



# Global Environment Facility

GEF/C.23/11  
April 16, 2004

---

GEF Council  
May 19-21, 2004

Agenda Item 14

## PRINCIPLES FOR ENGAGING THE PRIVATE SECTOR

### **Recommended Council Decision**

The Council reviewed the document *Principles for Engaging the Private Sector* (GEF/C.23/11) and approves the approach for engaging the private sector. The Council requests that the Secretariat, in consultation with the Implementing Agencies:

- (a) prepare for Council's review in November 2004 detailed strategic approaches for engaging the private sector in one or more business sectors;
- (b) amend the GEF *Project Review Criteria* to address the specific project issues identified in the paper;
- (c) develop, as part of its on-going corporate communications strategy, an information kit on how to work with the GEF and a web-based project tracking system both to advertise procurement opportunities and to provide information about the stages of project processing for all interested parties, including the private sector; and
- (d) prepare for Council's consideration in November 2004 an issues paper, detailed proposal, and cost estimate for a system to collect, analyze, and disseminate procurement data by country of origin.

## Table of Contents

<b>Introduction</b> .....	1
<b>Earlier Reviews of Private Sector Engagement</b> .....	1
Issues.....	3
<b>Proposed Principles</b> .....	3
Engagement.....	3
Objectives .....	5
Modalities .....	5
Timing.....	6
Priorities for strategic approaches.....	7
<b>GEF Corporate Approach</b> .....	8
UNDP.....	9
UNEP .....	9
IBRD and the RDBs.....	10
<b>Summary of Proposed Follow Up</b> .....	10

## INTRODUCTION

1. These principles have been prepared pursuant to the Action Plan to Respond to Recommendations for Improving GEF's Performance.<sup>1</sup> Among the recommendations calling for a response were the Policy Recommendations Agreed as Part of the Third Replenishment of the GEF Trust Fund<sup>2</sup>, which included the following:

[t]he GEF Secretariat, in collaboration with the Implementing and Executing Agencies, [should] develop a new strategy to better engage the private sector, taking into account previous practices and policies. Participants recommend that the GEF, in preparing the strategy, consult with private sector actors to identify perceived constraints in working with the GEF. Clear operational guidelines should be elaborated in order to define the scope of GEF collaboration with private sector activities.<sup>3</sup>

2. The GEF Secretariat and the Implementing Agencies have consulted the private sector on several occasions, most recently and very productively at the *Workshop on Business Models for Protecting the Global Environment*, sponsored by the Swiss Government in Geneva, November 11-12, 2003.<sup>4</sup> The GEF Secretariat has also begun to engage industry groups through one of the Implementing Agencies, UNEP. Following the private sector consultation, the GEF Secretariat and the Implementing Agencies then met on March 22, 2004 to consult on how the GEF would engage the private sector operationally. This group will continue to meet as an interagency consultative task force on the private sector, while other GEF interagency task forces will undertake any needed follow up that is specific to their own focal area or field of activity.

## EARLIER REVIEWS OF PRIVATE SECTOR ENGAGEMENT

3. There have been several earlier policy reviews related to GEF's engagement of the private sector. In October 1996, when it approved two global private sector investment funds, the *Small and Medium Enterprise Program Replenishment* and the *Photovoltaic Market Transformation Initiative*, Council "requested the Secretariat to ensure that the sub-projects developed under such funds would be consistent with GEF operational strategy and policies, including the incremental cost approach."<sup>5</sup> In 1998, in response to this request, the Secretariat prepared an information note on funds,<sup>6</sup> both non-profit funds as well as for-profit private sector investment funds. Four concerns about private sector funds were identified in the light of operational experience: concerns about country ownership, cost-effectiveness, conformity with the Operational Programs, and incremental cost. The note proposed that operational criteria be

---

<sup>1</sup> The revised version was submitted intersessionally on March 31, 2004.

<sup>2</sup> Incorporated as Annex C of *Summary of Negotiations on the Third Replenishment of the GEF Trust Fund*, GEF/C.20/4.

<sup>3</sup> *Ibid.* paragraphs 33 and 34.

<sup>4</sup> Two of the Executing Agencies acting under the GEF policy of Expanded Opportunities also participated.

<sup>5</sup> *Joint Summary of the Chairs*, GEF Council Meeting, October 8-10, 1996, GEF/C.8/3, 10(d).

<sup>6</sup> *Funds and Trust Funds*, GEF/C.12/Inf.5.

developed (on the basis of an independent evaluation) to maximize the advantages of private sector funds while ensuring conformity with the GEF strategy and policies

4. In 1999, in response to Council's request for a review of modalities to facilitate private sector involvement in GEF activities, the Secretariat prepared the paper *Engaging the Private Sector in GEF Activities*.<sup>7</sup> The paper noted the importance of the private sector in terms of global environmental impact, resources, technology transfer, and the sustainability of global environmental benefits. It also noted that while engagement had been increasing, there remained a number of special challenges such as lack of awareness of the GEF and the steps needed to achieve tangible returns through partnership with GEF, the complex approval processes, and the difficulty in maintaining commercial confidentiality given the transparency of GEF processes. The paper set out four specific modalities that would increase the range and number of successful private sector experiences in the GEF while conforming to GEF criteria:

- (a) Removal of barriers to the creation of, entry to, or transformation of markets that support global environmental objectives;
- (b) Non-grant financing modalities;
- (c) Alternative bankable feasibility studies;
- (d) Partnerships.

5. Since that time, the Monitoring and Evaluation Unit finalized its *Review of GEF's Engagement with the Private Sector: Final Report*.<sup>8</sup> The review drew specific conclusions in both the biodiversity and climate change focal area, and also a number of general conclusions. The review recommended, among other things, that GEF prepare a comprehensive strategy for engaging the private sector, both directly and indirectly influencing overall policy frameworks and market conditions. GEF should require its partners to shoulder a higher proportion of the risk, ensure real country ownership, identify global environmental benefits more clearly, define leveraged funding more rigorously, and develop an online project tracking system. For the Council Meeting in November 2003, the Secretariat prepared a preliminary issues note *Enhancing GEF's Engagement with the Private Sector*<sup>9</sup> that made use of operational experience and the emerging findings of the M&E private sector review. Lessons learned from GEF's past engagement with the private sector suggested directions for the improvement of GEF practices. The note stressed the need for:

- (a) A strategic, market-based approach;
- (b) The importance of the private sector as a change agent for policy reform;
- (c) The key role of host country engagement and a supportive policy framework;
- (d) The need to engage the whole "value chain" rather than individual players; and
- (e) The need for clear operational guidelines for the agencies.

---

<sup>7</sup> GEF/C.13/Inf.5.

<sup>8</sup> GEF/C.23/Inf.4.

<sup>9</sup> GEF/C.22/Inf.10.

## Issues

6. The note for the November 2003 Council Meeting recognized that the private sector is not homogeneous but comprises a vast range of enterprises differing in size, function, and business sector. There is “no single way” to engage the private sector, as the interaction must be context-driven. Following the two-step approach suggested in that note, this paper sets out as a first step some general principles and operational guidelines. If these are approved by Council, the second step would be the application those principles to develop specific strategies for individual sectors or markets. The initial strategy or strategies would be prepared by November 2004.

7. The broad questions that the principles in this paper address are:

- (a) *Engagement*: What does engagement of the private sector mean?
- (b) *Objectives*: Why do we want to engage the private sector?
- (c) *Modalities*: How can GEF engage the private sector?
- (d) *Timing*: At what point should GEF support private sector action?
- (e) *Priorities*: With which actors and in which markets should GEF work?

## PROPOSED PRINCIPLES

### *Engagement*

8. Even before establishing objectives for the GEF’s engagement of the private sector, it is necessary to clarify what “engagement” actually refers to, as there are several different ways in which GEF can be understood to “engage” the private sector. Engaging the private sector can mean any or all of the following:

- (a) *Indirect engagement*. Creating market conditions in recipient countries that -- by their very nature -- will promote the activities of certain categories of private firm (e.g., renewable energy firms that are able to take advantage of the outputs of a GEF-funded barrier-removal project -- outputs such as a more equitable energy pricing regime, publicly available information on renewable energy resources, and agreed standards for industrial inputs and renewable energy equipment);
- (b) *Direct engagement*. Treating private firms as eligible project proponents, or direct beneficiaries (e.g., renewable energy firms that seek incremental cost financing to cover increased costs of their own operations in manufacturing competitive renewable energy equipment); and
- (c) *Procurement*. Providing private firms with opportunities for procurement in GEF projects (e.g., renewable energy firms which can bid to supply equipment for a GEF-supported rural lighting project proposed by a local authority).

9. Engaging the private sector *indirectly* (e.g., when the GEF finances the removal of barriers to the creation of, entry to, or transformation of markets that support global

environmental objectives) is highly effective. Typically, such GEF projects have financed the incremental costs of government or parastatal agencies<sup>10</sup> in establishing frameworks, standards, quality norms, certification schemes, and market information for the benefit of the private sector. In fact the creation of markets for global environmental benefits and services can become a very strong pillar to maintain results over the long-term, and thus become a powerful sustainability tool.

10. In those cases where the partner agencies of the GEF engage the private sector *directly* (i.e., as a project proponent or direct beneficiary of the project), several special issues arise. First, as is their normal practice, the accountable GEF partner agency would need to ensure that any individual firm is sustainable as a *business* before considering it as a potential GEF recipient. Second, care must then be taken to ensure that the public funding of the GEF still creates a genuine *public* asset and not just a private one, does not distort market incentives, and does not unfairly favor the selected firm over unselected ones. Project Review Criteria will need to be adjusted to address the second group of issues. Options to be considered could include:

- (a) Working with an industry *association*, as opposed to individual firms; and
- (b) Ensuring *transparency* to at least partially offset the creation of a private asset such as a “first mover” advantage, e.g., by making the opportunity for direct engagement available to all firms even if ultimately only one is qualified; by publishing details of the transactions GEF finances; by designing GEF-financed outputs to provide publicly available lessons that would benefit similar firms in future rather than remain the property of only one firm; and by openly demonstrating the incrementality of the cost GEF finances.

11. The balance between the private and public will vary sector by sector: in some cases it may be to the advantage of the recipient to disseminate the lessons widely to sustain the value chain.

12. The last form of engagement listed, *procurement* in GEF projects, is also of keen interest to the private sector in donor as well as recipient countries. These private sector organizations (and the governments of their countries of origin) often seek advance information about opportunities for procurement in GEF projects. Governments also often seek information about their country’s overall historical share of procurement.

- (a) *Advance notice of procurement opportunities*. The former request could be met by requiring major GEF procurement to be advertised on (say) the GEF website.
- (b) *Historical procurement data*. Meeting the latter would require a major investment in either creating or modifying systems for collecting and analyzing procurement

---

<sup>10</sup> The mere fact that the objective of a project is the promotion of private sector engagement does not entail that the project proponent or direct recipient of the GEF grant will be a private sector entity. In fact, in many cases it would be a public entity. It could, for example, be a government standards institute or a resource mapping department.

data. GEF itself has no such system in place, and if required to provide such data would have to work closely with its Implementing Agencies and Executing Agencies so that they in turn can create or modify their existing procurement data collection systems to meet the agreed type of procurement data. It should be noted that the issues concerning the collection of such data have been investigated earlier: they include the difficulty in separating the GEF from the non-GEF procurement in blended operations for which GEF finances only the incremental cost, the issue of attributing national origin to supply from multinational companies that source their inputs from many countries, and the cost of collecting procurement information on large numbers of small items.

### *Objectives*

13. The overriding reason for engaging the private sector is that this is ultimately a powerful way to achieve global environmental benefits in a sustainable and cost-effective manner. The indicators for success at the impact level will be the same as for engaging the public sector, i.e. they will concern global environmental benefits in the focal areas. However, the indicators for success at the outcome and output levels will be different in the case of private sector activities. To the extent that the private sector is engaged instrumentally to achieve global environmental benefits in the focal areas, there will need to be goals and corresponding indicators for:

- (a) Bringing about policies and frameworks conducive to private sector approaches to the provision of global environmental benefits;
- (b) Creating sustainable markets for global environmental goods by identifying, demonstrating, replicating, and mainstreaming innovative private sector approaches;
- (c) Mobilizing private capital that will share the financial risk with GEF of providing global environmental benefits; and
- (d) Accessing and transferring innovative technology.

14. Specific activities should be approached with an experimental mindset. For a GEF-funded activity or program, a successful outcome would be either a replicable and sustainable business model or a valuable, well-documented lesson resulting from a rationally conceived, innovative (and hence risky) approach. An unsuccessful outcome would be either a failure that resulted from avoidably poor design, procurement, or management or even a nominal project success that did not have any market-transforming impact or from which no general lesson could be derived.

### *Modalities*

15. For the different forms of engagement, GEF has a number of tools at its disposal.



- (a) *Communications.* To promote greater opportunities for procurement it can develop, as part of its on-going corporate communications strategy, an information kit on how to work with the GEF and its partner agencies. It can also create a web-based project tracking system both to advertise procurement opportunities and to provide information about the stages of project processing for all interested parties, including the private sector.
- (b) *Projects.* To ensure that all GEF projects (and not just those that are categorized as “private sector” projects) help to create and maintain sustainable markets and advance innovation in accordance with these principles, the *Project Review Criteria* can be amended.<sup>11</sup> In streamlining the project cycle, special attention would be given to the requirements of any private companies that need to be directly engaged so that GEF can increase the speed and predictability of its decisions.
- (c) *Partnerships.* To promote policy frameworks conducive to private sector approaches and to help the creation of, entry to, and transformation of relevant markets, GEF would develop specific strategies. These would be focused on particular sectors and markets and be selective about the private sector and government partners to be engaged.
- (d) *Dialogue.* Dialogue with relevant and motivated industry groups will also be able to bring about changes in corporate strategies. Although this would be largely a non-project activity, clear goals and indicators would be developed to measure how instrumental GEF had been in bringing about any relevant industry or corporate changes.

16. For broad strategies to work, it would be necessary to foster interagency collaboration according to comparative advantage. Because the recent *Review of GEF’s Engagement with the Private Sector*<sup>12</sup> shows that so far there has been little cooperation among the Implementing Agencies or even between IFC and IBRD, a renewed effort would be made. The obstacles to cooperation would be reviewed and incentives for greater cooperation would be recommended.

### *Timing*

17. Private sector engagement goes through a number of phases. Initially, it is necessary to ensure that there is an enabling environment, and projects are typically focused on governments and institutions to help align relevant regulations, legal framework, and policies with global environmental priorities.

18. Then, during a specific innovation or market transformation phase, there is an innovation path that typically has the following steps: identification of the innovation, proof of concept, demonstration, scale-up, and commercialization. GEF projects in this phase typically involve

---

<sup>11</sup> The *GEF Project Cycle*, including the current Project Review Criteria, is documented in GEF/C.16/Inf.7.

<sup>12</sup> GEF/C.23/Inf.4.

public-private partnerships and are characterized by risk sharing and the search for synergy. The proponents would be required to describe matters such as the following:<sup>13</sup>

- (a) Which step in the innovation path they are supporting;
- (b) The reason (if a public entity is involved) that the private sector cannot be used;
- (c) How the GEF activity will help move the innovation along that path to the next stage;
- (d) The likelihood that all stages would be completed; and
- (e) An exit strategy, should more than one GEF activity be required.

19. The accountable proponent and agency would be required to describe the project in such a context and to set out indicators for market success.

20. It will also be important to schedule the actions needed to promote replication, including replication in other markets. While the private sector essentially takes the lead in this, GEF may facilitate this process with activities that are more limited and qualitatively different than those in other stages of innovation.

#### *Priorities for strategic approaches*

21. GEF will remain open to *projects* involving private actors wherever they are operationally desirable in achieving global environmental benefits. However, GEF would also pursue, very selectively, *strategic approaches* to influence business sectors or markets at a broad level.

22. Until now, strategic approaches have largely been developed within the focal areas. However, as shown in the workshop with the private sector in Geneva, it is difficult to maintain a dialogue along strictly focal area lines. The private sector is classified by business sector, and industry associations and forums follow such classifications. To shield the dialogue as much as possible from the internal complexities of GEF, it would therefore be more effective to structure future dialogue and any resulting strategic approach by business sector, rather than by GEF focal area.<sup>14</sup>

23. GEF would develop strategic approaches where there is strong likelihood of GEF achieving sustainable global benefits or showing the potential for replication. Priority sectors or

---

<sup>13</sup> The agencies and many private actors use similar characterization of the innovation path. It will be useful for the GEF Secretariat, in consultation with the Implementing Agencies, to define common terms for describing this sequence.

<sup>14</sup> Global environmental benefits within the focal areas still remain the ultimate objective of course, but each industry group may have opportunities in several focal areas.

markets would be those where there is both a business interest in global environmental issues and a business forum that permits representative and structured dialogue.

- (a) *Business interest.* This has been growing in recent years as companies have embraced the concept of sustainability in their operations and strategy. With the adoption of the “triple bottom line,” these companies have recognized financial, environmental, and social concerns as criteria for their businesses and have organized themselves into forums to engage each other and the wider community on these issues. Impetus for this has come from enlightened leadership, public and NGO pressure combined with a concern for corporate image, the need to attract a committed workforce, and new business opportunities. For example, in the banking and insurance sectors, the business case for promoting renewable energy and for mitigating the risks of climate change respectively are already well appreciated.
- (b) *Business forums.* GEF private sector strategic approaches can be developed using the various opportunities for dialogue that already exist with committed companies and industry associations. For example, there are UNEP forums for the finance sector and tourist operators, IFC has dialogue with the largest private commercial banks with business in emerging markets concerning the “Equator Principles,” and there are various primary industry associations.

24. Although broad strategic approaches and principles would be developed in this way at the global level in cooperation with industry forums, experience suggests that GEF should not be overly prescriptive about the individual country markets in which to promote private sector activity. The Implementing Agencies and Executing Agencies would remain responsible for anchoring specific programs of GEF support in local and not just global markets, and would need to incorporate both global and local perspectives in their programs. (Collaborating with national and local industry associations may also be an effective way to engage the private sector without giving any GEF endorsement or advantage to a particular firm.)

25. Development of strategic approaches for individual countries and local markets should be demand-driven. UNDP estimates that among the 166 countries served by its 130 country offices, the private sector has already proven to be a major driving force for development in a number of them. The *Review of GEF Engagement with the Private Sector* points to a lack of assessment of individual market conditions (including relevant policies) and to a pre-occupation with special technologies without considering the relevant economic and social conditions.

## **GEF CORPORATE APPROACH**

26. GEF is fortunate to have a range of Implementing Agencies as well as Executing Agencies,<sup>15</sup> because they have different comparative advantages and can add value in a complementary way to the implementation of the private sector strategies that would be developed. The Secretariat will consult with the Implementing Agencies to further integrate the contributions described below into a more rigorously corporate approach, e.g.,

- (a) Building on UNDP's capacity development activities that create pro-business policy reform;
- (b) Drawing corporate lessons from World Bank's economic and sector work; and
- (c) Enhancing the two-way dialogue with selected business sectors through UNEP's established forums.

#### *UNDP*

27. GEF activities implemented by UNDP shape the enabling environment and so help the private sector influence and modify local and global markets, supply chains, production systems, and service providers. UNDP has major experience in capacity building and technical assistance, can identify private sector opportunities at country level, and maintains a continuous country presence that helps it provide the assistance needed to establish an enabling environment for the private sector to flourish. In fact UNDP and the UN system maintain an important framework that can support country presence and the private sector activities: the global network of UNDP Country Offices (136 Country Offices serving 160 countries) and the Global Compact, a UN inter-agency initiative to challenge business that focuses in part on global environmental issues. In addition, UNDP's Division for Business Partnership Unit and the newly formed UNDP Private Sector Task Force, which will continue the work started by the UN Commission on the Private Sector and Development, both contribute to shaping UNDP's relationships with the private sector.

#### *UNEP*

28. The mission of UNEP's Division of Technology, Industry and Economics (DTIE) is to help decision-makers in government, local authorities and industry develop and adopt policies that are cleaner and safer; make efficient use of natural resources; incorporate environmental costs; and reduce pollution and diminish risks for humans and the environment. UNEP DTIE's long-standing efforts in industry consultation could be enhanced and improved to focus on GEF priorities, as several of these industry sectors have a direct interest in global environmental issues: the insurance industry (in the increased risk exposure due to climate change and environmental liabilities due to POPs), the banking industry (in criteria for lending on renewable energy projects), municipal services (in techniques for disposing of POPs, sustainable transport, and methane capture from urban landfills), tourism (in eco-tourism and the protection of habitat from the impact of tourism), etc. GEF dialogue and project activities could benefit from and

---

<sup>15</sup> "Executing Agencies" here refers to the executing agencies that have been admitted under the policy of expanded opportunities. They comprise: ADB, AfDB, EBRD, FAO, IADB, IFAD, and UNIDO.

build on the work of these forums, especially UNEP Finance Initiative (with 265 banks and insurers from 50 countries signed up and committed to integrate sustainable development considerations into their operations and service), the Global Reporting Initiative (which is designing and building acceptance for a common framework on sustainability reporting), and UNEP Sustainable Energy Finance Initiative (which provides current and targeted information to financiers and facilitates new economic tools that combine social and environmental factors – both risks and returns – as integral measures of economic success).

### *IBRD and the RDBs*

29. The investment banks follow an approach focused on operations. Their capacities are for macroeconomic work, diagnosing country-specific product and service markets based on extensive economic and sector work, sector dialogue, and large-scale follow-up investment. For example, because IBRD recognizes the private sector's crucial role in development, their economic and sector work focuses heavily on analysis of policy frameworks for private sector development and on the provision of advice to governments on how to strengthen those frameworks, which often involves substantial interaction with key private sector actors at national level. In particular, both EBRD and IFC focus specifically on the private sector lending without government guarantees.

### **SUMMARY OF PROPOSED FOLLOW UP**

30. The Secretariat will continue to consult with the Implementing Agencies to develop the proposed responses and to increase the corporate integration of agencies' contributions (paragraph 25). Three broad ways of engaging the private sector were identified (see paragraph 8), and for these the following responses were proposed:

- (a) *Indirect engagement.* This is recognized as a powerful way to generate sustainable global environmental benefits. To strengthen indirect engagement further it is proposed to develop (selectively) a few *strategic approaches*. (The way priorities for developing such strategic approaches will be established is set out in paragraph 22.) Developing and implementing those broad strategic approaches will require dialogue with committed business sectors in established forums. The strategic approaches will not be overly prescriptive, and partner agencies will continue to implement any such approaches primarily at the country level.
- (b) *Direct engagement.* Projects remain the main way of doing business, whether those projects form part of a strategic approach or are pursued individually within current frameworks. It is proposed to amend the *Project Review Criteria* to require partners to share risk equitably with the GEF (paragraph 5); to treat the special issues raised by private sector entities that are directly engaged (paragraph 10); to apply appropriate output and outcome indicators and to incorporate a definition of success that explicitly recognizes the support for innovation (paragraphs 12 and 13); to evaluate impacts on markets as a consideration for *all*

projects, not just those projects specifically identified as “private sector” projects (paragraph 14b); and to identify the stages of the innovation path that is being followed (paragraphs 16-19).

- (c) *Procurement.* Engagement through the procurement process raises special issues. It is proposed to address communications issues directly, and to submit a costed proposal to Council on the collection of procurement data (paragraph 11) for further consideration.