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ENHANCING GEF'S ENGAGEMENT WITH THE PRIVATE SECTOR

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GEF and the Private Sector

1. The purpose of this paper is to stimulate discussion from the GEF Council members and other GEF partners on a strategic approach to enhance the GEF's engagement with the private sector. It outlines an approach to a private sector strategy as the basis for a more detailed proposal in response to a Council request, to be presented at the Council meeting in May 2004. The paper builds upon lessons from the GEF's previous private sector efforts¹ and highlights conditions for developing innovative GEF partnerships with the private sector in the future. Inputs to the paper include: (i) several previous Council papers on this topic;² (ii) feedback from preliminary private sector dialogue; (iii) limited discussions with the Implementing Agencies; and (iv) interim findings from the M&E review on the GEF's engagement with the private sector. The paper was also informed by the recent UNEP Finance Initiatives (FI) Initiatives Global Roundtable held in Tokyo during October 20–21, 2003. It will benefit from additional outreach and consultation including the upcoming Brussels workshop on public private partnerships to attract investment in the water sector and the private sector workshop organized by the Government of Switzerland³.

Historical Role of the Private Sector in GEF Projects

2. The starting point for consideration of a private sector strategy is to recognize the manner in which the GEF has worked with the private sector to date. Most often, private sector involvement has been in one of the following forms:

- (a) As supplier and advisor to GEF funded projects;
- (b) In co-financing arrangements and as a recipient of grant and non-grant GEF financing; and
- (c) Indirectly, as the intended beneficiary of barrier removal for private sector activities in environmental markets in developing countries

3. Thus far, the majority of private sector activities⁴ were in the climate change focal area, with a smaller number in biodiversity, and even fewer in international waters.⁵ The overall

¹ The GEF's previous efforts are primarily based on a project approach. A limited amount of dialogue with private sector actors has also been held, mostly within the climate change group.

² Some of the issues and options related to engaging the private sector were outlined in earlier papers. See, e.g., C.13/Inf5; C.12/Inf5; C.7/12; and C.6/Inf.4. The paper also had the benefit of a STAP workshop in March 2003, which focused on experience with Operational Program 7 (reducing the costs of new greenhouse gas mitigation technology) and included substantial discussion of issues related to means for more effective collaboration with technology developers.

³ A paper on the results of the Swiss workshop, to be held on November 11–12, 2003 in Geneva with representatives of the GEF family and diverse representatives of private sector players, will be available for discussion at this Council meeting.

⁴ The M&E review includes a more formal definition of the "private sector", and also necessarily highlights certain types of projects and activities. This paper is based on a more expansive interpretation of terms consistent with the exploration of opportunities that may be new or previously outside GEF experience.

number of projects and volume of funds were relatively small in relation to total GEF funding. Typically the portfolio encompassed projects in renewable energy, energy efficiency, ecotourism, commodity based agroforestry, and payment for environmental services.

Lessons Learned - Room to Expand and Possibilities Remain Untapped

4. Lessons learned from the GEF's past engagement with the private sector suggest directions for improvement of GEF practices. Key issues highlighted include:

- (a) Achieving market transformation is difficult with single projects in one-off countries. A strategic, market based approach is required;
- (b) The importance of the private sector as a change agent for policy reform should be recognized and encouraged.
- (c) Host country engagement and a supportive policy framework is often key to achieve effective private sector activities. In nascent markets, assisting parastatals (state-owned enterprises providing commercial services, eg., utilities), engaged in barrier removal can be an effective approach; and
- (d) For effective results, engaging the whole value chain (from production to retail distribution), rather than individual market players is essential;
- (e) Previous GEF efforts were not driven by a coherent policy, resulting in an absence of clear guidance to the agencies on a range of operational issues

5. The prevailing sense in various consultations and the interim findings of the M&E private sector review report is that numerous possibilities for engaging the private sector remain untapped. These should be further explored.

The Increasing Importance of Engaging the Private Sector

Private Sector Entities Play an Increasingly Important Role

6. The importance of engaging the private sector in support of GEF objectives has been recognized repeatedly in previous Council papers, both Overall Performance Studies, and other related reports⁵. Engaging the private sector is increasingly important for a number of reasons:

⁵ In the M&E review, of a total of 76 "private sector" projects identified in the portfolio (out of 621 total), 53 were in climate change, 19 in biodiversity, and 1 in international water. An additional 29 climate change and biodiversity projects were identified as having substantial indirect effects on the private sector. The geographic distribution of projects was also found to be weighted toward countries and regions more economically developed.

⁶ See, e.g., C.13/Inf5; C.12/Inf5; C.7/12; and C.6/Inf.4. The paper also had the benefit of a STAP workshop in March 2003, which focused on experience with Operational Program 7 (reducing the costs of new greenhouse gas mitigation technology) and included substantial discussion of issues related to means for more effective collaboration with technology developers.

- (a) The private sector is a primary source of investment, talent, technology and other resources which could benefit GEF projects and objectives;
- (b) The private sector is a means for significant leveraging of GEF funds, at a time when public resources are declining or failing to increase commensurate with growing demands;
- (c) The private sector is increasingly important for global environmental projects due to the increasing scale of global commercial activity with potential adverse impacts on the global environment⁷; and
- (e) Engagement of the private sector is essential for a worldwide transformation to a more sustainable economy.⁸

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Corporate Culture has Changed in Favor of Sustainable Development

7. Recent developments regarding private sector interest in sustainable development tend to align private sector interests more closely with GEF objectives. Although far from fully mainstreamed, in recent years a growing number of companies have embraced the concept of sustainability as a fundamental element of their operations and strategy. With the adoption of the concept of the “triple bottom line,” recognizing financial, environmental and social concerns as criteria for doing business, these companies are working to demonstrate that sustainability criteria can make good business sense. Impetus for moving in this relatively new direction is provided by a number of factors, including: a) enlightened leadership, b) public and, particularly, NGO pressure and concern for corporate image, and c) genuine new business opportunities.

8. A number of indicators attest to the nascent, but rapidly expanding movement of private sector companies to embrace sustainability practices:

- (a) The number of international meetings, conferences, seminars, workshops, and other events devoted to issues of sustainability and business have risen sharply over the last few years;
- (b) A growing number of academic institutions, including some world renowned business schools, now offer programs on business and sustainability;
- (c) A growing number of business organizations dedicated to sustainability related issues have been launched in recent years and are steadily expanding. The World

⁷ By mid century, world gross domestic product is expected to reach \$ 140 trillion, up from \$ 31 trillion today, an unprecedented expansion likely to require a significant reorientation to more sustainable practices.

⁸ [There are some concerns within the GEF that the use of public funds for profit making purposes is inappropriate and that it potentially constitutes a subsidy that distorts local markets. These concerns can be addressed by ensuring that risk and incremental cost considerations are stringently applied to the use of GEF funds.](#)

Business Council on Sustainable Development, for example, which started with 48 member companies in 1994, now has 160 major international companies on its roster, representing \$ 3.1 trillion in business activity;

- (d) In less than a decade, the UNEP FI Initiative has grown to include over 256 of the world's largest banking and insurance companies, all of which committed follow sustainable development principles in their operations, while the Equator Principles announced by the IFC in June of this year now include 17 of the largest private banks engaged in project lending;
- (e) Movement to enhance reporting on sustainability related performance by companies has been gaining momentum with the launching of the Global Reporting Initiative (GRI);
- (f) Investment in socially responsible funds reached \$ 2.1 trillion in 2002, up 85% from 1996; and
- (g) In relation to climate change, the carbon market is becoming an important financial tool and is projected by some experts to reach \$10 – 30 billion in value by 2008.

Change in Private Sector Culture Creates New Opportunities

9. This evolving fundamental shift in business orientation creates new opportunities for future interventions that can contribute to GEF objectives. New opportunities include both financial and non-financial approaches. Non-funding possibilities would emphasize strategic partnerships where the GEF could act as a convener, broker, facilitator, and advisor. Leveraging single projects towards market aggregation through dialogue with key market players would be of particular importance for achieving greater market impact that is not attainable by individual players.⁹

Prerequisites for Effective Engagement

10. A number of issues, however, need to be addressed if the GEF is to significantly improve its ability to mobilize the private sector and take full advantage of new opportunities. Changes will be required in perception, mindset, and commitment, as well as operational modalities. The private sector needs to be viewed as an important partner, and the GEF will need to adopt more nimble and entrepreneurial approaches that fit more closely with private sector needs.

⁹ A few recent projects (some in the pipeline) illustrate these concepts. One is the IFC fuel cell program in the current work program, which reflects a global market approach to commercialization of fuel cells for stationary applications, based in part on a dialog with industry supported by an earlier technology assessment implemented by UNEP. Another is a new medium-sized project to support a dialog with renewable energy companies and developing country utilities as the basis for a possible global market aggregation strategy. The GEF has also participated in a dialogue with the developers of central station solar power to prepare a strategic vision for commercialization of the technology, building on three GEF projects already approved.

11. Matching GEF decision-making processes and management culture to private sector practices is essential. GEF processes are perceived to be too complex and cumbersome, stifling potential GEF private sector initiatives.¹⁰ Achieving an appropriate match between the GEF's decision making processes and the private sector must include addressing obstacles and delays related to the GEF project cycle and management, enhancing capacity within the Secretariat and the Implementing Agencies, and communicating a more coherent, strategic approach to interested private sector players.

12. The private sector encompasses diverse, complex and very dynamic entities and until now the range of relevant GEF experience has been limited. There is much to be learned about how and when to collaborate most effectively. Incorporating lessons already learned and experimenting with innovative modalities, many of which are unfamiliar to the GEF, will be required. A commitment to experimentation, with increased room for flexibility and less reliance on precedence and procedure, will allow the GEF to be more open to identifying and exploiting new possibilities.

Towards a Private Sector Strategy

13. Facilitating this necessary learning requires an approach that strengthens existing modalities, consistent with exploring new opportunities.¹¹ This will require thinking creatively to apply lessons from the past, enhanced collaboration within the GEF family, and experimenting with innovative ways of partnering with the private sector to leverage GEF objectives. A two-pronged strategy is needed that both

- (a) Strengthens existing Implementing and Executing Agency project focused practices; and
- (b) Supports experimenting with innovative approaches.¹²

Continue and Strengthen Existing Modus Operandi

14. The first step toward better engaging the private sector is to continue to build on the work that the GEF has already done and to improve upon it based on lessons learned. Emerging findings from the process of the "M&E Review of the GEF's Engagement of the Private Sector" are providing lessons that can be applied in the future. These include lessons learned at the

¹⁰ "According to IA staff, one of the most significant challenges for direct execution of GEF projects by the private sector is accelerating the GEF approval process. Given the uncertainty, risk, and high opportunity cost inherent in GEF projects, private firms do not have sufficient incentive to wait up to two years for approval and endorsement." Joint Summary of the Chairs", October 1998 GEF Council meeting, par. 15

¹¹ There are some concerns within the GEF that the use of public funds for profit making purposes is inappropriate and that it potentially constitutes a subsidy that distorts local markets. These concerns can be addressed by ensuring that risk and incremental cost considerations are stringently applied to the use of GEF funds.

¹² Although the full spectrum of future possibilities is yet to be determined, some types of activities might include: progressive partnerships that include all relevant market players; certification related options; engaging the financial services and insurance industries in developing risk mitigation strategies and other instruments that enable projects with global environmental benefit; non-financial approaches such as playing a convening role and more.

project specific, policy, and institutional levels. Some of some general lessons learned that support continuing and strengthening existing practices are:

- (a) *Project Specific* – Picking the right private sector partner and product are key. This will include conducting in-depth strategic analyses on country, private sector entity, project, and market appropriateness.
- (b) *Policy* – Although country policy and commitment are critical for private sector projects to succeed (because of legal, regulatory, etc. business conditions that comprise the investment climate), in the short-run the private sector can compensate for what the public sector is unable to provide. This has important implications for the private sector as a stakeholder where the policy environment may require improvement. In such cases, the private sector can serve as a change agent for policy reform.
- (c) *Institutional* – Building institutional capacity (both public and private) is important for sustainability of private sector initiatives.

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15. Lessons in the three categories mentioned above will be applied within the existing GEF project context. The GEF has engaged in some limited experiences with contingent financing, private equity funds, loans, guarantees, etc. Strengthening such engagements and building further on them to improve their implementation is envisioned.

Experiment with Innovative Approaches

16. The second step towards better engaging the private sector involves experimenting with new approaches. Although the importance of engaging the private sector in GEF activities has been recognized repeatedly, no focused GEF strategy has been developed with clearly defined and agreed upon goals, targets, or criteria for engagement. Projects have emerged individually from the Implementing Agencies rather than as the result of an overriding GEF perspective. It is timely now, after more than ten years, to consolidate and learn from the GEF's private sector experiences and institutionalize a coherent GEF-wide approach.

17. A key consideration for the GEF's private sector strategy is that the private sector is not homogenous. Rather, it represents different types of enterprises and initiatives that vary widely by size and function; from large global institutions to SMEs to individual entrepreneurs, that operate in well developed and fledgling markets, in different sectors, with different interests and needs, and offer a variety of opportunities. The challenge presented by this diverse set of players is compounded by the GEF's own internal complexity, including the Focal Areas, Implementing Agencies and Executing Agencies, and the various procedures and rules.

18. As a result, a flexible, dynamic, and entrepreneurial approach is needed. Rather than preparing a single "strategy paper" as a one-time event, a more appropriate response would involve a well-designed process that evolves over time and engages all key stakeholders. Such a process would overlap with a period of experimentation, preceding the formal proposal of new modalities and approaches.

19. A new private sector approach would involve more direct interaction with private sector entities. The intent would be to search for opportunities where the private sector's objectives overlap with those of the GEF. Given that the private sector has become a key stakeholder for achieving global environmental benefits, the GEF could leverage private sector entities to meet its objectives. Such direct experimentation, with room for innovation, represents a departure from the GEF's more narrowly defined project-based approach.¹³ The first task for the GEF in achieving this type of collaboration with the private sector will involve familiarizing itself with the full scope of private sector activities in the environmental arena and establishing its identity as a potential partner. Currently, the majority of private sector players are not aware of the GEF and its mission.¹⁴

20. Three strategic questions need to be addressed in developing such a GEF approach for strengthening involvement with the private sector:

- (a) In what manner should the private sector be engaged to optimize accomplishment of GEF objectives?
- (b) How would a private sector strategy best reflect GEF's unique mission and how will it differentiate from financial and other players in the development arena?
- (c) What resources are required in order to ensure that the best advantage is gained from engaging the private sector?

A hierarchy of related questions follows, which ideally should be addressed in a private sector strategy, ranging from purpose, to areas of emphasis, appropriate sectors, criteria for engagement, priorities, modalities, and technical details like specific risks, and instruments.

21. A viable private sector strategy calls for an approach that incorporates strengthening of existing modalities, enhancing collaboration within the GEF family, and experimenting with innovative ways of partnering with the private sector to leverage GEF objectives. The GEF private sector strategy will address: a) priority areas for engagement, b) management and organizational issues, and c) projected resource requirements and needs.

Process for Formulating Strategy

22. A GEF-wide team/advisory group led by the Secretariat, composed of experts from the Implementing/Executing Agencies, STAP, and private sector interests, will be established in order to carry out the strategy development process.

23. The following steps are envisioned for moving forward:

¹³ Although doing things differently could potentially be currently implemented, doing so in the absence of a systematic policy would result in opportunistic engagements without the full cooperation of the Implementing and Executing Agencies.

¹⁴ To varying degrees, the GEF country dialogue workshops have included private sector participants. This role might be expanded in future workshops in countries with appropriate conditions and interest.

- (a) Secretariat will launch consultations by relevant sector with private sector entities.¹⁵
- (b) Lay out strategic planning process, including key issues, processes, structures, and roles.
- (c) Establish core strategy development team including advisory group.
- (d) Identify preliminary strategy options, project ideas, and proposed concepts for consideration.
- (e) Circulate potential proposals and conduct a consultative process.
- (f) Present progress report for discussion by Council.

24. The months leading to the next Council meeting in May will be dedicated to this process. The Swiss Government private sector workshop and the Council meeting itself are important early milestones in the process. Strategic options that are developed will be complementary to the GEF's ongoing work and will improve upon its current project based private sector engagement. The Secretariat will report progress and outcomes for moving forward at the next Council meeting in May 2004 Council paper.

Summary

25. This paper offers a number of key points, namely that:

- (a) Building upon previous GEF experiences, there is room to expand and improve engagement with the private sector;
- (b) Exploiting new opportunities is particularly important in light of growing private sector momentum towards adopting sustainability practices;
- (c) In order to take full advantage of emerging opportunities and facilitate effective partnerships with the private sector, the GEF will need to develop the appropriate culture, capacity, and operational modalities;
- (d) Necessary steps in leveraging GEF objectives with private sector participation will be spelled out in a coherent, forward-looking GEF private sector strategy; and
- (e) A two-pronged strategy will be followed, which:

¹⁵ Beginning with the European workshop for water sector companies for meeting the Millennium Development Goals, Swiss Government workshop on business models for sustainable development, and COP 9 for climate mitigation opportunities. Ongoing opportunities for outreach will continue to be identified throughout the process.

- (i) Strengthens existing Implementing and Executing Agency project focused practices; and
- (ii) Supports experimenting with innovative approaches.