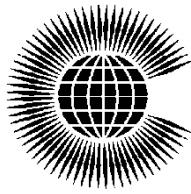


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**Report on Investment and Private Sector Development Activities**

Paper by Commonwealth Secretariat

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## Report on Investment and Private Sector Development Activities

### Introduction

Successive Finance Ministers meetings have reiterated the mandate for the Secretariats' work in the areas of investment and private sector development. Commonwealth Heads of Government, in their communiqué issued in Kampala, also called on the Secretariat to intensify its efforts in promoting access to capital. The Heads of Government recognized the importance of improving the business and overall regulatory environment in reducing investor costs and promoting investment, and called for a greater focus on developing domestic financial markets and providing opportunities for domestic investors.

2. This paper outlines the backdrop to this work provided by developments in the global economy; the current activities of the Secretariat in response to this mandate and the importance of continued work in this area to meet the needs of member countries.

### The Context

3. The outbreak of the global financial crisis brought an end to an unprecedented cycle of growth in foreign direct investment (FDI), which had reached a historic high of US\$1.9 trillion in 2007. According to a United Nations Conference on Trade and Development (UNCTAD) report released in April 2009, global FDI declined by an estimated 15 per cent in 2008.

4. The worldwide contraction in FDI inflows has been fuelled by (i) a reduced capability to invest, and (ii) a reduced propensity to invest. Falling domestic corporate profits and tighter international credit conditions have made it more difficult and expensive to invest in foreign operations. At the same time, gloomy growth prospects worldwide and increased risk aversion resulted in a curtailment of investment programmes.

5. The impact of the financial crisis on FDI differs by region. Whilst developed countries have been the most affected, FDI to developing countries grew by 7 per cent in 2008. According to UNCTAD, all developing regions, with the exception of West Asia experienced higher FDI levels compared to 2007. However, FDI in these regions is expected to decline in 2009 due to setbacks in export-oriented manufacturing, primary sector and market-seeking investment. FDI inflows to Commonwealth countries declined by 30 per cent in 2008, and developed regions have been the most affected (see Table 1).

**Table 1. FDI inflows of the Commonwealth countries by region, 2007-2008<sup>a</sup>**  
(billions of dollars and per cent)

	FDI inflows		
	2007	2008	Growth rate (%)
<b>Commonwealth countries</b>	455.7	318.5	-30
<b>Developed countries</b>	353.9	190.5	-46
<b>Developing countries</b>	101.8	127.9	26
Africa	25	37.1	48
Latin America and the Caribbean	4.3	6	39
Asia	71.9	84.5	17
Oceania	0.5	0.4	-25

Source: UNCTAD (2009); Note: <sup>a</sup> preliminary estimates.

6. In the short term, the global recession will continue to exert downward pressure on FDI. Developing countries are expected to see reductions in FDI in 2009, as companies favour divestments over investment programmes. Least Developed Countries (LDCs), already facing the challenge of falling official and private financial flows, will face stiffer competition to attract FDI.

7. Medium term prospects are more difficult to predict, and will depend on a number of inter-related factors including the strength and speed of economic recovery. The effectiveness of policy responses to the financial crisis in particular will play a key role in determining the future direction of FDI. Structural reforms to ensure more stability in the global financial system and the policies to promote investment will be key in supporting a return to growth.

### **Current Initiatives**

8. The Secretariat is working on a number of fronts to raise investment levels in member countries. The **Commonwealth Private Investment Initiative (CPII)** aims to mobilise capital for investment in developing member countries. Three regional funds were launched in the first phase – Comafin (Sub-Saharan Africa, \$63.5 million, 1996), Kula (Pacific Islands, \$16.9 million, 1997) and the South Asia Regional Fund (SARF, \$106 million, 1998). The Tiona fund raised for the Caribbean was subsequently merged with the Caribbean Investment Fund and now lies outside the initiative.

9. A second phase of CPII focusing on the SME sector was launched in 2005, based on a mandate from the Finance Ministers' meeting of that year. The Secretariat has partnered with Aureos Capital to deliver this mandate. Funds launched under this phase include Kula II (\$16 million, 2006) and the Aureos South Asia Fund (ASAF, \$85 million).

10. The Secretariat is currently working with Aureos to raise the Aureos Africa Fund (AAF), with a target capitalisation of US\$400 million. AAF will build on the success of three regional funds for Africa (Aureos East Africa, West Africa and Southern Africa Funds), which d invested a total of \$140 million in 43 companies, providing internal rates of return in US dollar terms of between 23 per cent and 72 per cent

11. The Aureos Africa Fund had its first close with \$253.5 million committed by CDC, Norfund, FMO, EIB, IFC, Galleon, Shamrock Holdings and Chapel Hill in September 2008. Current commitments are in excess of US\$300 million and AAF is on course to achieve its target of US\$400 million before a final closing later this year. The fund aims to attract African institutional investors, to demonstrate local confidence in the economies where the fund will invest and to deepen local financial markets. To date no African institutional investors, including public sector pension funds have committed to invest in the fund. The Secretariat is continuing to support efforts to engage these investors, particularly as the current global context places an imperative on the mobilisation of domestic resources for investment.

12. The Secretariat has, in partnership with Aureos, started exploring the feasibility of a Financial Services Fund (FSF), which would invest and build the capacity of companies providing a range of financial services (banking, insurance, etc) to low income groups in Commonwealth countries in Africa and Asia. The Secretariat's funding is enabling Aureos to consider investment in countries such as Botswana, Malawi, India and Bangladesh, which would not otherwise be covered by this initiative. A preliminary feasibility study was concluded in September 2009. Based on the results of this first phase, the Secretariat intends

to provide further support in 2009/10 for the preparation of the information memorandum and other related activities for the launch of the fund.

13. To strengthen the results delivered by the programme, a development impact review of the second phase of CPII will be carried out by the Secretariats' Strategic Planning and Evaluation Division. The review will allow the Secretariat to document the results of CPII and make strategic decisions about the future of the initiative.

14. The Secretariat has continued to explore ways of **reducing the levels of risk and transaction costs associated with SME financing**. Since the 2007/08 financial year, it has supported a pilot SME Credit Information Database in South Africa in partnership with the International Finance Corporation (IFC), and two private sector partners, Compuscan International and Status Credit Circle. The objective is to develop a credit information database on SME sub-contractors in the building and allied industry in the Western Cape Province of South Africa. The pilot database currently contains information on approximately 120,000 SME sub-contractors, of which some 10,000 have credit ratings.

15. Financial institutions including Alexander Forbes and ABSA are considering developing new products specifically for SMEs in the database, allowing them to access finance from the formal sector for the first time. Compuscan and Status have also negotiated discounts with leading suppliers of construction materials for the SMEs in the database. A number of these suppliers have begun to extend suppliers credit facilities to the sub-contractors.

16. The focus in 2009/10 will be on transferring the database fully to private sector management, in line with the original objectives of the project. The Secretariat will be working with its partners to develop and implement a marketing and exit strategy. We will also document lessons learnt from the experience and based on this consider implementing similar projects in other regions.

17. The Secretariat continued to **conduct research into alternatives to bank financing for SMEs in developing countries, starting with leasing products**. Leasing provides small and medium sized businesses who often lack the necessary collateral and credit history for traditional bank loans with a means of financing equipment. Whilst leasing accounts for 15-30 per cent of capital investment in OECD countries, it only represents an estimated 0-15 per cent in developing countries. The leasing industry in many developing countries faces structural obstacles such as an absence of clearly defined and predictable laws governing leasing transactions, unclear accounting standards, lack of an appropriate tax regime and the absence of a regulatory and supervisory framework.

18. The primary objective of the research is to assess the existing regulatory, legal and fiscal framework pertaining to financial leasing and, if necessary, provide recommendations for making this framework more conducive to financial leasing. A pilot study in Trinidad and Tobago and Barbados has now been completed. The Secretariat is consulting with potential partners on next steps.

19. The Secretariat also commissioned a study on the **Effects of the Global Financial Crisis on Investment and Private Sector Development in Small States**. The study

- (i) Analysed the effects of the global financial crisis on investment and private sector development policy in small states;

- (ii) Reviewed and analysed policy responses in selected small states the implications of international responses for small states, and
- (iii) Identified additional policy responses, both domestically and internationally.

20. These issues were analysed with respect to small states in general, and in further detail for Vanuatu, Mauritius and St. Lucia. The study was discussed at country workshops as part of ongoing work on Resilience Building in St. Lucia and Vanuatu, and at a July 2009 meeting on Small States in London. The final version of the study is being prepared for publication.

### **Looking Forward**

21. Private sector development is a core Commonwealth Secretariat activity for three reasons:

- The private sector is vital to development. Work in this area directly supports the second goal of the strategic plan which is focused on sustainable economic growth. A strong and vibrant private sector is a pre-requisite for such growth.
- The purpose of a functioning financial sector is efficient intermediation between private saving and private investment. The investment programme supports this from the demand side and is a natural complement to the Secretariat's work on financial sector regulation. Perhaps more importantly, the programme's focus on improving access to financial services for the poor and vulnerable contributes directly to the fight against poverty.
- These issues are even more important in the context of the current economic and financial crisis when the scarcity of foreign capital both intensifies competition for resources and strengthens the need to mobilise domestic resources.

22. Member countries have consistently supported the need for Secretariat work in this area. Indeed, Heads of Government have called for an increased level of support to member countries in financial sector development and improving the business environment. Whilst there are a number of other organisations contributing to both investment promotion and private sector development space, the Secretariat has distinct advantages in this area. Chief amongst these is our focus on regions and issues which orthodox approaches have failed to address or which are not a priority for other larger actors. The SME Credit Information Database is a prime example of this type of work, as is CPII. These projects have helped demonstrate that previously un-served populations (in the case of the database) and regions (through CPII) can provide profitable opportunities for the private sector in the right circumstances. The Secretariat's intervention in both cases has been crucial in mobilising other partners.

23. Resource constraints mean that the Secretariat's ability to realise its full potential is restricted and particularly the ability to carry out the type of sustained multi-year programme which are most effective in private sector development. This has implications for the Secretariats' ability to deliver on the mandates from successive Ministerial and Heads of Government Meetings outlined above. In the absence of a significant increase in resources in the foreseeable future, there will be strategic decisions to be made about the future direction and content of the Secretariat's Investment and Private Sector Development Programme.