creating markets

Developing new markets is essential to increasing private investment and achieving the UN Sustainable Development Goals

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Congested and crumbling roads have stunted Colombia's economic growth for decades. Following the 2016 peace deal that ended half a century of armed conflict, the Colombian government had high hopes for infrastructure—and new roads in particular—to build a strong foundation for the country's future.

But the government realized that financing one road project at a time would fall far short of providing the economic boost they sought. Instead they needed markets, one for the private construction of roads and another to channel savings into long-term loans to finance those road projects.

A key challenge was to put in place a framework that would attract large investors—pension funds, insurance companies, and hedge funds, among others—into ventures that until then were largely uncharted territory. Creating a market that would lure these institutional investors was critical to addressing the country's infrastructure shortage.

In response, the International Finance Corporation (IFC), the Colombian government, and the Development Bank of Latin America created a new financial institution to address market failures that were obstructing infrastructure financing. The government also introduced a number of investment-friendly measures such as guarantees and project support and established new capital market regulations that made it easier for pension funds to invest in infrastructure projects. In January 2016 a substantial infrastructure debt fund to finance large-scale projects was launched.

As a result, Colombia will get thousands of kilometers of new roads—and a major boost to its economy—while investors get a host of new business opportunities.

Colombia's road deficit is all too common in emerging markets, and the approach taken is an example of how countries can provide opportunities for private investors, whose participation will be essential to mobilizing the estimated $4 trillion a year investment needed to achieve the United Nations Sustainable Development Goals (SDGs) in developing economies.

Under current financing trends, the world's poorest countries are likely to fall short of these goals by large margins without greater access to private capital. The issue, then, is how can governments and development finance institutions create markets to scale up private investments?

Answering this question requires an understanding of the main building blocks of markets and their key attributes.

Creating frameworks

All markets have several building blocks in common. Following economic theory, governments aspiring to create markets should focus on actions that foster new technology, better institutions, and more abundant ideas and human capital. Governments can also create the frameworks for new markets through supportive incentives and regulations.

In India, for example, a new framework of government incentives and a new bidding structure for projects helped lure private investors to a solar grid project in Gandhinagar. The project is now being replicated in five other cities. And in Ukraine, the implementation of new food safety laws and industry regulations that comply with EU rules were critical to modernizing agricultural markets and boosting exports.

A key lesson from these examples is that development institutions have a central role to play in building a bridge between governments and the private sector to bring about such positive market changes.

In strategies to develop markets, it is vital to articulate a clear vision for how a market should evolve over time. Sustainable markets rarely emerge by happenstance or good luck.

To be successful in contributing to the SDGs, newly created markets should be:

- ***Scalable:*** Markets should influence and benefit a large number of people, and eventually include those not targeted by the original investment.
- ***Sustainable:*** Market development efforts should promote systemic market changes that persist on their own beyond the end of an investment by a government or a development finance institution—without imposing unsustainable fiscal burdens on governments. Markets should also be environmentally and socially sustainable.
- ***Resilient:*** Market participants should adapt models and institutions that can continue delivering goods and services even as the external environment changes.

In addition, to achieve the SDGs, markets should be inclusive and work for the poor. For example, in Bangladesh, an investment by the IFC and other development banks in the mobile financial services company bKash is an example of early-stage market creation. The company's rapid growth that followed the investment helped bring millions of unbanked poor people, who previously dealt mostly in cash and struggled to save for the future, into the formal financial system.

Channels of market creation

In creating markets, four channels are important:

- ***Putting in place platforms and reforms that enable markets to function.*** Effecting policy changes in sectors such as energy or agriculture removes obstacles and deterrents to private investors and allows them to enter those markets. Responsibility for this lies primarily with governments, often with advice and assistance from development finance institutions.
- ***Promoting competition that causes other market players to step up their game.*** For instance, investing in a new retail model that improves service and drives down prices will force competitors in that market to adapt through similar business improvements.
- ***Demonstrating success and promoting spillover of ideas.*** Success breeds imitation; this is the key logic of demonstration effects. So, for example, a novel bond structure that attracts capital and demonstrates the viability of a market will encourage other private institutions to offer similar bonds. Put another way, copycats are encouraged.
- ***Building skills that open new market opportunities.*** For example, training derivatives market regulators and boosting investment in financial institutions can create a market for hedging products, which are financial instruments that help corporate clients manage financial risk.

By triggering market activity in sectors and population segments not directly connected to the initial investment, these channels can all promote market changes that go well beyond the direct effects of a particular development project or investment.

For development finance institutions like the IFC, the challenge is to infuse operational business models with this focus on markets, rather than a traditional focus on individual investments. This calls for a shift in mind-set from pursuing one deal at a time to looking more broadly at how several investments can add up to a larger development impact. At the same time, one must focus on the impact on the environment, and on the poor and marginalized, to ensure inclusiveness and sustainability.

To advance this agenda, the IFC is unveiling a new analytical framework to assess the expected development impact of new investments and advisory work. This work includes assessing the dynamic effects of projects on the creation of markets. The ambitious framework will help the IFC staff systematically assess and better anticipate the market impact of projects and investments. By focusing on creating markets, this framework will also help the IFC do more in difficult environments, including fragile and conflict-torn states, where private investment is vital to meeting the poverty targets of the SDGs. FD

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