



INCLUSIVE AND INNOVATIVE FINANCE STRATEGY



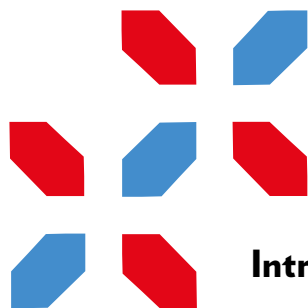
Luxembourg Development Cooperation



ACRONYMS

AAAA	Addis Abeba Action Agenda
ADA	Appui au Développement Autonome NGO
AFT	Aid for Trade
CGAP	Consultative Group to Assist the Poor, World Bank
CODEV	EU Working Party on Development Cooperation
COVID-19	Coronavirus Disease of 2019
DAC	OECD Development Assistance Committee
E-MFP	European Microfinance Platform
EFSD	European Fund for Sustainable Development
EIP	EU External Investment Plan
ESG	Environmental, Social and Governance
EU	European Union
FDI	Foreign Direct Investment
FINTECH	Financial Technology
FSP	Financial Service Provider
ICP/PIC	Indicative Country Programme
ICT	Information and Communications Technology
INFINE.LU	Inclusive Finance Network Luxembourg
LDC	Least Developed Country
LUXDEV	Lux-Development
MFI	Microfinance Institution
MSME	Micro- Small and Medium Enterprises
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Cooperation and Development
PF4SD	Private Finance for Sustainable Development
PPP	Public-Private Partnership
PSD	Private Sector Development
PSE	Private Sector Engagement
SDG	Sustainable Development Goal
SPTF	Social Performance Task Force
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development





INDEX

Introduction	p.4
Context, development challenges, and opportunities	p.5
Normative Framework	p.7
International Framework	p.7
National Framework	p.9
Rationale for working with the financial sector	p.10
Inclusive and innovative finance	p.11
Results Chain	p.12
Vision	p.12
Objectives	p.12
Outcomes	p.14
Implementation	p.17
Inputs	p.20
Geographical Focus	p.21
Cross-cutting principles	p.22
Policy Coherence for Development	p.23





INTRODUCTION

For more than twenty years, Luxembourg's Development Cooperation has actively supported the development of the microfinance and inclusive finance sectors with the aim of reducing poverty worldwide. By leveraging the expertise and potential of Luxembourg's financial centre, it aims to promote sustainable development and inclusive economic growth.

Luxembourg is recognized internationally for its progressive financial ecosystem and is well-positioned to contribute to international development through its role as an innovative finance hub and, as such, as a leading location for sustainable and impact finance.

The new general strategy of Luxembourg's Development Cooperation foresees the mobilization of additional resources through public-private partnerships and innovative financing mechanisms next to grant financing, in order to contribute to the financial inclusion of vulnerable populations and support the development of economic opportunities locally.

Luxembourg's financial inclusion and innovation actions are embedded in the context of sustainable development including its social, economic, and environmental aspects - with a focus on women, young people and vulnerable population segments. They are carried out in the framework of the achievement - by 2030 - of the Sustainable Development Goals (SDGs).

The previous strategy on microfinance dates back to 2012¹. A lot of research on best practices and innovative solutions has been done since, and many lessons have been learned, which calls for a revised and updated strategy in this sector that is growing in importance and is a key stepping stone towards realizing the goals of Luxembourg's general development cooperation strategy 'Road to 2030'.

¹ https://maee.gouvernement.lu/en/publications/gouv_cooperation%2Ben%2Bpublications%2Bbrochure-livre%2Bminist-affaires-etrangees-europeennes%2Bdir-cooperation-action-humanitaire%2Bstrategies-et-orientation%2Bmicrofinance.html



CONTEXT, DEVELOPMENT CHALLENGES, AND OPPORTUNITIES

The larger context of Luxembourg's financial inclusion actions is a fast-changing development landscape, where threats take on an increasingly global scale. This is best illustrated by the sanitary crisis of 2020, the post COVID-19 economic crisis and its consequences for international development. While poverty levels have declined overall over the past decade, extreme poverty is increasingly concentrated in fragile and conflict-affected areas.

The demographics in developing countries are swiftly changing too, as the proportion of young people in the population is reaching unprecedented levels in most developing countries, especially in Africa and South Asia. This demographic trend puts enormous pressure on the labour market, and thus job creation and education services are urgently needed on a large scale.

In the Sahel region alone, which is a focus area of Luxembourg's Development Cooperation, 46 million new jobs are required by 2050² and there is ample need for financing³. In addition, the security situation in the Sahel region is continuously deteriorating. This is largely due to an increase in the activity of extremist groups, which is fed by cohorts of young people who are missing economic opportunities, while populations in these areas are also especially vulnerable to the consequences of climate change.

Women in the Sahel region and worldwide still face a multitude of inequalities. In developing countries, women are still 9 percentage points less likely than men to have a bank account⁴. There is also a persistent digital divide when it comes to access to technology. The underlying social norms that cause digital, financial and consequently socio-economic exclusion need to be recognized. From an economic perspective, these inequalities hinder their access to decent employment and career progression, their income, as well as the financing and support of their projects.

It is, therefore, crucial to promote an enabling environment where especially women and the young generations can seize economic opportunities and thereby improve their livelihoods, which also facilitates public resource mobilisation in developing countries. This is where financial inclusion comes in as a tool for granting these underbanked populations access to financial services like credit, savings, insurance, or transfers. Financial services, combined with a broader proactive approach towards innovative finance and a responsible regulatory environment, will allow the local private sector to develop and create necessary opportunities.

²Source: UNDESA (compared to 2015 baseline)

³ IFC: The potential demand for MSME finance is estimated at US \$ 8.9 trillion, compared to the current credit supply of \$3.7 trillion, <https://www.ifc.org/wps/wcm/connect/03522e90-a13d-4a02-87cd-9ee9a297b311/121264-WP-PUBLIC-MSMEReportFINAL.pdf?MOD=AJPE-RES&CVID=m5SwAQA>

⁴ <https://globalfindex.worldbank.org/>

Another important contextual change is the improved penetration of digital services, a trend that has been accelerated by social distancing measures due to the COVID-19 crisis, and creates great opportunities. They can, on the demand-side, allow populations in rural areas to have access to public and private services that were previously out of reach and thereby make financial and social inclusion more accessible, as well as improve services and reduce costs on the supply-side. Nevertheless, digitalisation of the financial sector also creates increased cyber threats for clients and broader financial stability.

In addition to creating an enabling environment for inclusive economic growth, there is still a need for a considerable increase in Foreign Direct Investment (FDI) in developing countries, which has been declining in recent years. FDI can stimulate the creation of jobs and infrastructure, as well as promote the transfer of production technology, skills, innovative capacity, organisational and managerial practices, and increase the tax revenue of developing countries. The financing gap to achieve the SDGs in developing countries is estimated to be above two trillion euro per year⁵, which calls for increased private investment, as public investments will not be sufficient to reach these ambitious goals.

Following crises, like the COVID-19 pandemic and the toll it takes on economies and livelihoods, a special focus has to be put on supporting actors in developing countries to mitigate the negative effects of economic and financial crises, as well as strengthening their resilience to shocks. The unpredictability of crises also calls for experimentation and adaptive programme management, which allows flexibility during implementation in case contexts change.



⁵ <https://www.un.org/press/en/2019/dsgsm1340.doc.html>



NORMATIVE FRAMEWORK

Luxembourg's commitment to development cooperation is driven by global solidarity and guided by its values and interests. The challenges faced in an increasingly complex and hyper-connected world create an urgency for Luxembourg's ongoing commitment to development cooperation, and thus for promoting financial inclusion, and contributing to broader innovative and sustainable finance. Nevertheless, they cannot be addressed by any one country alone.

International Framework

Luxembourg therefore aligns its strategies with the international normative framework and the multilateral organisations of which it is a member, while it also actively contributes to shaping these, making sure that they represent its vision and values. At the political and technical level, Luxembourg will continue promoting knowledge and good practice in inclusive and innovative finance, including standards and principles to avoid 'social- and greenwashing'.

SDGs (UN): Luxembourg's Development Cooperation activities in general, and its actions in financial inclusion and innovative finance specifically, are part of a multi-stakeholder partnership approach in the framework of the 2030 Agenda for Sustainable Development and the Sustainable Development Goals established jointly through the United Nations.

SDG 1 explicitly mentions the importance of access to financial services. Through economic and financial inclusion, people are better able to climb out of poverty by investing in business or essential social services. Financial inclusion and financial sector development are also positioned prominently as an enabler of other SDGs. They have the potential to increase productivity and profits of MSMEs, support overall economic growth, and contribute to social and human development, by enabling people to improve their livelihoods and increase resilience.

Luxembourg's Inclusive and Innovative Finance Strategy aims to contribute to meaningful progress in achieving the following 10 SDGs in particular:

- SDG 1 (No Poverty),
- SDG 2 (End Hunger),
- SDG 3 (Health and Wellbeing),
- SDG 5 (Gender Equality),
- SDG 8 (Decent work and economic growth),
- SDG 9 (Industry, Innovation and infrastructure)
- SDG 10 (Reduced inequalities),
- SDG 13 (Climate action),
- SDG 15 (Life on land), and
- SDG 17 (multi-stakeholder partnerships).

The Agenda 2030's principle of 'Leaving no one behind' informs Luxembourg's Development Cooperation's activities, by putting special emphasis on the most vulnerable and underprivileged populations.

Addis Ababa Action Agenda (AAAA): This Action Agenda of 2015 establishes a strong foundation to support the implementation of the 2030 Agenda for Sustainable Development. It provides a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities. Specifically, the Agenda recognizes the importance of inclusive finance and the need to support microenterprises. In addition, it acknowledges the role of the active participation of the financial sector in promoting sustainable development, as the necessary resources that need to be attracted, leveraged, and mobilized to attain the ambitious SDGs will need to increase from billions to trillions. While Luxembourg can contribute to filling this quantitative gap, it will put special emphasis on the quality of its interventions in terms of development impact, and on the comparative advantage that it can bring.

European Union (EU): Luxembourg shares the values and principles promoted by and through the European Union's Common Foreign and Security Policy. The EU and its member countries have a unique position as the world's largest donor in terms of development aid to represent and enhance Luxembourg's voice and interests at the global level. Luxembourg's Development Cooperation engages in ongoing cooperation with the European Commission on the subject of inclusive and innovative finance, most notably through the PSD and AFT Expert Groups, its participation in the Working Party on Development Cooperation (CODEV), and related development tools in the area of blended finance, like the External Investment Plan (EIP), or the European Fund for Sustainable Development (EFSD).

Organisation for Economic Cooperation and Development (OECD): The Development Assistance Committee (DAC) of the OECD is an international forum of many of the largest providers of aid, including 30 members of the OECD. Its goal is to promote development co-operation and other relevant policies to contribute to the implementation of the 2030 Agenda for Sustainable Development, including sustained, inclusive and sustainable economic growth, poverty eradication, and the improvement of living standards in developing countries. Specifically, Luxembourg's Development Cooperation coordinates its actions with the Private Finance for Sustainable Development (PF4SD) working group and principles of the OECD, including the principles on Blended Finance and impact standards for financial service providers.

World Bank (CGAP): The Consultative Group to Assist the Poor is a global partnership of more than 30 leading development organisations that strives to advance the lives of poor people through financial inclusion. Using action-oriented research, they test, evaluate and share knowledge intended to help build inclusive, responsible and client-centric financial systems that move people out of poverty, protect their economic gains and advance broader development goals. Luxembourg's Development Cooperation actively supports the work of CGAP as the global think tank on best practices in the domain of inclusive finance. CGAP's updated theory of change for inclusive finance, which illustrates how financial inclusion is improving resilience, empowering women, and stimulating economic growth, serves as a general guideline for Luxembourg's financial inclusion activities.



National Framework

The international framework has represented the basis for developing Luxembourg's national policies in regard to development cooperation, and more specifically financial inclusion and innovative finance. Nationally, the legal basis of Luxembourg's Development Cooperation for financial inclusion and innovation is, in general, based on paragraph 2 of the 1st article of the law on development cooperation dating from the 6th of January 1996⁶, which states:

The objectives of the Grand-Duchy of Luxembourg regarding the development cooperation are:

- The sustainable economic and social development in developing countries and particularly in the most disadvantaged among them;
- The harmonious and progressive insertion of developing countries into the global economy;
- The fight against poverty in developing countries⁷.

Also, it is based on article 4 of this same law which explicitly mentions economic and financial cooperation as a means of intervention in favour of the populations in less developed countries⁸.

The governmental programme for the period 2018-2023 states that: [...] *As a first-class international financial centre, Luxembourg will promote innovative financing mechanisms for development, most notably through guarantees and risk-management instruments, as well as social impact investment funds, in cooperation with multilateral development banks and the private sector. The inclusive finance sector remains a priority of the cooperation policy. Luxembourg will cooperate primarily with actors from the private sector who disclose best practices in connection with environmental, social, and governance criteria*⁹. [...]

Luxembourg's general development cooperation strategy¹⁰ further details that : [...] *Complementing grant financing, Luxembourg's Development Cooperation will flexibly apply a diversified and innovative set of financing instruments and modalities to respond to specific country needs and thematic areas, including through the leveraging of partnerships with MDBs and the private sector, and to support blended finance instruments such as guarantees*

and risk mitigation instruments. This will include an increased focus on impact investing, notably through inclusive finance solutions. [...] Luxembourg will strengthen its [...] support for inclusive finance to ensure that the most vulnerable populations, typically cut off from formal financial services, have access to basic financial services, including insurance mechanisms, to enable their active participation in a sustainable economic environment and improve their livelihoods [...], and promote [...] responsible investment, by providing specialised training to support economic and financial reform as well as targeted and demand-driven technical assistance [...].

Closer collaboration and synergies will be pursued with the investment fund industry based in Luxembourg to promote responsible and inclusive investment and leverage private funding.

Luxembourg will, in particular, leverage its comparative advantage as a leading international financial center and in the information and communication technology (ICT) sector by promoting enhanced engagement with new partners, particularly the private sector [...]

⁶ <https://cooperation.gouvernement.lu/en/legislation.html>

⁷ Les objectifs du Grand-Duché de Luxembourg en matière de coopération au développement sont notamment:

- le développement économique et social durable des pays en développement et plus particulièrement des plus défavorisés d'entre eux;
- l'insertion harmonieuse et progressive des pays en développement dans l'économie mondiale;
- la lutte contre la pauvreté dans les pays en développement.

⁸ Le Fonds peut intervenir dans les pays en développement par des aides directes, par le financement ou le cofinancement de programmes ou des projets d'organismes publics ou privés, nationaux ou internationaux. Il peut intervenir dans la forme d'investissements ou d'études à effectuer au sujet des formes d'investissement. Le financement des interventions peut se faire par des contributions ou subventions financières, en capital ou en nature, à accorder à des programmes ou projets. Le financement des interventions peut se faire, sur décision conjointe du ministre et du ministre ayant dans ses attributions les finances, par des bonifications d'intérêts ou des crédits à accorder à des programmes ou projets.

⁹ [...] En tant que centre financier international de premier plan, le Luxembourg développera la promotion de mécanismes innovants de financement du développement, notamment par le biais de garanties et d'instruments de limitation des risques et de fonds d'investissements à impact social, en partenariat avec les banques multilatérales de développement et le secteur privé. Le secteur de la finance inclusive restera une priorité de la politique de coopération. Le Luxembourg coopérera prioritairement avec des acteurs privés qui divulguent des informations liées aux critères environnementaux, sociaux et de gouvernance d'entreprise. [...]

¹⁰ <https://cooperation.gouvernement.lu/en/publications/strategie-strategie-generale-2030.html>

RATIONALE FOR WORKING WITH THE FINANCIAL SECTOR

Inclusive and innovative finance are enablers allowing for a stronger response to current development challenges. In this sense, Luxembourg's Development Cooperation seeks to leverage the comparative advantage of Luxembourg's financial sector in areas such as innovative and sustainable finance, but also fintech, data, and cybersecurity. Through the engagement of a diversity of actors from the financial sector and the establishment of multi-stakeholder partnerships, Luxembourg aims at triggering the mobilization of private resources for achieving the SDGs, as well as the transfer of knowledge, technology and expertise in a results-oriented manner. These will create employment in developing countries, and potentially even in Luxembourg. Moreover, Luxembourg aims to utilize the inclusive finance sector's expertise to increase the availability and usage of financial services such as credit, insurance, savings, or transfers.

While these are relevant in the international development context, they can as well be mobilized in humanitarian situations, and to promote the humanitarian-development nexus.



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INCLUSIVE AND INNOVATIVE FINANCE

Inclusive finance aims at providing affordable, equitable and timely access to appropriate quality financial products and services for all households and entrepreneurs, especially the most marginalised and unbanked or underbanked population segments. By empowering people to access a wider set of economic opportunities, inclusive finance can be a pivotal tool to improve livelihoods and in driving economies on a sustainable growth trajectory.

While Luxembourg has been active in inclusive finance for more than two decades, it aims at also leveraging the potential of broader **innovative finance**. Innovative finance is understood as a diverse set of financial solutions and mechanisms that create scalable and effective ways of channelling both private money from the global financial markets and public resources towards solving development problems. These include blended finance, impact investing and results-based finance.

*As an example, **SDG500** is a groundbreaking impact investment platform dedicated to financing the Sustainable Development Goals (SDGs). The platform's objective is to raise 500 million USD investment into six impact funds targeting businesses in the agriculture, finance, energy, education, and healthcare sectors in Africa, Asia, Latin America and the Caribbean and Pacific regions. Its Luxembourg-supported **ABC**, **BLOC Smart Africa**, and **BUILD** sub-funds are three initiatives managed by **Bamboo Capital Partners** that illustrate this course of action. **SDG500** is a unique impact investment platform for both public and private actors, and allows interested investors to invest into specific SDGs, while bundling all the resources under the same umbrella in order to create development impact combined with financial leverage.*



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RESULTS CHAIN

The vision and objectives of the Inclusive and innovative Finance Strategy are fully aligned and contribute to those of the general strategy of Luxembourg's Development Cooperation 'Road to 2030'¹¹.

Vision

As such, the overarching vision of Luxembourg's Inclusive and Innovative Finance activities is to contribute to the eradication of all forms of poverty, in particular in least developed countries (LDCs).

Objectives

The below objectives of Luxembourg's general strategy 'Road to 2030' will be addressed through this sector strategy. As described below, Luxembourg's programme on inclusive and innovative finance and PSD will directly contribute to two of its primary objectives, as well as indirectly to two secondary ones:

Primary objectives :

Promoting inclusive and sustainable growth

Luxembourg aims at achieving long-term development, which requires attracting domestic and foreign investment next to grant financing, as well as fostering multi-stakeholder partnerships. To support inclusive and sustainable socio-economic development as well as the building and retaining of a skilled workforce in partner countries, Luxembourg will leverage its expertise as a leading international financial centre, combined with its Development Cooperation's expertise, in integrated local development approaches.

Luxembourg aims to create an enabling environment through promoting conducive regulation that takes into consideration the needs of the most vulnerable. Moreover, by drawing on the resources of its financial sector as well as its expertise in innovative finance, such as blended, green, sustainable and inclusive finance and insurance, Luxembourg will contribute to the funding of development and spur inclusive and sustainable growth.

Broad financial sector development is seen as a facilitator for inclusive growth, as well as an enabler for the transition towards more sustainable economies, and will be addressed mainly through capacity building and sharing of expertise. By further strengthening its long-term support for inclusive finance, Luxembourg's Development Cooperation will allow the most vulnerable populations to gain secure access to financial services such as insurance, savings, transfers, and loans, which in turn provides them with new opportunities and empowers them to participate in a sustainable economic environment while improving their livelihoods. Specific support to the development of adequate and customer-centric financial and non-financial services will allow vulnerable populations to seize economic opportunities, as well as seek and create decent jobs.

Enhancing socio-economic integration of women and young people

Women and youth are disproportionately facing the consequences of poverty, often lacking access to necessary skills and competencies to actively engage in sustainable productive activities as a means to foster their socio-economic integration. Investing in women's economic empowerment is a key driver for overall economic growth and sustainable development and reduces inequalities in access to quality education and training.

Luxembourg is committed to assisting and financing predominantly youth- and women-led MSMEs, as well as targeting women and the young in its efforts to increase economic opportunities and access to entrepreneurship, which will enable them to develop their full potential.

¹¹ <https://cooperation.gouvernement.lu/en/publications/strategie/strategie-generale-2030.html>

Secondary objectives :

As financial inclusion and innovative finance have been defined as key enablers and facilitators, this strategy also indirectly contributes to promoting the remaining two objectives of the general strategy:

Improving access to quality basic social services

Despite improvements, many developing countries still face disparities in access to quality basic social services, particularly in fragile and conflict-affected areas. Over the past years, the concept of inclusive finance has evolved towards the inclusion of financial services allowing access to basic services. As vulnerable and underserved populations gain extended access to financial services, they can undertake investments in essential social services, which in turn improves their livelihoods.

By building on the know-how and innovative approaches in inclusive financial services and responsible investments in health, education, energy, water and sanitation, as well as food security and nutrition, Luxembourg will continue to expand access to quality social services. Nevertheless, Luxembourg's Development Cooperation will in parallel support partner countries to provide universal basic social services, and will carefully evaluate the added value that the financial sector can bring in specific contexts.

Strengthening inclusive governance

Luxembourg recognizes the need to create common standards and principles to support accountability and ensure social and environmental performance. Leveraging its competitive advantage as a leading international and sustainable finance centre, and a member of multilateral development organisations, Luxembourg aims to play an active normative role, and will pursue its support to develop and implement standards and globally accepted principles.

Luxembourg actively supports the development and implementation of standards for responsible inclusive and innovative finance. As an example, SPTF's Universal Standards for Social and Environmental Performance Management are a comprehensive set of norms and best practices created by and for the inclusive finance sector, as a resource to help financial institutions achieve a triple bottom line, and reaching their social, environmental and commercial goals.

Ensuring equal access and effective delivery of quality services, responsive to the population's needs and aspirations, are critical for achieving inclusive and sustainable development. Therefore, Luxembourg will empower investors and financial service providers, by encouraging them to take underbanked and vulnerable population's needs, and more generally environmental, social and governance (ESG) criteria and social and environmental performance management standards, into account in all decisions, and to adjust their investments, products and services to these needs and priorities.

Through its many partnerships with local and national NGOs, multilateral actors, as well as academia, Luxembourg fosters enhanced civil participation in decision-making processes and promotes an inclusive and rights-based environment.

Moreover, by working together with regulators, and providing them with the necessary information and support for evidence-based policymaking, Luxembourg's Inclusive and Innovative Finance Strategy aims to create an enabling environment and to maximize its impact. Specifically, Luxembourg also stands ready to support its partner countries in addressing strategic deficiencies in their frameworks to counter money laundering and terrorist financing.

Outcomes

In order to contribute to the broader objectives of the general strategy laid out above, this strategy focuses on, and aims to achieve the following specific outcomes that are in line with these broader objectives and effectively promote their achievement:

Increased access to responsible agricultural finance, markets and innovative practices for smallholder farmers in an integrated manner

The agriculture sector, and especially smallholder farmers, have traditionally had difficulties attracting responsible financing. Adding to this the growing problem of climate change and the resulting decrease in productivity in the sector, it has become more important than ever to develop and improve the resilience of agricultural value chains in the countries of the global South. To achieve this, Luxembourg's Development Cooperation will enhance the access to various sustainable financial services adapted to the needs of the most vulnerable farmers, paired with non-financial services, which will result in the protection, diversification and increase of the revenue streams for smallholder cooperatives and farmers, and enable them to get out of poverty by independently taking economic decisions. This empowerment is enhanced further through the promotion of innovative practices and capacity building, including in financial management, entrepreneurship, and smart and ecological agriculture practices adapted to the changing climate.

Moreover, Luxembourg will work to enhance the access to expertise, technology, as well as regional and national markets by increasing the competitiveness of the farmers and improving their access to relevant market information. A common thread in all these activities is the use of digital technology in order to modernize the value chains, make them more environmentally sustainable, and increase productivity, but also to connect actors in the markets, improve financial services and their accessibility, or improve the resilience of smallholders through innovative tools based on meteorological data.

Improved access to adequate financial and economic opportunities for young people, with a focus on productive activities

Young people (18-35 years old) represent a significant employment pool that is only going to rise further through the demographic shift in Least Developed Countries (LDCs). Whether these countries can exploit this demographic potential, however, will depend on their economies' capacity to absorb and decently employ new labour market entrants.

In order to account for these significant changes, the need for opportunities, and the considerable financing gap for MSMEs, Luxembourg will develop and adopt solutions that are designed to accommodate the specific needs of young entrepreneurs. One principal way in which Luxembourg's Development Cooperation will grant MSMEs access to adequate information and financing is to support its partners and financial intermediaries to offer young entrepreneurs financial services like credit, savings and insurance products, coupled with non-financial services such as training, financial education, business management guidance, or follow-up and support. Microenterprises will be supported to grow and become more formalized. In addition, financial services that help youth to invest in homes or children's education, will also be supported to meet the financial needs of young families.

Moreover, this strategy aims at supporting the economic inclusion of young entrepreneurs through an integrated approach involving the market, technical support, international business partnerships and financing based on the complementary nature of actors specialized in supporting young entrepreneurs, such as incubators, catalysts or financial service providers, or development agencies. Luxembourg will strengthen these actors, for instance by offering technical support or partnership opportunities for young entrepreneurs, which in turn enables them to gradually develop their business, access the market, and attract investors, ultimately leading to decent job creation.

By developing an enabling environment for economic activities, for instance through data-driven policy-making facilitating the scaling of innovative and sustainable solutions by responsible FSPs, Luxembourg's Development Cooperation will enhance access to financing opportunities in LDCs, ultimately contributing to inclusive economic growth and socio-economic integration of young people.

The Luxembourg Microfinance and Development Fund (LMDF), is a social investment fund with a particular focus on the most excluded, which was created in 2009 and has grown ever since. It invests in emerging FSPs that work hard to provide a better life for micro-entrepreneurs who need a reliable and fair supply of basic financial services: microcredit, a safe place to keep their money, money transfer and micro-insurance. Private persons as well as banks invest in LMDF, adhering to the dual objective of the Fund: social impact and financial return. While the NGO ADA is responsible for conducting due diligence and preparing the investment proposals, the impact investors are protected by an initial absorption of losses by the Luxembourg Government.

Women have access to resources promoting their economic growth, decision-making, and empowerment

Through its commitment to target predominantly women in its financial inclusion and innovative finance interventions, in line with its strategy on gender, Luxembourg acknowledges the crucial role of women in the transition towards a more equitable and sustainable future. As women gain control and ownership of financial services and productive assets, they can improve their bargaining power in the household and enable numerous positive outcomes, such as increasing their participation in the labour force, getting access to educational resources, and improving the resilience of their households and communities.

Next to financial services focusing on, and addressing the specific needs of women, including in terms of health and essential social services, Luxembourg aims to contribute to the capacity building of women through training and technical assistance and to develop a more favourable environment for their economic inclusion through the creation and formalisation of women-led MSMEs, trade facilitation, and by driving conducive regulation and consumer protection, among others. Through strengthening women's autonomy in decision-making, Luxembourg's Development Cooperation will foster the entrepreneurial spirit among women, which in the long term will lead to a significant shift in the labour market and promote inclusive and sustainable economic growth, as well as women's economic empowerment and socio-economic integration.

Micro-, Small and Medium Enterprises (MSMEs) and their Financial Service Providers (FSPs) are resilient to environmental and economic shocks

In light of global crises, like the COVID-19 pandemic and its aftermath, it is crucial that MSMEs, which make up the largest part of the economy in LDCs, and the FSPs that provide them with capital and other financial services in a responsible manner, are well equipped to respond to environmental and economic shocks, as well as cyber threats, today and in the future. To this end, Luxembourg will promote the scaling of tools which increase the resilience of MSMEs and FSPs, for instance best practices regarding sustainable business models and strong value chains, or inclusive insurance services.

As the use of microloans for renewable energy is rising, this underlines their potential for promoting sustainability and long-term resilience along with economic growth. In this context, green microfinance will be promoted, in line with the Luxembourg Development Cooperation's environment and climate change strategy.

In addition, increasing the availability of financial services like savings will make vulnerable people less likely to have to sell assets to address health emergencies, stabilize their incomes in times of economic shocks, and provides greater control over their funds. In this sense, Luxembourg's Development Cooperation aims to enhance the adaptability of vulnerable populations, including smallholder farmers, in times of environmental or economic shocks, and to allow recipients to smooth out their cash flows, improve their long-term planning, and undertake productive investments. Moreover, Luxembourg's Development Cooperation will deploy trainings in partner countries and beyond, for example in governance and financial management, thereby contributing to more resilient structures in both MSMEs and responsible FSPs.

Another increasingly important aspect of the rapid digitalisation of the financial sector and beyond is cybersecurity, which is key in implementing the 'do no harm' principle by responding to threats for clients and providers. Luxembourg is and will remain involved in supporting the development of cybersecurity resources and solutions for the inclusive finance sector to ensure customer protection and resilience of FSPs by building on the expertise of its private, public and academic sectors in this domain.

Luxembourg will adopt a flexible approach towards development initiatives in general, including financial inclusion and innovative finance, as well as non-financial services, which will allow it to remain relevant to the needs of the target populations, and to avoid additional pressure on these actors in times of crisis.



Implementation

Strategic Focus

Digital for Development

With the overall objective to boost the impact of financial inclusion and innovative finance activities on agriculture as well as youth- and women-centred MSMEs, digitalisation has the potential to lead to an improved accessibility of services for vulnerable populations, especially in isolated areas, and to reduce costs as well as increase efficiency and effectiveness for responsible service providers. Digitalisation can at the same time simplify the access to knowledge, education, and the labour market, as well as improve communication.

The Luxembourgish private sector has developed a wide array of digital solutions, for instance in fintech or cybersecurity, which is further developed in Luxembourg Development Cooperation's PSE strategy. Luxembourg's Development Cooperation will proactively support interventions that use digitalisation as a positive force for stimulating inclusive and sustainable growth, and promote socially responsible entrepreneurship.

Nevertheless, while digitalisation is an important factor in development, Luxembourg will not support it at all costs, but only if it is deemed to significantly increase impact on the above outcomes. Furthermore, the trend towards a digital economy can also disrupt current market dynamics and concentrate the distribution of income. Therefore, as outlined in Luxembourg's Development Cooperation's Digital4Development strategy, it is crucial that the 'digital divide' is closed and that collaboration between countries is improved, so that innovations and digitalisation benefit all.

The Luxembourg House of Financial Technology's Catapult: Inclusion Africa programme supports selected African fintech start-ups that innovate for financial inclusion in building their network and expertise. Involving Luxembourg's inclusive finance and fintech ecosystems, these start-ups are supported in developing responsible and truly inclusive financial services based on the lessons learned of the sector, and focussing on the benefits for the clients. This increases the relevance of their solutions for sustainable development, and at the same time helps them secure funding. Previous editions have shown that the winners of the final pitches of these seminars have gone a long way in leveraging digital tools for inclusive finance.

Value chain strengthening

Luxembourg adopts a participatory value chain approach in its inclusive and innovative finance activities, by consulting target populations throughout the project cycle, by establishing partnerships and creating synergies with public and private partners, and leveraging technical assistance.

For instance, by supporting agricultural value chain market actors, Luxembourg contributes to enhanced farm risk mitigation and transfer instruments, and fosters the adoption of more responsible and sustainable business practices as well as of climate-smart farming practices in line with agro-ecological principles, which in turn increases the resilience of smallholder farmers, strengthens gender equality and encourages women economic empowerment, and creates decent jobs for the youth.

In combination with the responsible financial services and opportunities that Luxembourg promotes, value chain strengthening contributes to the creation of economic opportunities and sustainable growth, which in turn leads to improved resilience and income generation for vulnerable populations on all levels of the value chain, including women and young people.

Innovation

One of the important lessons of the past two decades has been the pivotal role of innovation in economic development. The build-up of innovation capacities has played a central role in the growth dynamics of successful developing countries.

Luxembourg will promote and support innovative solutions, partnerships, approaches and instruments in areas where it can leverage a distinct comparative advantage, notably as a leading international financial centre and as a hub for information and communication technology (ICT), fintech, and cybersecurity.

In addition, Luxembourg will use innovative financing mechanisms, and explore the development and scaling of impact bonds.

Broad interventions

During its implementation, this strategy will make use of an array of different intervention tools, namely the demand-based deployment of a diverse array of financial instruments; offering Technical Assistance alongside investments through its partners; promoting capacity building through training and coaching; supporting the transfer of technology and expertise; supporting and implementing research through a collaboration with academia; as well as furthering the use and advancement of inclusive financial and non-financial services.

Financial instruments that will be mobilized in collaboration with partners include:

- Guarantees
- Concessional loans
- Impact investment
- Blended finance and co-funding schemes
- Impact bonds and pay-for-results approaches

These interventions and tools will be used in a complementary way, and will be selected carefully to meet the diverse needs of national contexts and effectively work towards the outcomes of this strategy, while ensuring additionality and paying specific attention to Luxembourg's comparative advantage.

Intervention levels

Luxembourg will intervene on various levels in order to reach its objectives and achieve the highest impact, namely on the:

- micro-level (individuals, households, micro-entrepreneurs, etc.), the
- meso-level (incubators, networks, aggregators, professional associations, cooperatives, MFIs), and the
- macro-level (governments and policy makers, regulators, multilateral organisations).

Moreover, Luxembourg will actively encourage sector facilitation and coordination at local and regional levels, and seek to engage in a synergetic approach across its projects and programmes, and with its partners in financial inclusion and innovative finance.

The annual European Microfinance Week, organised by e-MFP in Luxembourg, is one of the top events in the financial inclusion calendar and a unique meeting point for professionals working worldwide. It brings together a variety of actors, like consultants and financial service providers, investors, multilateral and national development agencies, NGOs and researchers. In combination with the European Microfinance Award, co-organised with InFiNe.lu, that rewards innovation and excellence, and disseminates the most relevant practices, the event is widely recognised for its high quality sessions and excellent networking opportunities.

Together with the African Microfinance Week, managed by ADA, which biennially gathers hundreds of professionals in a different African country, they represent key events in promoting exchange between the large variety of stakeholders of the inclusive finance sector.



Inputs

In order to execute the above-mentioned interventions and the overall strategy, Luxembourg's Development Cooperation will promote a multi-stakeholder approach, bringing together a large variety of actors, with the aim to mobilise the comparative advantages of each one of them. It will use a diversity of inputs and resources, first and foremost in the form of human and financial resources. In order to reach its objectives, the Cooperation plans to work with the following partners:

- Financial and private sector actors,
- NGOs,
- Multilateral partners,
- Academia,
- Standard setters/labelling agency,
- Regulators,
- Lux-Development,
- Luxembourg's Embassy Network.

Specifically, Luxembourg's Development Cooperation foresees to strengthen the links to investors, and to proactively identify opportunities to mobilise and share financial sector expertise.

In order to maximise relevance and aid effectiveness, academia will be closely involved in the identification of promising innovative models and solutions, in determining the most appropriate regulatory approaches to facilitate impact, as well as in their measurement.

Luxembourg will promote a graduation approach by leveraging synergies with rural development, health, and TVET in the context of bilateral programmes. By working even more closely with Lux-Development in different country contexts, investment opportunities will be identified, and Lux-Development's role in providing technical assistance and in the Monitoring and Evaluation process will be reinforced. Linking private financial actors to Lux-Development's field presence will be useful in localizing and contextualising actions, in line with the objectives of Luxembourg's Development Cooperation.

To this end, internal human resources and capacity in terms of inclusive and innovative finance will be further strengthened through training and recruitment. This will also allow closer and more active collaboration with key actors, like the Luxembourg Sustainable Finance Initiative.

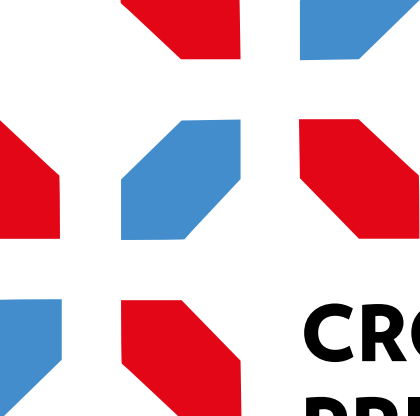
GEOGRAPHICAL FOCUS

From a geographical standpoint, Luxembourg's Development Cooperation pursues, for the sake of effectiveness and impact, an intervention policy that is targeted at a limited number of priority partner countries. Five of the seven partner countries are situated in Western Africa: Burkina Faso, Cabo Verde, Mali, Niger, and Senegal. The other priority partner countries are Lao PDR in Southeast Asia and Nicaragua in Central America. To the extent possible and whenever relevant, this strategy will be reflected in bilateral Indicative Country Programmes (ICP/PIC). Based on its experience and existing partnerships, specific attention will be given to countries located in West Africa and the Sahel region. Beyond these seven partner countries, Luxembourg will target countries and regions requesting its support in thematic areas in which it has an added value to offer, where financial inclusion and innovative finance will have a high potential for impact, and which are on the list of DAC ODA recipient countries¹².



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¹² <https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/daclist.html>



CROSS-CUTTING PRINCIPLES

Across all the activities of Luxembourg's Development Cooperation, and thus also in its interventions related to financial inclusion and innovative finance, several cross-cutting principles are underlying. By ensuring the systematic inclusion of cross-cutting priorities Luxembourg aims to provide a holistic and multi-faceted approach to supporting financial inclusion and innovation for sustainable development. For this strategy the following priorities will be given special attention, and will be addressed and proactively promoted through due diligence procedures, transparency and performance standards:

- Human Rights
- Do no harm
- Leave no one behind
- Environmental sustainability and climate action¹³
- Social performance and ESG standards
- Untied aid
- Ownership
- Gender Equality
- Regular Monitoring & Evaluation



¹³ In line with Luxembourg Development Cooperation's environment and climate change strategy

POLICY COHERENCE FOR DEVELOPMENT

Luxembourg's Development Cooperation will further promote coherence and coordination with existing and new initiatives in the field of sustainable and responsible finance and economic development, like the Luxembourg Sustainable Finance Initiative (LSFI), and its Luxembourg Sustainable Finance Strategy (LSFS).

In terms of the engagement with the financial sector, the overarching objective remains the effective contribution to development and the accomplishment of the set-out objectives and outcomes, not the development of new markets for Luxembourgish investors. In this light, Luxembourg's Development Cooperation recognizes the interested approach of most private and financial actors in Luxembourg and beyond, including in developing countries, and it aims to identify common interests and synergies while orienting the private financial actors, initiatives, investments and expertise towards impact and sustainability. Through the responsible engagement of the financial sector and the resulting impact on sustainable development, these synergies can lead to a triple bottom line, consisting of social, environmental, and commercial sustainability and performance, facilitated by Luxembourg's Development Cooperation.

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