EBCAM POSITION PAPER

Brussels, Wednesday, 19 January 2022

AU-EU 2022 Summit: Ensuring Effective EU Support for Private Sector Investments as Contributors to Development

Strengthening the private sector's contribution to development by using public funds to de-risk impactful investments and

Creating a dedicated, more flexible financial instrument to support private investments that promote development

---

Africa can become one of the most important partners for Europe politically and economically. EU Africa policy should be geared to this. The African continent requires much greater attention beyond traditional development cooperation and in close cooperation with the private sector.

Traditionally, Europe-Africa cooperation under the Lomé Convention and Cotonou Agreement is marked by relationships between states. However, the involvement of various actors in the private sector was one of the major developments in the Cotonou Agreement in comparison to the previous Lomé Convention, which were considered as the exclusive domain of the states. Despite very high expectations, no concrete actions have been undertaken to ensure the involvement of the private sector in the implementation of the Cotonou Agreement.

With that being said, things are starting to shift. The European External Investment Plan (EIP), adopted in 2017, is - to some extent - recognising the role of the European private sector in economic development. It regulates measures to be taken by the European Union and its Member States to stimulate private investment in Africa by offering guarantee schemes to mobilise additional funds for companies. To benefit from this, companies that do not have direct access to the EIP must approach the development financial institutions (DFIs) in order to be considered eligible.

Generally speaking, the DFIs, without exception, now notice the crucial role that the European private sector plays in promoting the sustainable development of African economies. All of them agree that business creates wealth, generates jobs and thus contributes to improving the living conditions of populations while increasingly ensuring the preservation of natural resources, biodiversity and protection of climate.

However, EBCAM considers that beyond the often-celebratory presentations of the new policy, the European private sector is still not sufficiently represented neither supported when it comes to the development of African economies, at a time when the African private sector is suffering considerably from the effects of the pandemic. Directly affected by the decline in domestic demand, it has been hit hard by the global economic downturn. Due to fiscal and social constraints as well as limited capability for manoeuvre in comparison to the informal sector, the private sector depends on the financing of national public spending and job creation in the future.

Therefore, it has become apparent that a strong mobilisation of private investment is essential in order to revive African economies.

European Business Council for Africa
Rue Montoyer 24 (B.5) – 1000 Brussels – Belgium
Tel. : +32 2 512 06 95 – website: www.ebcam.eu - email : contact@ebcam.eu

EBCAM POSITION PAPER

Brussels, Wednesday, 19 January 2022

The weaknesses of European official development assistance with regard to the private sector

Official development assistance to the European private sector is mainly channelled through DFIs, which intervene in two ways. On the one hand, they provide direct financing to companies through loans or equity investments. On the other hand, they act indirectly by supporting local financial institutions (banks, microfinance institutions) or investment funds through various instruments (credit lines, guarantees, equity investments).

DFI financing for private enterprises in Africa is increasingly based on blended finance with a subsidy and a market component. But while blended finance allows DFIs to provide loans or equity investments with long maturities and at lower costs than the market, **we believe that these financial instruments are in general ill-suited in this context due to the characteristics of enterprises:**

- Their intervention thresholds are relatively high. DFI financing, whether for loans or equity investments, rarely amount to less than €5 million, their involvement in investment projects usually being limited to those of at least €10 million,
- DFIs are relatively risk-averse. In addition to the usual requirements demanded by banks, DFIs tend to include other procedures to reduce their exposure to all risks (fiduciary, counterparty, reputational, environmental, social, climate, biodiversity). European DFIs show that they require their clients to comply with social, environmental and governance standards that are based on international standards. Compliance with these procedures implicitly assumes, and makes the both unrealistic and unreasonable requirement, that African SMEs have an internal organisation similar to that of an intermediate-sized European company, which disqualifies many potential clients.

In our opinion, the existing tools or the way DFIs operate need to be improved upon as soon as possible. To do so, the guarantee tools could thus be expanded to cover additional risks, such as first loss risks, commercial risks such as currency risks, security risks, etc. The DFIs could also dedicate part of their resources to financing projects of private companies with a high impact (economic, social and/or environmental).

Rethinking support for private enterprises in Africa

1) Increasing resources to support private enterprises in Africa

Large-scale, multi-faceted support for private enterprises in African countries is becoming urgent. For example, other regions in the world have shown that development is achieved through the progressive strengthening of these levels of the economic apparatus and the emergence of champions. **We strongly believe in the urgent necessity to carry out a "big bang", a "seismic shift" in the approach to the support of private enterprises operating on the African continent by substantially and rapidly increasing the number of projects dedicated to these private entrepreneurs**, as much for the financing of their preparation or their first period of activity as for their accounting, legal and fiscal supervision or the training of their teams.

European Business Council for Africa
Rue Montoyer 24 (B.5) – 1000 Brussels – Belgium
Tel. : +32 2 512 06 95 – website: www.ebcam.eu - email : contact@ebcam.eu

The EU has unveiled its €300 billion "Global Gateway" fund to support global infrastructure, which will support the EU's connectivity strategy. The EU has set out to establish the "Global Gateway" as an alternative to China's Belt and Road Initiative, which aims to address the most pressing challenges with a democratic, value-based approach. This can only succeed if Africa becomes a focus of the initiative.

Europe's opportunity to close the gap, that has emerged compared with Chinese involvement, lies in investments that create large-scale, value-added production in Africa. But to do so the EU must deploy its resources in a coordinated and strategic manner. The key to Europe becoming Africa's leading growth partner lies in combining the "Global Gateway" with the EU Green Deal and the EU's $1 trillion initiative to combat climate change at home and abroad. Rather than separating its green agenda from its response to China's Road and Belt Initiative, the EU should combine the two into a coherent whole. This is especially true for European engagement on our neighbouring continent. Projects within the "Global Gateway" should be implemented in close cooperation with the European private sector. The prerequisite for this is that companies are placed at the center and the toolboxes of development cooperation and foreign trade promotion are adapted accordingly.

2) Using European ODA to de-risk impactful private investments

We believe that increasing the positive impact of public aid to the private sector in Africa means targeting high-impact firms (economic, social, and/or environmental), namely the high-growth firms that drive most wealth and job creation and innovation, as well as the pioneering firms that explore new markets. However, investing in these companies involves taking on and managing high risks due to the associated uncertainty and potential volatility concerning their intrinsic initial potential and the multiple exogenous shocks they will be met with during their life cycle.

DFIs and private banks have difficulty targeting these companies because of an overly conservative approach to risk. It is therefore necessary to rethink the support mechanisms provided to these companies in order to facilitate 'de-risking' a significant proportion of the investments.

Lifting the taboo on the use of public funds for the European private sector

The action of DFIs is based on their access to public resources that allow them to offer additional services (technical assistance) or more favourable credit conditions than the market (extended maturities, grace periods, concessional rates, blending, etc.). Nevertheless, the notion of supporting the European private sector through the use of public funds, and the benefits this provides to commercial activities, is not always well received. Despite declarations of intent, there is a strong reluctance to support private investment with public resources. However, auditing and traceability tools exist to guarantee the proper use of public subsidies. Even though they are considered the engine of development, companies, unlike NGOs, neither have access to calls for projects financed by public aid, nor to grants that are particularly useful for starting up projects and de-risking their investments.

European Business Council for Africa
Rue Montoyer 24 (B.5) – 1000 Brussels – Belgium
Tel. : +32 2 512 06 95 – website: www.ebcam.eu - email : contact@ebcam.eu

Many private projects, although useful for development, are not carried out

The impact of the Corona pandemic and its economic consequences in Africa are leading to increased financial risk-taking for investors in Africa, both African and European. In sub-Saharan Africa, as elsewhere in the world, the crisis triggered by the virus has not created trends that did not already exist in terms of risk. It has, however, profoundly changed the terms. It has accentuated, amplified and exacerbated both their reality and their perception as well as their emergency nature. In taking steps to ensure that the positive economic development of many African countries over the past decades and also the positive developments in European-African economic relations in recent years are not undone, the EU should exhaust all possibilities to mitigate the economic consequences of the Corona crisis for the African continent as far as possible, while at the same time already preparing measures to strengthen trade and investment with and in African countries after the end of the pandemic. After all, the economic development of our neighbouring continent continues to play an important role for Europe.

Therefore, the risks for European investors linked to the current European Draft Directive on Corporate Due Diligence and Corporate Accountability of European parent companies and principals[1] should be kept to a minimum. If European investors are thus held criminally responsible for the actions or failures of their suppliers and subcontractors in Africa that they do not control, they will think twice before investing in Africa, even if the investment in question is likely to bring relative progress to the livelihoods of local populations. This has the adverse knock-on effect of benefiting their non-European competitors who are not obliged by a legal framework to adhere to strict controls such as those proposed in the European directive draft.

Too often, creditors step in when companies have been able to prove the viability of their investment. However, many well-structured European and African companies with profitable projects struggle to raise external funds to finance this first step. As a result, many development projects, often small in size and with a delayed profitability, are not carried out because they fall at the first hurdle.

This is typically the case for solar energy. The needs in this sector are immense. Despite the obvious appetite of private investors for solar in Africa, African grids are often not able to accommodate projects larger than 50 megawatts. But intermediate-sized projects that would allow for power agglomerations are often too small to have access to financing adapted to the constraints and risks of African countries. In essence, the projects are too small to bear the disproportionate cost of mobilizing the tools provided by development banks.

Another obstacle is the systematic use of tenders that are often unsuitable regarding the maturity of the market and, last but not least, the presence of projects subsidised by some donors and development aid programmes, resulting in artificially low prices and thus distorting competition.

[1] According to this project, all European companies with more than 250 employees and SMEs listed on the stock exchange will now have to prove that their international supply chains respect due diligence obligations in terms of human rights (including social, commercial and workers' rights), respect for the environment (in particular the contribution to climate change or deforestation) and good governance (corruption...). In case of violation, they could be held legally responsible while exposing themselves to criminal sanctions before a European court.

It is in this context that we consider that public development policies could be implemented much more efficiently and with tangible results for the benefit of the population of African states, if private companies were not only more involved in the implementation of projects, but also direct beneficiaries of a part of the ODA for their projects in favour of development.
It is a question of mobilising the private sector within the framework of a public-private partnership, public resources to support companies that participate in development by creating added value, jobs, distributing salaries, paying taxes and providing essential services for the population. The principle is simple: profitable private projects are not subsidised.
Essentially, the private sector is asking for a start-up boost to make their projects viable at a later stage. It is indeed necessary to adapt the amount of amortisation of a project to the standard of living of the populations, the size of the markets and the capacities of the specific countries. Often, a minority share (between a quarter and a third) of subsidies is needed to make the project viable. The rest of the financing is covered by the private sector itself in the form of equity or debt. Subsequently, the expected revenues from the project will cover the financial investment and ensure its autonomy.

Creating a dedicated, more flexible financial instrument to support private investments that promote development

According to EBCAM, an innovative solution would involve the creation of a new financial vehicle within the EU framework that is more flexible, faster, and less constrained by the traditional rules to have a real leveraging effect on high-impact private investments in Africa. This financial vehicle could mobilise public resources in the framework of a public-private partnership.

The provision of subsidies would thus make it possible to assume the necessary risk-taking and thus guarantee the sustainability of the system. The remit of the proposed financial vehicle could cover the financing needs of the targeted European private companies. The vehicle would thus offer lines of credit or guarantees to local private banks, more or less subsidised direct loans, equity investments and, when justified, subsidy support.

The instrument would thus make it possible to de-risk (through guarantees, a mix of grant and loan resources) certain investments, which, in the current context, would present a deferred profitability or would not be made without this support. The combination of loans and grants, as well as their maturity, would depend on the level of profitability of the operation, the risks involved, and the expected impact of the investment.

The advantages of this specific financial vehicle are fourfold. It allows for significant leverage by including private investors. It also offers a certain flexibility allowing the necessary procedures to advance at an accelerated pace (avoiding a round of creditors for each investment project) and to free oneself from the internal rules of each investor (in terms of compliance or due diligence). Furthermore, the establishment of such a financial instrument would contribute to the promotion of good governance.

The way forward: a shift in the concept of ODA to promote investment by private enterprises in Africa

It is therefore clear that despite appearances and well-intentioned statements, ODA and the European private sector are still worlds apart. Those responsible for ODA and those in the private sector communicate with one another, exchanges are made, and the existing mechanisms are somehow known but on a small scale. In reality though, ODA is deployed solely between states, while the private sector conducts its business and investments on its own, without too much concern for the objectives of national and inter-state policies, even though the enterprises contribute just as much, if not more, to the achievement of the SDGs in Africa as ODA and NGOs.

In this context, only a paradigm shift in ODA in favour of the European private sector will make it possible to support the emergence of many more formal private enterprises, the only ones capable of creating jobs on a large scale and generating wealth directly at the bottom end of the pyramid.

Shifting the concept of ODA to one that supports and promotes **investment** for development would reflect a frequently expressed desire to shape a new type of partnership, one that would be more ambitious and better adapted to current realities, and one that could generate real interest and political traction for all parties concerned.

The controversy over the use of public funds to support the European private sector is not new. Opponents argue that public funds should not be used to enrich private shareholders. However, this vision of aid ignores the fact that productive enterprises have not only positive economic effects (creation of jobs and activities, diffusion of knowledge) but also highly beneficial impacts on the rest of society (innovation, fiscal mobilisation, pacification). It is a reflection of a zero-sum game mentality rather than a win-win scenario.

Based on this real possibility for cooperation, **EBCAM advocates a substantial increase in ODA to be directed to private enterprises in Africa**, which of course requires breaking the taboo on providing aid and financial incentives to the private sector. We recommend using these additional public resources to de-risk investments in Africa, notably through the creation of a dedicated financial vehicle within the EU framework.

In a context marked by growing rivalry between the great powers, the EU could in this way further assert its role as Africa's leading partner. To do so, it must go beyond declarations of intent to propose a more engaging and more legible "narrative" based on a partnership of projects that are close to the ground and that meet the real needs of Africans.

European Business Council for Africa
Rue Montoyer 24 (B.5) – 1000 Brussels – Belgium
Tel. : +32 2 512 06 95 – website: www.ebcam.eu - email : contact@ebcam.eu