Using Enterprise Challenge Funds to Promote a More Enabling Environment for Business: Challenges and Opportunities.

by

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Contents

[1] The views expressed in this paper are those of the authors and do not necessarily represent those of AusAID.

1. Executive Summary

Whilst a continued emphasis from donors on reforms to improve the enabling environment within which businesses operate (BEE) is appropriate, there is also scope to seek new ways to partner business to accelerate pro-poor development, and by so doing, improve the effectiveness of BEE reform efforts. This paper argues that Enterprise Challenge Funds (ECFs) are an emerging instrument by which donors can directly encourage pro-poor outcomes from private sector activity, and also indirectly enhance the effectiveness and pro-poor focus of BEE reforms.

ECFs make matching grant funds available to business on a competitive basis. They are designed to encourage the private sector to pursue activities that they would not otherwise and that have explicitly pro-poor outcomes. They seek to bring about sustainable change, both through promoting projects that change the way markets work and by changing the way the private sector behaves.

Recent ECF experience suggests these firm-level interventions can promote pro-poor BEE change in a variety of ways. These include:

- encouraging business to realise opportunities for poverty reduction created by BEE reforms that have already occurred;
- utilising the close engagement with business that ECF management necessitates to sharpen the focus of other BEE reform efforts;
- capitalising on the focused public-private interactions that are part of ECF implementation to add impetus to BEE reforms;
- using ECF to fund specific projects on BEE reforms;
- less tangible effects, such as the pro-poor influence on corporate decision making behaviour that can arise through the demonstration effect of ECF projects.

Specific examples drawn from prior ECF experience are presented to demonstrate these actual and potential effects.

AusAID has recently undertaken fieldwork to assess the feasibility of an ECF for poorer regions of Asia and the Pacific. Mindful that the systemic effects of ECFs on the BEE have not always materialised to the extent envisaged at design, AusAID was keen to explore these potential synergies between ECFs and BEE reform at an early stage. Whilst the findings from the current feasibility study are necessarily speculative, they confirm that such potential synergies do exist. The findings suggest that ECFs would be most effective at focusing BEE reform efforts through pro-active coordination efforts and business to business demonstration effects. Some potential exists for ECF projects to target imminent BEE reforms. An ECF is less likely to be effective if used directly as a ‘BEE reform project’ tool. Some conclusions are drawn concerning how best to design an ECF to maximise the synergies with BEE efforts without compromising the effectiveness of the ECF instrument.

2. Introduction

The recent publication of the Australian Government’s White Paper on Aid entitled ‘Australian Aid: Promoting Growth and Stability’ marked an important shift in the focus of AusAID’s developmental effort (AusAID, 2006). As the title implies, the agency is seeking a renewed emphasis on economic growth as the key driver of poverty reduction. The Paper further stresses the importance of the private sector as the main engine of growth, and the need to reinvigorate efforts to promote private sector development in partner countries. AusAID’s efforts to help create a more enabling environment for private sector activity in Australia’s partner countries in Asia and the Pacific are increasingly taking centre stage.

The majority of AusAID's current efforts in this regard are concerned with investments and reforms in the public sector to improve the regulatory and competitive environment for private activity. Examples include support to financial sector reform and state-owned enterprise reform in Vietnam; supporting the development of new laws relating to enterprise registration and development, and research into land market impediments to private sector development (PSD) in Vietnam; support to trade institutions in Laos; and programs to improve the tax system, management of domestic debt and provide advice on trade policies in Indonesia.

More recently, AusAID has been considering more direct partnerships and engagement with the private sector. An important aspect of these considerations is how a direct engagement with business might lend greater focus, impetus, and effectiveness to efforts to improve the business enabling environment (BEE) in partner countries. In the recent past, AusAID's efforts to partner directly with the private sector has been through other agencies, such as the International Finance Corporation's (IFC) private sector development facilities and ADB, to support capacity development in particular firms or sectors. Now, serious consideration is being given to developing a regional Enterprise Challenge Fund covering poorer and less dynamic parts of Asia and the Pacific in order to directly stimulate pro-poor growth, and to refine and strengthen donor BEE efforts in these countries.

Drawing upon AusAID's real-time Enterprise Challenge Fund (ECF) design process, this paper explores the ways in which an ECF can most effectively support positive and pro-poor change to the BEE, and add value to other BEE efforts. The following section outlines the key concepts and rationale behind an ECF instrument. This is followed by an overview of ECF experience, and then a discussion of the different ways in which an ECF can directly and indirectly influence change in the BEE. Some examples of ECF influence on the BEE are offered from previous ECF implementation experience. Potential opportunities for an AusAID ECF to influence BEE change, identified from an ongoing ECF design process are then presented, before concluding with some broader lessons for BEE practitioners and ECF designers concerned with promoting systemic changes to the BEE.

3. *The concept and rationale of an ECF*

An ECF is basically a means to encourage firms to innovate and take risks in ventures that benefit the poor and can be sustained by market forces. It does this by providing time-bound grant assistance to the private sector and sharing short-term risk with them. An ECF leverages investment by the business of at least an equivalent amount, often much more. ECF-supported ventures are selected through open competition in terms of their potential for impacting large numbers of the poor both directly and through demonstration to other firms. The grants enable new business models to be developed that may otherwise not be pursued at all or may only receive marginal attention by the private sector. Only upfront grants are required: the business is expected to be commercially sustainable once the grant is factored in. ECF grants can also directly advance BEE agendas. Applicants are typically firms, though NGOs, business associations and regulatory agencies may be important collaborating partners also. While not all proposals supported are necessarily successful, the overall impact on poverty reduction is expected to be significantly positive.

ECFs are funded, but not implemented, by donors. An ECF requires a Fund Manager (competitively selected) to administer the fund (including monitoring, accounting and audit) and market the fund; they may also help firms or partnerships develop and improve their proposals for ECF funding. Typically, ECF applications are evaluated by independent Expert Panels, comprising private sector (including from the financial sector), civil society and other stakeholders. In some cases, both local and international Expert Panels have been established with the local Panel screening projects primarily for their potential poverty impacts and international Panels scrutinising the business case.

There are sound economic and social reasons behind the establishment of an ECF. These become clear on consideration of examples of the sort of projects ECFs have supported (see Annex 1). ECFs often help expand financial or agricultural extension services to the poor. These are ventures which trial new technologies or modes of organization to the intended benefit of a large number of poor people. They are ventures which fill market gaps and provide products which were simply unavailable before. ECFs stimulate private sector activity in markets involving poor people. They can also stimulate and support wider changes in the BEE as the following sections demonstrate.

ECF projects have three characteristics which justify public intervention: significant externalities, risks, and pro-poor benefits. The externalities emerge from the institutional or technological innovations embedded in the projects funded. If one of these projects can be shown to be successful, the innovation is proven, and others can be expected to adopt it. The risks also emerge from the innovative nature of the project. Whether the project will then move ahead will depend on the willingness of the entrepreneurs or the financial sector to bear risk. Risk-bearing capacity is often extremely limited when the financial sector or the private sector more generally is thin. Firms often lack good information about markets involving the poor which compounds the risks faced. Finally, the projects are selected to benefit the poor, often farmers and other rural households, often as producers, sometimes as consumers. This provides another reason why the social returns to investment might outweigh the financial returns to the firm.

Donors are well-placed to provide funding through ECF-type instruments to help internalise the costs of externalities, and can also help to share risk. Donors are also well placed to use specific ECF projects to promote and support wider BEE change.

4. Brief overview of ECFs

Enterprise Challenge Fund-type approaches have been used for a number of years by European governments as a way of promoting service delivery and SME growth in difficult or lagging regions. Some examples include: the Single Regeneration Budget, where public funding of £5.7bn since 2002 has leveraged private funding of £8.6 for around 1100 projects; the Urban Programme, where for example Bristol was recently awarded £8m for the revitalisation of business and employment in poor wards of the city; City Challenge, where for example Birmingham successfully bid for £40m over 5years to stimulate business development. Australia also has similar schemes such as the Employment Innovation Fund which is a A$4m discretionary funding programme designed to provide seed funding to organisations to develop innovative approaches to resolve specific labour market problems and open up employment opportunities.

In recent years, donors such as DFID have developed and evolved ECF approaches to promote poverty-reducing private sector growth in developing countries. The initial rationale for ECFs was primarily about projects that catalysed private companies to engage poor people as market participants; as experience has evolved, there is a growing realisation of the potential for ECFs to create systemic changes at the level of the firm, the industry, and more widely across the BEE.

Prominent examples of donor-funded developing-country ECFs follow below:

Development Marketplace (DM) is a competitive grant program of the World Bank that funds innovative, small-scale development projects. A key aim is to encourage Bank engagement with civil society. The total funds available in 2006 were $4m, targeted at water, sanitation and energy projects. The Development Marketplace has been an inspiration for the current generation of ECFs, but differs from them in two respects: the majority of funding go to NGOs (only around 15% goes to private companies and a similar amount to academia), and there is no matching-funding requirement.

The Consultative Group to Assist the Poorest (CGAP) launched a competitive innovation fund in 2002, the ProPoor Innovation Challenge (PIC), providing up to USD50,000 in grants to microfinance organisations that have developed innovative methodologies to deepen rural poverty outreach and impact. A thorough evaluation is pending, but a recent survey suggests good growth from the selected organisations.

DFID launched a Financial Deepening Challenge Fund (FDCF) and Business Linkages Challenge Fund (BLCF) around four years ago, both with a capitalisation of £18m. Both funds are now closed. Both sought applications from private firms for grant funding with requirements for a matching investment ratio of at least 1:1. The FDCF has 29 interventions in 12 countries ranging from £50k to £1m and has achieved an average leverage ratio of 1:3.9. The BLCF which has 53 interventions covering a range of productive sectors including agriculture, tourism, and wider enterprise development achieved a leverage ratio of 1:2.3. A third DFID ECF in Ghana closed down early, after little disbursement.

In PNG, the Sustainable Development Program (funded by dividends from shares in the Ok Tedi Mine, which BHP granted to a trust) provides grant funding to match private sector contributions for development projects in PNG, particularly in the Western Province. Projects under implementation or consideration include rural telephony, rural electrification, and technical training. The SDP does not take a competitive route, but otherwise is set up very much as an ECF.

There are also several ECFs in the pipeline:

- DFID is currently designing an African ECF that has a target capitalisation of $100m over 7 years, to start in 2006.
- The ADB and IFAD have also begun exploring the potential for an ECF in Vietnam.
- Other agencies such as GTZ (micro-insurance) and USAID are considering similar instruments.

Examples of typical projects supported by ECFs are provided in Annex 1.

5. Using ECFs to promote pro-poor BEE change

ECF evaluations have been broadly positive about their ability to generate sustainable poverty impacts and their effectiveness as an aid instrument (Deloitte & Touche with DFID, 2004; Enterplan with DFID, 2004). These evaluations have yielded a range of insights and lessons for PSD practitioners, including insights regarding the actual or potential impact of ECFs on changes in the BEE.

Targeting ECFs at opportunities created by BEE change

Experience from working on changes to the BEE suggests that there are sometimes cases where changes in laws or regulations for example, result in greater opportunity for private sector activity amongst the poor, but only in theory. Because the incentives for the private sector to realise these opportunities are perceived as too weak, or the risks of moving into a new market niche are too high because of limited information about that market for example, these opportunities do not get realised in practice, or in a timely manner, or even at all. This can represent a significant lost opportunity in terms of poverty reduction, particularly where the process of supporting a specific BEE change has been long and costly. ECF projects are a potentially important mechanism to minimise such opportunity costs and maximise poverty reduction gains by strengthening the incentives and or sharing the risks that potential private investors face in order to realise the benefits of a specific BEE change.

An example of such a link between ECFs and BEE change might be when legal changes permit electronic and mobile banking but banks and or mobile telephone companies are reluctant to realise such opportunities in rural areas because of perceived risks or traditional business paradigms about opening new markets in these areas. An ECF could help share the risk with businesses willing to move into this market, resulting in earlier and wider access to financial services amongst the poor. More specifically, a number of FDCF projects in Southern Africa have emerged as a result of the close coordination of the FDCF with DFID's regional financial sector development program – FinMark Trust – which works extensively on issues relating to the enabling environment for financial services for the poor in the region. Similar information and coordination linkages were made between the DFID financial sector development program in East Africa which directly resulted in increased deal flow for the FDCF.

A further example is in Fiji, where the Reserve Bank recently adapted the requirements for proof of identity to open a bank account. Formerly an employer's letter was required, which excluded many of those in the rural and informal sectors. Changes to these requirements suddenly opened up the rural sector to financial institutions unfamiliar with this potential market. The traditional banks were slow to develop new business models to access these markets on their own. With UNDP assistance however, including demonstrating the bankability of the poor and the provision of financial literacy training, new microfinance models are now being piloted by a commercial bank (Liew, 2006).

Using ECF experience to better target BEE efforts

Establishing an ECF project necessitates very close engagement with private sector actors often across different economic sectors. The process of marketing of an ECF within a particular sector demands a close understanding of the businesses in that sector and the opportunities and constraints they face. Such understanding is often taken to a higher level in the development of ECF proposals for funding and in the subsequent scrutiny of such proposals. By engaging with private companies to explore specific pro-poor market possibilities and encourage 'out of the box' thinking by decision makers in those companies, ECF managers and the donors that support them are likely to gain substantially richer, or at least important supplementary, information about BEE constraints than that from 'Doing Business' surveys for example. This can be potentially crucial in guiding and sharpening the content and strategy of BEE interventions.

Similarly, a key rationale behind ECFs is their ability to catalyse and promote new business models in a sector or industry that result in greater market participation by the poor. Where companies are incentivised to move into new markets using new business models, the intention behind an ECF (and one criterion in the assessment of ECF proposals) is to encourage and crowd-in competitors into that market. By encouraging this interest in new markets and business models across the business community, there is likely to be greater pressure for associated changes in the BEE to enable competitors to enter this new-found market.

For example in India the FDCF funded three different approaches to micro insurance. All three projects encountered regulatory impediments that had much wider BEE implications. For example, existing regulations stipulated that insurance sales agents had to receive at least 100 hours of training before they could be licensed. This was clearly excessive for very straight forward micro-insurance projects. One project in particular - which was creating Self-help groups and training women to sell the products - was anxious to have this modified, as there was no way that the women they were working with could spend so much time away from homes and families, and the whole project would have floundered at this point (BF, pers. comm.). The FDCF helped to raise the profile of such issues, focus regulators' minds on the practicalities of such impediments, and helped the micro insurance businesses work together to lobby for changes. This experience demonstrates how and ECF can bring particular BEE issues into focus. It may suggest that authorities are more likely to respond to these kinds of "live" issues than to the government-to-government enabling environment programmes that are typically pursued.

Similarly the FDCF Deutsche Bank Commercial Microfinance Facility project which is investing substantial sums in the microfinance sector in Africa, South Asia and Latin America is likely to have significant impacts on the environment for, and performance of, microfinance institutions. This project is pioneering the creation of an asset class for investments by commercial institutional investors in microfinance, pioneering a partnership model of investors, intermediaries and MFIs that can be adopted by other similar facilities, and linking local commercial banks and the microfinance industry through the provision of flexible risk reducing financing, thus creating a framework for locally based systems that serve the financial needs of the poor. Thus one major ECF project is leveraging industry-wide BEE change. A very important wider BEE corollary of the linkages created through this FDCF project is that they will stimulate MFIs towards greater transparency and good governance, aspects of MFIs that are commonly weak.

By catalysing the development of new business models, ECFs may also venture into previously unregulated markets, simply because they did not exist before. These cases can provide a sharper and more tangible focus for existing BEE programmes to pursue. A good example of such linkages between ECF experiences and BEE refinement comes from Kenya where the ECF funded the Vodafone M-Pesa mobile banking pilot. This enabled people, many of whom were unable to access financial services, to use mobile phones and SMS messaging to undertake financial transactions including sending money, repaying loans and making deposits; the network of airtime merchants collect and disburse cash and thus lower the distribution costs of banks and MFIs. Due to the small scale and novel approach, this breakthrough in mobile banking was not explicitly covered by Kenyan bank regulators. As the pilot scaled up, Vodafone feared that the pilot and related business opportunities may be regulated out of existence altogether. Coupled with donor concern to ensure a level playing field for competing businesses wishing to develop similar approaches to extend the reach of financial services, this resulted in a very focused mobile banking BEE project that brought together regulators from telecommunications, competition, and e-commerce with mobile banking providers for the first time (DP, pers. comm.).

In conclusion, it seems clear that the FDCF has initiated changes in the way that markets influence the owners and recipients of capital which has led to significant positive pro-poor enabling environment impacts (Enterplan, 2004).

Using ECFs to facilitate and enhance Public-Private Dialogue

Meaningful face to face interactions between business people and those charged with designing and enforcing business regulations have proven crucial to promoting pro-poor BEE change. The establishment of Expert Panels, typically comprised of local opinion leaders, business people and NGOs, in order to assess and provide feedback on ECF proposals represents a significant opportunity for meaningful Public-Private Dialogue on BEE issues. The very focused nature of such discussions, on specific aspects of ECF proposals or the risk perceptions of private companies considering moves into markets dominated by poor people for example, means these Panels can become important and influential fora for BEE change.

The FDCF experience has highlighted the potential importance of such Panels on the local BEE in Africa. Local African panels were comprised of important opinion makers, including regulators. The process of assessing ECF projects opened them up to practical issues faced by companies operating in a particular environment. Several eminent local panel members commented to a FDCF Reviewer on how they or their colleagues' eyes were opened to a 'Bottom of Pyramid approach' through reviewing the applications, since most came from a fairly conventional financial regulator or financial background. Whilst it is not possible to give specific examples of what this led to, it is reasonable to surmise that there will be some positive spin-offs from this in terms of pro-poor BEE change given that the Panel members were influential on the regulatory environment and well connected in their countries (DP, pers comm.).

Using ECFs to directly fund BEE projects

Where specific aspects of the BEE impede business from profitably entering into markets for the poor, it should be possible and desirable for ECFs to be used to fund projects that directly seek to change the BEE. The extent to which ECF projects are able to partner regulatory agencies with business ventures is also important here. Where such a project is with business, it may be appropriate for the matching element of such a project to be shared across businesses that will benefit from the BEE change, and or for the matching grant requirements of ECF funding to be waived where the opportunities to directly profit from such a change are less clear cut.

This is reflected in the experiences of the FDCF and BLCF that found using standard ECF criteria simply did not attract strict 'BEE projects'. Following a study on this issue (ref), both ECFs established dedicated BEE 'windows' with modified fund access criteria, including a 10%, rather than 50%, minimum business contribution (Deloitte, 2004).

The BLCF subsequently directly funded several BEE projects that received much less than 50 per cent funding by business. Examples of such efforts include the 'Cutting Red Tape' project. This was a partnership between the Commonwealth Business Council and Business Associations across Africa, Anglo American, and the South Africa Foundation to provide evidence-based research to advocate for the improvement of the BEE and raise awareness of regulatory best practice amongst regulators.

In Tanzania, the BLCF provided funding to support the efforts of large corporations such as BP Tanzania, Tanzania Breweries, Tanga Cement Company in their quest to expand outsourcing and procurement linkages with local Tanzanian SMEs. This involves a quarterly meeting where the CEOs of the participating companies meet to review progress and has resulted in a group of high profile influential businessmen in Tanzania with a much better understanding of the issues that face SMEs. These CEOs have now become more effective advocates for the SME sector with Government. Even though the grant agreement has ended the initiative continues, sustained by corporate interests.

Another example is the support BLCF provided to honey producer organisations to develop Residue Monitoring Schemes to enable their products to meet EU import criteria.

More recently, the BLCF has seen an increasing number of project applications through the original (ECF, non-BEE) 'window' with 50 per cent or more business funding, that target the enabling environment for business in specific sectors. One example is the Vietnam Business Links Initiative that aims to deliver systemic, sustainable and continuous improvement in workplace conditions in the Vietnamese Garment Industry, by raising OH&S standards in a rigorous model of change through business linkages. It has the support of the International Business Leaders Forum, an international NGO set up to promote responsible business practices.

The response to the BEE window in the FDCF was more limited; overall the FDCF managers estimated that private business had contributed around £1.4m to BEE efforts, which was lower than expected at project outset but is expected to yield benefits that far outweigh the monetary value of the contribution (Enterplan, 2004:8). One example was a project that created a Sustainability Index with the Johannesburg Stock Exchange whereby companies adopting pro-poor objectives can be recognised by the market and ultimately rewarded through share values. The Index seeks to coalesce the South African corporate sector to bring about changes in or responses to the BEE. It is evident that the process of simply discussing and establishing the Index has already influenced over 100 corporations. A further example was the co-funding of Women's World Banking efforts to stimulate commercial banks in India to remove barriers to their provision of retail and wholesale microfinance, and to disseminate best practice microfinance regulatory frameworks in East Africa.

Using links between ECF activity and dispersed BEE efforts to improve donor BEE coordination and impact.

A key challenge to donor's being able to influence substantial and pro-poor change in the BEE is ensuring coordination of effort and consistency of approach across donors. Unlike relatively tightly defined sectors such as health or education, the range of strategic and non-strategic issues influencing the environment for PSD in any particular country is potentially very broad and often highly contested. The nature and modalities of potential interventions around BEE change also vary widely making a wider donor effort coherent and consistent more challenging. An indicator of this particular challenge for PSD is reflected in the existence and performance of donor partnership groups on PSD in Asia. While there are undoubtedly country exceptions, in the authors' experience, these groups are probably consistently less effective and coherent than in the social sectors for example.

Improving donor coordination around BEE change requires concerted efforts on a number of fronts. ECFs can provide further impetus for donor coherence by creating a more real and focused demand for BEE change through the issues that arise under ECF projects with private companies. For any donor funding both BEE work and an ECF-type approach, the potential synergies between the two streams of effort are likely to become readily apparent. With wider donor engagement in ECFs, either directly or through fellow donors' experience, the momentum for improved donor coordination is likely to be further increased.

Other less tangible ECF effects on BEE

As the BLCF fund managers stress in their internal reviews, there is much to be gained by donors, in terms of how to support PSD, from the proactive engagement with business that ECFs demand[2] (Deloitte, 2004). The interest stimulated by the BLCF was significant in terms of bringing new private sector partners into contact with the development community – over 90 per cent of BLCF projects were with businesses that did not have previous donor contact (for the FDCF it was closer to 30 per cent). It is likely that these interactions, and the awareness that they create, would lead directly or indirectly to greater pressure for pro-poor BEE changes. As an internal FDCF review demonstrates:

"There are many more decision makers in the private sector that are now aware of the possibility that genuine commercial opportunity exists in poor countries, and that have observed definite signs of businesses viewing these markets in different ways. Inevitably these trends reflect more general developments in international business, but through the FDCF it is thought that DFID has played a significant influencing role. It is known that some unsuccessful bidders, convinced of the

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[2] For more than 20 years the donor community has worked with the private sector, mainly SMEs, initially through soft lending and hands on technical assistance direct to the companies themselves. However, experience suggests that such direct engagement may not be the best use of resources, and more recently support has shifted from direct engagement with SMEs to broader support to the infrastructure that supports the private sector (including chambers of commerce, financial institutions, and, importantly, the policy environment). Developments in sustainability and commercial provision of microfinance and the market development approach to business development services support, argue for market based approaches to donor support at the individual enterprise level. Part of the rationale behind the BLCF is to engage more directly with the real private sector to ensure initiatives are relevant to and led by the commercial sector. This overcomes some of the weaknesses in other approaches that seek to support the private sector without necessarily engaging directly with it or building effectively on existing capacity (Deloitte, 2004).

potential commercial benefits of their new thinking, are seeking alternative ways of taking forwards - sometimes modified versions of - their projects.” (Enterplan, 2004:12).

6. Insights from AusAID’s ECF Feasibility Study

Following AusAID’s consideration of the ECF concept in July 2006, a study was launched to consider the feasibility of an ECF for poorer regions of Asia and the Pacific. Fieldwork for this study was conducted in Indonesia, Philippines, Cambodia, Laos, Papua New Guinea, Solomon Islands, and Vanuatu over a seven week period from early October 2006. The work was conducted by AusAID advisory staff, a UNDP adviser and international and local consultants, and comprised individual interviews with around 75 businesses, workshops with the business community, and meetings with government and donor representatives in each country. The business interviews focused on the extent of current pro-poor business projects[3] undertaken by the company, the barriers to undertaking (more of) these types of projects (including explicit questions about issues relating to the broader BEE), views on the ECF concept, and some preliminary discussions about projects for potential ECF funding.

Preliminary analysis to date unsurprisingly reveals a wide range of BEE issues that constrain businesses from undertaking pro-poor projects. Examples included legal and regulatory barriers such as business registration and the identification evidence requirements to open bank accounts; high costs of doing business due to slow legal processes and generally high prices and wages, particularly in the Pacific; a simple lack of, or inefficient monopoly control over, infrastructure services particularly in transport but also in the utilities and communications sector; excessive state intervention, particularly with regard to commodity marketing and export; and what was described as ‘bureaucratic lethargy’ where state regulatory or legal systems for example, are in place and functional, but operate in a non-dynamic and unmotivated manner (JL, pers. comm.); this is seen to create tremendous frustration amongst businesses, particularly where there is acknowledgement of BEE constraints by the state but a general apathy towards acting upon them. The acknowledgement by government of some of these BEE issues was reflected in the interviews with government stakeholders, with some implicit acceptance that their record on corresponding actions was inadequate.

Interestingly, there were fairly consistent signs that businesses perceive such BEE issues to be relatively ‘immovable givens’ that they simply needed to operate around. This is in spite of the wide range of donor-supported BEE projects, that businesses were largely unaware of. Only 16 per cent of businesses interviewed believed donors were effectively tackling the key BEE issues. Twenty five per cent of businesses believed donors were not addressing key BEE issues, and 60 per cent felt donor efforts were ‘partial’. A related message for donors was that their efforts were perceived by businesses as targeted at an overly ‘strategic’ level and were therefore rather vague and had little bearing on the practicalities of doing business.

[3] Pro-poor business projects are defined as commercially viable business ventures that result in quality jobs for poor people and or access to goods and services by the poor.

Whilst this ECF fieldwork was concerned with ECF possibilities rather than ECF projects underway, there was a range of potential ECF examples and related insights that suggested opportunities for ECF projects to enhance BEE efforts exist.

The fieldwork revealed several instances of recent or imminent changes to the BEE, where proposed ECF projects might help ensure that the potential benefits of such changes are realised amongst the poor. One such example is where the State Bank has recently relaxed the requirements necessary for customers to open new bank accounts. There are now a number of commercial banks eager to extend the reach of their financial services deeper into remote rural areas using (undisclosed) information technology innovations. However, the risks are currently perceived to be too high to develop this technology and market, and without ECF funding this project will possibly be shelved for two years or more. Another example of imminent change concerns work supported by ADB to enable the use of chattels and land leases as collateral against which loan finance can be secured. Whilst no ECF proposals from the business community were explicitly linked to this change, given the consistent complaint about inadequate access to flexible finance by businesses in the same country, and the continued hesitancy of the national bank and commercial banks to move downstream with their lending, it is reasonable to speculate that an ECF project may help to unlock this constraint.

There was a much greater range of examples whereby a proposed ECF project would likely add value to existing BEE reform efforts or stimulate fresh efforts. One example concerns an IT firm looking to develop rural internet 'kiosks' as a platform for the provision of rural banking, insurance, post office-related and other services. The key risk to realising this opportunity concerns their reliance on government telephone and related infrastructure. ECF funding was considered necessary to reduce this risk to manageable levels; and if the venture was successful, it was expected to leverage reforms to the way in which the government infrastructure was managed to increase its reliability. A Jakarta-based multinational firm in Indonesia talked about the possibility of sourcing inputs from eastern parts of Indonesia, but one of the (multiple) impediments was the rather arbitrary and obstructive behaviour of local government. This gave rise to discussions about the potential for an ECF-supported project to support a process of local government lobbying and 'cultural change' to enable specific supply chain efficiencies and a general improvement in business conditions. In Papua New Guinea, a total absence of transport infrastructure provision and commercial banks' unwillingness to lend against the non-land assets of a business means several thousand copra farmers have no means of shipping their copra to market. An ECF project that enabled a commercial loan to go ahead would not only realise this market opportunity for copra farmers, but would likely lead to government investment in transport infrastructure and related services, although the desirability of such a development is uncertain (WJ, pers. comm.). Another example concerns the development of a bottled spring water venture that was delayed over the lack of government legislation concerning watershed protection; an ECF project could be expected to help realise such a business venture and thereby increase the impetus in government to complete such legislation.

Unsurprisingly, the interviews revealed little demand from businesses to use ECF funding to address BEE issues directly. Little emphasis was placed on exploring this aspect of ECF-BEE synergies in the fieldwork, and given the non-excludable, public good nature of such efforts, strong demand from individual firms was not expected. However, some of the workshop discussion and several individual business interviews suggested there may be value in collaborative action by the private sector to address BEE issues at a practical level. Specific examples were often around infrastructure service monopolies in telecommunications and transport to remote areas; getting government permission to permit direct charter flights to tourist destinations; providing an efficient quarantine service to enable the import of seed material with potential pro-poor benefits; providing a local organic and fairtrade certification capacity. However, it was not clear that an ECF was the appropriate vehicle to support these efforts to address BEE issues.

There were also signs of other, less tangible, potential benefits of ECF projects on the BEE in the wider sense. Annex 2 provides a list of potential indirect effects of an ECF on the BEE in Papua New Guinea; these were expected to arise primarily through the powerful and varied demonstration effects that ECF-supported business ventures could have. The possibilities ranged from demonstrating the inhibiting impacts of property registration, to the positive effect on the business culture of role model businesses, the likely effect on skills development, and possible contributions to reduced lawlessness.

As alluded to previously, the effect of one business successfully developing markets at the bottom of the pyramid, was seen as likely to encourage other businesses to do likewise; this was most evident from the tone of the workshops with businesses and the flurry of proposals that has emerged, and continues to emerge, since. One commercial bank representative indicated that without the presence of an ECF, their corporate strategy would be to 'stick to where the easy money can be made'. By implication, the ECF could change 'corporate mindsets' in the financial sector, which would be a significant shift in the business environment.

Over half of the businesses interviewed believed donor and government BEE reform efforts needed to be much more focused on the practicalities of doing business; one implication of donor financing of an ECF project would be that such practicalities would likely be better understood by government and donors. There was also evidence that the presence of ECF projects around certain BEE issues could help to hasten reform where donor BEE projects typically lack a sense of urgency and immediacy – that is, to unlock the 'bureaucratic lethargy' (JL, pers. comm.)[4]. A typical list of such issues is provided at Annex 2.

BEE projects were also widely perceived by businesses as lacking the flexibility to respond to practical business issues, and donors felt they were too often bound by the contractual milestones of a project document. Furthermore, the client for such projects was usually a regulatory authority, with little accountability to business. Some donors considered that the practical engagement with real business issues, along with the pro-poor nature of potential ECF projects, would help to hasten practical BEE reforms.

A similar finding, apparent in a number of the fieldwork countries, was that commercial banks stated that a project's attainment of an ECF grant would make them more likely to lend to a project. This was not only because they would view the ECF finance as quasi-equity, but because they would award credit scoring points to the fact that a project had gone through a thorough ECF review. In fact several companies stated that they would view an ECF grant as effectively lowering their borrowing costs.

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[4] A donor sat in the Reserve Bank Rural Banking Committee for two years without any tangible results. Once the business proposal to develop rural banking with a commercial bank was signed, the amendments to the bank account identification requirements were amended within a few weeks. Imminence of action and the potential benefits accruing to rural people were the compelling impetus for quick action by the Reserve Bank. (JL, pers. comm.).

7. Some Preliminary Conclusions for ECF Design

Whilst it is clear from earlier sections of this paper that ECFs are not, and should not, be the only or even primary vehicle by which donors seek to influence pro-poor BEE change, evidence from previous ECF experience and recent AusAID fieldwork suggest there is potential for ECFs to positively influence BEE change. Recent ECF experience suggests this has already occurred in some limited and indirect ways. Together, these suggest that there is clearly scope to design ECFs to realise BEE opportunities to a greater or lesser extent. Some preliminary conclusions in this regard are drawn below.

The clearest and most basic challenge is for ECF managers to ensure that the opportunities outlined in section 6 above to (re)focus and progress BEE reforms are identified and acted upon. This implies effective monitoring of ECF projects and a high degree of pro-active coordination between the ECF managers and other agencies working explicitly on these BEE issues. A clear mandate and sufficient incentives are necessary for the ECF manager to undertake this role, particularly as these are not central to the success of the ECF per se. This also necessitates the ECF manager having sufficient credibility with key BEE actors and being able to effectively communicate from the micro perspective of ECF-supported ventures to more macro-oriented BEE programs.

Some practical suggestions to help ensure this include having active 'BEE donors' as observers on the Expert Panels for the ECF so that they can remain appraised of ECF-supported projects and opportunities to collaborate. Another is to require specificity from ECF applicants about the particular BEE issues they face and how the ECF may help to overcome these. This could also be used to inform government and donor stakeholders in real time about critical BEE issues; where common themes or obstacles emerge, these could be taken up by BEE programs. There is clear scope here to also use such information to better coordinate donor BEE efforts. A further suggestion is to include the potential impact of an ECF project on the wider BEE as criterion for assessing and ranking proposals, although this risks distorting the primary objective of an ECF. An alternative approach would be to develop the capacity within the ECF management function to directly pursue specific BEE agenda, or to establish this capacity in a specific parallel program (such as the FinMark Trust example referred to in section 5).

A further implication of the occasional divergence between business perceptions of BEE issues and BEE programs, is that BEE programs need to be designed with sufficient flexibility and appropriate incentives to ensure that they achieve outcomes that enable more pro-poor business. In other words, BEE programs need to avoid rigid project structures and milestones that may become irrelevant, and instead operate as flexible, results-oriented facilities.

ECF managers also need to remain alert to imminent changes in the BEE that might create pro-poor business opportunities. This implies maintaining close contact with the BEE agenda, whilst steering and stimulating businesses to consider how they might realise such opportunities. This could take the form of tasking ECF managers with funding market research studies, identifying frontier business models, and organising expert roundtables in specific sub-sectors to enhance the dialogue between business and public sector agencies, for example.

In conclusion, experience with ECFs to date and the recent AusAID fieldwork confirm that effective reforms to the business environment take time and are best achieved through specific BEE interventions. However, with appropriate design, ECFs can contribute and add significant value to these processes.

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Annex 1. Examples of ECF-funded projects

An FDCF project awarded the Kenyan Equity Bank (then Building Society) £277,550 to extend banking to isolated communities who previously had no access to financial services. The funds were used to purchase vehicles and develop systems to support a mobile banking model. Using a laptop and GSM technology, 18 mobile units travel to some of the most remote villages in Kenya, allowing customers to deposit, withdraw and borrow money. The mobile units have proved to be financially sustainable, while demand in several villages has been high enough to support the opening of full bank branches. The grant accelerated the bank's outreach efforts. Once the risk was taken, the bank discovered unanticipated benefits, such as servicing all the centres on route to the most remote village thus maximising the utilisation of the vehicle and staff.

In India, FDCF provided £729,285 to ITC, one of India's largest private companies, to deliver a range of insurance products. ITC had previously established an eChoupal (Choupal being Hindi for meeting place) for small farmers, via installation of a computer terminal and internet connection in one home in each of many small villages. This online meeting place allowed small farmers to access information about the current market price for soybeans and other produce, and exchange news and information. The FDCF grant allowed ITC to use this delivery mechanism to deliver affordable life insurance and savings schemes to poor farmers, while also generating an additional income stream for the home owner in whose house the terminal is located.

In Uganda, a £1m grant from FDCF allowed DFCU, a well known east African financial institution, to offer, for the first time, affordable leasing finance to SMEs. Prior to the grant DFCU had focused on providing lease finance to large corporations, recognising that while there was demand from SMEs, servicing them would be too expensive given high transaction and servicing costs. The grant allowed DFCU to acquire the necessary physical, technical and human capacity to grow the business, with 341 leases being signed with SMEs over the first two years of operation, with only 1.5% of these subsequently falling into arrears.

In 2001, PIC awarded Alternativa Solidaria Chiapas (AlSol) US$50,000 to extend microfinance services to poor people in Chiapas, Mexico, to include insurance for burial services. In partnership with Zurich Insurance, AlSol offers US$1,000 of life coverage for a US$10 premium. Zurich processes insurance applications of groups of 125, while AlSol collects small weekly premiums from its clients. At the time the grant was awarded, AlSol was small, with just 1200 clients, and thus establishment of the relationship with Zurich would have been too costly without the grant.

The Toledo Cocoa Growers Association in Belize received a £225,000 grant from DIFD's BLCF to help expand cocoa production in Mayan communities to commercially viable levels. The grant was matched pound for pound by UK fair trade chocolate company Green and Black. The funds were used to plant new cocoa trees (following the 2003 hurricane), train staff and work towards self-sustainability for the farmers. The Association has now quadrupled the amount of cocoa supplied to Green and Black, attracting back many farmers who had abandoned the industry after the hurricane.

The BLCF awarded £450,000 to Wagtech, a Bangladesh company, to create a linkage with UK companies to facilitate the local assembly and production of appropriate level technology, low-cost, water testing kits for use in Bangladesh and West Bengal. Local customers including UNICEF are now being supplied with kits which enable the regular testing of water for arsenic and other contaminants.

A fruit project in South Africa used a £340,000 grant from the BLCF to support disadvantaged groups in the local fruit industry by establishing an export label (the fair trade brand 'Thandi') and associated infrastructure to lift revenues, enhance viability and accelerate land transformation in South Africa. Export volumes have well exceeded targets, while the 1 Rand per carton Thandi premium is financing expansion of a community centre.

In 2002, Mocit, a new business established by the Negrao family, who had been one of Mozambique's largest fruit exporters prior to independence, received £123,400 in grant funding from the BLCF to purchase two large but abandoned state citrus plantations and produce export quality oranges and grapefruits. By 2004 the plantations were employing 250 workers and generating in excess of 30,000 cartons for export every year. At the same time, some funds are used to fund local NGOs in constructing schools, and HIV/Aids and malaria education. A mid term review of the BLCF program indicated that while the Wagtech, Thandi and Mocit projects may have proceeded without funding, the grants enabled them to take more risks and take decisions more quickly than would have otherwise occurred.

1) A BLCF-funded partnership between large companies and associations of small-holders in the Great Lakes region of Agrica provided pre-treated seeds and other inputs to registered farmers resulting in cotton production almost tripling for 180,000 farmers.

Annex 2. Potential Impact of an ECF on the Business Enabling Environment in Papua New Guinea

An ECF in PNG may play some role in improving the business enabling environment (BEE) but this is likely to revolve around infrastructure. Positive impacts in other areas would be more indirect and rely on the demonstration of regulatory and procedural blockages to proposed and supported business projects.

In terms of the main weaknesses in the BEE in PNG the impact of an ECF program could be summarised as follows:

Legal/regulatory framework: demonstration of negative impact of cumbersome and non-transparent land property registration procedures.
Import and export procedures: demonstration of their shortcomings and the impact on costs and business efficiency
Weak supporting government institutions: likely to clearly demonstrate the substantial shortcomings at both the central and provincial government levels and how some private sector projects can more effectively address economic development. Some projects in rural areas would fulfill the gap caused by the almost non-existent government extension services to agricultural suppliers.
Weak business culture: successful projects are likely to be positive role models in an environment where these have been scarce. Inclusion of rural communities into the cash economy would have a positive impact on the business culture in a particular region.
Shortage of skilled and experienced workers: new sizeable projects would incorporate skills training and transfer.
Poor infrastructure: some ECF projects would demonstrate means of circumventing these fundamental shortcomings and/or provide supplementary facilities (although in most cases the reach of such facilities is likely to be limited). Possibility of projects that address the telecommunications shortcomings and relatively high costs.
Law and order: experience has shown that when local communities feel they are genuine partners in a business project there will be considerable pressure to reduce lawlessness but this endemic problem requires broader government and community action.

Source: Interim Field Report. John Hardin, November 2006.