesetz, LkSG), many companies delve into the question of how they can effectively mainstream their human rights and environmental due diligence obligations in business processes and supply chains respectively. The AWE' Helpdesk on Business and Human Rights offers them a first port of call for obtaining initial advice free of charge. Since 2017, the Helpdesk has received more than 3,600 inquiries – and the trend is rising, with over 1,000 incoming queries just in 2022 alone.

Since the Supply Chain Act came into force in January 2023, a growing number of MSMEs have called on the Helpdesk who, whether out of intrinsic motivation or due to their clients' rising requirements, are addressing their human rights due diligence obligations. Many suppliers are required by their major clients to contribute information to human rights risk analyses.

Many companies contact the Helpdesk to clarify questions with the advisory team about drawing up declarations of principles concerning human rights or about conducting analyses of risks related to child labour, living wages and deforestation, among other issues. The companies are subsequently able to review their suppliers more closely and implement suitable preventive and corrective action.

2.4 Capacity development

Development organisations and German or European companies jointly implement

Example: Digital Skills Accelerator Africa e.V.

More vocational training and education for new jobs
Under the brand "Invest for Jobs" (special initiative "Good Employment for Socially Just Change"), the BMZ has put together a package of measures for German, European and African companies who engage in Africa. "Invest for Jobs" supports, for example, the Digital Skills Accelerator Africa (DSAA) e.V., a non-profit association founded in 2019 with meanwhile 20 German, international and African member companies in the digital services sector. The DSAA offers training programmes in software development, data science, system integration, cybersecurity, client service and cloud solutions in six partner countries: Egypt, Côte d'Ivoire, Ghana, Morocco, Rwanda und Senegal. The goal of the DSAA is to get international and African companies to jointly develop and implement practice- and needs-oriented training and education programmes. The aim is to help participants gain good prospects for subsequent local employment. GIZ, who implements "Invest for Jobs" on behalf of the BMZ, supports the DSAA with grants for implementing and scaling training courses and for further developing approaches for gender equality and inclusion. These efforts are specifically designed so women and people with disabilities or of differing educational backgrounds will benefit from the training and education programmes.

Processes and development outcomes
The DSAA is in charge of administering the training interventions and assumes a portion of the costs, while the member companies must pay their own contribution of at least 50 per cent. The model of direct contracting allows the DSAA to conclude a service agreement directly with the given company following a review of the market conventionality of a project proposal by an external auditing firm. Monitoring of the planned impacts is done on the basis of jointly defined performance indicators, and forms an important component of the contractual agreement. Precise target requirements specifying the number of jobs to be created are defined in the DSAA grant agreement. Moreover, the funding is disbursed incrementally once previously specified milestones have been reached.

A company network operated by the DSAA serves as a knowledge platform aimed at exchanging ideas and information on establishing companies in Africa and at creating new partnerships. Another aim is that the companies benefit from advisory services that help when exploring new markets and employment potentials and facilitate access to local actors, promotion agencies and partners in the political sphere.

By supporting "Invest for Jobs" with over 30 projects, the DSAA seeks to offer some 2,500 training interventions and thereby create up to 5,000 good jobs in the field in the coming years.

interventions in the partner countries to develop capacities. In many cases, this involves contractually agreed partnerships between DC organisations and private companies. The companies receive technical support or advisory services from the DC implementing organisations, which in Germany are usually GIZ, DEG Impulse and sequa.

GIZ-co-financed develoPPP projects for promoting innovation in the agricultural and food sector also contain activities for capacity development, such as vocational training and education courses. The same applies for the vocational training and association partnerships implemented by sequa, which are aimed at establishing and strengthening chambers of commerce, trade associations and training centres in the partner countries.

2.5 Policy dialogue

Policy dialogue measures are intended to jointly address market distortions and failures with actors from the political arena, civil society, academia and business. Such systematic

Example: Partnership for Sustainable Textiles

The Partnership for Sustainable Textiles founded in 2014 (also known simply as the Textile Partnership) is a multi-stakeholder partnership whose members include companies, industry associations, NGOs, labour unions, standards organisations[1] and the German Federal Government. It is a voluntary alliance with which German DC supports engagement between the private sector, civil society and public policymakers for venturing and promoting action for more sustainable textile supply chains. The objective is to jointly define social and environmental standards along the textile supply chain and support efforts by companies to meet their due diligence obligations. The Textile Partnership believes that the key challenges facing the sector are, in particular, ensuring fair purchasing practices and living wages for workers at the start of the supply chains, promoting the circular economy and climate action and ensuring gender justice and participation of employees (for example through complaints mechanisms).

The work of the Textile Partnership is based on three pillars:
1. Individual responsibility: The Partnership requires its member companies to report on their implementation framework and status with regard to their corporate due diligence obligations.
2. Joint action: The members are obliged to implement Partnership Initiatives. These are projects in production countries that address themes such as living wages, biological raw materials such as cotton, or chemicals and environmental management.
3. Mutual support: The Textile Partnership acts as a learning and dialogue platform. This includes organising webinars and workshops and providing information materials.

In 2024, the Textile Partnership counted some 120 members. The companies represented account for just under half of all retail sales in Germany's textile industry.

Source: Heucher et al., 2023, p. 15, 63ff.

[1] Standards organisations are understood to be organisations which develop and publish social and environmental standards and norms for business, such as Fairtrade Deutschland e. V.

Policy dialogue measures can initiate coordinated and agreed processes of change among the participating actors, for example the introduction of new standards or a more efficient set-up of controlling and administration processes.

and, in many cases, long-term exchange of ideas and information can be organised in the form of national and international partnerships and initiatives. Key to such dialogue is a defined scope of shared interest, which can usually be linked to a specific sector or theme.

In this respect, multi-stakeholder partnerships are particularly prominent. The BMZ deploys this instrument in several sectors. It pertains to voluntary arrangements with four characteristic features (GIZ, 2024a):

The stakeholders

1. originate from at least three different sectors (state, organised civil society, the private sector or academia),
2. collaborate in an organised manner, pursuing a long-term perspective,
3. engage one another at eye-level on a level playing field, and
4. wish to contribute to the common good.

Policy dialogue measures can initiate coordinated and agreed processes of change among the participating actors, for example the introduction of new standards or a more efficient set-up of controlling and administration processes.

Marian Wittenberg
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Miriam Amine
DEval Team Leader (until 06/2023)

Dr Cornelia Römling
DEval Team Leader

From the perspective of a bilateral donor organisation:

Guarantees – an efficient instrument for mobilising private capital to achieve the SDGs?

Some donor countries use the same or similar instruments for engaging the private sector in DC measures, others apply specific instruments. Donors can learn from each other's experiences. Sweden through The Swedish International Development Agency (Sida) has been issuing guarantees for investments e.g. loans conducted in developing countries for around 20 years, and has been very successful in effectively mobilising large private capital flows with a small amount of budget funds. According to OECD statistics, Sweden mobilised almost 2 billion euros in private capital through guarantees in the period from 2012 to 2020, while Germany only mobilised 316.6 million euros in the same period. According to Sida, the leverage of invested (public) to realised (private) capital, calculated in Swedish krona, was over 1:60 for the outstanding portfolio at the end of 2022.

The 'Swedish model'

The 'Swedish model' is based on two principles: (1) the fees that companies pay for a guarantee from Sida in order to obtain a loan from a bank can be subsidised with public funds, and (2) Sida's guarantees can not only cover specific risks, such as the insolvency or bankruptcy of companies, but can cover a range of risks – as long as they can be quantified with a price using standard methods. This means that risks related to external shocks, such as political unrest in the company's country or currency fluctuations can be hedged as well as risks related to other financial instruments applied, such as bonds or a bank's entire investment portfolio. The Swedish National Debt Office, a sub-organisation of the Ministry of Finance, plays a decisive role in assessing the risks and calculating the fee in close collaboration with Sida.

The two components of Sida's guarantees

In accordance with the case-specific risk calculation, the fees paid by the companies to Sida for utilising the guarantee consist of an administrative and a risk component. Sida allocates these funds to a guarantee reserve for future claims. This reserve is backed by the Swedish government without the need for financial provisions (unfunded guarantees). This means that possible defaults are covered by the fees paid by all guarantees without the need to set budget funds aside. Should defaults exceed the numerical amount held within the reserve, the claims would be paid through the regular operational activities of the Ministry of Finance and the guarantee reserve would become negative. However, this has never been the case in around 20 years. Public funds are only used in this mode, if the fees for the guarantees are subsidised. The liquidity in the guarantee reserve is not sitting idle but is used for general purposes within the Swedish government. This makes this instrument extremely efficient.

Flexibility is an asset

Another advantage of guarantees is, that they can be used very flexibly and serve different maturities, sectors, financial modalities and (private and public) actors. This instrument covers different levels and financial activities, for example backing-up MSMEs and micro-lending activities by local financial intermediaries in partner countries, issuing guarantees for loan portfolios of multilateral development banks as well as securing investments in large infrastructure projects. In terms of geographical focus, at the end of 2022 Sida's guarantee portfolio reported 35 per cent of the volume of funds as 'global', 25 per cent related to investments in Asia and 19 per cent to investments in Africa.

Peter Hallbom
Lead Transaction Manager, Sida

From the perspective of AWE:

AWE's Business Scouts for Development reporting from three countries

> **Companies in the partner countries take great interest in implementing projects with German DC. Yet, the needs for support are complex.**

From Viet Nam: Huyen Nhu Lanh

For Vietnamese companies, the German economy and notably its industrial sector present a major potential sales market for their products. However, they perceive the German market as being extremely demanding, in particular due to its strict import regulations and standards which, as a result of the German Supply Chain Act, the Carbon Border Adjustment Mechanism and the EU Deforestation Regulation, have recently been tightened even further. This is why local companies in Viet Nam have extensive need for support in order to adapt to the conditions of the German market and secure their supply chains.

As many European companies are looking to diversify their portfolio of suppliers in Asia, their demand for suppliers in Viet Nam is rising, for example in the machine building sector, processing industries, furniture manufacturing and the agricultural and automotive industries. This is why the Business Scouts for Development want to generate a sense of awareness in Viet Nam for sustainable and climate-resilient supply chains, for example through vocational training and education courses and communication of technical know-how by way of standardised tools. Their service portfolio also includes referral of points of contact between supplier firms and buyers, and advising on financing opportunities available through instruments of DC. These efforts focus in particular on small and medium-sized enterprises.

From Ghana: Stefanie Simon

Companies in Ghana take great interest in implementing projects with German DC. Yet, the needs for support are complex: German companies are looking mainly for information on market entry, training and skilled workers as well as on potential partners. By contrast, what Ghanaian companies need above all are advisory services on project development and relevant networks. Interest in cooperative arrangements is particularly strong in the energy, waste management, water management, construction, information technology and food processing sectors.

Ghanaian and German companies frequently view the complex administrative processes as posing barriers to launching DC projects. What's more, they find it challenging to secure the financing for projects. Local Ghanaian as well as German medium-sized enterprises oftentimes wish to initially implement small projects that let them explore how they can best integrate DC themes into their work. They would welcome formats that are more readily accessible for this purpose, which is why the focus is on referral of points of contact and on advisory services on promotion and financing opportunities as well as project development. Standardised training offerings have been developed which, at a low-threshold level, take up the support needs for example of women shea entrepreneurs who seek to design their production to be more socially and environmentally sustainable.

From Mexico: Emmanuel Winker

Mexican companies are showing rapidly growing interest in socially and environmentally sustainable ways of doing business. Under the pressure of new standards, it is becoming increasingly difficult for them to design their strategies and processes sustainably and orient them to international environmental and social standards. This includes measures such as generating sustainability reports. Their development-related needs of support primarily concern vocational training and education structures aimed at creating new green jobs. Demand is strong, for example, for the DC-supported "In-House Sustainability Manager" training offerings designed to train managers in various sectors to become sustainability managers. In addition, local companies often seek advisory services on sustainable financing and other development opportunities for sustainable investment. Companies in particular in the automotive, renewable energy, logistics, chemicals, pharmaceuticals, finance and agricultural sectors are interested in Germany's technical know-how and the opportunities for networking that German DC offers.

Huyen Nhu Lanh
Business Scout for Development at the Delegation of German Industry and Commerce in Viet Nam

Stefanie Simon
Business Scout for Development at the Delegation of German Industry and Commerce in Ghana

Emmanuel Winker
Business Scout for Development at the German Chamber of Commerce Abroad in Mexico

DEval evaluations and studies on private sector engagement

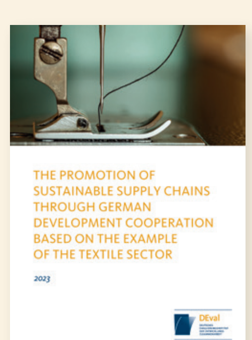
Since 2016, DEval has conducted five strategic evaluations and two studies of PSE. The two studies and three of the evaluations focused exclusively on instruments of PSE, while the other two evaluations examined both PSE and private sector development.

Many other DEval evaluations refer to PSE or private sector development, such as the evaluations of reform partnerships, human rights in development policy, the Aid for Trade initiative and budget support (development policy loans), as do the evaluations and studies examining adaptation to climate change.

The Promotion of Sustainable Supply Chains through German Development Cooperation Based on the Example of the Textile Sector (2023)

DEval examined the interaction between various instruments and interventions of DC aimed at promoting sustainable global supply chains in the textile sector. The evaluation shows that German DC addresses relevant social and environmental challenges in the textile supply chain. In the partner country Bangladesh, for example, it contributes to reducing human rights violations and environmentally damaging practices in textile factories.

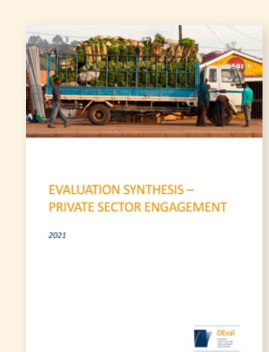
In Germany, DC supports efforts by purchasing companies to fulfil their corporate due diligence obligations better. However, the evaluation also reveals deficits in the strategic steering by the BMZ and in the combination of the DC instruments that were used. DEval therefore recommended that the BMZ develop an overarching impact- and action-oriented concept for promoting sustainable global supply chains and reinforce its efforts to bring about national and international policy coherence.



Evaluation Synthesis – Private Sector Engagement (2021)

This study examined whether PSE is achieving its objectives as a development policy approach, and whether it succeeds in mobilising additional resources for attaining the SDGs. Prior to this study, research into these questions had focused solely on individual interventions and instruments. This evaluation synthesis filled this gap by systematically analysing the available evidence gathered from PSE at national and international level.

The almost 50 evaluations and studies examined in this analysis reported mainly positive impacts in the form of mobilising capital and promoting employment and in terms of knowledge transfer and environmental effects. However, more in-depth analyses, for instance to assess the quality of the evaluations, suggest that a positive-results bias is present. Higher-level effects (i.e. outcomes and impacts) in the evaluations examined in the synthesis had been estimated rather than measured, and unintended negative effects were generally not considered. DEval therefore recommended in general for evaluation of PSE that indicators be defined, the additionality measured more closely, and knowledge management in this area be intensified.



Structured Funds (2020)

Structured funds are an innovative financing approach aimed at increasing the involvement of private actors in development finance. At the point in time of this evaluation, little was known about the development impact of this financing approach, which is a balancing act in the field of tension between the aspirations for financial sustainability and the drive to achieve development impact.

In the evaluation, DEval established that structured funds are a fundamentally suitable means of mobilising additional capital for DC and contributing to the stability and financial sustainability of the financial intermediaries involved in the financing of MSMEs. The evaluation also demonstrated that structured funds facilitate access to finance for sub-borrowers. It likewise confirmed the conflicting issues in the field of tension between development policy objectives on the one hand and the private sector orientation to sustainability and minimising financial risk on the other hand. DEval therefore recommended that the BMZ and KfW ensure the financial sustainability of the funds and define an exit strategy for public donors.

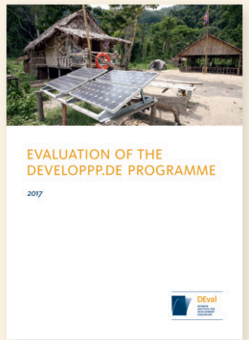
Cooperation with the Private Sector in the Agricultural Sector (2018)

The potential that the private sector offers for DC is of particular interest to the agricultural and food sector since it plays a decisive role in combating hunger and poverty. DEval examined the portfolio of German TC in the area of cooperation with the private sector in agriculture at a time when few insights into this approach and its effectiveness were available. The analysis confirmed that this cooperation contributes or can contribute to achieving development policy goals. The assessed evidence indicates that there is extensive development potential among purchasing companies active in partner countries. However, the anticipated additionality – i.e. added value – as well as the overlaps of development goals and corporate goals should be defined more clearly, and thereby also more effectively pursued and tracked. This applies, for example, to the transfer of knowledge and technology as well as to job creation and the higher incomes such inputs enable. While DEval welcomed the establishment of the AWE as a point of contact for private sector companies, it recommended that increasing emphasis be given to long-term partnerships.
– full report only available in German –

Development Partnerships with the Private Sector – the develoPPP.de Programme (2017)

DEval analysed the implementation and potential effect of the develoPPP.de programme, meanwhile re-dubbed simply develoPPP. The resultant assessment is that the programme contributes to knowledge and technology transfer in developing and emerging economies. In a separate, dedicated portfolio analysis of the programme it was furthermore revealed that the distribution of develoPPP.de projects across countries was essentially in line with development policy steering principles. Up until 2016, for instance, the levels of poverty and democracy in partner countries were identified as structural factors influencing the promotion of develoPPP.de projects.

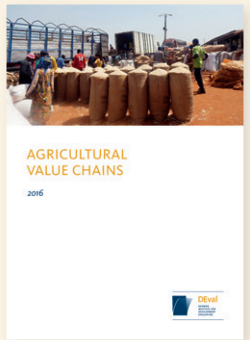
Moreover, corporate goals and DC interests are often dissimilar at the level of individual interventions. While DC may focus, for instance, on targeted support of marginalised segments of the population, private sector actors may not be able to readily serve such segments with their core business operations. Hence, the programme does not inherently contribute to inclusive economic growth or to reducing poverty in the partner countries.



Agricultural Value Chains (2016)

The promotion of agricultural value chains in German and international DC serves to integrate smallholder farms in national and international production and trade processes. Its purpose is to initiate improvements in entrepreneurial processes aimed over the medium term at contributing to decent employment and higher incomes. Since the food crisis of 2007/2008, value-chain promotion strategies are also increasingly viewed as a means of fostering food security.

Based on the criteria of the Development Assistance Committee (DAC) of the OECD, it has been determined that these promotional efforts contribute to poverty reduction and food security. However, the evaluation also revealed that market integration of such segments of the population is an essential precondition for enabling them to benefit from the market-based approach. People living in extreme poverty must therefore be reached by other means.



3. How effective is private sector engagement?

What challenges does the evaluation of PSE face?

How can financial and development additionality be measured, and what effects of PSE has DEval identified for intermediaries, households and partner countries?

What insights have been provided by DEval since 2016 from the perspective of independently evaluating PSE, and how have these insights been used?

3.1 Challenges in evaluating PSE

As in all evaluations of DC, evaluating PSE interventions serves to ensure accountability and institutional learning. By analysing the intended effects and impacts in comparison to those actually achieved, evaluation provides evidence that ideally leads to more effective policymaking. However, measuring the results and impacts of PSE entails dealing with a number of challenges.

National and international practice for evaluating PSE reveals difficulties in particular when assessing the additionality of interventions and measuring the outcomes and impacts of development policy at a higher intervention level. One initial finding of the DEval Evaluation Synthesis of PSE was that many national and international studies and evaluations – despite having been identified as relevant – could not be incorporated into the final evaluation due to their deficient quality with regard to these two points (Habbel et al., 2021). The following specific challenges arose:

- **Hampered identification of PSE projects due to a lack of markers or inconsistent markers**
  It is difficult to identify which interventions involve PSE because policy marker systems at national and international level are either lacking or imprecise. While data on interventions are sometimes available, in many cases it isn't possible within the framework of cross-project evaluations to recognise the relevant data as such. Ultimately, the interventions usually cover multiple sectors, which hampers the establishment of a marker system even more.

- **Limited access to data**
  Data and reports on (unlisted) companies and banks are not publicly available and often difficult to access due to bank and corporate confidentiality requirements. Confidential handling of information is aimed at protecting client data and preventing illegitimate competitive advantages or financial losses. However, in view of the difficulties with impact measurement already widely incurred, this confidentiality poses a significant obstacle for evaluations. Access to data is oftentimes only made possible by concluding comprehensive confidentiality agreements. Alternatively, data analyses in the evaluations must only be performed in aggregated or anonymised form (Dembele et al., 2020; Heucher et al., 2023; Orth et al., 2020).

- **Diminished data quality due to inadequate monitoring systems**
  A uniform, transparent monitoring system is not only necessary for measuring outcomes and evaluating projects: it also delivers substantive rationale for communication within an area that is the object of contentious discussion. Inadequate monitoring has a correspondingly negative impact, which has been ascertained in many of the PSE evaluations conducted by DEval. If data originate, for example, from review processes conducted in preparation for investment decisions (also referred to as due diligence), there is often a lack of performance indicators to which the data can be correlated. Consequently, the sustainability of the projects and their impacts are difficult to assess at a superordinate level of development policy, and correspondingly difficult to communicate. In only a few of the evaluations conducted by DEval do the surveyed indicators refer to the target group and/or the partner country, which impeded the assessment of outcomes (Habbel et al., 2021).

- **No uniform understanding of the measurement of additionality**
  In evaluations, the additionality of interventions and instruments is considered only rarely, and not by applying uniform standards. However, measuring additionality is of essential importance – particularly in PSE – so that public funding does not go to finance activities that the private sector would have implemented anyway.

Measuring additionality and capital mobilisation

Additionality analysis is important for determining whether public funding is used effectively and efficiently and generates the desired development policy outcomes. The OECD's Blended Finance Principles (2018), which provide definitive guidelines in this regard for international DC, distinguish between financial additionality and development additionality:

1. Financial additionality: private sector funding invested within the framework of a DC intervention which would not have been mobilised without public participation, or not for the same terms and conditions.
2. Development additionality: the results or impacts of an intervention that is publicly financed in cooperation with the private sector which, without the public contribution, would not have been achieved or not achieved to the same quality level.

As a general rule, both forms of additionality should be reviewed and assessed both ex-ante and ex-post.

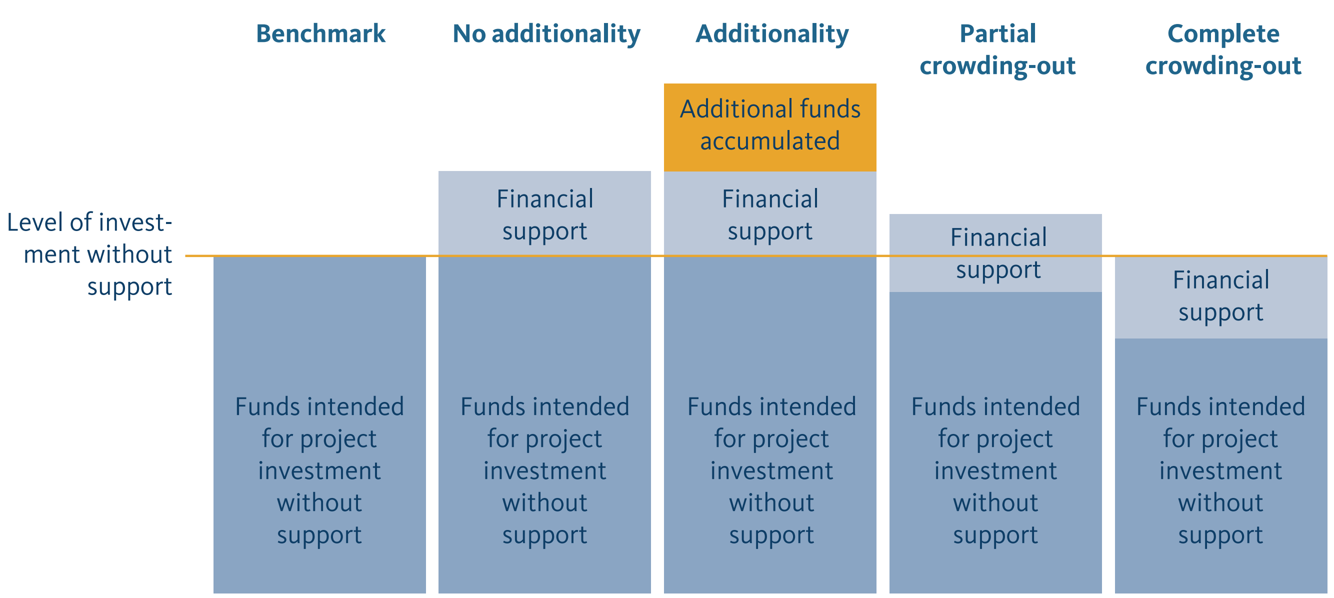
Ex-ante measurement of financial additionality

To review the financial additionality of an intervention during a project's preparation phase, the participating actors should precisely review and document in detail the proposed financing terms and conditions. Examples include loans which the public donors can only grant in local currency or with long financing terms and/or fixed interest rate. In this way, for example, the European Bank for Reconstruction and Development (EBRD) determines prior to approving a financing arrangement whether the applicants have alternative opportunities for obtaining financing elsewhere (EBRD, 2018).

Such assessment should also always include assumptions and risks regarding the continuing additionality of the interventions. Closely linked with this is the review for potential crowding-out effects. Crowding-out occurs when a public investment displaces an envisaged private investment. In principle, every state intervention in economic activities can lead to market distortion. The assessment depends on the ratio of the public funding to the privately envisaged amount of investment or the additionally mobilised capital.

One method for measuring additionality is shown in the DEval Evaluation of the develoPPP Programme. There, the flow of German direct investments to partner countries was compared with the investments under the programme. The evaluation examines whether the amount of the direct investments by the private sector that flowed to a country even without the grants through the develoPPP programme impacted the probability that the companies would apply for a develoPPP grant (Hartmann et al., 2017).

Financial additionality or crowding-out?



Source: Winckler Andersen et al., 2021.

The evaluation shows that foreign direct investment did not increase the probability of an application being submitted for develoPPP projects. This is an indicator that the develoPPP projects are additional and would not have been implemented without support.

In its Evaluation of Structured Funds, DEval examined whether the funds invest in regions that the globally active, purely private-sector microfinance funds cover to a lesser extent. If financial intermediaries of the structured funds also invest directly in the development finance institutions refinanced by the funds, the capital of these investors provides no additionality, as the risk mitigation through the public capital in the fund is apparently not needed for an investment.

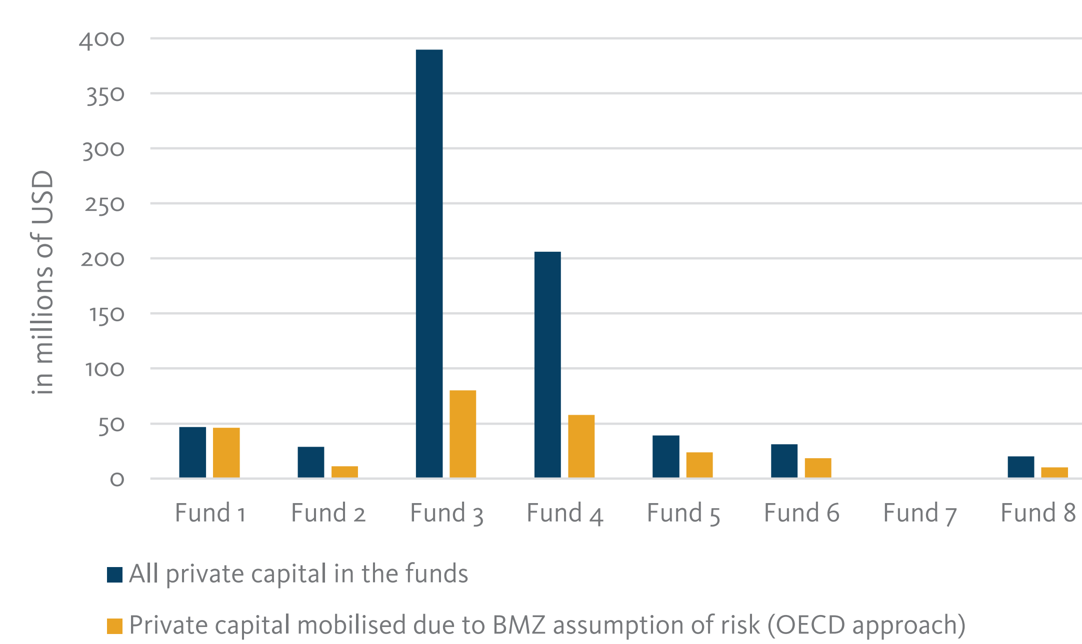
Funds are rated as additional if they invest in regions, sectors, countries and development finance institutions that have extensive need for and poor access to financing. At the same time, there is an apparent tension between financial sustainability and additionality: where investments do not take place without public support due to a presumed high level of risk, it is simultaneously probable that their financial sustainability is limited. These funds resolve this tension by investing in regions with extensive need for financing and in development finance institutions which, though they do indeed reach the targeted sub-borrowers, are nevertheless financial institutions of a more established standing with lower investment risk (Orth et al., 2020).

Ex-post measurement of capital mobilisation

By contrast, ex-post review of financial additionality shines a spotlight on whether the use of public funding has been worthwhile in terms of the achieved mobilisation of additional private capital. Assessing what leverage effect has been achieved requires that the exact amount of financing from the private sector be determined (Winckler Andersen et al., 2021), although this figure cannot simply be derived from the total volume of mobilised capital (Hartmann et al., 2017). Differing definitions of what counts as mobilised capital influence the measurement of leverage effects, and need to be presented transparently (Orth et al., 2020). Moreover, a complete analysis should also consider the financial instrument used and the governance structure of the given financing system (Winckler Andersen et al., 2021).

An analysis of this nature was performed within the framework of the DEval Evaluation of Structured Funds. As shown in the figure below, the quantified amount of mobilised private capital differs considerably depending on the applied definition or type of measurement. For example, the OECD DAC approach considers solely the capital that can be attributed to the risk assumption by the public donor (yellow bar). Other approaches include all mobilised private capital in their total (blue bar). This significantly alters the assessment of the achieved impacts, as the mobilised private capital amounts to less (Orth et al., 2020).

Private capital and mobilised private capital



The figure presents a comparative analysis of eight funds examined in the Evaluation of Structured Funds. For reasons of anonymisation, they are labelled here simply as Fund 1 through 8.

Source: Orth et al., 2020.

There are also differing definitions of the term "leveraging capital". In the reporting to the fund investors, the leverage effect is often indicated as the ratio of public investments to all other capital invested in the fund. This implies that, besides the private capital, the funding from the financial intermediaries through the financing approach of structured funds is also leveraged. Yet, in actual fact, not all of the funding provided by the financial intermediaries is leveraged capital (Orth et al., 2020). In order to achieve a transparent presentation of the differing leverage effect, a distinction should be made in the capital sources between private capital and capital from financing intermediaries, and the share of this capital in the fund's total volume assessed. This can reduce the risk of overestimating the leverage volume.

Example: Mobilising private capital for climate action

In a macro-quantitative study on reducing greenhouse gas emissions, DEval analysed the mobilisation of private capital through the BMZ's fund and direct investments (Wencker et al., 2024). The analysis focused on the BMZ's fund and direct investments held in trust by KfW with a marker for climate change mitigation (CLM marker) during the time period from January 2017 to June 2023.

To assess the capital mobilisation potential of interventions relevant to reducing greenhouse gases, 19 fund and direct investments within the relevant mitigation area were compared with 60 BMZ fund and direct investments that are not relevant to climate change mitigation. The control group for this purpose was weighted such that it was as similar as possible to the mitigation-relevant interventions with the exception of its climate mitigation relevance.

The analysis shows that, so far, despite the broad interest of private investors (Bernhard-Rau et al., 2022), mobilising private capital for climate action and clean energy sources has not succeeded any better than in other areas. And, so far, assumption of greater risk has likewise not led to any improvement in capital mobilisation. Against the backdrop that the BMZ invests primarily in the mitigation-relevant area of structured funds, the effectiveness and efficiency of this instrument should undergo critical review moving forward.

In view of the consequences of climate change, stronger use of private capital for global efforts to reduce greenhouse gas emissions is urgently needed. Accordingly, it is vital that greater priority be assigned to leveraging market opportunities, innovation potential and the future security offered by clean technologies. This can work towards getting all financial flows moving consistently on the pathway of sustainably reducing emissions.

Assessing the extent to which certain strategies of private capital mobilisation are better suited than others for climate action is not possible on the basis of analysing the mobilised capital and leverage. These data are insufficient to gain any insights into the extent to which other instruments would be more successful: for example, whether a strong mobilisation effect can indicate that private investments would have been undertaken even without public support. This is why the effectiveness of private capital mobilisation should continue to be evaluated in future on a differentiated basis.

> **Assessing the development additionality of interventions is a complicated task, because it is often related to the meso or country level, and thereby goes beyond the micro level of a single company.**

Development additionality

The basic concept behind assessing development additionality is that the outcomes of an intervention publicly financed in cooperation with the private sector would not have been achieved without the public contribution, or not achieved to the same quality level. A standardised evaluation practice has yet to be established for this purpose. Ideally, the additional contributions made by the private companies would first have to be identified, then documented and, if need be, quantified (AfDB et al., 2018; Winckler Andersen et al., 2021). However, this approach requires that the investors have knowledge of the DC project management as well as time and personnel resources. This information is unavailable in many cases. Instead, personal estimates by employees of companies or DC organisations are frequently the means of choice for assessing the development additionality of projects. Such estimates are oftentimes not based on traceable criteria or indicators, and come with the risk of positive bias.

Sharpening the sense of awareness among companies more keenly for development policy issues could provide an approach to improving how the development additionality of investments is assessed. For instance, changes in the objectives of the companies who benefit from DC projects and their target groups could serve as indicators (Habbel et al., 2021; Heucher et al., 2023). The participating public DC actors could provide assistance in this regard, supporting the companies with positive best-practice examples of DC monitoring.

Another factor contributing to the complexity of assessing the development additionality of interventions is that such measurement is often based on the meso or country level, and thereby goes beyond the micro level of a single company. As shown in the DEval Evaluation Synthesis of PSE, relevant effects concern, for example, the income of certain demographic groups, structural changes to markets, and improvements in carbon footprints. What does this mean for the regions and countries in which the private sector prefers to enter into partnerships with public DC actors?

DEval's portfolio analysis of the develoPPP programme (Lücking and Roggemann, 2016) utilised statistical methods to examine the correlating interaction of country-specific factors and the probability of applications for and approval of support funding. Interestingly, over the course of time a growing number of develoPPP projects were applied for and approved in countries which, while politically more stable and democratic, are also poorer.[2]

However, the DEval Evaluation of Structured Funds shows that the funds are increasingly active in countries with higher average incomes (Orth et al., 2020).

[2] Why poorer countries, and in particular those with lower average incomes, are preferred by companies when applications are received could not be conclusively clarified. However, it is feasible that the programme appeals more readily to companies that wish to contribute to DC, have already collaborated with offices of the implementing organisations in the partner countries, or who presume that the probability of an application's approval is increased by their participation (Lücking and Roggemann, 2016, p. 42f.).

Critical voices are accusing private sector actors of wanting to use such investments to reap the highest possible profit at little cost and effort.

Yet, under certain circumstances, a financing input in more highly developed partner countries can produce development additionality there as well. Key in this regard is to duly consider the given sector, market and region in which a project is to be implemented. If the relevant sector, market and/or region are underdeveloped in comparison to the given country's structure and performance otherwise, the investment can indeed generate development additionality. To assess such effects, an index oriented to conventional governance indicators can be used, for example, in a comparative analysis against the effect strength of the additionality (Hartmann et al., 2017).

Measurement of impacts

Many evaluations spotlight the measurement of impacts at various levels and for specific target groups. Based on the theory of change for PSE illustrated in Section 1, impacts are typically expected among companies, financial intermediaries, households and governments, and consist of, for example, the mobilisation of additional (private) capital or introduction of technologies and working standards. Identifying and measuring development impacts of a more long-term nature, such as structural changes in the partner country or sustainable growth in income among the target groups, is a much more complex task. Many evaluations spotlight the measurement of impacts at various levels and for specific target groups. Based on the theory of change for PSE illustrated in Section 1, impacts are typically expected among companies, financial intermediaries, households and governments, and consist of, for example, the mobilisation of additional (private) capital or introduction of technologies and working standards. Identifying and measuring development impacts of a more long-term nature, such as structural changes in the partner country or sustainable growth in income among the target groups, is a much more complex task.

The following sections provide an overview of the effects and outcomes that DEval identified in the PSE interventions and instruments examined. A distinction is made thereby between outcomes and development impacts, and resulting recommendations are presented according to the three target groups of PSE: intermediaries, households and partner countries.

The DEval Evaluation Synthesis of PSE serves as the evidence base. It summarises the findings of 51 German and international evaluations and studies selected from a total of 308 evaluations and studies of PSE. They show positive and negative impacts of PSE interventions in all categories and among all target groups along the theory of change presented in Section 1. The category "Financing of companies", public-private partnerships, grants as utilised in the develoPPP programme and debt and equity financing were examined particularly frequently. The results of the evaluation synthesis were supplemented with findings from other DEval evaluations.

Excursus: DEval's approaches and methods for impact measurement

All DEval evaluations of PSE are premised on a theory-based approach (Astbury und Leeuw, 2010; Chen, 2015; Funnell und Rogers, 2011) and a theory of change custom-tailored to fit the given object of evaluation, as described in the example presented in Section 1 (see page 20). With the help of this instrument, DEval identifies assumptions on which the interventions are based, and analyses those premises empirically. A theory-based approach for complex interventions – as they often occur in PSE – requires frequent application of various quantitative and qualitative methods of data collection and evaluation (Stern et al., 2012; White, 2009; White and Phillips, 2012).

Contribution analyses

With an eye to applying qualitative methods, multiple DEval evaluations – including the Evaluation of the Promotion of Sustainable Supply Chains in Development Cooperation (Heucher et al., 2023) – succeeded in compensating for problems of data availability with contribution analyses. Contribution analysis is a theory-based design for evaluating impacts. It is based on the plausible interlinkage of cause-effect relationships on the basis of the theory of change, and it is used for systematic examination of whether the assumed causal pathways bear up to reality taking the relevant assumptions, risks and alternative explanations into consideration. To assess the assumed causal effects, the factors of the established impact model are operationalised by means of indicators. Data must be available for the selected indicators to serve as a basis for enabling assessment of the assumed causal pathway (Heucher et al., 2023; Orth et al., 2020).

The difference-in-differences approach

As a quasi-experimental design, the difference-in-differences (DID) approach is often applied in DEval evaluations. This analytical technique is intended to help answer the question of causality, meaning whether an intervention actually resulted in the desired effect or is the cause of an observed effect. So, what is the counterfactual? What would happen without the intervention, or with some other intervention? In the Evaluation of Structured Funds, a DID approach was used to conduct a comparative analysis of the development of microfinance institutions (MFIs) with and without interventions. Evaluation designs that measure the causal effect of an intervention by experimental or quasi-experimental methods are characterised as rigorous impact evaluations and are used by DEval for example in a specially established support programme (Faust, 2020; Krämer et al., 2021; Faust/Bruder et al., 2019; DEval, 2024).

In contrast to experimental methods in which the intervention group (i.e. the treatment group) and the control group are selected at random, in quasi-experimental approaches such as the DID approach the control group is constructed after the intervention. It should be as similar as possible to the intervention group, but has not received the intervention. In both groups, the target indicators are measured before and after the intervention. If changes are identified in the intervention group that do not occur in the control group, it is probable that the intervention is responsible for the effect.

Preconditions for applying DID

However, the DID method places demanding requirements on the database, the scope of which is only sometimes adequate in PSE interventions. The publicly available MIX Market database of the World Bank contains annually collected data on MFIs around the globe (World Bank, 2024). DEval drew on this database in its Evaluation of Structured Funds. Based on the data on MFIs available for various years, including information on their size, financial performance and target group orientation, changes in the intervention group and control group have been analysed. In this analysis, DEval compared two points in time to show the influence of the funds on the MFI: one year before the fund was established, and the current year.

Further prerequisites for application of the DID method are that the impact model is constructed very precisely, the indicators fit the impact levels, and the data for the indicators are precise. Moreover, provisions must be made so that no unexamined effects influence the control group and/or the intervention group, and thereby distort the results.

3.2 Impacts of PSE on intermediaries

3.2.1 Intermediaries as investors

Intermediaries in PSE include, for example, investors, institutional investors or impact investors. According to the results of the DEval evaluations, the PSE interventions – particularly the ones following the "financing with companies"-approach – can mobilise capital among German, European and international investors for implementing the SDGs. The amount of mobilised capital varies widely, ranging from a few thousand to several million US dollars.

There is potential for increasing the amounts mobilised from investors. Among the structured funds examined by DEval, the shares of private capital mobilised lay on average around 22 per cent, compared to 36 per cent from public donors and 40 per cent from development finance institutions. Individual private investors indicated in the evaluation their willingness to assume greater risk. Such opportunities need to be better utilised. Moreover, according to DEval's examinations, the fund organisations have been lacking a clear acquisition strategy regarding private and institutional investors for fully leveraging the risk appetite available there and thereby mobilising more capital (Orth et al., 2020).

Studies conducted by other institutions, too, demonstrate that the mobilisation of private capital so far has fallen far short of expectations (World Bank, 2021; OECD, 2020, 2023; Lee, 2017). In order to reduce the existing financial gap for achieving the SDGs, the Independent Expert Group of the G20, for example, is calling for multilateral development banks to mobilise private capital in the amount of 500 billion US dollars by 2030. Instead, the actual amount of US dollars estimated to be mobilised annually stands at approximately 63 billion, a considerable difference (Forster und Lee, 2024).

The leverage effect of public funding for mobilising private capital will therefore be decisively important. According to the multilateral development banks and the International Monetary Fund, this leverage effect should amount to a ratio between 1:2 and 1:5. This means that two to five US dollars of additional private investments should be mobilised for each US dollar invested by public institutions (in the private sector) (World Bank et al., 2015, p. 2). Currently, however, for every US dollar deployed by multilateral and international development finance institutions, only 75 US cents are mobilised in developing countries, and in low-income countries a mere 37 US cents (Attridge and Engen, 2019).

Furthermore, coordinating the investments of public and private donors entails high transaction costs. Among other reasons, this is due to the complex efforts to define and measure objectives, in particular for capital mobilisation. In many cases, a lot of time has to be invested in the initial phase of a cooperative arrangement (Habbel et al., 2021). DEval therefore recommended in its Evaluation Synthesis of PSE that participating actors plan their interventions wherever possible over a longer advance period in order to be compensate later for the high costs incurred in the initial phase (Habbel et al., 2021). Within the framework of its Evaluation of Structured Funds, DEval recommended that the fund structures be simplified and that various types of investors such as public and commercial investors and development finance institutions as well as foundations and NGOs be approached for designing the mobilisation of private capital more attractively (Orth et al., 2020).

3.2.2 Intermediaries as implementers

The intermediaries integrated in DC interventions oftentimes also act – in addition to their function as funders – as implementers, for example by advising companies. They thereby contribute directly to implementing development interventions and potentially to achieving the SDGs. One example of such effects is a financial intermediary in the Global South who is granted a publicly supported line of credit from a German investor, and is thereby able to serve multiple MSMEs. This input facilitates access to finance for small and medium-sized enterprises as well as households, resulting in positive income effects as well.

In its evaluations, DEval was able to determine that intermediaries contribute not only to knowledge and capacity development, but also to the financial viability of investments that had been enabled by loans granted from the structured funds. DEval also observed that not in all intended cases were the portfolios oriented to specific target groups like MSMEs or vulnerable households, which would be particularly important for achieving the goals of development policy.

DEval therefore recommended that PSE interventions be designed to reach more companies, and that those companies design their proposals more attractively, including for example stronger publicity and acquisition through DC (Hartmann et al., 2017; Kaplan et al., 2018). Moreover, the interventions should be more impact-oriented in their focus. For structured funds, this would enable financial intermediaries to be selected with stronger focus on sectors and target groups relevant to DC, or the financing to be linked to activities geared towards such sectors and target groups (Orth et al., 2020).

Examples for DEval evidence: Impacts among companies and financial intermediaries

The **Evaluation Synthesis of PSE** revealed particularly frequent positive effects of DC interventions aimed at the transfer of knowledge and technology, knowledge generation and vocational training and education in the development finance institutions and companies (Habbel et al., 2021). DEval also ascertained that intermediaries are orienting their efforts in part more strongly to target groups of development policy.

The **Evaluation of Structured Funds** shows that the funds enhance the financial sustainability of the development finance institutions in developing countries and emerging economies by providing them with reliable financing as well as know-how for capacity building measures (Orth et al., 2020). In this way, the institutions can diversify and professionalise their financing structure and thereby improve their access to other financing opportunities. In some cases, capacity development results in a simplified access to financial products for the target groups, for example through development of new, needs-oriented products or through training for sub-borrowers.

In the **Evaluation of Agricultural Value Chains**, the promotion of agricultural value chains is found to be effective when, for example, smallholder farms are integrated into national and international production and trade processes by modernising agricultural production and processing (Kaplan et al., 2016). Such interventions serve in particular the increase of productivity and improvements in quality management and marketing.

The **Evaluation of the develoPPP Programme** focused first and foremost on examining changes in attitudes and behaviours in European companies. Its findings: while knowledge of the function and structure of DC is increasing, there has been no significant rise in the awareness of development issues (Hartmann et al., 2017). Moreover, companies make use of the lessons learned from develoPPP programmes in new markets, for example in their international business, and often mainstream these project activities into their core business once promotion efforts have ended. This enables them to increase their competitiveness.

Examples for DEval evidence: Impacts on human rights and environmental and social standards

In the **Evaluation of the Promotion of Sustainable Supply Chains**, the example of the textile sector was used to analyse the impacts of PSE on socially and environmentally sustainable global supply chains (Heucher et al., 2023). Analysis showed that, through the DC activities, purchasing companies are complying more pro-actively with their corporate due diligence obligations along their supply chain, for example concerning respect for human rights. In addition, the statutory framework conditions improved with the adoption of the German Supply Chain Act. Efforts seek to achieve impacts in the partner countries as well, especially in the textile factories. However, the example of Bangladesh in the evaluation shows that marked progress in achieving such impacts is not evident there (Heucher et al., 2023). The evaluation team came to the conclusion that the identified changes are not sufficient enough to contribute decisively to protecting workers against work accidents, reducing resource consumption and environmental pollution and improving workers' representation.

The **Evaluation Synthesis of PSE** makes particular mention of positive effects achieved in the approach area of "financing with companies" in terms of introducing standards (such as work and safety standards as well as environmental and sustainability standards) and certifications for intermediaries (Habbel et al., 2021). With regard to vocational training and education as well, positive effects are reported in the form of training courses in environmental and social standards. The same holds true for sustainable supply and value chains, particularly in interventions aimed at financing companies (Habbel et al., 2021), as stronger collaboration has been observed between European and local companies, new standards have been introduced and the competitiveness of local producing businesses has been strengthened.

Structured funds are using the environmental, social and governance standards (ESG standards) and other sets of rules in their decision-making on financing interventions. If a development finance institution displays poor performance in this respect, financing will oftentimes only be approved if accompanying measures for implementing the standards take place. With regard to respect for human rights, it is especially important to protect clients and prevent them from falling into over-indebtedness. Various initiatives are intended to bolster this protection and help provide for fair financing terms and conditions, such as the Responsible Finance Principles and the Smart Campaign for protection of microfinance clients. The evaluation team found, however, that very few institutions would take part in these initiatives if principles of protecting clients are to be observed in the selection of development finance institutions, and that the guidelines are in part vague, would not be observed, or compliance would be difficult to track and trace (Orth et al., 2020).

Even if companies and financial institutions are not engaged in DC, universally recognised human rights constitute a binding framework for their action as well.

Public actors such as DEG could leverage new investment strategies that help companies act more sustainably (see page 74). DEG wants to structure their portfolio to be climate-neutral by 2040 and thereby contribute to limiting global warming to two degrees at maximum.

3.2.3 Intermediaries as defenders of human rights and environmental and social standards

Even if companies and financial institutions are not engaged in DC, universally recognised human rights constitute a binding framework for their action as well (Polak et al., 2022). Yet, how is the protection of human rights concretely manifested in PSE? On the one hand, the DEval analysis of the develoPPP portfolio shows, for example, that companies systematically prefer countries with more democratic governmental regimes when selecting their locations, where human rights can generally be better implemented than under more autocratic regimes. On the other hand, civil society organisations express concern regarding the sensitivity of PSE to human rights aspects in the partner countries. They assume that companies would not pro-actively meet their corporate due diligence obligations and other human rights requirements because such compliance entails administrative effort and potentially higher costs.

In its reports, DEval has delved into the issues of respect for human rights and compliance with social and environmental standards, and in its evaluations of value and supply chains it has examined the human rights approach in DC with the private sector and financial systems. DEval has analysed, for example, the extent to which the core labour standards of the International Labour Organization (ILO) are respected in PSE interventions, which include the freedom of association, the right to collective bargaining, the elimination of forced labour, the abolishment of child labour and the elimination of discrimination in respect of employment and occupation. DEval also took into account on an ad hoc basis the implementation of the Performance Standards on Environmental and Social Sustainability of the International Finance Corporation (IFC), which constitute an important reference framework for German development actors (IFC, 2012).

The evaluations conducted by DEval reveal in part positive impacts that the intermediaries have on the human rights situation, and also show that social and environmental standards are being applied to some extent. However, this was outweighed by a rather critical assessment of what PSE achieves in this respect. Human rights reviews and requirements for interventions and companies are oftentimes not systematically mainstreamed in processes, and fail to produce any impact adequate enough to ensure full compliance with the requirements in respect of human rights as well as the comprehensive social and environmental standards (Hartmann et al., 2017; Kaplan et al., 2018; Polak et al., 2021).

In its Evaluation of the Promotion of Sustainable Supply Chains, DEval recommended that the BMZ develop an overarching impact- and action-oriented concept, and strengthen voluntary initiatives such as the Textile Partnership (Heucher et al., 2023). These recommendations are aimed at strengthening companies' efforts to meet their corporate due diligence obligations. DEval thereby tied in with similar recommendations provided in the Evaluations of PSE in the Agricultural Sector and its Evaluation of the develoPPP Programme regarding, for example, risk analyses, guidelines, complaint mechanisms and monitoring (Hartmann et al., 2017; Kaplan et al., 2018).

3.3 Impacts of PSE on private households

DEval examined the impacts of PSE on private households as a target group in terms of outcomes and development impacts. The evaluations reveal positive outcomes for households for all categories and instruments of PSE – including short-term employment effects, higher incomes and access to financing opportunities through the financial intermediaries in structured funds. Yet, according to the evaluations, this has not necessarily resulted in significantly improving working conditions or reaching vulnerable groups in particular (Habbel et al., 2021). However, the instruments could be conceptually improved for these purposes. In many cases, the DEval recommendations relevant for households as a target group concern the conception and orientation of the

Examples for DEval evidence: Economic impacts on target groups

The **Evaluation Synthesis of PSE** presents a large array of outcomes and development impacts for households (Habbel et al., 2021), in particular positive employment and income effects. However, determining whether employment opportunities on the labour market are only shifted or merely secured, or whether new opportunities are indeed created is oftentimes a highly research-intensive task. In the evaluations and studies examined, new jobs were described in part as being short-term or poorly paid. At a superordinate development policy level, however, the Evaluation Synthesis of PSE reports primarily positive impacts for households in terms of poverty reduction, gender justice and improved living conditions (Habbel et al., 2021). However, these impacts were in many cases only estimated due to the challenges encountered with their measurement, which can lead to bias in judging the actual impact.

The **Evaluation of Structured Funds** addresses the question of whether the supported financial intermediaries provide their sub-borrowers with a better offer than other, non-supported financial institutions (Orth et al., 2020). While the offering of financing loans was indeed increased, neither were the loan terms and conditions modified nor was the offering expanded in particular for development-relevant households such as smallholders or sub-borrowers without collateral.

The **Evaluation of the develoPPP Programme** presented only a limited scope of impacts on households (Hartmann et al., 2017). It proved challenging to translate new knowledge and technology through develoPPP.de projects into income and employment effects; thus the local population benefitted only to a limited extent. The projects would in many cases only cover small groups of the population and far-reaching changes are probably not to be expected.

The interventions for promoting **agricultural value chains** lead to higher incomes and employment among households. However, some target groups are reached less, such as persons who do not lead any directly marketable, risk-adverse smallholder farm, and the chronically poor (Kaplan et al., 2016). In the DEval evaluation, the effectiveness of development policy was rated as limited, due for example to entry barriers for a portion of the development-relevant households because of inadequate availability of resources such as land, knowledge and capital.

programmes, the selection of intermediaries and their action framework (see Section 3.2.3).

The Evaluations of Agricultural Value Chains and of PSE in the Agricultural Sector point out that the promotion efforts are not reaching certain groups. These include, for example, smallholder farms operating on the borderline of marketability, or companies seeking to sell their products in contrast to purchasing companies. DEval recommended accordingly in its Evaluation of PSE in the Agricultural Sector that promotion of inclusive business models be bolstered, particularly for companies selling their products, with the aim of reaching households particularly relevant to development efforts and to contribute to asset accumulation (Kaplan et al., 2018). By contrast, people affected by severe poverty would not be able to be reached – or only indirectly – via the promotion of agricultural value chains, and would have to be supported by other interventions (Kaplan et al., 2016).

Negative effects were identified in individual cases in the analyses of the Evaluation Synthesis of PSE: a number of PSE interventions caused price increases and created new dependency relationships for households. While this was indeed the consequence of an improved quality of services and products, the resultant price rise nevertheless excluded particularly vulnerable groups from its benefits. What is more: after the DC withdrew, the quality of services sank again, thereby reversing the positive impacts.

In many evaluations and studies of the agricultural sector it is likewise reported that large purchasing companies have created new, asymmetrical dependency relationships due to the integration of smallholders in the value chain: smallholder farms are confronted with various structural hindrances when integrating into international value chains, facing for example a competitive disadvantage compared to larger producers in terms of access to capital or storage spaces, and their resultant lack of ability to meet the necessary quality and quantity requirements. Large companies can exploit this situation through their function as gate keepers to promising markets, such that smallholder farms only manage to achieve the necessary competitiveness by paying their workers low wages (in many cases their own family members) (BASIC, 2014).

3.4 The balancing act between corporate interests and development policy

In PSE, it is often difficult to reconcile private-sector profit-oriented efforts with development policy objectives such as reducing poverty or supporting particularly vulnerable segments of society. To counter these conflicting goals, the Global Partnership for Effective Development Cooperation (GPEDC) developed what are called the Kampala Principles for Effective Private Sector Engagement in Development Cooperation. The GPEDC is a multi-stakeholder forum whose mission is to foster efficient and effective cooperation among governments, bilateral and multilateral organisations, civil society and the private sector (UNDP, 2024).

The existence of conflicting goals between corporate interests and development policy is confirmed in many DEval evaluations (Hartmann et al., 2017; Habbel et al., 2021). Particularly in the initial phase of cooperation arrangement, the resulting balancing act leads to high transaction costs, and synergy effects to not kick in automatically. Both these aspects impede the efficiency of the approach.

The aim of DEval's recommendations in this regard is for the development-policy and corporate actors to jointly identify and negotiate common goals early on in the planning of interventions. These efforts should transparently address the various target groups and explicate existing fields of tension and conflicting goals (Hartmann et al., 2017). Finally, the progress towards achieving their joint objectives should be continuously monitored (Habbel et al., 2021).

Longer-term cooperative arrangements are advantageous so that the initial effort and cost for identifying common goals pay off in the long run. DEval also explains in its Evaluation of the develoPPP Programme and Evaluation of Agricultural Value Chains that the reconcilability of these objectives succeeds better if the DC activities of a company also contribute to that company's core business (Hartmann et al., 2017; Kaplan et al., 2016).

Examples for DEval evidence: Fields of tension between the conflicting goals of corporate interests and development policy

In the evaluations and studies examined within the scope of the **Evaluation Synthesis of PSE** a number of cases are presented in which the private sector actors prioritise their economic added value, and no positive development effects take place (Habbel et al., 2021). This occurs in all forms of cooperation examined; for example, when commercially less relevant segments of the population are not reached, despite the fact that they stand to benefit the most from the intervention if their socio-economic situation would thereby be improved. Moreover, no development policy effects were observed when the tasks of project management fell primarily to the private sector partners.

According to the **Evaluation of Structured Funds**, the private sector partners pursue development policy goals to the extent possible on the condition that financial sustainability is maintained. For example, development-relevant households in the form of sub-borrowers are reached in particular through MFIs which turn the funds received into more loans to vulnerable end-borrowers such as smallholder farms led by women (Orth et al., 2020). However, access is not facilitated for particularly vulnerable groups who, for example, do not possess any collateral such as through ownership of land or living space.

It became clear for the **develoPPP programme** as well that the additionality provided by development partnerships for DC diminishes when there is only little overlap between the goals of development policy and those of corporate interests (Hartmann et al., 2017). Deadweight effects on the part of private sector companies cannot be ruled out. For private sector companies, the marginalised and vulnerable segments of the population who are the main focus of DC are usually less relevant as target groups (whether as consumers or producers). Hence, according to the evaluation, it cannot be presumed that develoPPP projects per se contribute to inclusive economic growth and poverty reduction in the partner countries.

The **Evaluation of Agricultural Value Chains** shows that any development policy additionality can only arise if the company activities within the framework of PSE contribute to the company's core business and if development policy and companies jointly identify interfaces for their collaboration and for reaching objectives (Kaplan et al., 2016).

3.5 Impacts at partner country level

In the DEval Evaluation Synthesis of PSE, specific effects at the level of partner countries are presented (Habbel et al., 2021): positive outcomes of PSE, for instance, were identified in terms of network building in the partner country, for example in the form of business relations, and for dialogue at the public policy-making level, for example between governmental ministries. It was frequently reported that political reforms were taking place in individual sectors, and national laws, regulations, strategies or guidelines for certification were being changed accordingly. This concerns interventions within the framework of policy dialogues in particular. With respect to partner-governments (ownership), it was observed in a number of evaluations that partner governments themselves invest in a structured fund or additionally conduct their own advisory interventions.

With regard to development impacts, many of the evaluations and studies examined in the DEval Evaluation Synthesis of PSE report on impacts on the environment and on market and sector development as well as on demonstration effects. Through PSE interventions, the partner countries thereby reduce greenhouse gas and pollution emissions, save energy, slow deforestation and expand their renewable energy sources. New business models and products are being introduced and new actors are entering the market as part of market and sector development. This generates further effects and impetus in markets, in particular in the renewable energy, agribusiness, infrastructure, telecommunications and finance sectors. Moreover, these interventions enable loans to be provided in local currencies instead of foreign currencies, which reduces the exchange risks that sub-borrowers face. Demonstration effects were identified for mobilisation of additional capital, piloting of new interventions and instruments and for further development and consolidation of sectors.

However, it bears asking to what extent individual cases of positive impetus actually lead to useful and sustainable reforms. Only a few evaluations described these effects as being lasting impacts. In one case, a PSE intervention contributed to market-based financing becoming established in sectors which prior thereto had been grant-financed sectors. While isolated evidence points to an increase in production, investments and exports, it remains unclear whether these increases potentially trigger

The Kampala Principles

The Kampala Principles (GPEDC, 2019) serve as an important orientation and aid for the transparency and accountability as well as measurement and additionality of PSE. They are often thought of in conjunction with the Blended Finance Principles of the OECD (2018), and state that

1. the partner countries are responsible for coordinating the cooperation and ensuring coherence with national development goals,
2. the goal of PSE is to achieve development outcomes through mutually beneficial results,
3. it is important to promote continuous dialogue between all private sector, public and civil society stakeholders,
4. the measurement and dissemination of the outcomes of PSE enable transparency and accountability, and
5. no one involved in the cooperation shall be left behind (in accordance with the Leave no one behind principle of the UN 2030 Agenda), and risks must be consistently mitigated.

Source: GPEDC, 2019.

displacement effects. Besides, it is generally difficult to measure to what extent individual interventions and small investment amounts can impact the economic development of an entire country. The situation with DC promotion of supply and value chains is similar. While some reports speak of the introduction of new standards and a strengthening of the competitiveness and export capability of local producers, their sustainability and broad-scale impact are nevertheless merely assumed and not proven.

Furthermore, DEval's Evaluation Synthesis of PSE identified framework conditions that inhibit or promote the success of PSE interventions. As presented in Section 1, deficits in statutory and regulatory frameworks are in many cases the reason for providing support through PSE. On the other hand, the framework conditions significantly influence the course of interventions as well. Feasibility studies therefore offer a suitable means of realistically assessing the developments of relevant markets before starting an intervention.

Moreover, a number of evaluations and studies demonstrate that PSE interventions are more successful when they also match the goals and reform plans of the partner governments. As part of the Evaluation Synthesis of PSE, stakeholders in German PSE interventions were surveyed to determine how well the interventions and instruments are integrated with one another at portfolio level. The survey responses allow conclusions to be drawn at the level of the partner countries in which multiple PSE approaches and instruments see frequent use. The stakeholders expressed the priority need for the various instruments and interventions of PSE – such as project initiation and development, advisory services, implementation and financing – to be integrated more closely in order to generate synergies. Interventions which are implemented for example with German financial intermediaries should also match the goals of project development interventions in the partner countries and of reform financing interventions (policy-based loans) at government level. Advisory services at the macro level, for example with government entities or central banks, could contribute to coordinating and agreeing on interventions promoting capital markets, as these would be heavily dependent on regulations and framework conditions in the partner countries.

Synergies between reform policy promotion and PSE

With the help of PSE-instruments, DC creates incentives for companies and financial intermediaries to invest in partner countries in the Global South despite challenging framework conditions. Once the state framework conditions there improve, the private sector can develop with fewer constraints. Many PSE instruments can then be used more effectively or – at best – be rendered superfluous. The framework conditions for the private sector can be improved through policy dialogue and, in particular, by way of policy-based approaches of private sector development. This includes the instrument of (sectoral) budget support, which is meanwhile called policy-based lending (Bielek, 2019) or development policy loans, and is widely used among multilateral development banks.

In its evaluations and syntheses on general development policy loans, sector development policy loans and reform partnerships, DEval assesses these policy-based approaches positively (Krisch et al., 2015; Orth et al., 2017, 2018; Roxin et al., 2022).

> **With the help of PSE-instruments, DC creates incentives for companies and financial intermediaries to invest in partner countries in the Global South despite challenging framework conditions.**

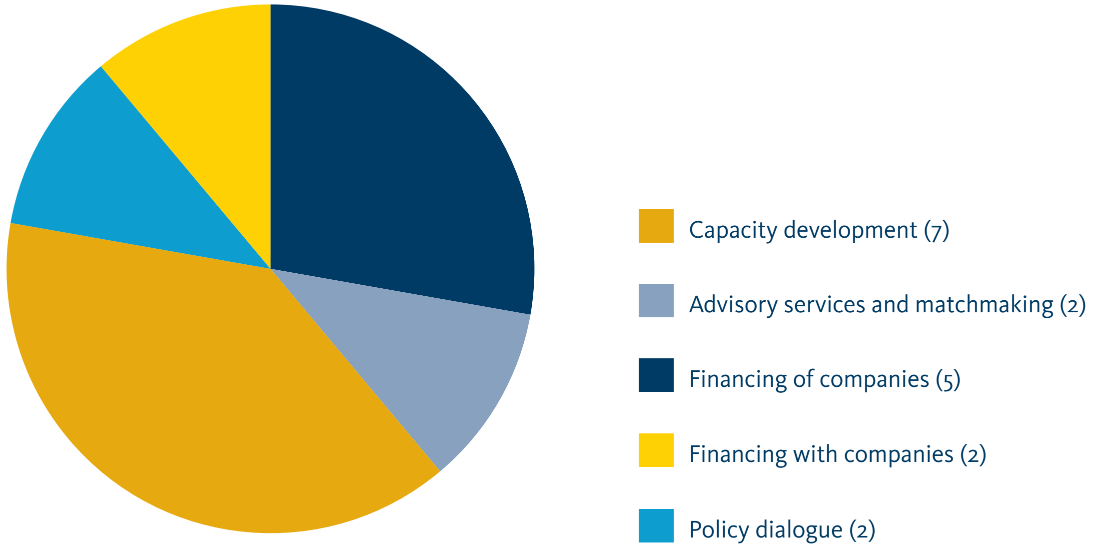
Particularly in the Evaluation Synthesis of PSE, DEval highlighted not only their positive impacts on the public finance system and the structuring of government expenditures, but also their contributions to improving the macro-economic stability of the partner countries (Orth et al., 2017). The reform partnerships also garnered a positive rating from DEval with respect to their effectiveness (Roxin et al., 2022). Efforts to date have mainly served to establish the prerequisites for targeted development impacts, i.e. laws, decrees, regulations and ordinances drafted and initial steps towards implementation undertaken such as founding or restructuring institutions. According to the evaluation, impacts reflecting improvement in the economic boundary conditions and increased investments are expectable, and in certain cases have already been achieved (Roxin et al., 2022).

Policy-based financing operations differ from other PSE approaches owing to their macro-economic impacts that are based on the intention to improve the framework conditions for the private sector. As success factors, DEval identified ownership by the governments of the partner countries and the (strict) conditionality of activities and financing (Orth et al., 2017; Roxin et al., 2022), which presents the donor community with, in part, major challenges. In its evaluation of the future of integrated policy-based DC, DEval emphasised that the combination of development policy loans with components of TC, policy dialogue and the conditionality can be particularly relevant and effective (Orth et al., 2018).

Despite many positive findings, the evidence collected for this approach this approach also points to challenges. Firstly, the conditionality is mainly designed for the actual effectiveness of the reform leverage. However, it is often incorrectly scaled or defined too weakly by applying an aspiration level that is too low (Schmitz, 2006). If the case does arise that the sanction needs to be applied, operational or policy-related intentions can sometimes pose an obstacle. One example is the pressure to disburse funding, i.e. the pressure to spend available funding by a certain point in time, or to continuously grant loans in order to enable repayment of old outstanding debts (Schmitz, 2006, p. 12).

In addition, the competition between donors for visibility and influence can adversely impact a more forceful reform policy and give the partner country leverage

Overview of the Deval PSE-related evaluations and studies (number given in parentheses)



Source: DEval, own presentation.

for delaying interventions they do not desire or circumventing them altogether by choosing other partners (Roxin et al., 2022; Ashoff, 2004; Faust, 2012). Ultimately, from the standpoint of safeguarding human rights and the principle of leave no one behind, the question arises as to how development policy loans should be applied in fragile states and authoritarian systems. After all, as part of the decision-making on DC allocation, development policy loans are also facing conflicting interests arising from the intended support of particularly needy segments of the population and their geographic location in what, in many cases, are poorly governed countries led by authoritarian regimes (Wencker, 2022). The complexity of the resulting balancing act is exacerbated even more by the expectation that additionally must unleash the greatest possible benefit for private sector development and PSE interventions.

The World Bank, too, seeks to link development policy loans more closely with other policy-based approaches to improve the framework conditions in the partner countries. These approaches are to be systematically supplemented with DC instruments – and explicitly with PSE interventions, as well.

This is one of the changes which the World Bank is currently implementing as part of a comprehensive reform process aimed at not just combating poverty, but also injecting more investments into preserving a liveable planet (CGD, 2024; World Bank, 2023).

3.6 Provision and use of evidence

DEval has a mandate to contribute to long-term improvement of DC by providing not merely the evidence but to

Example: Innovations introduced to the develoPPP programme

The develoPPP programme underwent a comprehensive reform process from 2017 to 2023. This reform was based on the experience gained from project implementation since 1999, the feedback from stakeholders in the political arena, private sector and civil society, and on DEval's own programme evaluation published in 2017. One objective of the reform process was to measure the effectiveness of DC projects more systematically and increase their efficiency. For this purpose, the support mechanisms were tailored more closely to the various target groups such as local or young businesses. Moreover, processes were standardised and digitalised and the differing strengths of the two implementing organisations GIZ and DEG were brought more clearly to the fore.

Expanded access

Since 2018, not only European companies but also businesses in developing countries and emerging economies can apply to develoPPP to have the programme's initiatives contribute to solving local problems. GIZ and DEG thereby embraced the impetus of a recommendation from DEval, because sound local businesses unite market expertise with high cultural sensitivity and long-term interests in the given target country – all of which are important success factors for effective development partnerships. Local companies have meanwhile assumed the lead in 68 per cent of all projects currently underway.

While develoPPP Classic continues to comprise cooperation with established medium-sized and large business enterprises, the programme has been expanded to include the develoPPP Ventures component for promoting start-ups. This expansion is aimed at helping young, innovatively strong businesses registered in a partner country to cross the threshold of bankability. Prerequisite to this step is that the start-up company be active on the market with an innovative, development-relevant business model that offers high scaling potential. The public contribution to promoting the expansion of a company's core business can amount to 100,000 euros, plus an additional 100,000 euros if certain specified indicators are achieved. These young entrepreneurs receive advisory services in addition to this financial support. In line with the suggestion in the DEval evaluation "that business activities (should) generate development results as a side effect," start-ups whose business model aims to improve the living conditions of people in the partner countries are specifically targeted for support.

Distinctly selective support

Since 2018, DEG Impulse and GIZ are the only two remaining implementing organisations carrying out the develoPPP programme on behalf of the BMZ. Both focus the support on their respective core competencies: DEG Impulse supports partner companies through financial expertise and entrepreneurial know-how for implementing projects locally under their own responsibility. GIZ implements projects in the field jointly with companies, provides technical support and helps to mainstream practices locally and integrate local stakeholders.

Source: DEval, 2023.

Instruments of the develoPPP programme

develoPPP Classic		develoPPP Ventures (available in Ghana, Kenya, Nigeria and Tanzania)
Established companies	**Target group**	Young companies and start-ups
Project support	**Type of support**	Support promoting growth
100,000 to 2 million euros	**Scope of support**	Up to 100,000 euros

Source: GIZ, 2024

conclude on recommendations based on that evidence. This is why DEval makes its findings available not only to the actors directly involved, but also to the German Parliament and the general public.

To systematically track the extent to which the target groups implement its recommendations, DEval always conducts implementation monitoring in follow-up to its evaluations. For every evaluation recommendation, such monitoring examines whether the DC institutions concerned have reviewed and adjusted their working methods in line with the recommendations. The first DEval synthesis report on monitoring the implementation of evaluation recommendations (DEval, 2023) assesses the extent to which PSE actors have embraced the recommendations from DEval's three PSE evaluations. The redesigning of the develoPPP programme (Hartmann et al., 2017) is a good example of how such evaluations can initiate changes (see page 63). Furthermore, DEval intends to incorporate the evidence from its evaluations into PSE reform processes as done for example in 2023 in the agile process of the BMZ's Sustainable Development Financing task force.

Whereas improvements to DC practice are found to have been initiated as a result of recommendations from DEval and other sources, there is also evidence on stubborn challenges. For instance, DEval has on multiple occasions identified the divergence of corporate intentions from development policy goals as an obstacle to implementing PSE interventions, for example in the develoPPP programme (Hartmann et al., 2017) and within the scope of the Evaluation Synthesis of PSE (Habbel et al., 2021).

There is no unified PSE marker for German DC interventions applied. Whether the existing PPP marker could be reviewed and adjusted for a higher validity remains to be enquired.

With reference to the Evaluation Synthesis of PSE (Habbel et al., 2021) and the Evaluation of Structured Funds (Orth et al., 2020), DEval came to the conclusion that, in future, the additionality of PSE interventions needs to be reviewed and documented. The recommendation from DEval states that GIZ, KfW and other bilateral and multilateral actors involved in PSE should examine the financial and development additionality when planning, implementing and evaluating such interventions.

After all, DEval has already repeatedly criticised the fact that there is no marker in German DC for interventions applying the PSE approach. The Evaluation of PSE in the Agricultural Sector (Kaplan et al., 2018) concluded that a review is needed to determine the extent to which the existing PPP marker can be adjusted to strengthen its application and validity. The problematic nature of identifying PSE interventions came to the fore again in the Evaluation Synthesis of PSE, (Habbel et al., 2021) and artificial intelligence was utilised to provide a solution. This and other challenges need to be addressed for the future so that German DC gains greater clarity of what role PSE has to play in DC.

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From the perspectives of financial intermediaries and fund managers:

Striking the right balance between risk and return

Statements obtained from Martin Ewald (formerly Allianz Global Investors), Elvira Lefting (Finance in Motion), Stephanie Lindemann-Kohrs (KfW Development Bank) and Alessandra Nibbio (BlueOrchard)

Risk appetite of investors and the role of structured funds

Stephanie Lindemann-Kohrs: The current political crisis all over the world increases the risk profile and makes private investors even more reluctant to invest in developing countries. Structured funds are essential for developing new markets, new regions and new sectors to provide the private investors with risk mitigation.

Elvira Lefting: Let us also not forget that, occasionally, risks materialise, as we have seen in Ukraine. That is what the private investors model. The question is therefore, how to de-risk them further and what do they assess as a risk? The very clear governance setup of the structured funds helps to raise their comfort levels. The more the structure of a fund is familiar to private investors, the more they understand it. The same applies to capital stack and notes.

Martin Ewald: Risk appetite as a general concept is very hard to grasp, and I do not think that it is possible to increase it. Rising interest rates make it more difficult for equity investors in emerging markets to generate returns which are high above the risk-free return investors can generate for example in OECD countries. Decision makers have to find the right balance between risk and reward. Therefore, within our blended finance vehicles like the Emerging Market Climate Action Fund we facilitate a dialogue about the appropriate risk-return-ratio, which in turn allows to mobilise private capital at scale.

Alessandra Nibbio: Another important element is trust. If investors see a stamp of approval provided by players such as the BMZ and KfW, it helps them to gain trust in the true developmental value of a certain strategy and to be willing to deploy capital for development finance in emerging markets that would normally be seen riskier than a plain vanilla investment in developed markets.

Additionality, impact and reporting

Nibbio: It is the principle of a structured fund to seek new investment opportunities where there is a market gap. We apply additionality both on the financial and developmental side, including capacity building, which we can provide thanks to the grants from development finance institutions. We measure additionality across several dimensions, for example how we are additional to a specific client group, for example, a local community. We also assess the additionality with a set of predefined indicators including the investor contribution, the impact classification and the degree of influence.

> If investors see a stamp of approval provided by players such as the BMZ and KfW, it helps them to gain trust in the true developmental value of a certain strategy and to be willing to deploy capital for development finance in emerging markets.

Lefting: The additionality concept is difficult to measure, as that would require proof that an impact would not materialise without our investment. We therefore assess our investor impact contribution more broadly along the multilateral development banks' harmonised framework for additionality in private sector operations. At the investment stage, we specifically look at the financing conditions available in the market and provide financing additional to that, for example, with longer tenures or very importantly in local currency.

Lindemann-Kohrs: Structured funds are highly individual, and it is important to make them more standardised. Processes are not only complex, but they also differ. Fund managers receive different reporting requirements and different environmental and social requirements. It would be helpful to establish one reporting requirement tool and one standard with regard to environmental and social requirements. That would make it much easier to leverage private capital with regard to timing and to capital organisation.

Ewald: It is very difficult to apply the additionality concept on the ground. Moreover, I see a trade-off in that very specific small scale, high impact targets do not allow a private fund manager to build a large enough vehicle to mobilise private capital at scale. Therefore, a dialogue between public and private actors must address the question if a desirable high impact might be too small to mobilise large-scale capital. This trade-off also limits structured funds.

Promising sectors and regions for private capital mobilisation

Ewald: I see the biggest potential in large-scale industry decarbonisation. There is not enough private capital flowing into fast-growing developing economies to help them decarbonise not only their energy production, but also the value chain across whole industries. Conservation is also key. It gives an impetus on forests and on biodiversity, which again impacts peoples' livelihoods. With relatively low volume, a massive impact can be generated. REDD, for example, is not perfect, but it is at least a tool which works. However, it is not getting enough access to capital.

Lindemann-Kohrs: Private investors are very keen to invest in climate change mitigation and to some extent in adaptation. Regarding the health sector, we see some appetite from private investors to invest in venture capital companies which develop innovated products and services. Gender equality also has a lot of unlevered potential. Merely 7 to 8 per cent of the agricultural sector is managed by women, notwithstanding that companies in which women have a leadership role are in most cases very successful. Regarding regions, there are certain limits. Private investors are very reluctant to invest in fragile regions. Africa in general is still a challenging continent for private investors, with the exception of South Africa.

Nibbio: Some sectors such as education or even infrastructure are complicated, but over the years, private sector contributions have increased. Health could also become a sector for the private sector to explore. Before, there was a focus on financial inclusion and financial institutions like MFIs. They remain relevant, but there is also a shift to sectors such as infrastructure, renewable energy and energy efficiency projects. We have recently explored more of Southeast Asia. There are some young public entities which are contributing to impact finance and triggered the interest of the private sector. As to Africa, creating the capital markets in some countries, especially in West Africa, will have the greatest potential for achieving impact.

Lefting: I see the agriculture sector coming more and more into play. It is very attractive for investors to invest in sustainable value chains of large commodities for tea, coffee or cocoa with a clear strategy and vision. Moreover, I would like to see a more holistic approach. We have not done ourselves a service to chase climate targets and not think holistically. Water can be saved alongside energy. Soil erosion can be mitigated while saving energy. Considering regions, we need to take a differentiated and tailored approach: Latin America and Southeast Asia, for example, are very attractive regions for private investors, while other regions need more support to fully unlock their impact potential. This is exactly where structured funds can make an important contribution.

Future needs, ideas for improvement

Nibbio: The differences between the public and the private sector make it complicated to bring them together. Their needs, requirements and goals do not always fully overlap. That makes the negotiations sometimes cumbersome. Therefore, streamlining processes and potentially getting the private sector feedback early on in a process would help to overcome certain challenges.

Lefting: KfW is doing a tremendous job, but it is always a filter and there is no direct dialogue between the BMZ and the private sector. Institutionalising such an exchange between the ministry and the private sector would help massively. In addition, the flexibility has to be improved. It is difficult to run large investments with tight limits, such as a single industry limit or a country limit. Then it takes you much longer to scale a fund and to make it attractive to the private sector. This is a vicious circle.

Ewald: We need predictability, long-term planning in a pragmatic way, transparency and the willingness to act fast. In addition, we need more competition, more players who are able mobilise more capital. And we have to build our ecosystem of investors in blended finance.

Lindemann-Kohrs: I would definitely say we need more standardised structures and more alignment with regard to reporting requirements.

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From the perspectives of multilateral development banks:

The principle of additionality in PSE

Additionality is an operating principle in multilateral development banks (MDBs) and development finance institutions (DFIs) that has been attracting increasing policy attention. The value that DFIs bring to the projects and programmes they finance, beyond that available from other sources and private actors, is fundamental for two reasons: (1) it justifies the use of public funds to support private sector development, which is under growing government scrutiny given the high opportunity cost of those funds, and; (2) it represents the development contribution of DFI projects compared with that from other market participants such as impact investors or partner DFIs. Despite its relevance, the DEval Evaluation Synthesis on PSE (Habbel et al., 2021) found that additionality was rarely addressed in the studies, and thereby lacking the attention it deserves and confirming some of the findings of an earlier report by the Evaluation Cooperation Group (ECG) (ECG, 2020).

DFIs consider additionality mainly at project level and rely on certain project characteristics to justify their intervention as additional. Additionality relates to financial and/or non-financial aspects of the project. Over time, sources of non-financial additionality such as risk mitigation, standards setting and capacity building have gained more attention than sources of financial additionality, including terms and conditions, innovative financing structures and resource mobilisation. This is partly due to the increased availability of private financing, which weakens DFIs' claims of financial additionality. It is also due to a higher scrutiny around the non-financial additionality of projects at approval stage and post-completion.

Evaluating additionality depends on the quality of information available in the DFI's project documents and data systems, and on management's attention. MDBs have made progress in the identification of sources of project additionality and in the design of systems and operating guidelines to assess additionality ex-ante and during project implementation (AfDB et al., 2018). Nevertheless, evaluators still face information and methodological challenges in assessing the validity and strength of a project's additionality. A set of recent MDB evaluation reports illustrate those challenges (EBRD, 2018; IDB, 2023; IEG, 2022; Independent Evaluation, ADB, 2022).

Information challenges and evaluation approaches

Despite the above-mentioned progress, there continues to be limited information on the financial terms and conditions available at the time of project approval and at project completion. Most project documents lack either market data or any detailed discussion of alternative sources of finance. This complicates the task of assessing financial additionality. Attempts to "recreate" and interpret market conditions several years after project approval, when conducting an ex-post evaluation, are fraught with "heroic" assumptions about alternative financing options prevailing in the past, across project risk levels, markets and countries.

Establishing the financial needs of a private client using the company's data is one way to help assess the strength of a project's financial additionality claims. It involves a degree of time-consuming, forensic review of the company's sources of finance (debt/equity), and their terms and conditions, at the time of project approval. Another assessment approach is to review developments around fund disbursements during project implementation that could signal a dilution of financial additionality. These include, for example, partial or unused disbursements of funds, early prepayment or project completion prior to disbursement.

Regarding the evaluation of non-financial additionality, the challenges relate to information on the motivation, client capacity and change pathways of the project. Approval documents tend to lack detailed information on how, and through which channels, the DFI will deliver its value add – for example, a narrative that explains in detail why the DFI intervention is necessary to achieve the high ESG standards that motivate the additionality, or a detailed discussion of the extent in which the private client has the capacity to improve those standards on its own; or what incremental additionality justifies another project with a repeat client. There are many examples for each potential source of non-financial additionality.

To address these challenges, an ex-post evaluation of non-financial additionality involves firstly a degree of process tracing —to confirm the channels through which the DFI has influenced or supported the project and/or the private client. It involves, secondly, an assessment of the nature and the extent of the DFI support. The presence of technical cooperation or advisory services, for example, can be a strong signal of non-financial additionality.

Challenges interpreting additionality outcomes

Given the dynamic and evolving nature of additionality, evaluators also face challenges around the knowledge required to build theories of change that can capture such evolution, assess development outcomes, and identify the project's contribution across topics such as climate change, sectors including infrastructure, finance and industry or instruments like equity and blended finance.

Additionality sources vary by sector: the pattern of additionality in financial markets, for example, differs from that in infrastructure sectors. The stage of sector development – early or advanced – influences the sources of additionality, which can evolve over time as markets become more sophisticated. Some DFIs use triggers that consider the level of development of markets or sectors, differentiating between projects where additionality is evident, and those where a stronger demonstration of additionality is needed.

The changing needs of the private client, and therefore an understanding of the client circumstances and incentives, are also key to evaluating the project's additionality. Regarding non-financial additionality, the presence of an advisory service to support a market study, for example, might be added to improve the internal rating of the project. If such addition does not reflect the client needs, it increases the likelihood that the project component will be unsuccessful. Evidence that the client internalised the need for advice or technical cooperation in the project is necessary in an ex-post evaluation of additionality (e.g. when the client financed a share of the cost of such technical assistance or advice).

Some sources of additionality, such as blended finance, donor-funded technical assistance or government grants, represent advantages to the private client that can distort the market. They represent a challenge for evaluators who have to (1) understand the presence of market failures or the de-risking involved that justify the presence of subsidies, and (2) assess the extent conditions changed during the life of the project. This is an aspect of heightened importance with the increasing use of financial instruments designed to reduce project risk – and attract private investors – that rely on such financial advantages.

> **Some sources of additionality, such as blended finance, donor-funded technical assistance, or government grants, represent advantages to the private client that can distort the market.**

Results management frameworks

DFIs have designed information management systems to help identify different sources of additionality and thus distinguish their contribution. Some systems, such as IDB Invest's DELTA tool (IDB, 2023), value additionality-related efforts in an aggregate manner along with the development impact of the project. However, in other DFIs, the relevance of additionality, its magnitude and effects are not taken into account, and instead a sufficient argument is to confirm that the DFI offered a financial package and conditions that did not prevent the client from opting for another source of private financing. This could result in other sources of finance being effectively crowded out.

The integration of DFI systems to analyse additionality and development impact can help to present a coherent narrative of the project's objectives, and its contribution and expected results, although they also present risks. One of the risks is that, by integrating both dimensions (additionality and impact), the weaknesses of one dimension are offset by the strengths of another without reaching a minimum acceptable level. Another risk arises from the links between the sources of additionality and the dimensions of impact. For example, an infrastructure project that commits to improving the economic regulation of the sector counts such a potential result as both a source of non-financial additionality and a source of development impact, creating the risk of double counting.

Improvements in results management systems carry the potential to accumulate data on the additionality (and development impact) of DFI-financed projects. Identifying and storing data on the different sources and types of financial and non-financial additionality, the relative strengths and weaknesses and the presence of certain financial instruments can allow aggregate analysis of the contributions DFIs make across markets, sectors and countries. Such a database could help DFIs identify trends and patterns of results that help formulate country and/or sector strategies, for example, and support ex-post evaluation. Results management systems in DFIs are still far from using additionality performance information to contribute to strategic decision making.

José Carbajo
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From the perspective of DEG:

On track to sustainable financing

DEG's goal: a greenhouse gas-neutral portfolio by 2040

DEG wants to shape its portfolio to be climate-neutral by 2040 and thereby contribute to limiting global warming to two degrees at maximum. With its strategy "Impact.Climate.Returns" adopted in 2022, DEG is focusing explicitly on the climate- and impact-related transformation of companies in developing countries and emerging markets. From 2025 onwards, all new business must be compatible with the goals of the 2015 Paris Agreement: the DEG portfolio is to be greenhouse gas-neutral by 2040.

The organisational structure has been changed to this end. The Sustainability unit has been reorganised and the business restructured into three client clusters (Industries & Services, Infrastructure & Energy, and Banking). Thanks to in-house and external experts as well as training programmes, all personnel have expanded their knowledge of climate and impacts, and an in-house knowledge hub has been established.

Finally, the funding and advisory offerings such as the Business Support Services have been further expanded and, in fall 2022, bundled in a dedicated subsidiary called DEG Impulse. In addition to supporting private companies' efforts to design their business models towards achieving greater development impact, such as by creating jobs, increasing local incomes and establishing sustainability standards, more emphasis is now also being given to reducing emissions intensity and strengthening resilience to climate risks. DEG sees steadily growing demand in this regard, as its clients with investments in developing countries and emerging economies are heavily impacted by climate change.

DEG measures the development impacts of its investments by means of the Development Effectiveness Rating system (DERa) (DEG, 2022). In the DERa system, data on quantitative and qualitative indicators of development measurement are collected and rated annually in five impact categories: good and fair employment, local income, development of markets and sectors, environmentally-compatible business practices, and benefits for local communities.

Structural innovations

Following some further development, DERa 2.0 now contains two structural innovations:

1. Development impacts are being analysed with the aid of a net impact approach. This means that the DERa rating of a company may be reduced by minus points due to potential negative effects such as in the case of high greenhouse gas emissions.
2. The rating is being expanded to include a second pillar in which the transformation that DEG is promoting at the client is rated. The DERa 2.0 system should thus fulfil the new DEG strategy – with increased weighting of climate aspects and a stronger focus on transformation in thematic areas such as resource conservation, gender justice and digitalisation.

> **More emphasis is now given to development impact, reducing emissions intensity and strengthening resilience to climate risks.**

What this consequently means for the portfolio is that DEG's existing clients are supported accordingly with dedicated advisory offerings targeted to achieve the necessary transformation. In new business, DEG focuses on financing high-impact interventions that entail the lowest possible emissions, and interventions undertaken by companies seeking to reduce their carbon footprint. On the pathway to climate neutrality at the portfolio level, DEG developed its own instruments for measuring and budgeting greenhouse gases. The DEG climate strategy is based on the following hierarchy of goals: (1) preventing greenhouse gas emissions, (2) jointly implementing with the financed companies climate-related transformation pathways aimed at reducing emissions and strengthening climate resilience, and (3) neutralising unavoidable greenhouse gas emissions in the portfolio by directly investing in projects for maintaining and expanding measures for reducing carbon footprint such as afforestation and reforestation interventions to internationally recognised standards.

From the end of 2022 through March 2023, over 85 per cent of the portfolio was analysed for greenhouse gas emissions with the aim of validating the modelled baseline emissions for 2021 on the basis of available client data. This is intended to increase the data quality in the reporting system in stages in accordance with the standards of the Partnership for Carbon Accounting Financials (PCAF) and, as a development funder, to ensure a more realistic baseline scenario of the DEG-financed greenhouse gas emissions and the greenhouse gas intensity arising from its usual business activity. The detailed, knowledge-based data collection and the insights it generates into DEG's portfolio clients and their greenhouse gas intensity enable the DEG to pilot approaches to greenhouse gas budgeting for industrial clients and infrastructure projects and to develop appropriate transformation approaches for high emitters that contribute to climate-friendly, social and sustainable economic development in the partner countries. Implementation of this strategic realignment is to be completed by 2025.

Natalie de Wit-Solounov
Head of Strategy at DEG

From the perspective of the World Bank:

Mobilising private capital through budget support

Budget support plays a key role in addressing critical economic reforms and supporting structural transformation in debt-stressed and other vulnerable countries. It remains critical in facilitating implementation of important reforms that help leverage private capital to finance projects and programmes. Budget support can mobilise private capital by creating a favourable policy environment. For example, budget support can be used to support policy reforms that make it easier for businesses to operate and invest in a developing country. This can include measures such as improving infrastructure, streamlining regulations, and reducing corruption.

Addressing investment constraints

Constraints to private sector investment in low-income countries are frequently the focus of dialogue and action in budget support operations. These include market dominance by state-owned enterprises and unfair competition policies that prevent new market entrants, domestic or foreign, from risking investment capital.

The complexity of business regulations and difficulty in navigating property rights and land laws often give local and politically connected investors an advantage over foreign or smaller businesses. Trade and investment policy can increase the risks of sourcing imported inputs or accessing external markets.

The possibilities of budget support

By promoting good governance practices (such as changing the management of government corporations or enhancing transparency in the sector), or changes in laws or the regulatory framework (for example, laws allowing private investment in sectors previously reserved for government, or regulations affecting the profitability of private enterprise in a sector – such as pricing reform of energy tariffs), budget support can help attract private investment and create a stable environment for businesses to operate in.

Because budget support is not earmarked to specific expenditures - unlike traditional project finance – it eases a recipient country's fiscal constraints and thus frees up government resources that can play a critical role in promoting private investment and driving economic growth, such as funding critical infrastructure projects, promoting innovation and entrepreneurship or providing financing to MSMEs.

Another channel through which budget support can mobilise private capital is by providing incentives for private investment. For instance, budget support can be used to create tax breaks for companies that invest in specific sectors or regions.

Providing public grants or subsidies to attract private investors is not new. Governments have long used tax expenditures (tax holidays) or targeted infrastructure (export processing zones) to attract investors.

> A new approach to mobilising private financing is needed that recognises the scarcity and importance of public resources.

These practices have spawned numerous critiques about beggar-thy-neighbour practices that can become a race to the bottom as costs outweigh benefits and are often unsustainable or create contingent liabilities. Kenya, Rwanda, Tanzania and Uganda together lose up to 2.8 billion US dollars a year from the tax incentives and exemptions they provide to attract foreign investors (Tax Justice Network, 2012).

A new approach

A new approach to mobilising private financing is needed that recognises the scarcity and importance of public resources and applies it judiciously with clear empirical justification to incentivise priority investments in areas with measurable development impact. Historically, budget support has advanced priority investments in substantive ways, for example by supporting programmatic work in parallel with conventional project finance with cross-cutting conditionality to address project risk. This can be achieved by strengthening regulatory institutions and the rule of law to establish transparent and more evenly applied business laws.

Vehicles for blended finance such as leveraged grant facilities, public-private partnerships, hedging instruments and development impact bonds show a mixed performance record. This is in part because they rarely address the underlying causes of market failure and because the perceived and real risk to investors is high. Budget support used in parallel with these tools to advance critical policy and institutional reforms can extend the impact beyond the immediate transactions being facilitated.

Looking ahead, budget support could play an even more central role in leveraging private capital by enhancing the de-risking function in the form of guarantees, addressing fiduciary concerns and supporting future-oriented policy reforms that crowd in private capital to finance green infrastructure, digital technology and climate-related investments.

Stefan G. Koeberle
Director for the Middle East and North Africa, World Bank

4. Private sector engagement and its evaluation: what lies ahead?

In view of the multiple international crises ongoing today, what potential does PSE have for future DC: what are its strengths, and where do limits exist?

What knowledge gaps hinder impact-oriented steering of PSE?

How can the instruments currently available to the BMZ be supplemented?

Every year, efforts to achieve the SDGs in the Global South fall short of funding by some four billion US dollars – despite new all-time highs being reached among publicly funded development services in 2023 (ECOSOC, 2024). At the same time, the multiple crises ongoing worldwide, in particular the advancing state of climate change, are generating a whole new awareness of the urgency for effective development-policy action. It is clear that each individual group of actors, irrespective of whether public or private, civil society or business organisation, Global North or Global South, must increase their contribution if future opportunities are to be maintained.

4.1 PSE being put to the test

Earlier positive expectations of private sector input, manifested for example in the World Bank's vision of "Billions to Trillions" (World Bank Group et al., 2015) have fallen short. Instead, the actual leverage effect of only about 40 per cent of the dedicated public capital comes as a sobering realisation (Orth et al., 2020, p. 64) and reinforces the scepticism with which some public policymakers and civil society view the private sector as an actor in DC.

These concerns are based mainly on the sense that business enterprises are not perceived to be a group of primary actors driving social and environmental development. While the philanthropic engagement and growing sustainability reporting by companies are praised, these efforts are simultaneously viewed as an indication that purely financial interests dominate in corporate core business. In contrast, activities aimed at mitigating negative impacts on vulnerable groups and the environment have actually only been implemented by a few major companies or are left entirely to civil society. Moreover, some segments of civil society express fundamental doubts as to whether the economic objectives of business enterprises and the environmental and social goals of DC can ever be reconciled to strive together in concert.

Moreover, under certain circumstances, the presence of PSE in a partner country and its concrete impacts within a given area of DC activity may not be directly recognisable. The interventions are designed for long-term implementation and thus influenced by many contextual factors. Combined with the lack of monitoring and reporting systems, it is difficult to attribute positive impacts in the field of PSE to any one particular group of actors. And while the same is true for other approaches and actor groups of DC, cases of the private sector active in the public sphere are perceived more critically, in particular with regard to potential deadweight effects (Elliesen, 2022).

This is why the engagement of private sector actors urgently needs not only to increase, but also be more effective. By the mid-term review of the 2030 Agenda in 2023, just under 20 per cent of the SDGs had been reached. At the same time, the general economic and financial state of affairs worldwide is marked by tension, with the poorest and most vulnerable groups in particular feeling the negative effects most keenly. Persisting consequences of the COVID-19 pandemic, the military conflicts in the Middle East, the Russian war of aggression against Ukraine and the drastic impacts of the triple planetary crisis are currently constraining DC funding for other areas – and thereby driving up the need for investment from the private sector.

> It is clear that each individual group of actors, irrespective of whether public or private, civil society or business organisation, Global North or Global South, must increase their contribution if future opportunities are to be maintained.

These challenges acutely threaten people's lives and are therefore marked by heightened (political) urgency. For the time being, they are pushing structural aspects of DC into the background. At the same time, interventions geared to counter clientelism or reform the systems of taxation in partner countries of DC could also significantly reduce the noted financing gap. Furthermore, in many donor countries the tight budgetary constraints caused by today's crises are driving a growing public debate over the sense and necessity of DC (Kielon, 2024).

Against this backdrop, the various approaches of PSE are being put to the test, in particular regarding their effectiveness and efficiency. Private investments and assets – which can include insurance and pension funds in the Global North as well as private assets in the partner countries – should be utilised more effectively for the development agenda than has been done in the past. Doing so will require a better understanding of the lessons learned from the past, and a keener ability to track what impacts currently ongoing interventions are achieving. It is imperative that reliable data and (rigorous) evidence be available to enhance the implementing actors' orientation to targeted impacts.

4.2 The impact orientation of PSE: Do we know what we need to know?

Many fields of public policymaking are confronted today with a contradiction: on the one hand, data are available in quantities like never before while, on the other hand, the information is often not of the quality and level of conditioning needed to properly draw fitting strategic conclusions from the data and to leverage the information for establishing evidence-based policy. This phenomenon affects PSE as well. The data gaps in this context are many and varied. Neither do uniform definitions of PSE exist, nor do the implementing organisations have uniform markers at their disposal. Hence, it is impossible to financially map out approach models or their individual instruments within the budgetary funding of the BMZ (and other government ministries), or to track their development in recent years.

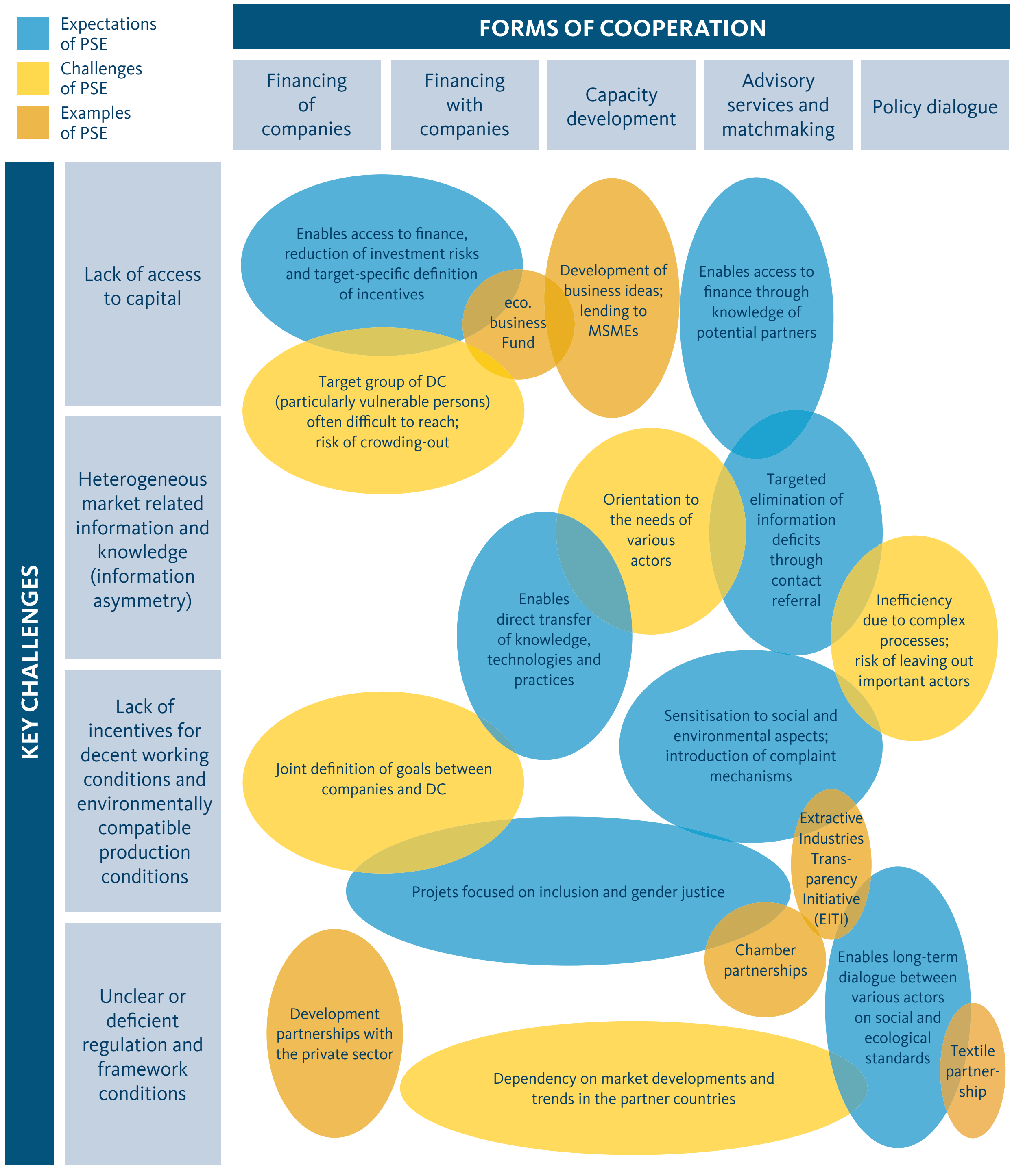
Moreover, PSE faces the (usual) challenges when it comes to evaluating DC interventions: due to complex contexts, long pathways to impacts and the simultaneous occurrence of various external factors, effects are not always manifested in plainly apparent ways, but instead oftentimes only indirectly or over the medium to long term. In addition, impacts in many cases only materialise through successful interaction of multiple interventions of various categories (involving a mix of instruments), which makes monitoring and impact identification more demanding. The BMZ has devoted intensive efforts to addressing this challenge in recent years and established its own dedicated monitoring system (see page 88).

Effective impact-oriented steering of PSE instruments and interventions requires a uniformly defined understanding of their financial and development additionality. To systematically measure additionality both ex-ante and ex-post, a harmonised system of instruments and uniformly applied indicators must be established between the participating actors. As described in Section 3.1, this entails overcoming a number of challenges. However, tried and proven and partially standardised approaches and instruments are already available, in particular from the OECD and multilateral development banks, which can be used for a comparative approach to measuring the additionality in German DC. For example, the multilateral development banks have jointly developed a Harmonised Framework for Additionality in Private Sector Operations (AfDB et al., 2018) designed to contribute to a common understanding of additionality and serve as guidelines for a uniform approach to ensuring and measuring additionality.

Joint institutionalised decision-making processes would facilitate the evaluation of PSE because approaches to PSE are increasingly interlinked among cross-sectoral as well as bilateral and multilateral entities, and the instruments of PSE are applied at micro, meso and macro levels. Establishing uniform processes for success measurement and reporting requires that demanding, overarching theories of change be developed already in the conceptual planning of interventions (see Section 3.1.1). The evaluation community and research institutions can support this process with their knowledge of theory and practice.

Ultimately, the important thing is this: the better the expected effects and actual achieved effects can be specified (and verified in documentation), the more target-focused the various instruments of PSE can be oriented to the given key challenges for development and contextual factors. In this respect, the current toolbox of PSE instruments serving German DC must prove its mettle moving forward, and meet the essential needs or be strategically and conceptually expanded accordingly.

At a glance: Private sector engagement



Source: DEval, own presentation.

4.3 Turning impacts into strategy

Alongside the key challenges identified at the outset and the individual categories of PSE, the figure on page 83 presents the expectations placed on PSE as well as the challenges and limits the use of such engagement entails.

The evidence that DEval has collated shows that not every category of PSE is suited to contribute to solving every key challenge that PSE is intended to address in general. For example, the financing of companies and financing with companies are approaches particularly apt for accessing capital, yet they are less suitable for addressing the lack of incentives for decent working conditions and environmentally compatible production conditions. In this context, raising awareness by way of capacity development or advisory services is more effective.

Overall, its innovative strength and ability to mobilise additional financial resources are what make PSE stand out. DC could thereby benefit in particular from the interest in business models that deliver long-term success in order to increase the sustainability of DC interventions. At the same time, PSE appears to be less suited to addressing the needs of vulnerable groups. From the perspective of DC, it is vital to strategically pursue an approach that lives up to the principle of “Leave no one behind” which German DC committed to under the UN’s 2030 Agenda.

This also demonstrates that the strategic combination of categories and instruments is possible and, in part, imperative to successfully operate in complex contexts over the medium and long term. Even though one of the great potentials of PSE lies in unleashing demonstration effects and technological innovations in markets of the partner countries, without accompanying inputs such as policy dialogue the sustainability of such effects is limited. Similarly, information asymmetries can be addressed through targeted referral and facilitating of contacts and the direct transfer of know-how, but will be hardly capable of unleashing the intended impacts without addressing the regulatory framework conditions.

Ultimately, PSE can only provide initial impetus for action: reforming entire national economies will require coordinated efforts by every stakeholder. Hence, in the concrete designing of PSE, it is the needs-based conceptual planning of interventions that essentially shapes their effectiveness. The extent to which private sector actors and development actors in the Global North and South succeed in identifying their common goals and, in follow-up thereto, complementing one another in their activities, will be of decisive importance.

In doing so, it is vital that they bring together their perspectives and convictions as private and public actors, and thereby also clearly identify priorities and any conflicting goals. To this end, the oftentimes differing needs and expectations of the participating actors need to be thoroughly analysed in advance, while it is decisively important to also consider the needs of the target groups. Only in well-functioning partnerships is it possible to succeed in transparently discussing fields of tension between conflicting corporate and development goals and alleviating those tensions by implementing suitable interventions.

Without public support, the private sector is still active too little in the Global South because it lacks access to (affordable) capital and assesses the political and financial risk in the partner countries to be too high. Other donors have instruments available to them in this context which are currently not yet supported by German DC. The granting of guarantees by Sida (see page 35) is one example of an instrument that the BMZ and KfW could use more widely once such solutions have been adapted to German conditions and circumstances. Private investors who take part in structured funds need financing instruments designed for longer-term commitments and equipped for higher financing volumes. The (growing) introduction of bonds and securities for nature conservation purposes and impact investment could be scaled on the basis of the initial positive experiences gained in German DC. The same applies for supporting innovative companies through venture funds in order to promote the development of sustainable solutions and business models.

At the same time, it is important from a development policy perspective to include in PSE interventions those segments of society whose vulnerability limits their access to markets, for example by promoting inclusive business models. This affects women and low-income rural households, for example. Getting the needs of target groups heard is, on the one hand, a basic precept of DC partner orientation, numerous successful inputs for micro-financing and supporting women as entrepreneurs prove, on the other hand, that PSE harbours vast potential in this regard as well.

The approach of PSE should be considered holistically in the context of pursuing the UN’s 2030 Agenda and effectively addressing the key challenges of DC. It is only possible to solve the key challenges when various categories of interventions are strategically interlinked with one another by design. In this way, the financing and advisory services for economic actors can be prepared or flanked in more targeted fashion with interventions geared to improving the framework conditions in the given partner countries.

This expands the strategic horizon of PSE beyond the scope of its individual interventions. It corresponds to Germany’s enlightened self-interest: the German domestic economy, with its heavy dependency on exports, should stand to benefit from the political and economic stability in the DC partner countries. Moreover, German companies can contribute their innovative strength and production quality and leverage their technology transfers to structurally strengthen the economy in the DC partner countries and drive major growth in people’s incomes and welfare there. Doing justice to both these aspects requires a coherent strategy that is built on the available evidence and takes more deeply into account the potential and limits of PSE. Such a strategy forms the foundation for sustainable DC that is fit for the future, effectively meets the global challenges and offers future opportunities for everyone.


Amélie zu Eulenburg
DEval Head of Department


Marian Wittenberg
DEval Evaluator (until 01/2024)

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Ariane Bischoff
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From the perspective of the BMZ:

The effectiveness of PSE

The BMZ undertook a thorough review of its private sector engagement in 2023, resulting in a partial redesign of its approach. The review was based for example on evaluations conducted by DEval and on critical voices in the private sector, civil society and the political sphere. Efforts are now turning to action implementation in which the focus of interest is shifting to the effectiveness of PSE.

In order to live up to the high aspirations for socio-economic transformation, the BMZ seeks to better understand how specific interventions function. This is the only way that German development policy can live up to its claim of evidence-based programme design and further develop as a learning organisation.

A new impact model

To this end, the BMZ has established a new monitoring system for its cooperation with the private sector. For the first time, a portfolio-wide, cross-programme impact model now reinforces the system and specifies key impact goals and hypotheses for achieving socio-ecological transformation of the economy. This includes efforts to mobilise companies, improve social and environmental standards and promote decent employment. The impact model considers the broadly conceived design of the BMZ's economic cooperation that ranges from advisory services, network building and project development to financing, implementation of investments and public-private partnerships.

Quality instead of quantity

The BMZ is raising its aspirations in terms of content: the outcome and impact levels now take centre stage in impact measurement. For example, surveys staggered over time, such as through tracer studies, now aim to track whether companies have indeed improved their sustainability standards following the advisory services and training, and whether graduates of training and education programmes are (newly) employed as intended.

Portfolio-wide minimum standards ensure the comparability of the data from the individual programmes, for example when quantifying "good" jobs. For this purpose, a portfolio indicator catalogue provides uniform definitions and methods for data collection in all programmes. The BMZ is expanding corresponding digital solutions to simplify access to project data and the data collection for monitoring purposes.

Accountability and continuous improvement

The monitoring system delivers a valuable database for portfolio analyses with which the BMZ also in future wants to record long-term impacts of programmes under the budget item of "Development Partnerships with the Private Sector" (labelled by its German acronym EPW). External accompanying evaluations are aimed at examining how accurate the impact hypotheses are, and whether these impacts can be achieved more efficiently. The BMZ is reviewing more closely the use of rigorous impact evaluations. The core purpose of these efforts is not only to provide an account of the BMZ's programmes aimed at PSE, but also to continually improve those programmes.

Benjamin Knödler
Head of Private Sector Engagement, BMZ

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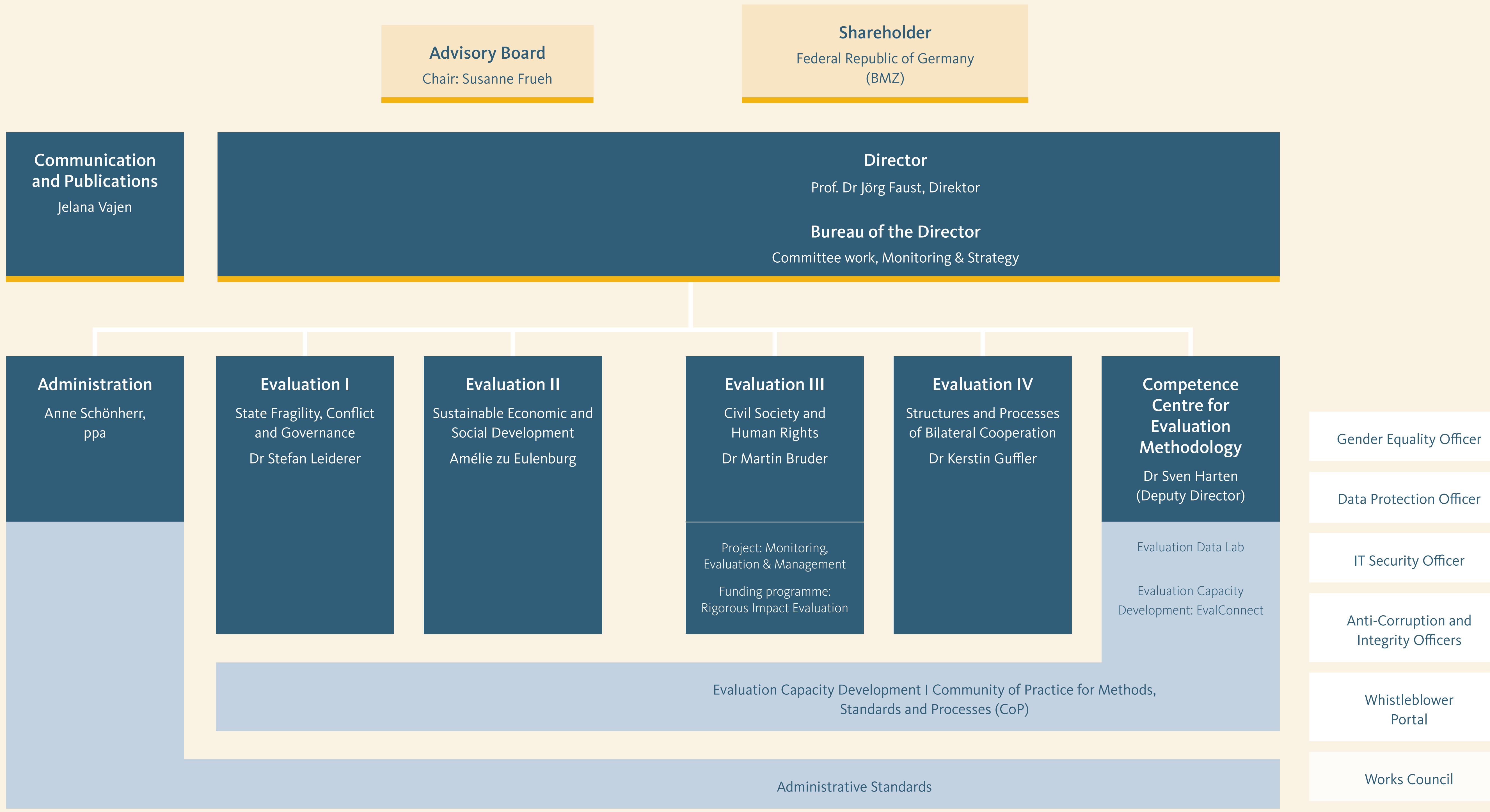
DEval organisational chart



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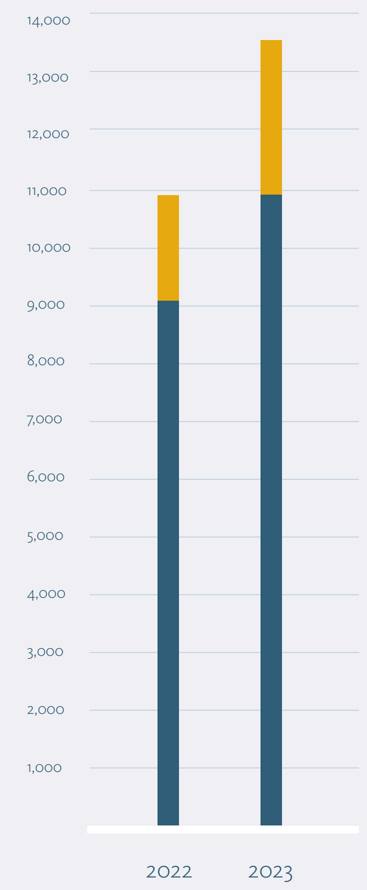

Financial support
(in euros, thousands)

2022	2023
Institutional support	
9,706	10,940
Project support	
1,886	2,739

Staff members
including project staff, excluding students, assistants and interns
(in full-time equivalents)

	2023	30 June 2024
Management and heads of departments	6	7
Academic and research staff	57.95	53.2
Project administration	6.3	5.9
Corporate units and administration	20.1	21.5
Total	**90.35**	**87.6**

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Dr Cornelia Römling, Sabrina Disse, Magdalena Orth-Rempel, Janis Schnell, Dr Wiebke Stein

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2023

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Implementation of Recommendations from DEval Evaluations. Synthesis of the Implementation Monitoring of DEval Evaluation Recommendations (2015 – 2018)
Heike Steckhan, Prof. Dr Jörg Faust

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Dr Angela Heucher, Judith Ihl, Michèle Kiefer, Dr Marcus Kaplan, Steffen Schimko, Dr Kathrin Wolf

Evaluation of Interventions for Climate Change Adaptation. Synthesis Report
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Evaluation of Interventions for Climate Change Adaptation: Agriculture, Water and Environmental Protection, Nationally Determined Contributions and National Adaptation Plans
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2022

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Dr Jan Tobias Polak, Dr Angela Heucher, Lea Smidt, Lena Taube

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2023

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Deutsches Evaluierungsinstitut der
Entwicklungszusammenarbeit (DEval)
Fritz-Schäffer-Straße 26
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Design
Fazit Communication GmbH, Frankfurt am Main

Translation
CBG Konsult/Information, Sundbyberg

Photo credits
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Bibliographical reference
zu Eulenburg, A.; M. Orth-Rempel; C. Römling;
M. Wittenberg (2024), Different perspectives –
joint success? Private sector engagement in
development cooperation, Focus report,
German Institute for Development Evaluation (DEval),
Bonn.

Print
Bonifatius Druck, Paderborn

Editorial deadline: November 2024

ISBN 978-3-96126-236-6 (printed Edition)
ISBN 978-3-96126-237-3 (PDF)

This report can be downloaded as a PDF-file
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