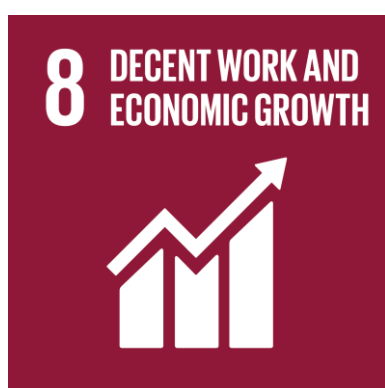


# Decent Work and Economic Growth

## Theory of Change for

## Private Sector Development

October 2022



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## 1. Introduction

This Theory of Change (ToC) focuses on private sector development. It describes challenges in this field of work, the context in which we work, medium and long term changes leading to the desired outcomes and impacts and the Dutch efforts to reach these outcomes, based on evidence, knowledge and experience. It clarifies the assumptions and parameters that underpin our work and the risks that may affect the achievement of the stated outcomes and impact. This ToC also refers to the strategies we have developed for private sector engagement (PSE) and for taxation, since these are closely related to private sector development.

The timeframe of this ToC is up to 2030, the year set for achieving the Sustainable Development Goals (SDGs). Our strategy may be subject to review in response to changing insights and developments over time. As a learning department we will monitor, evaluate and learn (MEL) to future-proof our strategy in order to achieve the impact we aim for. The ToC will also be used to underpin our portfolio management and external communications.

Finally, this document is based on studies and research and contributions by internal and external partners, including knowledge institutions and implementing partners.

## 2. Why focus on private sector development?

Research by the OECD and the World Bank,<sup>1</sup> among other sources, shows that we cannot achieve the SDGs and climate goals if we do not develop and cooperate with the private sector, with small and medium-sized enterprises (MSMEs)<sup>2</sup> in particular. MSMEs are the drivers of economic development around the world, providing long-term jobs and income even for the poorest. Tax payments fund public services. Their market power and potential for innovation make MSMEs key partners in achieving economic growth. Where MSMEs work in markets, sectors and regions where many poor people live and work, they make a direct contribution to reducing poverty and inequality (pro-poor growth). Stimulating the transitions to decent and safe work and ecological sustainability is important, among other things for alignment with the European market. Participation in the labour market is essential for women and young people, since there is clear evidence that this contributes to improving employment and thereby accelerating economic growth.<sup>3</sup> A healthy business, trade and funding climate, access to appropriate financial services, distribution of economic power, effective taxation and a well-functioning labour market and legal framework are key conditions for businesses to flourish.

## 3. Context and trends

**For the first time in decades, extreme poverty and inequality are on the rise.**

The past several decades brought major improvements in the living conditions of a large proportion of the world's population. There has been a spectacular decline in the number of people living in extreme poverty, from 1.85 billion in 1990 to less than 700 million in 2018. These days, extreme poverty is concentrated in the poorest countries or those facing conflict and political instability. In 2020, the COVID-19 pandemic caused unprecedented economic contractions around the world, which revealed fundamental inequalities and structural flaws in economies. Global demand for some

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<sup>1</sup> World Bank: *The 2030 Sustainable Development Agenda and the World Bank Group*; OECD: *Promoting Pro-Poor Growth*.

<sup>2</sup> In the definition of SMEs we include micro, small and medium-sized enterprises in the formal and informal sectors.

<sup>3</sup> UN: *'The Centrality of Employment to Poverty Eradication'*.

goods disappeared for a while and supply chains were severely disrupted. The service sector collapsed almost entirely, including tourism that is so important for Africa. The crisis hit SMEs hard.

Inequality between and within developing countries is still significant and is once again on the rise. The impact is felt mainly by the unemployed and people working in poor or highly insecure environments, particularly in the informal sector. In recent years the number of children being forced into child labour, which was already in the millions, has risen alarmingly.<sup>4</sup> One of the root causes is parents' and carers' lack of living wages and income, and lack of access to education.

The World Bank recently estimated that the COVID-19 pandemic could set back the pace of development by 10 years and cause a slight rise in extreme poverty and inequality, putting an end to the downward trend. This rise is compounded by the negative impacts that climate change and conflict and instability are having on poverty eradication in many developing countries. Recovery from this arrested development will take time and will demand major efforts in the poorest countries, which are often fragile, and those with a large informal sector.<sup>5</sup> This means that the SDGs and climate goals will be far from achieved. Therefore, something needs to change, urgently.

### [A strong MSME sector is key to turning the tide of rising poverty and inequality](#)

MSMEs, including those in the informal sector, farmers and micro enterprises, play an important role in reducing poverty and inequality; they provide the majority of jobs and incomes and can also lead the transition to better jobs. In many developing countries, however, the enabling environment for MSMEs is underdeveloped. Access to work (let alone decent, safe and well-paid work), to financial services, natural resources, knowledge, general and vocational education is limited and unequal. All this impedes business productivity and competitiveness. Weak governance, corruption, an unfavourable business climate and instability (political or otherwise) are obstacles to growth and discourage foreign or domestic investments. In addition, the lack of physical and digital infrastructure in many developing countries makes it difficult or even impossible for companies to produce goods and/or services cost-effectively, or to transport them to markets. Lagging demand for sustainable production and trade has a continuously negative impact on people and on the environment. Strong MSMEs can foster a culture of entrepreneurship in which decent jobs are the norm, human rights are respected, people earn a living wage or income and excesses such as child labour or forced labour are a thing of the past. The absence of sustainable production methods undermines the opportunities for businesses to sell to international markets. Trade barriers discourage entrepreneurship. Furthermore, MSMEs are often denied business loans because local banks consider their business plans too risky or lacking commercial potential. The rising debt problem has only served to intensify the banks' traditional focus on lending primarily to the public sector. When banks do provide loans to MSMEs, businesses can often barely afford meeting the high interest rates charged.

### [Participation by women and young people yields better results](#)

The economic position of women must be addressed; often they earn less as an employee or entrepreneur, even though research shows that a more equal balance between men and women, at all levels of the hierarchy, improves growth, innovation and stability within companies.<sup>6</sup> Moreover, 90% of women's earnings are channelled back into the family. Of the population of Africa as a whole, 35% is aged between 15 and 35. While young people<sup>7</sup> are vital to stimulating the economic

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<sup>4</sup> [ILO & UNICEF: 'Child Labour: Global Estimates 2020, Trends and the Road Forward'](#).

<sup>5</sup> World Bank: *The Long Shadow of Informality: Challenges and Policies*.

<sup>6</sup> McKinsey: *How Advancing Women's Equality Can Add \$12 Trillion to Global Growth*.

<sup>7</sup> [ILO: Global Employment Trends for Youth 2020: Technology and the Future of Jobs](#); [IFC jobs study: Assessing Private Sector Contributions to Job Creation and Poverty Reduction](#).

development of this huge continent, the economic opportunities for many of Africa's youth are far from stable.

### Digitalisation: an opportunity or a new obstacle?

It is striking that in recent years the service sector has grown faster than other economic sectors. The service sector now comes second only to agriculture as the biggest driver of employment in developing countries. Especially in sprawling urban areas, the number of poor people is expected to grow.<sup>8</sup> Digitalisation is an important factor in the growth of the service sector, including financial services. MSMEs in developing countries are increasingly benefiting from the opportunities arising from digitalisation and access to information. Women and young people in particular are seizing digitalisation as a means to overcome their work and income disadvantage.<sup>9</sup> Digitalisation can help remove trade barriers and contributes to transparency in value chains, which helps in tracing abuses. However, developments in this field may not be moving as quickly as they should. There are increasing concerns about the digital divide between advanced economies and developing countries: developing countries tend not to reap enough of the benefits that digitalisation brings and, relatively speaking, are more vulnerable to misuse of data.

### Sustainability is a matter of urgency

Despite the fact that increased globalisation of value chains has fostered economic growth, inequality between 'the West and the rest' has increased since the 1990s. Business models based on cheap production in developing countries shift the costs of production on to people and the environment. Robust local, national and international legislation can help combat this trend. Companies in the Netherlands and other consumption countries can also adapt the way they do business and switch to more sustainable production methods. In addition, developing countries and the poorest sections of their populations bear a disproportionate share of the impact of climate change and environmental and natural degradation. They are highly dependent on natural resources and have limited access to means to mitigate these negative impacts. Agriculture in particular clearly bears the brunt of these negative – and sometimes disastrous – impacts. At the same time, this trend creates opportunities for MSMEs in developing countries. These include cost savings through reduced water and energy consumption, and new business models arising from the application of circular economy principles. Access to climate funding could help MSMEs – including smallholder farmers – adapt to climate change. Value chains can also be made more sustainable. Improved interlinkages between global, regional and local value chains could enhance climate-adaptive solutions, ensuring that products are manufactured more sustainably and efficiently and CO<sub>2</sub> emissions are reduced. Studies show that the transition to a sustainable economy, including circularity and renewable energy, may present both opportunities and risks to lower and middle income countries<sup>101112</sup>. These countries are often at the beginning of the transition to a sustainable economy and effects have not been sufficiently documented. Mapping out the unintended effects of the transition to a sustainable economy is essential for an inclusive and just transition.

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<sup>8</sup> World Bank: 'The New Poor are Different: Who they Are and why it Matters'.

<sup>9</sup> World Bank: *World Development Report 2021: Data for Better Lives*; UNCTAD: *Technology and Innovation Report 2021*.

<sup>10</sup> European Commission: *Circular economy in the Africa-EU cooperation*

<sup>11</sup> Irena: *Renewable energy and Jobs: Annual review 2022*

<sup>12</sup> Include: *Green Jobs for Young People in Africa: Work in Progress*

## 4. Mission and vision

**Mission:** We strengthen MSMEs in developing countries and maximise development impact by working with the private sector to leverage change.

**Vision:** We accelerate the transition to continuous, inclusive and sustainable economic growth in developing countries, through decent work for all, with a special focus on women and young people (SDG8).

## 5. Strategy

In view of the limited resources available and the urgency of the matter (2030 is just around the corner), we will narrow and deepen our range of activities. Our focus manifests in the ‘why’ (goal: reduce poverty and inequality), the ‘what’ (results: stronger MSMEs that can promote jobs and sustainable economic development), and the ‘how’ (the strategy).

With regard to **the goal**, our efforts will be concentrated even more on low income countries<sup>13</sup>, and within them on sectors with high potential for direct or indirect poverty reduction. Our interventions will be unequivocally aimed at promoting employment and increased incomes for young people and women. Our aim is twofold: to reduce inequality between countries and between our specific target groups and other population groups. We are therefore reducing the number of countries in which we work to strengthen MSMEs and the business climate. We are also aligning our efforts more clearly with demand from developing countries and with the local context.

With regard to **results**, our holistic approach to MSMEs will ensure coherence in our range of activities. This means that we will not aim to strengthen large companies in developing countries, except where they can be partners in increasing demand for more sustainable MSME products and services. This also implies that we will not target households and individual employees directly. Rather, we will focus on enhancing and applying pressure on their employers (for instance through trade unions), using a broad range of interventions targeting the MSME sector.

With regard to **strategy**, our primary focus will be on improving the enabling environment required for MSMEs to do business. We will use our funding, influence and partnerships, reflecting the Dutch government’s specific added value, to leverage **systemic change**. We will take three approaches based on three portfolios of cohesive interventions, expertise and partners.

We define a system as a dynamic network of actors, interests, norms and practices that supports a specific economic outcome. We ourselves are part of this dynamic network. For systemic change, the incentives in the system should be changed to such an extent that it will be more effective in achieving the SDG8 targets. Our long-term ambition is for all PSD activities to make a cohesive contribution to systemic change. This does not mean, however, that all individual activities must have systemic change as their ultimate goal. What matters is that the three portfolios of activities (which each consists of individual activities and the interplay between them) make an overall strategic contribution to the systemic change we envisage. We realise that this can take various forms (varying from market transformation and working towards system innovation to systematic efforts to improve systems). Our work is based on analyses of where potential for change lies. We do so in partnerships where necessary; we do not work in isolation. We endeavour to spread our risk and learn more about what works.

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<sup>13</sup> Complementary to this engagement we also work on an integrated approach for foreign trade and development cooperation in 14 middle income countries (“combination countries”). See chapter 3 “Dutch solutions for global challenges” in the 2022 policy note “[Do what we do best: A strategy for Foreign Trade and Development Cooperation](#)”.

The three strategic approaches/portfolios are distinctively tailored to the systems we seek to strengthen.

### **Portfolio 1: Strengthening the business climate in focus countries**

Portfolio 1 seeks to contribute to systemic change in our focus countries<sup>14</sup>. To reduce fragmentation and increase our leverage, our list of focus countries will be reduced from 70 to 40. The Multiannual Country Strategies (MACS) will be the starting point to determine (together with our partners) which enabling environments for business we can improve in the 40 countries to help (local) MSMEs continue to grow in a sustainable way. We will focus on those sectors where we can have the greatest impact on reducing poverty and inequality and where the Netherlands has most to offer (for instance agriculture). Specific choices will be based on local demand and on analyses of where we can achieve the greatest impact and add the most value. The themes, programmes and partners we offer will then be aligned with these choices.

Depending on the local needs, we will work with interest groups representing farmers and employers, including trade unions and chambers of commerce. We support these organisations in their efforts to transform existing jobs into decent work, through peer-to-peer cooperation: Dutch interest groups share their expertise with their counterparts in low and medium income countries. Local trade unions, employers' associations and agricultural cooperatives will be strengthened to represent their members' interests more effectively and improve the services they offer. In this way we support organisations to enhance their service provision to their members and give (local) MSMEs a stronger voice and lobbying potential in their consultations with governments. The Netherlands is often praised for its "polder model", and we will take advantage of this. We will combine political access and influence with delegated funds. These will be supplemented by certain activities that are better suited to centralised funding given the need for specific expertise and networks. These may include infrastructure projects to which the Netherlands can bring specific expertise in project development and institutional embedding. Another example would be to improve projects' access to financial services and their cooperation with Dutch and other multinational enterprises to foster sustainable production and trade through voluntary sectoral agreements. We will only engage to improve policy and regulation through social dialogue and providing expert support when requested in areas where the Netherlands can add value (for instance, agriculture, water management and circular economy).

We will partner with financial institutions to promote financial inclusion for women and young people. Working with vocational education organisations, we will better align supply and demand in the labour market, again with the emphasis on women and young people. We will achieve this for instance by promoting interlinkages between education and business, by encouraging curriculum development that is responsive to business needs, by helping to create work placements and apprenticeships and, when necessary, coaching young people to help them find long-term work. In the medium to long term we will support successful female and young entrepreneurs as role models to inspire others. Finally, we are considering directing some of the funds that invest in local MSMEs more towards the focus countries, when this can serve as a catalyst to improve access to financial services for poor target groups in these countries. In the interest of the revolving character of the fund, it will remain accessible for a broader group of countries than the focus countries alone.

We heed the recommendations from the Policy and Operations Evaluation Department (IOB) 2022 policy review of Foreign Trade and Development Cooperation article 1, with regard to creating scale and mass. In 14 "combination countries" we have identified one or more "combination tracks" to focus our combined efforts on trade, investment, and private sector development. To achieve

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<sup>14</sup> See list of countries in annex of 2022 policy note ["Do what we do best: A strategy for Foreign Trade and Development Cooperation"](#)

system improvements at country level, we strive for a combined focus on ecosystem improvement and strengthening (local) MSMEs, by piloting a programmatic approach to sustainable economic development (PADEO) in five countries: Ghana, Tunisia, Uganda, Sudan and Kenya. We will base this approach on close cooperation and intensive policy consultation with the embassies, the Netherlands Enterprise Agency (RVO), implementing partners, local actors and knowledge institutions to test what we learn, what works and what does not work. Our approach to the pilot schemes will be iterative to ensure that the lessons learned are incorporated along the way.<sup>15</sup> In order for this approach to be successful it is of paramount importance that our programmes sufficiently contribute to systemic change. We will actively monitor and steer on this outcome. From 2022 onwards, this approach will be rolled out in other countries and aligned with the new programme for Vocational and Higher Education (BHO) of the Social Development Department (DSO) and the Food Systems Approach of the Inclusive Green Growth department (IGG). This too will contribute to scale and mass.

## Portfolio 2: Trade for development

By working at an international level to improve market and trade systems, we create conditions for economic activity to cross borders more easily. We also encourage transitions to more sustainable production and trade practices through economic and social reforms (market transformation) in developing countries. To improve trade conditions and enhance the sustainability of production and trade we need to influence policy in Brussels, Geneva, Washington and within the African Union. Additionally, we need to use our influence with businesses and on the demand side by targeting funding at innovation, technical assistance and capital.

As a trading nation, the Netherlands plays a major role in value chains such as cocoa, palm oil and textiles. This role carries responsibilities and provides an immediate focus: we work to achieve systemic change in trade systems where the Netherlands is most visible. This applies to the specific value chains mentioned, but also to the logistics and transport sectors, including ports, which our activities also help improve. We take advantage of the Netherlands' added value through activities related to different systemic factors, such as increasing international demand for sustainable products in value chains and the transition to more sustainable production. We also work on systemic policy objectives through public-private partnerships and by promoting development cooperation policy coherence in international trade agreements and in Responsible Business Conduct policy (including due diligence legislation) at European and/or international levels.

One important lesson from the COVID pandemic is that we must hone the right incentives to enhance MSMEs' resilience, so that producers and workers in developing countries do not lose their livelihoods and incomes when demand dries up. Courses of action under consideration include: diversification of production, trade regionalisation, helping MSMEs export to and compete with Europe, facilitating trade and reducing costs of trade, digital trade, improving investment power and making better agreements with customers. We will also look into whether the Netherlands can add value in strengthening the international trade finance environment.

Some private sector development activities take place in countries where we can create a demonstration effect to improve international or regional trade systems. For instance, activities in Ghana or Ivory Coast are necessary to make the cocoa value chain sustainable in the long term and pilot projects in two countries are helping to develop international standards for digital trade. Where possible, we align with the aspirations of the country itself and with national-level programmes that we are involved in. Furthermore, the European Union's Team Europe approach provides

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<sup>15</sup> [Srivastava and Hopwood: 'A Practical Iterative Framework for Qualitative Data Analysis'](#).



opportunities to scale up the Netherlands' added value to achieve greater local impact, for instance through public-private partnerships and our innovative approach to strengthening the agricultural sector.

### **Portfolio 3: Financial sector development**

The international community sees the Netherlands as a significant and innovative actor in the financial sector, with the Dutch development bank FMO as a leading development financial institution (DFI). This gives us both influence and added value. When the Dutch financial sector further strengthens its sustainable finance efforts, this influence and added value can only increase. Among other institutions, De Nederlandsche Bank (DNB) and other green investors appear to be taking the lead in this direction.

The Netherlands strives for a more sustainable and inclusive financial sector in developing countries. Our activities include fintech innovations, developing financial services targeted at female entrepreneurs and developing and applying good Environmental, Social and Governance (ESG) policies.

Our approach may be direct or systemic. Direct actions include programmes to provide appropriate financial products and services to MSMEs in developing countries. These programmes focus particularly on female and young entrepreneurs and on entrepreneurs who develop jobs, products and services for disadvantaged groups.

At a systemic level, we pursue our goals through active policy influence and technical assistance, aimed at an inclusive and sustainable international financial sector. This may take the form of national legislation, new forms of financial services within the parameters set in Basel, or principles governing additionality in blended finance between International Financial Institutions (IFIs) and Development Finance Institutions (DFIs), for which policy is negotiated in Brussels, Washington and New York.

These actions are mutually reinforcing. Our starting point is the added value that the Netherlands brings to the table, which manifests in our strong fintechs and our sound international reputation for investing venture capital in high-risk countries and sectors and our flexibility in innovating and learning. We seek to demonstrate that there are feasible business cases in areas that market actors are reluctant to enter, given the negative cost/benefit analysis and (perceived) high risks. Working closely with European and other multilateral or bilateral financial institutions, we show that there are opportunities for the private sector to develop appropriate financial services, either independently or in partnership with governments. These efforts tip the balance in favour of commercial viability and thus create more robust international financial institutions and sustainable and inclusive financial sectors/ecosystems: sectors that effectively provide local MSMEs with appropriate financial products and services, which are less vulnerable to capital flight in times of crisis.

### **Approach**

Our approach within all three portfolios is similar. We are working on – and are recognised for – system innovation and upscaling with partners with a proven track record. We acknowledge that innovation is a high-risk, high-impact activity. We combine patient capital with willingness to take risks. Our approach is iterative, through continuous learning, sound analyses and, when necessary, adapting our targets and our intervention strategy. Knowledge partners are important in this approach. When something is not working, we stop and exit carefully and responsibly. When something does work, we build on these results in an evidence-based manner and with a focus on learning. For instance, we take the initiative to scale up through a financial partnership with international funding institutions or by helping to create the right trade conditions.



Where possible we work in partnership with companies (Dutch, multinational or local) so that we can use their market power (especially that of large companies) and their capacity for innovation (particularly that of smaller businesses, including social enterprises). They create leverage that helps us achieve our goals. We work with businesses through (pre-competitive) public-private partnerships, calls for proposals and knowledge sharing.

The planet's boundaries are also our boundaries. Our guiding principle is 'Do no harm', meaning that climate and environmental risks are adequately mitigated in conjunction with social risks. Where possible, we utilise our instruments to make a positive contribution to climate adaptation and mitigation. We make optimal use of all possible circular and climate-neutral opportunities to accelerate the achievement of SDG8, and thereby contribute to sustainable economic development and a just and inclusive transition.

The *Youth at Heart* Principles underpin our efforts. We will learn how young people in developing countries can participate in our work in a meaningful way, since this is the only way for us to achieve sustainable results for future generations.

We are conscious of the path-dependency of our work. This is logical, since that is where our added value lies and where we have already made substantial investments. At the same time, we do run the risk of limiting our efforts for systemic change, since we ourselves are part of the system. This is the reason why we wish to contribute to the economy of the future. Our development agenda emphasises economic renewal and our role in bringing this about, including themes such as the *Future of Work*, circularity and digitalisation. These themes will have a central role in our knowledge and learning agenda and will be visible in new and ongoing financial and other partnerships and activities.

## 6. Results

The impact we seek is a structural reduction of poverty and inequality, for women and young people in particular, by strengthening MSMEs. We aim to achieve this by working towards two long-term objectives:

1. A favourable business climate for private sector development that supports a strong MSME sector (SDGs 8.4; 8.5; 8.10; 8A)
2. Strong MSMEs that ensure more and better jobs and sustainable economic development (SDGs 8.2; 8.3; 8.5; 8.7; 8.8).

These goals are mutually reinforcing: without an enabling environment, MSMEs cannot make an effective contribution to the envisioned development goals. And without strong, active, vocal MSMEs, the engine of a healthy and inclusive economy is lacking.

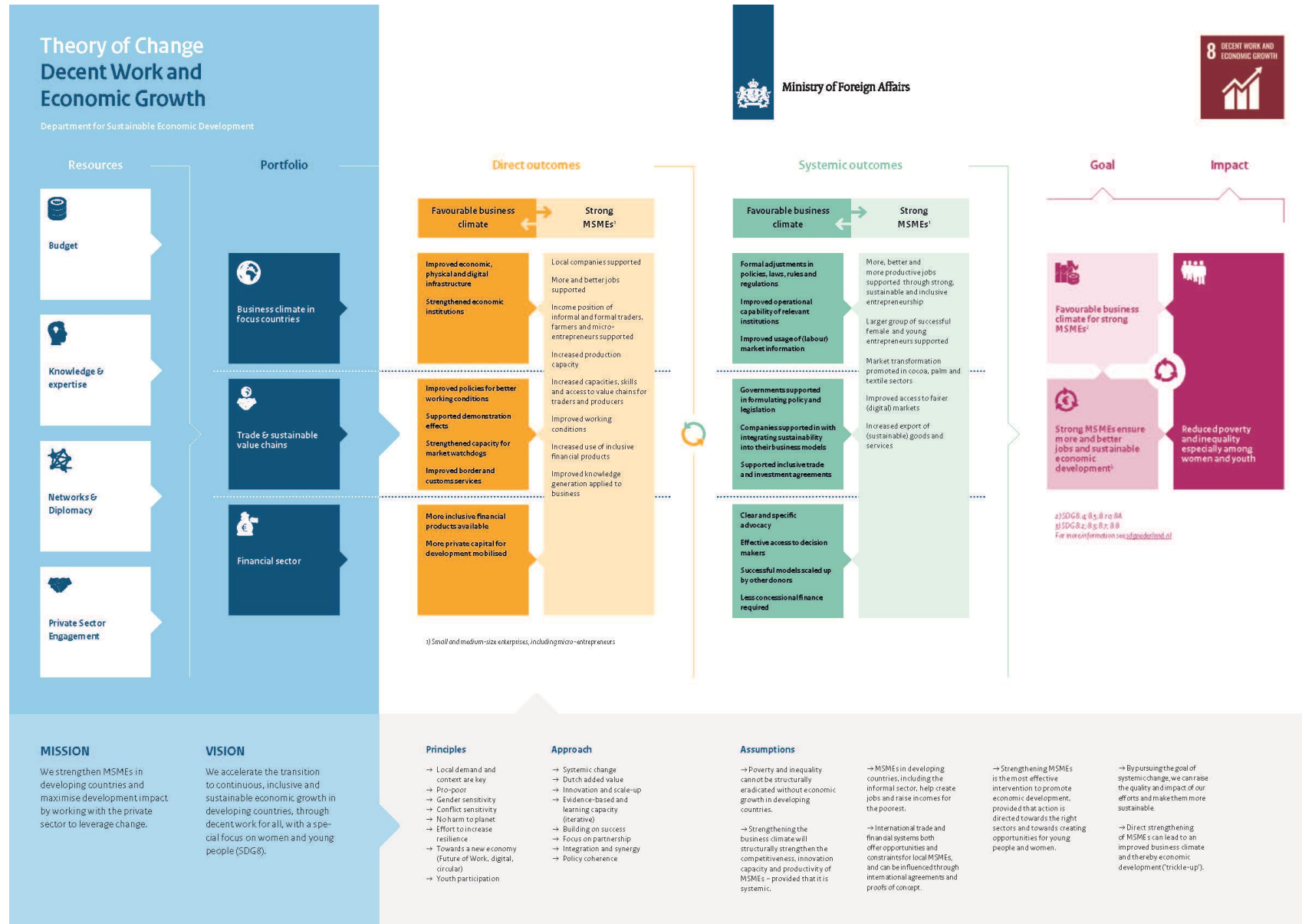
Each portfolio contributes to both long-term objectives. When it comes to both strengthening MSMEs and improving enabling environments, we will achieve results that contribute **directly** to our objectives. These are our 'immediate outcomes': results we achieve together with our implementing partners in the short term and within our sphere of influence.

In addition, we contribute to stronger MSMEs and help improve the enabling environment by pursuing **systemic change**. These are our 'systemic outcomes': results that tend to take longer to achieve, that are more complex and require more collaboration with other donors, multilateral organisations, governments and implementing partners.

Together, direct and systemic outcomes contribute *simultaneously* to our two long-term objectives. Systemic results are not an automatic consequence of direct results. These are **two different tracks**

to achieve our long-term objectives, each with its own approach. By working to achieve direct and systemic results simultaneously, we maximise our impact, capitalising on the interplay between the enabling environment and stronger MSMEs.

The three diagrams below illustrate the direct and systemic results we achieve within the three portfolios and how each contributes to strengthening MSMEs and to improving the enabling environment (favourable business climate for MSMEs). The footnotes describe how the results in the diagrams are linked to our results measurement frameworks.



Portfolio 1: Strengthening the business climate in focus countries		
Results matrix	LONG-TERM OBJECTIVES	
	Strong MSMEs	Favourable business climate
OUTCOMES	Direct	<p><b>Results</b></p> <p><b>1.1</b> Local companies supported with business plans,<sup>16</sup> business development,<sup>17</sup> revenue growth,<sup>18</sup> new or improved access to value chains<sup>19</sup> and increased exports<sup>20</sup></p> <p><b>1.2</b> More and better<sup>21</sup> jobs<sup>22</sup> supported in the formal and informal sectors, increased income<sup>23</sup> for informal traders, farmers and micro-entrepreneurs, especially young people and women</p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Direct strengthening of MSMEs can lead to an improved business climate and thereby economic development ('trickle-up').</li> <li>A focus on young people and women helps reduce inequality.</li> </ul>
	Systemic	<p><b>Results (SDGs 8.1, 8.2, 8.3, 8.5, 8.6)</b></p> <p><b>1.8</b> Larger group of successful female<sup>27</sup> and young entrepreneurs supported</p> <p><b>1.9</b> <u>More, better and more productive jobs supported<sup>28</sup> through strong, sustainable and inclusive entrepreneurship<sup>29</sup></u></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>MSMEs in developing countries, including the informal sector, help create jobs and raise incomes for the poorest.</li> <li>Strengthening MSMEs is the most effective intervention to promote economic development, provided that action is directed towards the right sectors and towards creating opportunities for young people and women.</li> </ul>
		<p><b>Results</b></p> <p><b>1.3</b> Economic, physical and digital infrastructural improvements<sup>24</sup></p> <p><b>1.4</b> Strengthened capacity<sup>25</sup> and membership<sup>26</sup> of economic institutions (e.g. trade unions, cooperatives, etc.)</p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Better (access to) infrastructure ensures structural improvements in the enabling environment for successful entrepreneurship, creating more and better jobs.</li> <li>Effective economic interest groups contribute to economic growth, inclusion, poverty reduction and more just social policy.</li> <li>The commitments, knowledge and skills of Dutch and other companies contribute to improving the enabling environment to strengthen MSMEs in focus countries.</li> </ul>
		<p><b>Outcomes (SDG 8.1, 8.3, 8.8, 8B)</b></p> <p><b>1.5</b> Formal adjustments in policies, laws, rules and regulations<sup>30</sup></p> <p><b>1.6</b> Improved operational capability of relevant institutions<sup>31</sup></p> <p><b>1.7</b> Improved usage of (labour) market information<sup>32</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Strengthening the business climate will structurally strengthen the competitiveness, innovation capacity and productivity of MSMEs – provided that it is done systematically.</li> </ul>

<sup>16</sup> Number of companies with a supported plan to invest, trade or provide services.

<sup>17</sup> Number of MSMEs that use business development services.

<sup>18</sup> Average compound annual revenue growth rate of directly supported MSMEs.

<sup>19</sup> Number of MSMEs gaining new or improved access to a value chain.

<sup>20</sup> Increase in exports by directly supported MSMEs.

<sup>21</sup> Number of people supported with improved labour conditions in accordance with international agreements.

<sup>22</sup> Direct jobs supported (in individually supported MSMEs).

<sup>23</sup> Number of people supported with increased incomes.

<sup>24</sup> Number of end users with access to new or improved infrastructure.

<sup>25</sup> Number of strengthened organisations contributing to a sustainable local business climate.

<sup>26</sup> Number of members of supported organisations.

<sup>27</sup> Qualitative description of the contribution that financial and non-financial, diplomatic and other interventions make to one of the following gender indices. (depending on availability of data at country level): [GEM Special Report on Women's Entrepreneurship](#), [OECD Gender Data Portal](#), [Evidence and Data for Gender Equality \(EDGE\)](#), [Global Women Entrepreneur Leaders Scorecard](#), [Female Entrepreneurship Index](#).

<sup>28</sup> Direct jobs supported (impact level, see [DCED guidance note](#), Approach 2: Estimate the number of direct, indirect and induced full-time (equivalent) (female) jobs supported).

<sup>29</sup> Analysis of contribution made by Dutch financial and non-financial, diplomatic and other interventions to national trends in the area of sustainable, inclusive and innovative business development (sources still to be defined).

<sup>30</sup> Description of changes achieved in legislation, policy plans, outcomes of social dialogue or development strategies.

<sup>31</sup> Analysis of contribution made by Dutch financial and non-financial, diplomatic and other interventions to country-specific improvements in institutional implementation capacity as measured in the annual World Bank [Ease of Doing Business](#) index, or other reliable sources.

<sup>32</sup> Qualitative description of contribution made by Dutch financial and non-financial, diplomatic or other interventions to the following indicators: 'Employment agencies (public/private) active on the labour market', 'Jobs advertised on job matching websites (private/public)'.

## Portfolio 2: Trade for development

Results matrix		LONG-TERM OBJECTIVES	
		Strong MSMEs	Favourable business climate
OUTCOMES	Direct	<p><b>Results</b></p> <p><b>2.1</b> Traders and producers supported in the formal and informal sectors through increased capacity,<sup>33</sup> (digital) skills<sup>34</sup> and improved access to regional or international value chains,<sup>35,36</sup></p> <p><b>2.2</b> More and better<sup>37</sup> jobs<sup>38</sup> supported in the formal and informal sectors, improved income positions<sup>39</sup> for informal traders, farmers and micro-entrepreneurs, especially young people and women in developing countries<sup>40</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Trade offers opportunities for diversification and enhances the competitiveness of MSMEs.</li> <li>Higher wages and improved labour conditions help reduce abuses such as child labour and deforestation, and positively impact the health and wellbeing of workers and their families.</li> </ul>	<p><b>Results</b></p> <p><b>2.3</b> Governments supported in formulating policy and legislation for better and safer labour conditions, raising minimum wages and eradicating child labour<sup>41</sup></p> <p><b>2.4</b> Companies (denk ik?) supported by demonstrating the opportunities and benefits of fair and sustainable trade<sup>42</sup></p> <p><b>2.5</b> Strengthened capacity<sup>43</sup> of market watchdogs contributing to adopting and improving policy and legislation, and to reporting and publicising abuses</p> <p><b>2.6</b> Improved (digital) customs and border services<sup>44</sup> to facilitate (regional) trade</p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Supporting stronger policy and legislation by governments helps improve the enabling environment for companies (through both binding mandates and support), which in turn helps reduce abuses such as low wages, child labour and deforestation.</li> <li>Supporting market watchdogs by advocating for the interests of workers, farmers, informal traders and vulnerable groups, and giving these groups a voice in political processes, leads to legislation that better meets their needs.</li> <li>Improved digital and other customs and border services makes trade faster, cheaper, more secure and more inclusive, bringing benefits to informal traders and other vulnerable groups.</li> </ul>
	Systemic	<p><b>Results</b></p> <p><b>2.10</b> Market transformation<sup>45</sup> promoted in cocoa, palm and textile sectors, leading to more sustainable production by MSMEs, thereby reducing abuses in these sectors (deforestation, child labour, unacceptably low wages, poor labour conditions)</p> <p><b>2.11</b> Informal traders and vulnerable groups supported through improved access to fairer (digital) markets<sup>46</sup></p> <p><b>2.12</b> Exports of goods and services increased and more sustainable,<sup>47,48</sup></p> <p><b>2.13</b> <u>Creation of more, better and more productive jobs<sup>49</sup> supported through strong, sustainable and inclusive entrepreneurship<sup>50</sup></u></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>MSMEs in developing countries, including the informal sector, help create jobs and incomes for the poorest.</li> <li>Strengthening MSMEs is the most effective intervention in to promote economic development, provided that action is directed towards the right sectors and towards creating opportunities for young people and women. A stronger MSME sector has an exemplary function, leading to a change among a critical mass of market players generating a snowball effect whereby an increasing number of market players can participate and benefit from increased opportunities. This generates a self-reinforcing mechanism.</li> </ul>	<p><b>Results</b></p> <p><b>2.7</b> Governments supported in formulating policy and legislation for better and safer labour conditions, raising minimum wages and eradicating child labour<sup>51</sup></p> <p><b>2.8</b> Companies supported with integrating sustainability into their business models, improving (safer) labour conditions, raising minimum wages and preventing child labour in their supply chains<sup>52</sup></p> <p><b>2.9</b> (Digital) international trade and investment agreements made, implemented and made more inclusive<sup>53</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Supporting stronger policy and legislation by governments helps improve the enabling environment for companies (through both binding mandates and support), which in turn helps reduce abuses such as low wages, child labour and deforestation.</li> <li>Companies and governments see the importance of sustainable purchasing practices and will therefore adopt them (either voluntarily or as a result of improved binding legislation).</li> <li>Governments see the importance of (digital) inclusive trade and investment agreements and will therefore implement them.</li> <li>Adequate (digital) international trade and investment agreements provide local MSMEs with opportunities for sustainable economic development.</li> </ul>

<sup>33</sup> Number of companies with a supported plan to invest, trade or provide services.

<sup>34</sup> Number of MSMEs that use business development services.

<sup>35</sup> Number of MSMEs gaining new or improved access to a value chain.

<sup>36</sup> Value of exports of products and services (in euros) by directly supported MSMEs (in developing countries).

<sup>37</sup> Number of direct beneficiaries supported in improving working conditions in accordance with international agreements.

<sup>38</sup> Direct jobs supported (in individually supported MSMEs).

<sup>39</sup> Number of direct beneficiaries supported in raising incomes.

<sup>40</sup> We also work in developing countries with companies larger than SMEs, for example in textile factories, particularly so that we can reach factory workers at scale.

<sup>41</sup> Number of legislative or policy reforms implemented.

<sup>42</sup> Number of companies (including MSMEs) that meet firm-specific, national or international sustainability standards.

<sup>43</sup> Number of grassroots organisations with increased lobbying and advocacy capacity.

<sup>44</sup> Number of MSMEs benefiting from improved customs and border services.

<sup>45</sup> Dutch contribution to reaching tipping points which lead market players to make ongoing improvements to workers' rights, pay a living wage and ensure decent livings, and enforce decent working conditions without child or forced labour.

<sup>46</sup> Dutch contribution to participation by informal traders and vulnerable groups in trade in local/regional/global markets.

<sup>47</sup> Dutch contribution to rising regional and other [Exports of goods and services \(current US\\$\)](#) and [Increase in intra-regional exports compared with total exports](#).

<sup>48</sup> Dutch contribution to rising inclusive and sustainable exports.

<sup>49</sup> Direct jobs supported (impact level, see [DCED guidance note](#), Approach 2: Estimate the number of direct, indirect and induced full-time (equivalent) (female) jobs supported).

<sup>50</sup> Contribution made by Dutch financial and non-financial, diplomatic and other interventions to national trends towards more sustainable, inclusive and innovative business development (sources still to be defined).

<sup>51</sup> Case studies of Dutch contribution to changed government policy and legislation (Note: this result is also reflected in both direct and systemic work under portfolio 2).

<sup>52</sup> Case studies of value chains (still to be defined) in which integrating sustainability into company business models is realised at scale through the contribution of Dutch financial and/or non-financial resources.

<sup>53</sup> Dutch contribution to ratification and implementation of digital and other trade and investment agreements.

		Portfolio 3: Financial sector development	
Results matrix		LONG-TERM OBJECTIVES	
		Strong MSMEs	Favourable business climate
OUTCOMES	Direct	<p><b>Results</b></p> <p><b>3.1</b> Increased use of inclusive products<sup>54</sup></p> <p><b>3.2</b> Improved knowledge generation applied to business<sup>55</sup></p> <p><b>3.3</b> Increased production capacity<sup>56, 57, 58</sup></p> <p><b>3.4</b> Support for more and better jobs<sup>59, 60, 61</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>Direct strengthening of MSMEs can lead to an improved business climate and thereby economic development ('trickle-up').</li> </ul>	<p><b>Results</b></p> <p><b>3.5</b> Extended availability of inclusive products<sup>62</sup></p> <p><b>3.6</b> More private capital for development mobilised<sup>63</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>An increase in mobilised private finance contributes to a better enabling environment for sustainable and inclusive economic development.</li> </ul>
	Systemic	<p><b>Results</b></p> <p><b>3.12</b> <u>More, better and more productive jobs supported, even for marginalised groups, through strong, sustainable and inclusive entrepreneurship<sup>65</sup></u></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>MSMEs in developing countries, including the informal sector, help create jobs and incomes for the poorest.</li> <li>Strengthening MSMEs is the most effective intervention in to promote economic development, provided that action is directed towards the right sectors and towards creating opportunities for young people and women.</li> </ul>	<p><b>Results</b></p> <p><b>3.7</b> Clear and specific advocacy<sup>66</sup></p> <p><b>3.8</b> Effective access to decision-makers<sup>67</sup></p> <p><b>3.9</b> Successful models that are scaled up by other donors (catalyst/demonstration effect)<sup>68</sup></p> <p><b>3.10</b> The inclusive offer of the financial sector, especially for women and young people, requires increasingly less concessional financing to attract commercial financing.<sup>69</sup></p> <p><b>3.11</b> Strengthened financial sector<sup>70, 71, 72</sup></p> <p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>International trade and financial systems both offer opportunities and constraints for local MSMEs, and can be influenced through international agreements and proofs of concept.</li> <li>By pursuing the goal of systemic change, we can raise the quality and impact of our efforts and make them more sustainable.</li> <li>There is a clear link between DDE's direct results and demonstration effects or other forms of traction relating to advocacy in the framework of systemic improvement.</li> <li>There is a clear link between an increased supply of inclusive finance and reducing poverty and inequality.</li> </ul>

<sup>54</sup> Number of MSMEs and/or households that obtain financial services.

<sup>55</sup> Number of MSMEs that use business development services.

<sup>56</sup> Average compound annual revenue growth rate of individually supported MSMEs.

<sup>57</sup> Number of MSMEs gaining new or improved access to a value chain.

<sup>58</sup> Number of companies (including MSMEs) that meet firm-specific, national, or international sustainability standards.

<sup>59</sup> Direct jobs supported (in individually supported MSMEs).

<sup>60</sup> Number of direct beneficiaries supported in raising incomes.

<sup>61</sup> Number of direct beneficiaries supported in improving working conditions in accordance with international agreements.

<sup>62</sup> Number of improved or introduced new products.

<sup>63</sup> Private capital mobilised using the method devised by Trinomics on the basis of OECD guidelines.

<sup>64</sup> Direct jobs supported (impact level, see [DCED guidance note](#), Approach 2: Estimate the number of direct, indirect and induced full-time (equivalent) (female) jobs supported).

<sup>65</sup> Contribution made by Dutch financial and non-financial, diplomatic and other interventions to national trends towards more sustainable, inclusive and innovative business development (sources still to be defined).

<sup>66</sup> Case studies, based on a selection of internal monitoring of policy advocacy activities.

<sup>67</sup> Ibid.

<sup>68</sup> Amount of external finance mobilised for existing PF 3 programmes and/or new programmes/vehicles inspired by existing PF3 programmes and/or specification of models, and inventory of their use by others at baseline, midterm and end.

<sup>69</sup> Amount of private finance for development in the market (compared to concessional financing at baseline, midterm and end).

<sup>70</sup> Number of legislative or policy reforms implemented.

<sup>71</sup> Description of changes made to legislation, policy plans, social dialogue outcomes or development strategies.

<sup>72</sup> Number of financial institutions using business development services.

## 7. Risks and mitigation

The situation in various countries is so precarious and unstable that our approach sometimes requires us to take calculated risks with regard to policy implementation. Established and predictable policy is inadequate for regions that are going through rapid change on the one hand and stagnation on the other. In such cases, we invest not only in traditional programmes but also in innovative programmes that can have a greater and/or more rapid impact. Effective monitoring of implementation is required in these cases. The outcomes of the monitoring process can help us find better ways to support systemic improvements in a phased approach. Risk-taking requires patience as well as tolerance of the possibility of failure. We can raise the effectiveness of interventions by working in partnership, learning and exchanging experiences with other actors such as governments and international organisations. If failure is inevitable, we ensure a careful exit.

### Internal risks

- Strategy fails due to weak implementation and/or lack of cooperation.
- Insufficient capacity.
- Interventions fail to achieve desired impact due to inadequate problem analyses.
- Not enough focus on systemic change. Systemic change requires stamina, perseverance and sometimes a certain amount of luck. Disappointing results can cause a drop in internal morale and efforts and weaken external support for our work. Patience and continuity are essential.
- Lack of expertise: the MFA staff rotation system means changes of staff every three to seven years at headquarters and at the embassies.
- Lack of continuity in thematic and regional focus, due to policy changes at the start of a new four-year cabinet cycle.
- Some activities require a long time to materialise and a long time to yield results. Radical or rapid changes in the country focus at MFA/DDE create a risk of undoing work that has been in the making for many years.
- Failure to achieve the ultimate goal, by not explicitly taking vulnerable groups into consideration.
- A policy agenda that is not aligned with local priorities.
- Inability to define what constitutes success, sometimes because results and successes cannot be effectively measured, and therefore a lack of focus.

### External risks

- Political instability, geopolitics, trade wars, fragility in countries, etc.
- Repressive local government policy / shrinking space for implementing partners.
- Impact on policy/work and incomes as a consequence of external shocks/pandemic.
- Dysfunctional local government/corrupt regimes.
- Lack of implementation capacity/compliance and follow-up.
- Assumption that parties are willing and able to implement changes.
- Absence of local political will.
- Excessive focus on official rules in countries where, in fact, unwritten rules are more important.
- Supporting Dutch businesses is not our goal, which is justified but risks losing political support for policy.

### Mitigation

The Netherlands and its partners take joint responsibility for managing and mitigating risks. For implementation risks, we will likely have to take measures to safeguard proper project and fund management. Risk management is underpinned by the following principles:

- The principles of the Paris Declaration on Aid Effectiveness must be observed when considering changes to the support modalities.
- We work with our embassies and permanent missions to monitor programme risks and consult with partners on mitigation measures.



- The results framework must be a good mix of short- and long-term results that align closely with this Theory of Change.
- Risk identification and analysis, risk management and monitoring will be incorporated into all programmes and the PADEO pilots.
- The knowledge and learning agenda sets clear learning objectives as a basis for effective evaluation.
- When performance is declining and/or risks increasing, we may request approval from the management team to transfer some or all of the funding to other implementing partners, in accordance with the objectives outlined in this Theory of Change.

## 8. Definitions, approach and principles

**Building Back Better:** Where there is an obvious link to green and inclusive development, we set out a few major, attractive activities for each portfolio with which we can have a big impact. At country level our work is underpinned by the principle of taking the local political economy and local ownership as our points of departure.

**Coherence and synergy:** We achieve greater impact by joining forces and enhancing coherence between themes in private sector development. This requires us to take an in-depth approach, seek synergies between different policy officers' activity portfolios and linking policy influence and funding efforts more closely.

**Conflict sensitivity:** We consciously integrate conflict sensitivity into our programmes and are alert to the root causes of conflict, instability and migration. Private sector development opens up perspectives for entrepreneurship and employment in fragile settings. It contributes to greater social cohesion within and between countries and, by extension, to stability.

**Digitalisation:** Digital technologies contribute to the productivity and resilience of MSMEs in developing countries. The application of context-specific digital solutions provides opportunities to make great leaps forward.

**An evidence-based approach and learning capacity:** Private sector development interventions do not automatically make a direct contribution to reducing poverty and inequality. This is why we consciously take an evidence-based approach: evaluations and research give insights into the relationships between economic development, employment, poverty and inequality. By explicitly examining the impact of our interventions and learning from our partners we can focus our efforts more effectively on reducing poverty and inequality, based on what actually works.

**Gender sensitivity:** Investing in equal opportunities for women is a theme that cuts across all our private sector development interventions. We improve the position of women as entrepreneurs or employees by developing good working conditions, facilitating female entrepreneurship and creating a private sector that respects women's rights.

**Informal sector:** DDE's inclusive approach also extends to the informal economy, which is the largest source of work and income in developing countries. Young people and women are over-represented in this sector and form the most vulnerable groups.

**Innovations:** New products, services, business models and partnership models can help to drastically reduce the investments and time needed to make an impact on a large scale. For this reason we actively seek to introduce innovations, such as digital technologies and circular principles, so that we can accelerate and increase the impact of our activities.

**MSME:** Any entity engaged in an economic activity, irrespective of its legal form, which employs fewer than 250 persons. This includes, in particular, self-employed persons in the formal and informal

sector. The English term used by the European Commission is ‘micro-, small and medium-sized enterprises (MSMEs).’<sup>73</sup>

**Netherlands’ added value:** Based on specific Dutch expertise not provided by other donors or parties, related to our approach, network or position in developing countries and/or our role as a government.

**Private sector:** An organising principle of economic activities in which private ownership is a major factor, in which markets and competition are drivers of production and where private initiatives and risk-taking set activities in motion. The private sector principle can be applied to all economic activities: agriculture, industry and services.

**Private sector engagement (PSE):** Activities aimed at involving the private sector in achieving development outcomes. This can take various forms: from informal cooperation to formal partnerships. PSE assumes that the parties involved can reap the benefits of complementarity. We work towards PSE by approaching multinational corporations, banks and other financial institutions on an equal basis to make a contribution to sustainable development.

**Pro-poor growth:** Promoting pro-poor growth is about increasing the contribution of economic growth to poverty reduction. This is pursued through policies enabling a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth.<sup>74</sup>

**Financial resilience of MSMEs:** Direct funding of MSMEs and efforts to develop the financial sector and strengthen the financial infrastructure are structured to make businesses and (over time) economies more resilient to economic shocks.

**Systemic change:** A system is defined as a dynamic network of actors, interests, norms and practices which supports a specific economic outcome. We ourselves are part of this dynamic network. By pursuing long-term objectives and scale, we raise the quality and enhance the impact of our efforts and make them more sustainable. Systemic change means that the incentives in the system should be changed to such an extent that it will be more effective in achieving the SDG8 targets.

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<sup>73</sup> <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:en:PDF>.

<sup>74</sup> <https://www.oecd.org/greengrowth/green-development/43514554.pdf>.