AusAID

Enterprise Challenge Fund for the Pacific and South-East Asia

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Exchange Rates and List of Acronyms

Currency Equivalents

1 Australian Dollar (AU$) = 0.78 US Dollar (US$)
1 AU$ = 0.41 British Pounds (GBP)

Acronyms and Abbreviations

ADB	Asian Development Bank
AU$	Australian Dollar
BEE	Business Enabling Environment
BLCF	Business Linkages Challenge Fund
BOP	Base of the (Economic) Pyramid
CBA	Costs-Benefits Analysis
CN	Concept Note
DFID	(UK) Department for International Development
ECF	Enterprise Challenge Fund
FDCF	Financial Deepening Challenge Fund
FinMark	Financial Markets for the Poor
GBP	British Pound
IFC	International Finance Corporation
MDG	Millennium Development Goal
M&E	Monitoring & Evaluation
MMW4P	Making Markets Work for the Poor
MNE	Multi-national Enterprise
PDR	People's Democratic Republic
PEPP	Private Enterprise Partnerships Program
PPB	Pro-poor Business
PSD	Private Sector Development
RAMSI	Regional Assistance Mission to the Solomon Islands
SME	Small and Medium Scale Enterprise
UN	United Nations
UNDP	United Nations Development Programme
US$	US Dollar
WBCSD	World Business Council for Sustainable Development

1 Executive Summary

1 As reflected in the recent White Paper, AusAID is committed to finding effective ways to enhance the contribution of Private Sector Development to poverty reduction in its countries of operation. In addition to its work to improve the enabling environment, the recent White Paper on aid commits the organization to partnerships with the private sector to promote pro-poor private sector development.

2 The UK Department for International Development has had similar objectives and recognised the potential for actively engaging with the international private sector to significantly increase the volume of resources allocated to poverty reduction. In particular it sought to take advantage of an apparent increasing interest in commercial opportunity in low income markets, and to maximise sustainable impact through finding coincidence of interest between profit making and poverty reduction. To this end Enterprise Challenge Funds (ECFs) were adapted to the international development context, and applied in a way that ensured open and fair opportunity for the private sector to win cost sharing grants that would help them implement commercially viable projects that would deliver benefits to the poor, but that would only be able to reach sustainability with the help of some (up to 50 percent) subsidy.

3 These challenge funds have generally been perceived to be effective aid instruments, and an innovative way of accelerating pro-poor growth. AusAID identified the tool as a potentially useful way of responding to its White Paper commitments and commissioned a feasibility study to verify the extent to which it could be expected to deliver required impacts in selected countries in the Pacific (Fiji, Papua New Guinea, Solomon Islands and Vanuatu) and some of the lagging countries in Asia (Cambodia, eastern Indonesia, Lao PDR and southern Philippines).

4 The feasibility study, which has been comprehensively documented, has identified a very definite opportunity for such a challenge fund in these regions, with varying levels of demand and likely impact in the different countries. The field work included interviews with 86 companies and five business associations across Asia and the Pacific. Of these, 75 (or 82 percent) agreed with the view that pro-poor business offers real commercial opportunities for companies and a further 14 (or 15 percent) were undecided. Specifically pro-poor profit-oriented companies tended to be large and/or foreign-owned with distinct pro-poor offerings such as the ANZ Bank, or those with products specifically designed for less accessible markets.

5 Over 75 percent of companies interviewed in the Pacific thought the ECF would be an effective risk-sharing mechanism, with the balance undecided; in Asia 51 percent of companies thought it would be effective, with 40 percent undecided. A total of 69 projects were identified during the field work, analysis of which tentatively suggests that every AU$100,000 distributed through the ECF should directly benefit around 800 poor people. Many of the projects addressed different ways of getting the poorest connected into the cash economy by giving them a market for the natural resource assets (agricultural produce, timber, fish) they already possess or could easily grow, harvest or catch. Such projects thus tend to focus on creating new sales for companies through these added resource inputs, as opposed to lowering production costs. (Several in biofuels also had positive environmental impacts.) There was also considerable interest in offering banking or renewable energy services to remote or rural communities. These

projects offer the prospect of substantial systemic/multiplier impacts, given that the distribution methods that are used to bring people into the cash economy can then be used to supply them with other goods and services, or similarly transport out other products. In many projects it is this transport, distribution or supply chain "link" that an ECF will be used to partially fund.

6 The sectors offering the most potential for positively impacting the lives of the poorest were thus identified as those in natural resources such as agriculture, forestry and fishing, with linkages through into transport, distribution, renewable energy, banking and telecommunications — the latter particularly in Cambodia and the Philippines given extensive mobile phone infrastructure. Whilst some countries exhibit higher absorptive capacity than others all demonstrated a capacity to use grants in innovative ways that could potentially bring benefits to very high numbers of poor people. In addition to a high degree of private sector interest the study also identified considerable enthusiasm amongst the donor community, many expressing interest in varying levels of collaboration should the scheme be launched.

7 By combining the findings of the feasibility study with lessons from the implementation of challenge funds elsewhere it has been concluded that there is a sound rationale for launching an ECF in the Pacific and poorer parts of Asia. Given the demand assessment it is recommended that AusAID assign AU$20 million to a Pilot covering all eight countries over a period of six years. To make the launch manageable it is recommended that the scheme first be introduced to eastern Indonesia, southern Philippines, Fiji and Papua New Guinea, one full bidding round being operated to enable fine tuning before rolling out to the remaining countries. Given budgetary approval in early 2007 the aim should be to mobilise a fund manager in July 2007, for a high profile launch of the ECF around October 2007.

8 Feasibility confirmed the necessity of outsourcing the management to a qualified private contractor, as per previously established practice. Given that the basic challenge fund mechanism has been proven in the field, procurement of a highly effective fund manager is generally viewed as critical to the success of the fund. It is recommended that the fee available for the manager should include a significant pay for performance element.

9 Whilst building on the practical experience of previous ECFs some fine-tuning of the basic business model is recommended. In general the manager should seek to operate with a light touch, and help to facilitate high impact ideas within the market. To maximise impact these efforts should refer to value chain studies and assessments of the business enabling environment in the target countries, so that the fund manager can, whenever appropriate, guide ideas so that they both harness the main commercial opportunities and deliver the highest development impact, in particular by bringing about systemic improvement in the conditions for pro-poor business. This level of targeting is an evolution of the generic challenge fund approach, and it is recommended that pay for performance be used to incentivise this type of behaviour. It should also encourage the fund manager to operate so as to promote enhanced coordination of donor-related private sector development activities in both regions.

10 The feasibility work has also highlighted inadequacies in current abilities to accurately measure the impact of pro-poor business projects, particularly in terms of the secondary impacts that often accrue and that may offer the highest development gains. It is recommended that the AusAID ECF pay particular attention to benefit measurement, including through the application of cost-benefit analysis on a sample of projects, which should then help better predict impact at an aggregated level. Amongst other things this should help AusAID prove the concept and use this pilot to encourage other donors to invest in a larger-scale ECF that helps further accelerate poverty reduction through private sector investment in the Pacific and Asia.

1 Introduction

Critical Issues in Private Sector Development

The Evolution of Donor Approaches to Private Sector Development (PSD)

11 Many in the development community have for some time been convinced that support to the private sector was a necessary part of the fight against poverty. In particular the 1990s witnessed a growing emphasis on the development of small and medium enterprises (SMEs), this part of the economy increasingly being viewed as that which could most easily link economic growth to direct benefits for the poor. Thus SME development became a mainstay of many PSD programs, the early focus being on the creation of the types of enterprise support networks that had become increasingly prevalent in the West. The belief was that this approach would enable donors to create opportunities for the disadvantaged majorities in developing countries, the expectation being that the SME sector would generate the necessary high volume of job creation.

12 The rationale behind this approach is clear, and there remains a strong belief within donors that the SME sector has to be a critical part of pro-poor private sector development. Unfortunately past efforts to stimulate SME development have generally failed to work at anything like significant scale, and have exhausted public sector funding before bringing about the hoped for benefits. This is not to say that there have not been success stories – but unfortunately these have generally remained small scale and localised. The common problem has been that nascent SMEs in developing countries have generally been unable or unwilling to pay for the kind of information and advisory services that many desperately require, so the support networks that donors have helped establish have fallen apart once external subsidy is removed.

13 A more recent focus on the Business Enabling Environment (BEE) was a key part of the response to this. Spending time and resources working with governments - to help them better understand what kinds of legal and regulatory frameworks would foster a flourishing private sector - were seen to be a more cost effective way of bringing about the large-scale impact that is required. Remove the – undoubtedly substantial – impediments, and enterprise would take over. By helping to create a level playing field for business, donors would achieve the broad-based impact that they strive for, without having to favour any one firm over another.

14 Again the rationale behind this approach is obvious, there being clear evidence that unsympathetic government policy was stifling enterprise in many parts of the world. There are also clear signs that this focus on institutional factors is helping to stimulate pro-poor economic growth in many developing countries. However, in some countries progress has been obstructed by an inability to bring about the essential changes in behaviour within recipient governments. More generally there is concern that, whilst improvements in the BEE are evident, these have not always brought about the necessary flows of pro-poor commercial investment demanded by the Millennium Development Goals (MDGs). On the whole, developing countries continue to be characterised by failing markets, and the poor – deprived of access to goods, services and income earning opportunities – are the ones suffering most.

Mobilising the Necessary Resources

15 Therefore, while BEE work is likely to remain the mainstay of donor involvement in PSD, there seems to also be a need for instruments designed specifically to bring about the necessary large-scale mobilisation of resources. This is reflected in approaches often referred to as "Making Markets work for the Poor" (MMW4P). Central to these is the removal of impediments – which could be lack of vital resources such as information, skills or infrastructure – that are preventing businesses pursuing productive (profitable) endeavour that in some way meet the needs of the poor. Under this paradigm the donor becomes a catalyst for change, identifying key market failures and then working with the various players – government, business and civil society – active in and able to transform the way that the market works at the base of the economic pyramid (BOP).

16 An example of this development approach is the "FinMark" program, which has been devised to make financial markets work for the poor in Southern Africa. A key feature of this has been the use of detailed market research designed to help financial service providers more easily identify the commercial opportunities open to them. This approach has been extremely successful in stimulating increased commercial resources to respond to the financial services needs of the poor and is a pioneering example of the power of information in BOP market development. However, this approach has had noticeably less impact in those southern African countries with the most under-resourced private sectors. The implication is that, whilst a critical element of MMW4P, the provision of information by itself may not be sufficient to catalyse the desired flows of pro-poor private sector investment, and that donors may have to directly invest public sector resources to stimulate the appropriate private sector response.

17 Such an approach would appear to have potential, as there is evidence of increasing interest in commercial opportunities in the BOP within the private sector, including amongst international firms and multi-national enterprises (MNEs). Over the past five years many companies have become involved, individually and/or through such organisations as the World Business Council for Sustainable Development (WBCSD), in researching ways of profitably working in low income markets. Whilst the actual volume of investment in these markets remains small there are clear indications that this will grow, at least in part as a response to often stagnating conditions in established markets. There are now many examples of international business implementing projects in the BOP for profit-making reasons.

18 This suggests there is a major opportunity for donors to engage the international private sector in activities that will help contribute to poverty reduction. Of course, donors will not want to support projects that would have happened in any case, but they do have an interest in catalyzing projects that are economically viable and deliver benefits to the poor, and which would not happen without their intervention. Specifically, they have an interest in promoting such projects which, because of some sort of "market failure", can not proceed on a purely commercial basis. The source of the market failure can vary. There are many innovative projects that are unable to compete for finite investment resources because of their initially high risk profile. There are projects which face infrastructure constraints, yet which, due to the "public good" nature of infrastructure, cannot fully capture the benefits of the provision of the required infrastructure, and so will not proceed without some form of non-market intervention. While working with governments to address these market failures over the long-term, it also makes sense to promote private-sector solutions to them through private sector partnerships, and which can reinforce efforts being made at the level of the BEE.

19 Notionally, by encouraging the private sector to focus on and harness commercial opportunity in low income markets, it should be possible to leverage much greater volumes of investment in sustainable ways. However, to be able to justify using public money in this way, donors need instruments that:

- Create open, fair and inclusive opportunity for all;
- Ensure that any funds allocated do bring about the desired impacts, and are not captured for predominately private gain; and
- Ensure that the public good benefits warrant the donor investment.

20 In response to this apparent opportunity, since 2000 the UK Department for International Development (DFID) has been using ECFs to help catalyse pro-poor private sector investment. In particular they established[1]:

- The Financial Deepening Challenge Fund (FDCF) to encourage increased private sector investment in financial services that better meet the needs of the poor; and
- The Business Linkages Challenge Fund (BLCF), to promote new business models that result in poverty reducing economic activity.

Key Features of Challenge Funds

21 Challenge funds define an objective, specify what types of organisation are eligible to compete for grants, and then publicise the scheme so that all eligible organisations have equal opportunity to apply. This helps avoid any accusation of "picking winners" or favouring particular organisations.

22 The objective set by the challenge fund in effect becomes the justification for using public funds in this way. To be able to win FDCF or BLCF grants bidders had to be able to:

- Demonstrate that their projects could, with the assistance of a grant, become commercially sustainable, thereby providing reason to believe that projects would continue after a grant had been spent;
- Demonstrate that there were impediments to the project (market failures) that would prevent it from starting on a purely commercial basis, and unless a grant were available; and
- Articulate – and as far as possibly quantify – the impacts that the project would have on the poor.

23 By rigorously applying the second and third conditions, these schemes could ensure that money was awarded only where there was the likelihood of clear public gain. Furthermore the competitive nature of a challenge fund – whereby all bidding is against fixed deadlines and proposals are compared against each other – encourages applicants to strive for the best possible ratio of public investment to development impact.

1 Information on both these challenge funds can be found at www.challengefunds.org.

24 Thus the challenge fund instrument has given donors like DFID the comfort they require to engage the private sector in their programs, confident that their money will be channelled in justifiable ways. What also became clear was that the challenge funds provided a supplementary route to influencing and improving the BEE. Many projects – often unpredictably – encountered BEE barriers to their successful implementation, and were therefore motivated to lobby for necessary changes. In a number of instances the project implementers and the ECF managers worked together to push for the required improvements. Indeed in India, as a result of such measures, the FDCF managers were requested by the Ministry of Finance to produce recommendations on ways that the BEE could be improved in the interest of pro-poor financial services. So in fact ECFs emerged as being more powerful instruments than had first been envisaged, and the potential for more rigorously integrating these in the PSD landscape became clear.

Assessment of Previous ECF Impact

25 The FDCF and BLCF have between them invested £30 million in grants awarded to around 110 pro-poor business (PPB) projects, which independent assessment panels felt offered sufficient developmental impact to merit the award of cost-sharing grants. These projects have leveraged a combined £90 million in private sector investments, and each project has been carefully managed to ensure that grants are gradually disbursed to projects that are implemented in compliance with the original proposals, or a mutually agreeable variant thereof.

26 The FDCF and BLCF have stimulated a broad array of market responses each with distinctive impact characteristics, and discerning patterns can therefore be difficult. Many of the projects are still being implemented, and so the full impact has not yet been reached. Even where projects are themselves complete, business activity has continued, and therefore further benefits are accruing (these might be thought of as multipliers). Indeed, it is quite possible that the indirect benefits from such projects are of greatly more significance than the direct ones originally predicted by the project sponsor. The highest impact projects are likely to be those that have secondary impacts through, for example, contributions to improvements in local infrastructure or building momentum for enhancements to the BEE.

27 However, efforts have been made to gauge specific types of impact. For example, an analysis of 25 BLCF projects[2] has calculated that the cost of direct job creation across these projects works out at AU$8,927. This indicates that AU$100,000 invested in challenge fund grants could be expected to produce a minimum level of benefit of 11 new direct jobs. However, data available for the project sample referred to suggest that the projects also between them helped create nearly 90,000 indirect jobs, at an average grant cost of AU$210. This being the case AU$100,000 invested in challenge fund grants might be expected to help generate approaching 490 (direct plus indirect) jobs at an average cost of just over AU$200.

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2 Because of difficulties with data collection the numbers on employment generation should be considered to be indicative only. More information on the methodology of analysis has been provided in Appendix A1. Key information sources are as follows: for job creation - Baker Kiggundu, "The Business Linkages Challenge Fund as a Private Sector Development Instrument", http://www.businesslinkageschallengefund.org/components/download.aspx?id=1d2e4f44-2332-4e55-b9cf-759bc5204382; for BLCF key statistics (including grant amounts, etc) - http://www.businesslinkageschallengefund.org/section_blcf.aspx?siteId=9035ead6-bbb5-48bd-8dc5-bbe195339 18b&sectionId=9c04a2bf-b514-47af-b7c4-290942836b64; for additional BLCF News and Links - http://www.businesslinkageschallengefund.org/section_blcf.aspx?siteId=9035ead6-bbb5-48bd-8dc5-bbe19533918b&sectionId=f37da5c6-bb51-4741-b522-26e41895fe0e.

28 This particular analysis of the BLCF is confined to just one type of beneficial impact that could be expected – and is evident – from ECFs. The secondary benefits that that might accrue from the projects – in terms of increased capacity and generally improved conditions for pro-poor business – might represent a far greater prize for donors.

29 Both the FDCF and the BLCF were launched at a time when the potential relationship between the instrument and pro-poor impacts were not fully understood and therefore it was not possible to establish measurement systems that reliably quantify the impact of these types of project. However, independent reviews of the schemes have highlighted and verified the economic rationale for ECFs, as described in Box 1.

Box 1: Economic Rationale for ECFs

- There are commercial opportunities in low income markets that, if successfully pursued, would also significantly contribute to the reduction of poverty.
- Business is increasingly interested in pursuing these opportunities and for largely commercial reasons.
- There are barriers to these opportunities, which prevent them being pursued on a commercial basis.
- Because of the public good nature of these barriers it would be legitimate to use public sector money to help remove the obstacles and enable the successful pursuit of commercial opportunity.
- Given an appropriate risk sharing mechanism, businesses will be prepared to commit their own resources to pursue these opportunities.
- By focusing public sector money on projects that deliver broad-based improvements in the conditions for doing business, donors are able to maximise the poverty reducing impact.

30 Reviews of ECFs have also concluded that, in all probability, projects would not have gone ahead in their actual form if a grant had not been available. Certainly there has been no obvious sign of any of the most significant projects that failed to win grants then being implemented, other than perhaps one which the FDCF assessment panel did not feel was appropriate to the scheme. In this regard it is informative to note the following conclusion from an Output-to-purpose Review conducted for the FDCF.

> "One question that is difficult to answer is whether firms that received support from FDCF would have gone ahead anyway. Of course, almost all recipients said that FDCF money was essential or at least important to their going ahead; or at least that they would have sought other donor sources if FDCF had not come through. Interestingly, the converse was also true: i.e. two failed bidders interviewed did not go ahead when they lost. However, closer analysis suggests two main versions of additionality: Catalysis: i.e. genuinely supported something which would not have happened; Acceleration: might have happened anyway in time but FDCF accelerated or boosted the process. We believe that both of these occurred amongst successful bidders."

AusAID ECF Rationale and Objectives

Rationale for the Proposed ECF

31 AusAID seeks to support economic growth leading to poverty reduction. AusAID's current support for PSD is primarily through a "Technical Assistance Approach", delivered directly or through multilateral agencies such as the ADB and IFC, primarily to promote improvements in the BEE, with some support to capacity development in particular firms or sectors.

32 While AusAID plans to continue to focus on BEE work, and this constitutes by far the largest part of the Agency's support for PSD, AusAID is also keen to identify ways in which it can enhance its contributions to poverty reduction through private sector partnerships, in particular using approaches that are additional/complementary to the work of other donors in the region.

Relevance to AusAID White Paper

33 These priorities are highlighted in the recent White Paper, which calls for a renewed emphasis on economic growth, and stresses both the importance of the private sector as the main source of growth and the need to strengthen partnerships with the private sector to promote and sustain development. It proposes the establishment of a pilot Asia-Pacific small and medium enterprise development program as part of a Rural and Business Development Initiative (see Initiative Box 4 on p. 40 of the White Paper) including support "for private-sector led enterprise development activities in Pacific island countries that have the potential for delivering strong returns".

Private Sector Development Framework

34 An ECF appears very consistent not only with the White Paper emphasis on further private sector development as a way to boost economic growth in lagging regions, but also with the existing suite of PSD initiatives currently funded by AusAID.

35 AusAID's main PSD funding occurs via support for BEE reform. For example, it has helped establish an Economic Reform Unit in the Solomons, to which a number of staff from Australian Treasury have been seconded, to help promote microeconomic reform in that country. AusAID also provides significant support for IFC and ADB programs. Through the IFC's Private Enterprise Partnerships Programs ("PEPP"), AusAID supports the growth and development of SMEs in the Pacific, southern Philippines and eastern Indonesia. This program has a broad aim of improving SME access to finance, and specific regional focuses such as tourism in the Pacific, and improving market opportunities in the Philippines. AusAID also provides significant funding to the ADB's Private Sector Development Initiative, which focuses on reform of the finance sector and state owned enterprises, and improvements in the BEE.

36 An ECF is complementary to these types of programs and offers a different way of engaging more directly with the private sector. Undoubtedly government-to-government work needs to continue and donors have established ways of pursuing this approach. The ECF presents the opportunity to simultaneously engage and change the behaviour of private enterprise, so that it becomes a willing partner in tackling poverty, by helping markets to work better for the poor.

37 Furthermore, unlike many current donor PSD programs, an ECF offers the potential to engage and partner with much larger corporations in order to generate wider systemic change

and substantial resource mobilisation. While SMEs are also eligible for ECF funding, their prime opportunity under an ECF may be to participate in, rather than to drive, major projects. In this way the ECF would respond to the White Paper's intent to support SME development.

38 Therefore there is a clear prima facie case for an AusAID-funded ECF in selected regions, given the close alignment of this instrument with current policies, and the potential complementarity to its broader program. A more rigorous analysis of the potential impact of an ECF would help to substantiate this belief and enable fine tuning of challenge fund techniques to meet the specific circumstances of the regions in which perceived need is greatest.

2 Assessing ECF Feasibility and Design

Methodology

39 A feasibility study was conducted during October and November 2006, comprising some desk research supplemented by field work[3]. A small team was engaged for the study, which was led by Bob Fitch, an experienced ECF practitioner. Other team members include Jeff Liew, Pro-poor Partnerships Specialist from the Suva-based United Nations Development Program's ('UNDP's') Pacific Sub-regional Centre, private sector development specialists John Hardin (covering the Pacific) and Trent Eddy (Asia), and Alwyn Chilver, Christine Groeger and Wendy Jones from the AusAID Advisory Group.

40 Field work was conducted in eight countries that AusAID had identified as being the most likely to be able to take advantage and/or most in need of an ECF. The field work comprised the following interviews.

Figure 1: Summary of Field Work Interviews

Country	Type of Organisation Interviews		
	Private Sector	Donor/Agencies	Government
Pacific Region			
Fiji	18		
Papua New Guinea	11	4	14
Solomon Islands	20	5	18
Vanuatu	6	4	
Asia			
Cambodia	9	1	0
Indonesia	7	6	1
Lao PDR	10	3	1
Philippines	10		1

41 Organisations were selected to provide a representative view of PSD requirements in each country. As far as possible priority was given to meetings with private enterprises, to ensure that clear insight into the likely business response was obtained. Standard templates were developed to guide and record the interviews. Given the limited time and resources available for the study the intention was not to attempt detailed market research and demand measurement. Rather the priority was to establish whether there would be adequate demand for the proposed facility, and whether this would result in projects likely to bring about high development impact. (While workshops were held with donors in the Philippines and Fiji, and with government in Fiji, individual responses could not be isolated thus they have not been included in interview numbers.)

3 A more detailed summary of the feasibility study and its findings can be obtained from the document, "Final Report, Feasibility Study for Enterprise Challenge Fund".

Tests of Feasibility

42 Feasibility was assessed by first outlining the rationale for the ECF, then identifying particular objectives, and finally by determining how to test each aspect of the rationale. Each aspect of the tests of feasibility is recorded below.

Rationale for the Proposed ECF

a) Markets in the Pacific and Asia are not working for the poor – that is, the poor have inadequate access to goods and services and quality jobs.

b) Business (domestic and international) believe these markets represent commercial opportunities.

c) There are barriers to these opportunities being pursued on a commercial basis.

d) Businesses believe that a risk sharing mechanism would help break down barriers and enable markets to work commercially.

e) Businesses believe that an ECF would be an effective risk sharing mechanism.

f) Donors believe that an ECF provides a legitimate basis for sharing private sector/commercial risk.

g) A properly implemented ECF would be expected to generate at least an equivalent level of impact to that achieved by previous equivalent schemes.

Objectives

i) Reduce poverty – increased number of poor and disadvantaged men and women with jobs, income, goods and services provided by commercially sustainable businesses.

ii) Raise awareness broadly across the private sector in the Pacific and poorer parts of Asia of profit making opportunities in poor markets.

iii) Catalyse more commercial investment in poor markets.

iv) Help bring about sustainable change in corporate behaviour – an increased proportion of private sector resources gets allocated to pro-poor business for commercial reasons.

v) Improve conditions for profitable business in poor markets – in terms of more enabling rules and regulations, enhanced business-to-business services, improved infrastructure, and so forth.

vi) Add value to PSD activities in the region, leveraging the efforts of businesses to help advance broader improvements in the enabling environment.

Tests of Feasibility

Rationale Statements	How to Test Statements
a) Markets in Pacific and Asia are not working for poor women and men – inadequate access to	• Refer to available (particularly sex disaggregated) research

Rationale Statements	How to Test Statements
good and services and quality jobs	• MFP reports Cambodia & Lao
b) Business (domestic and international) believe these markets represent commercial opportunities	• Primary - interview businesses • Secondary – media report, other reports
c) There are barriers to these opportunities being pursued on a commercial basis	• Primary – interview businesses • Secondary - BEE, cost of doing businesses, telecom and transport studies
d) Businesses believe that a risk sharing mechanism would help break down barriers and enable markets to work commercially	• Primary - interview businesses
e) Business believe that an ECF would be an effective risk sharing mechanism	• Primary – elicit opinions on key features including fixed deadlines, matching grants, competition, donor monitoring, linking to the broader business environment, and deal size
f) Donors believe that an ECF provides a legitimate basis for sharing private sector/ commercial risk	• Primary – AusAID to consult with donors at high level • Consult with donors at country level
g) A properly implemented ECF would be expected to generate at least an equivalent level of impact to that achieved by previous equivalent schemes	• Determine proportion of sample in feasibility study interested in pro-poor business, and categorise by type/deal size • Extrapolate to likely number of successful applications by type • Use FDCF/BLCF track record to determine likely number of beneficiaries by type/size of project • Estimate total number of projected beneficiaries

Consultative Processes

43 An ECF is a relatively unfamiliar instrument for donors and therefore particular care needs to be taken in assessing its feasibility and proposing an appropriate design. To this end the feasibility work has adopted broad-based consultation, in particular to canvass views on how to most effectively measure the performance of any proposed scheme.

Conclusions from Field Work

44 The field work included interviews with 86 companies and five business associations across Asia and the Pacific. Key statistics from this research have been summarised in Figure 2. Given the small size of the samples the statistics provided are not intended to be precise measures of the study findings; rather they are provided as indicators that help discern relevant patterns.

45 There was a broad consensus among companies that pro-poor business presents commercial opportunities, but that there are barriers to undertaking this type of business. There was less uniformity in views about the specific barriers to pro-poor business, and whether an ECF would be effective in helping companies overcome them.

46 Of the 86 companies and five business associations interviewed, 75 (or 82 percent) agreed with the view that pro-poor business offers real commercial opportunities for companies and a further 14 (or 15 percent) were undecided. Specifically pro-poor profit-oriented companies

tended to be large and/or foreign-owned with distinct pro-poor offerings such as the ANZ Bank, or those with products specifically designed for less accessible markets. There were also companies with employment or supply chain involvement of the poor but where motivation was only partially for profit, such as resource companies with commercial activities around mine sites. Many SMEs are also pro-poor by default, due to geography or location.

Figure 2: Summary of Key Findings from Field Work

Issue/Country	No. of Responses	Agree	Maybe	Disagree	% Agree	% Maybe	% Disagree
PPB represents commercial opportunities							
PNG	11	7	4	0	64	36	0
Solomons	20	14	6	0	70	30	0
Vanuatu	6	6	0	0	100	0	0
Fiji	18	18	0	0	100	0	0
Lao	10	7	2	1	70	20	10
Indonesia	7	5	1	1	71	14	14
Cambodia	9	8	1	0	89	11	0
Philippines	10	10	0	0	100	0	0
Total - Pacific	55	45	10	0	82	18	0
Total - Asia	36	30	4	2	83	11	6
Total	**91**	**75**	**14**	**2**	**82**	**15**	**2**
There are barriers to PPB							
PNG	11	11	0	0	100	0	0
Solomons	20	20	0	0	100	0	0
Vanuatu	6	6	0	0	100	0	0
Fiji	18	18	0	0	100	0	0
Lao	10	9	0	1	90	0	10
Indonesia	7	7	0	0	100	0	0
Cambodia	9	9	0	0	100	0	0
Philippines	10	10	0	0	100	0	0
Total - Pacific	55	55	0	0	100	0	0
Total - Asia	36	35	0	1	97	0	3
Total	**91**	**90**	**0**	**1**	**99**	**0**	**1**
ECF would be an effective risk sharing mechanism							
PNG	11	4	7	0	36	64	0
Solomons	20	18	2	0	90	10	0
Vanuatu	6	2	4	0	33	67	0
Fiji	18	18	0	0	100	0	0
Lao	10	5	2	3	50	20	30
Indonesia	7	3	4	0	43	57	0
Cambodia	8	6	2	0	75	25	0
Philippines	10	4	6	0	40	60	0
Total - Pacific	55	42	13	0	76	24	0
Total - Asia	35	18	14	3	51	40	9
Total	**90**	**60**	**27**	**3**	**67**	**30**	**3**
Donors believe ECF is a legitimate risk sharing mechanism							
PNG	4	2	2	0	50	50	0
Solomons	5	5	0	0	100	0	0
Vanuatu	4	0	4	0	0	100	0
Fiji	0						
Lao	3	2	1	0	67	33	0
Indonesia	6	5	1	0	83	17	0
Cambodia	2	0	2	0	0	100	0
Philippines	0						
Total - Pacific	13	7	6	0	54	46	0
Total - Asia	11	7	4	0	64	36	0
Total	24	14	10	0	58	42	0

47 Only two companies disagreed with the statement that pro-poor business offered commercial opportunities. One conceded their thinking to date had been dominated by viewing pro-poor activities as simply community development, while the other viewed the poor as lacking the cash required to pay for (its telecommunications) services. This latter company was also the only one which disagreed with the statement that there are barriers to pro-poor business. Every other company strongly agreed with the statement.

48 Companies gave a wide range of responses when asked to describe the types of barriers which stop them from pursuing pro-poor business opportunities. Finance was a significant barrier everywhere, with over 70 percent of companies in both the Pacific and Asia naming it as a major barrier. For many countries this reflected an inability to borrow against land either due to customary land ownership or uncertain or non-existent land titling, as well as serious law and order issues in countries like PNG and the Solomon's which have led banks to adopt understandably risk averse lending practices. The widespread citing of finance as a barrier may also reflect the fact that 63 percent of interviewed companies were classified as SMEs.

49 In the Pacific, virtually every company cited weak or non-existent transport and/or infrastructure as the most important barriers to pro-poor business. While these were occasionally mentioned in Asia, companies were more likely to cite the lack of a well educated workforce, poor market information and BEE issues such as excessive bureaucracy and over-regulation. In the latter case this often added to physical transport difficulties. For example in the Lao PDR, inter-provincial freight has to satisfy extensive loading and unloading requirements, and undergo customs inspection at both ends of a journey. In all the surveyed markets, these barriers hinder the establishment of wholesalers or supply chain intermediaries to provide cost-effective consolidation, consistent supply volumes and transport services. This leads, among other things, to the widespread (more expensive but reliable) importation of agricultural produce at the expense of local produce.

50 The differing importance of barriers by region was reflected in different levels of support being expressed for an ECF as an effective risk-sharing mechanism. Over 75 percent of Pacific companies thought it would be an effective mechanism, with the balance undecided. These companies viewed the cash grant as a way of partially overcoming the lack of bank finance, with many intending to use a grant to overcome transport and infrastructure shortcomings. By contrast, only 51 percent of companies in Asia thought an ECF would be an effective mechanism, with 40 percent undecided and nine percent (which comprised three large companies in the Lao PDR) believing it would be ineffective. This is unsurprising given that, while an ECF may help overcome a lack of market information, it does not directly address BEE issues and may not be the most potent instrument in addressing workforce skills.

51 The majority of donors in both regions expressed the view that an ECF would be an effective mechanism, with the remainder undecided. Not one donor expressed the view that an ECF would be ineffective and all supported the introduction of a pilot scheme in the first instance.

Demand Characteristics by Country

52 Specific findings from individual countries are considered below. While the indicated levels of demand are only estimates, and whilst taking care in interpreting findings from disproportionate samples, they do suggest that Asia may generate five to six times the number of competitive proposals that emerge from the Pacific. While this is perhaps not surprising given the relative size of the economies and populations in the Asian areas compared to the Pacific, the tendency apparent in the research findings for Asian companies to view projects in stages (the

suggestion being that an ECF grant may be needed for each stage) may mean that in fact the numbers are misleading. If we assumed that every three "projects" cited actually equate to one ECF project then the difference may be cut to a factor of two. This might seem more realistic, and would in fact be more in line with experience from past ECFs (for example, the 12 countries participating in the FDCF only produced around 70 competitive proposals - that is, concepts that were converted into full applications - over the life of the Fund).

Pacific

- **Fiji.** This country is likely to generate the largest number of competitive proposals from the Pacific, with 15 to 20 anticipated over the three year period. This reflects the larger and more developed nature of the economy compared to many other Pacific countries, and the greater proportion of businesses which could satisfy ECF criteria and prepare solid business proposals. Proposals are expected to be quite diverse, mirroring Fiji's broader economy, and are likely to range from agricultural and horticultural projects to opportunities in tourism, small scale energy, rural banking and telecommunications.

- **Papua New Guinea.** While the difficult environment may limit the number of viable projects put forward, there is expected to be considerable interest in the ECF, with between 10 and 15 competitive projects over the three year period. The majority of demand is expected to come from existing companies who want to expand by accessing raw materials from more remote locations, but face considerable hurdles in doing so. While these projects may exhibit a high degree of risk, potentially including the purchase of assets such as planes and boats, the development benefits from linking remote smallholders currently without any cash income into markets should be considerable. There is also expected to be demand from companies wanting to deliver services such as banking, energy and communications into more remote locations.

- **Solomon Islands.** A number of entrepreneurs have demonstrated a desire to implement pro-poor projects and shown that they can maintain business operations through very difficult periods. This market is expected to generate around 10 competitive ECF proposals over the three year period. While a majority of demand is expected to come from companies seeking to expand raw material resource supplies from outer islands for processing, export, and/or conversion into biodiesel, broader demand is also anticipated from the business community wishing to re-establish ventures that were closed/ destroyed during the tension. This estimate of ECF demand is predicated on the continuing presence of the Regional Assistance Mission to the Solomon Islands (RAMSI) in the country—any early withdrawal may cut ECF demand dramatically.

- **Vanuatu.** There are expected to be seven or eight competitive ECF proposals from Vanuatu over the three year period. Projects are anticipated to mirror those in other Pacific countries, being centred around opportunities in agriculture, fisheries and tourism.

Asia

53 The estimates of demand summarised below include numbers of projects before allowing for grouping of related stages. Therefore these are not directly comparable to the numbers provided above for the Pacific.

- **Cambodia.** Around 60 competitive proposals are expected from this market. As well as anticipated proposals from agriculture and banking, rural energy and telecommunications are also expected to feature prominently, the latter exploiting the country's large build-out of mobile phone infrastructure.

- **Eastern Indonesia.** There is expected to be over 70 competitive ECF proposals from this area over the three year period, including those from large companies based in Jakarta and Surabaya. In line with its dispersed and relatively isolated island populations, proposals are likely to come from a broad range of sectors, including agriculture, tourism, the provision of services to mine sites, telecommunications, and affordable housing.

- **Lao PDR.** This market is expected to generate between 10 and 15 competitive proposals in the three year period. While projects are likely to address natural resource opportunities, and focus on overcoming market access and distribution problems, there are also likely to be projects in telecommunications, ecotourism and those seeking to support new mining ventures.

- **Southern Philippines.** This area is expected to generate the largest number of competitive proposals in Asia, with potentially 130 in the three year period. While demand is anticipated to be strongest from large companies in the agricultural sector, with proposals intending to address supply chain weaknesses, there is likely to be solid demand from companies wanting to develop banking, energy and telecommunications services.

Likely Applications of ECF Grants

54 A total of 69 project concepts were identified during the field work, of which 65 were sufficiently detailed to allow some form of assessment. There was general agreement among respondents that the poor lived in rural and remote locations, with the poorest being those most cut off from the cash economy. While lack of physical transport and infrastructure are key impediments to the poor getting products to market virtually everywhere, in Asian countries such as Cambodia and the Lao PDR, difficulties are compounded by excessive bureaucracy and regulation. Although social structures in many of these countries offer the poorest a security net that provides adequate food and shelter, they have no cash income to educate their children or provide even basic healthcare. Thus at the simplest level, ECF projects cannot address the poorest as they have little or no cash with which to purchase anything.

55 Many of the projects addressed different ways of getting the poorest connected into the cash economy by giving them a market for the natural resource assets (agricultural produce, timber, fish) they already possess or could easily grow, harvest or catch. Such projects thus tend to focus on creating new sales for companies through these added resource inputs, as opposed to lowering production costs. (Several in biofuels also had positive environmental impacts.) The systemic/multiplier impacts arise from the fact that the distribution methods that are used to bring people into the cash economy can then be used to supply them with other goods and services, or similarly transport out other products. In many projects it is this transport, distribution or supply chain "link" that an ECF will be used to partially fund.

56 The most common types of project ideas from the demand side were those offering banking or renewable energy services to remote or rural communities. These services in turn can have significant and hard to quantify multiplier effects, with small loans and power services opening up options for small scale processing.

57 The sectors offering the most potential for positively impacting the lives of the poorest were thus identified as those in natural resources such as agriculture, forestry and fishing, with linkages through into transport, distribution, renewable energy, banking and telecommunications — the latter particularly in Cambodia and the Philippines given extensive mobile phone infrastructure.

58 Only one (banking) project offering cross border opportunities was identified during the field work. This may reflect the fact that the majority of companies interviewed (with the exception of the banks, the miners and Coca Cola) operated within a single country, with management believing they lacked the necessary knowledge to operate internationally. A different picture may emerge if research was conducted into businesses domiciled in Australia or other more developed countries.

Anticipated Impact of the ECF

59 While the field work in Asia and the Pacific was undertaken by two separate consultants, their estimates of impact are very similar. For the Pacific, the fund cost per beneficiary is expected to be AU$123, while for Asia the estimate is AU$120. This implies that every AU$100,000 distributed through an ECF should directly benefit around 800 poor people. This compares to the indicator derived from the BLCF that suggested AUS100,000 should create in the order of 500 jobs. Whilst both figures can only be considered to be rough indicators and clearly beneficiaries and jobs are not direct equivalents, this does suggest that projected impact would be in line with other similar past experience.

60 The field work in fact identified significantly greater potential benefit from an ECF. Between 50 and 60 percent of identified projects in both regions were put forward by companies wanting to tap hitherto unavailable resources and reduce production costs and/or increase sales. These types of projects, which lift rural livelihoods by providing a market for natural resource assets (be they agricultural produce, timber or fish), would be expected to generate quite large numbers of indirect beneficiaries. Given average household size of say four to five persons, this implies a lowering of cost per beneficiary in these types of projects down to AU$27. For these types of projects AU$100,000 in grants should have in the order of 3,700 beneficiaries.

61 However, this may still be quite a conservative estimate. One project identified in the Solomon Islands, which seeks to produce biodiesel from coconut oil, would require an ECF grant of AU$500,000 and could potentially benefit over 100,000 people, implying a cost per beneficiary of only AU$5. As well as the low relative cost, this project would potentially benefit 20 percent of the country's population, give many people access to a cash income for the first time, and by collecting copra from islands outside Guadalcanal may help to stem the urban drift towards Honiara. Projects which give households access to a cash income will have beneficial secondary social impacts in terms of facilitating the payment of school fees and the ability to access medical services.

62 Many of the projects lifting rural livelihoods will provide the transport and/or infrastructure necessary to link smallholders into markets in some way. Once established, other goods and services (such as banking) can then be piggybacked onto this infrastructure. While impossible to estimate in advance, these secondary impacts may be considerable and will go some way towards generating a positive upward spiral in economic activity outside of the pure project benefit. If even partly successful in countries like PNG and the Solomon's, this upturn could, in part, help to stem urban drift by building up regional economies, stabilise law and order and reduce the costs associated with running other parts of the aid program.

Conclusions and Recommendations

63 The field work confirmed that there is significant demand for an ECF in both Asia and the Pacific. In total, the consultants estimate there could be as many as 278 competitive proposals emerging from Asia, and 45 projects in the Pacific, with the potential to absorb AU$65 million over a three year period. Note that these figures imply an average grant size of around AU$200,000, much lower than the actual AU$600,000 average grant size of specific projects identified in the field work. The difference between the implied overall grant size and that identified in the field work appears to the tendency of some larger companies to talk about projects in stages, for which each stage could receive an ECF grant. In addition the sample may well have included meetings with a higher proportion of smaller companies than may ultimately win grants, which would also tend to reduce the average grant size.

64 At this indicative level of demand, there is likely to be considerable competition given ECF disbursable funds of up to AU$20 million, as allowed for in the rationale for the feasibility study. While this should be viewed as positive, allowing the rationing of funds to the best projects and ideas, it needs to be carefully managed to ensure that companies do not feel discouraged (and thus do not apply) due to the relatively small amount of funding available. This appears to be a greater concern in the Pacific than in Asia.

65 While there is broader support for an ECF in the Pacific, (with 76 percent of interviewed companies supporting the idea against 51 percent in Asia), the consultants believe there is sufficient demand in Asia to warrant its inclusion in the ECF. Only nine percent of companies in Asia did not think an ECF would be an effective risk sharing mechanism, with the balance of companies not able to express a view one way or the other. It is felt that many of these "undecided" companies may become more positive once the ECF has been launched and they have become more familiar with the concept. Almost every company interviewed expressed a wish to be provided with examples of ECF type projects. While this can be problematic, potentially limiting the types of ideas considered, it may be essential in broadening support for the ECF in markets and sectors where companies do not initially feel it applicable.

3 Detailed Design Recommendations

Principles of Good ECF Design

66 Challenge funds enable the public sector to effectively engage with the private sector to achieve mutual objectives in open, fair and consistent ways. Challenge funds:

- Are demand driven and encourage the private sector to devise solutions to public sector objectives;
- Must be put in the public domain, to ensure that all eligible organisations have equal chance to compete for available funds;
- Rely on bidding against fixed deadlines to ensure processes are competitive;
- Require bidders to contribute their own resources to funded projects, as a way of maximising resource mobilisation and applicant commitment to success; and
- Depend on the capacity of the private sector for successful implementation of funded projects.

67 Reference to previous ECFs reveals the following lessons that are particularly relevant to the application of this instrument in developing economies.

- Proactive marketing is vital. One of the objectives of an ECF is to help change business behaviour. Therefore it would be unwise to expect the target market to be ready with workable project proposals. It will be necessary for a manager to actively solicit responses from businesses.
- Indeed the manager should operate as a facilitator of ideas, including by helping to put potential partners/collaborators in contact with each other. Therefore managers must have very clear understanding of the markets in which they operate.
- Whilst being willing to act as a facilitator of ideas the fund manager must be clear not to lead applicants into areas to which they might not be fully committed. It is essential that applications are the work of the bidding consortium, as this will maximise their commitment to successful implementation. Given that the grantee will be providing the majority of the project's resources it is reasonable to expect that the applicant will be determined to retain control over the proposal at all times.
- Because managers are actively engaged with applicants they should have no formal role in deciding on the award of funds. Decision making should be undertaken by an independent Assessment Panel, to which the managers act as secretariat.

- Decision making is a highly judgemental process. While training and guidance can be provided to improve the effectiveness of a Panel, ultimately the effectiveness of ECF decision making is dependent on the involvement of highly capable and committed practitioners.

- Recognising the pressures that can be exerted on decision making bodies, participation in Assessment Panels should be kept anonymous.

- Typically there is a significant time-lag (in exceptional circumstances of up to a year) between a grant being awarded and the respective project commencing. This is particularly the case where projects rely on new and/or complex partnerships.

68 These principles have been carried into the design of the AusAID ECF, with the details adapted in light of the findings from the feasibility study. The ECF should pay attention to ensuring women, as well as men, are able to benefit. Women in the Asia Pacific region do much of the productive work, but are often excluded from markets due to strict gender roles, lack of education and resources and ongoing discrimination. Research shows that delivering the benefits of development to women also benefits the lives of children, so gender inclusive development is particularly pro-poor.[4] Gender equality is an overarching principle of the Australian Government's White Paper and is a central consideration in all development work. Care will be taken to ensure that the process is gender sensitive by careful engagement with potential bidders, requiring proposals to consider the effects on gender equality, including gender expertise in critical positions and measuring impacts of the program on male and female beneficiaries.

Structure and Scale of the ECF

Structure

69 The feasibility work has identified significant interest amongst some of the donors in working with AusAID on an ECF for the region. At a very minimum every donor spoken to expressed interest in one or more of the following:

- Helping advertise the ECF;

- Acting as a "spotter" by referring potential projects to the ECF manager; and

- Using their existing programs (such as small business training, microfinance programs, etc) to help underpin different parts of an ECF project, this representing a promising opportunity for AusAID to contribute to PSD coordination.

70 Beyond these forms of support, interest tended to be in either co-funding or with some degree of management involvement. The most significant interest identified is summarised in Figure 3.

Figure 3: Donors Indicating Highest Degree of Interest in Participating in an ECF

Donor	Interest in Co-funding	Interest in Management
NZAid	High, if pilot successful	Low

4 See, most recently, *State of the World's Children* UNICEF 2006 http://www.unicef.org/sowc07/docs/sowc07.pdf

Donor	Interest in Co-funding	Interest in Management
IFC	Medium, if pilot successful	High — view ECF as closely related to core business
UNDP	High, if pilot successful	High
GTZ	High (in Asia)	Low
USAID	High (in the Philippines)	Low
JICA	Medium (in Asia)	Low
EU	Medium-Low	Low, but very keen to liaise
Commonwealth Secretariat	Low	Low, but very keen to liaise
ADB	Not possible under charter	Low, but very keen to liaise

71 Broadly speaking the interest in co-funding tends to be something that might harden in the future and in the light of practical experience, whilst some of the interest in management is more immediate. Taking this into account it is recommended that the ECF be established with the potential to become a multi-donor fund, but something that AusAID can take forward itself initially. Primarily for this reason it is recommended that the project should in its entirety be considered to be a Pilot, to enable AusAID to rigorously test the utility of this donor instrument, in ways that satisfy the priorities set in the White Paper.

72 At the same time, and whilst likely more time-consuming and complex to establish, a multi-donor fund has the potential to be larger and more flexible than a stand alone AusAID fund, and may encourage better donor coordination in PSD. Therefore the Pilot should be specifically designed to create opportunities to leverage additional funding (internal and from other donors) to better meet the demand it identifies. This should have the added benefit of helping AusAID to establish a distinctive and value adding role in the context of PSD in the region. The implementation plan should therefore allow for potential up-scaling of the ECF should the Pilot establish a clear justification.

Scale

73 An ECF needs to be sufficiently large to generate good scale economies. This applies to the recommended Pilot, if this is to be an effective demonstrator of what is possible and a reliable lesson learning exercise.

74 Determining the appropriate scale of funding is difficult, as stated demand for a grant facility will always be high. As far as was reasonably possible the feasibility study did elicit information to help assess size of fund, the indication from the field work being that a total of in the range of AU$1-3 million could be effectively absorbed in any one country in an "average" year. Taking the middle figure this suggests that AU$2 million could be awarded in each of the eight countries, implying an annual requirement of AU$16million. If funding rounds were to be operated over three years then this implies a total funding requirement of AU$48 million for the ECF.

75 However, it is essential that a high degree of competition is applied to fund application process, to enable AusAID to confine support to projects that really will meet ECF objectives. To this end it is recommended that the total "demand" identified by the feasibility study be reduced by a factor of up to three, this suggesting that a fund in the region of AU$16-20 million would be optimal for the Pilot. To be conservative, the consultants suggest AU$16 million. The addition of management costs would be expected to bring the cost of the fund to AU$20 million to be disbursed over six years.

Organisation of Funds

76 These funds should be allocated to a central fund with no quotas across regions or countries, because it is important that an ECF have sufficient flexibility to allocate grants to the best business models wherever they happen to emerge at any given point in time.

77 Should a multi-donor fund emerge from the Pilot this could be created as a stand-alone entity (perhaps under a World Bank or UN Trust Fund arrangement), or located and managed within one of the funding donors. Under either scenario the principle of a single fund with no specific donor conditions or quotas attached should be retained. Otherwise there is a danger that the competitiveness and impact of the ECF will be undermined.

78 The main disadvantage of a multi-donor fund is the possible additional management overheads that may result. For example, there may be more administrative burdens if donors have different reporting requirements. Having said this, such additional overhead might be outweighed by advantages accruing from improved PSD coordination. Therefore the recommendation is that the Pilot be used to establish standardised ECF modalities and that, as far as possible, subsequent co-funders agree to comply with these as a condition of participation.

Scope

Grant Size

79 Using prior experience as an initial benchmark, the feasibility study was based on the proposition that ECF grants should range in size from a minimum of AU$100,000 to a maximum of AU$1.5 million. It was considered that this range would be wide enough to accommodate proposals from SMEs and MNEs. Very small grants could result in a large number of grants being awarded with associated high administration costs and potentially restricted scale and/or chances of systemic impact. Conversely, if grants were too large, an ECF could be fully absorbed by a few grants to large companies.

80 The recommended range does imply that companies asking for the smallest grants would need to commit to making a matching contribution (in cash or in-kind) of at least AU$100,000, which clearly represents quite a substantial commitment. However, the rationale is that lead applicants have to have the capacity necessary to design and manage substantial undertakings, so this minimum acts as an effective filter. Smaller companies still would obviously have the opportunity to participate in projects led by others.

81 This proposition was tested during feasibility and respondents were broadly in agreement with the suggested range. In particular:

- 74 companies (86 percent) agreed with the AU$100k to AU$1.5m range, whilst nine thought the minimum too high and three thought the maximum too low; and
- Total sum of grants specified in relation to projects suggested by respondents was just under AU$30m, with average size of circa AU$600,000.

82 Thus there is clear consensus supporting the suggested range of grant size. Whilst some interviewees expressed concern that the minimum would exclude the majority of SMEs seen to be so important to pro-poor development, in the opinion of the Consultants, these views tend to reflect a partial understanding of the distinctive nature of the ECF. Those that were most readily

able to identify the types of project that might appeal to a challenge fund were also comfortable with the proposed scale of grants. In light of this and the experience of previous ECFs, the Consultants have concluded that the recommended range of AU$100,000 to AU$1.5m is the one that should be applied at the launch of the ECF.

Environmental and Gender Focus

83 Environmental and gender issues are cornerstones of donor policy and it is clearly critical that the ECF can contribute in this context. Previous ECFs have tackled this by expressing an interest in positive impacts on environment and gender in the schemes' assessment criteria: therefore, all other things being equal, those projects that impact positively in these areas will be more competitive than those that do not. In this way applicants are always encouraged to look for any ways of bringing about these additional benefits, without compromising the fundamental principles of commercial sustainability and large-scale poverty impact. It is recommended that the ECF works on the same principles, and applies rigorous assessment techniques to ensure that gender and environmental impacts are clearly identified.

84 In accordance with Australian government policy the ECF will comply with the Environment Protection and Biodiversity Conservation Act 1999, the objectives of which are to:

- protect the environment;
- promote ecologically sustainable development;
- promote conservation of biodiversity;
- implement Australia's international environmental responsibilities; and
- properly assess and address activities likely to have significant impacts on the environment.

85 ECF eligibility criteria and assessment processes will ensure full compliance with this Act, which would require referral to the Minister for Environment before entering "into a contract, agreement or arrangement for the implementation of a project that has, will have or is likely to have a <u>significant negative</u> impact on the environment anywhere in the world".

Eligibility Criteria

86 ECFs are intended to create broad-based opportunity for business and a level playing field for all, and therefore eligibility criteria should be confined to those that are essential. At the same time there is the consideration of cost effectiveness of management, so it is important that ECF management resources be devoted to those projects that are of relevance to the scheme's objectives.

87 Therefore it is recommended that, to be eligible for ECF grants:

- Applications must be led by companies that are for-profit, and
- Proposals must be able to demonstrate that their ideas could not be funded on a normal commercial basis.

88 This should ensure that attention is focused on commercially driven projects that do not carry the risk of crowding out financial services markets. Demonstration that the proposals could not be funded commercially could be undertaken by evidence that commercial funding has been sought, but not obtained, or by evidence that this is not the sort of project that commercial sources should finance. It should be noted that experience with other ECFs suggest that in reality the risk of crowding out is very minimal, and that the sort of innovative solutions which ECFs support will not be picked up without external intervention.

89 Given the type of business environment that the ECF is being targeted at it is also recommended that lead applicants be able to provide two years of audited accounts, or at a minimum demonstrate that they are up-to-date with tax submissions. It is important that the ECF use these types of criteria to try to discourage interest from those organisations that might abuse or misappropriate funds. State-owned enterprises should not be eligible.

90 In addition it is recommended that, to be eligible for ECF grants, projects must:

- Contribute to improving the livelihoods and opportunities for poor men and women,
- Be willing to contribute at least 50 percent of required project resources,
- Be financially sustainable after the grant period ends,
- Avoid social damage, including exacerbating existing gender equities, and have no significant negative environmental impact,
- Not involve tobacco, alcohol, or gaming,
- Not conflict with AusAID's (and/or other donor's for a multi-fund) policy in the country in question, and
- Have a duration of up to three years.

Bidding Rounds

91 A critical aspect of an ECF is its competitive nature. Competition avoids the view developing that an ECF is simply another Government hand-out. It is recommended that ECF grants be offered in a series of bidding rounds held every six months. It is also recommended that the ECF adopt the classic two-stage process for bidding rounds, comprising Concept Notes and full applications. Concepts Notes should be brief and used as a way of screening out less competitive proposals. Full applications should enable detailed assessment of project ideas and effective award of funds, with applications being similar to commercial business plans.

92 Under normal circumstances bidding rounds are held sequentially, with one round completing before another begins. The field work did find that some respondents would prefer a higher frequency of bidding rounds. This could be accommodated, for example by adopting the approach the FDCF introduced in its later stages, whereby bidding rounds were commenced every three months, with each quarterly assessment considering Concept Notes as well as applications. In the view of the Consultants, the standard approach should be adequate at ECF launch and whilst the market is getting accustomed to the instrument, there being the option to accelerate bidding should this prove to be necessary. It should be remembered that there is an overhead related to the operation of bidding rounds, in particular in terms of the organisation of the necessary decision making body, so bidding should be confined to essential levels.

93 The amount of funding available should not be restricted in any particular round other than to not exceed the outstanding total of the fund.

94 Whilst competitiveness is an essential element of ECFs this does of course mean that there will be losers in every bidding round. The two-stage process has been designed specifically to minimise the amount of time that organisations need to devote to proposals that will not be competitive, and only those with genuine chances of winning should be asked to submit full applications. Nevertheless, some bidders will inevitably feel disappointed by ECF decisions and it is important that these reactions are carefully managed. Any ECF is likely to have a relatively limited base of potential customers and it is often the case that unsuccessful proposals could be refined to become very attractive ideas. Therefore ECF design must include effective ways of providing feedback to and encouraging positive responses from unsuccessful bidders.

95 To ensure equity, it is recommended that the ECF meet the costs of translating into English any applications (not Concept Notes) from bidders who felt disadvantaged by a requirement to produce documents other than in their mother tongue.

Sectoral Focus

96 Prior experience indicates it is very hard to determine upfront what form new business models are likely to take and the whole idea of an ECF is to encourage businesses to think in new ways to reach poor women and men. For this reason, an ECF should be open to all sectors. Many successful ECF projects that have implemented new business models have in fact spanned several industry sectors, such as banking and telecommunications.

97 While the ECF should be open to all pro-poor business ideas, it is recommended that the fund manager focus attention on sectors that have the potential to generate real systemic change (that is, they exhibit potential multiplier effects). The field work suggests that these sectors are likely to be those in natural resources such as agriculture, forestry and fishing, with linkages through into transport, distribution, renewable energy, banking and telecommunications. As noted, those that are gender sensitive will likely have better pro-poor outcomes. The relative importance of these or other business sectors will need to be reviewed by the Fund Manager, to ensure that primary sectors can be identified and promoted to the market, taking into consideration the different conditions in individual countries.

Geographical Focus

98 Based on the limited samples covered by the study the case for operating the ECF in the four selected Pacific countries would appear to be unequivocal. The same is not obviously the case in the Asian countries, although significant demand has been identified in this region also. Indeed, whilst a smaller proportion of companies in Asia have expressed definite interest, there is a higher level of absolute demand in this region overall. The concerns expressed in the Pacific regarding difficulty of competing with proposals in particular from Indonesia and the Philippines perhaps also testify to the potential of the private sector in Asia to put ECF grants to good use. The recommendation is therefore to launch and operate the ECF in all countries covered by the feasibility study.

99 However, recognising the practical difficulties that would be encountered if the ECF were to be launched in all eight countries simultaneously, it is also recommended that a first phase of 9-12 months is organised where the ECF is launched in two countries from each region, before the remaining countries are covered in the second phase. Based on the study findings, and in the

interest of maximising learning from the first phase, it is recommended that the ECF is initially launched in Fiji and Papua New Guinea in the Pacific, and eastern Indonesia and southern Philippines in Asia. This would enable testing in the larger scale markets with a variety of impediments to pro-poor business investment.

Business Enabling Environment Focus

100 It is not recommended that the ECF be specifically designed to attract projects primarily aimed at generating improvements in the BEE. Prior experience indicates that companies are understandably reluctant to finance at least 50 percent of projects where benefits will be shared disproportionately with competitors.

101 Nevertheless, donor and other initiatives designed to bring about beneficial changes in the BEE can be reinforced and supplemented by an ECF which can help companies exploit these changes and operationalise new business models. For example, a lessening of the identity requirements needed to open a bank account may pave the way for banks to offer rural services. While that service is now possible, in the absence of an ECF, banks may still judge the information gap created by uncertainty over demand as sufficiently high to not enter the market. An ECF can help a bank overcome this information gap and take advantage of beneficial legislative change.

102 Therefore, rather than try to directly support BEE initiatives, it is recommended that the ECF be designed so as to systematically reinforce improvements in the broader business environment in its countries of operation. This should be reflected in ECF assessment criteria, which should make it clear that, all other things being equal, preference will be given to projects that result in general improvements in the conditions for doing business.

103 Other than through the grant award process, experience suggests that the most effective/realistic way of achieving impact on the BEE is through the management body of an ECF becoming a recognised centre of excellence, which other initiatives will seek to both utilise and cooperate with. A prime example of this is the FinMark programme in Southern Africa, which has established itself as the leading authority on issues relating to the access of the poor to financial services in that region, to the extent that the private sector now funds annual research (FinScope) undertaken by the programme.

104 Having this kind of impact on the BEE would be entirely consistent with AusAID's overall approach to PSD and its desire to improve donor coordination in this area in its countries of operation. It is therefore recommended that the fund manager be required to act as an information repository in its countries of operation, using highly selective research to help the private sector identify the most compelling market opportunities. It is also recommended that the fund manager be required (and, as far as possible, properly incentivised) to ensure that all impacts from funded projects be used to promote improvements in the BEE to the greatest practical extent. In this way the ECF will maximise its sustainable impact. This will inevitably add to the costs of management but this is considered to be worthwhile and likely to be significantly outweighed by the greater impact that will result from the scheme when operated in this way.

Project Assessment Criteria

105 Assessment criteria should be clearly specified in the advertising for every bidding round. Criteria need to be flexible and broad enough to allow consideration of any worthwhile pro-poor

project. Given the critical issues identified above it is recommended that ECF grant decisions be based on:

- The improvement generated in the incomes and livelihoods of poor people including their access to products and services relative to the investment made by the ECF;
- The anticipated extent of capacity building in the local market;
- The extent to which a project helps a poor country to harness its natural resources and/ or comparative advantage on a sustainable basis;
- The extent of new private sector resources mobilised (that is, the leverage on the ECF grant);
- The extent to which the project shares appropriately the costs and benefits between the grantee and the other organisations participating in the project;
- The likely extent of social/developmental benefits proportionate to the projected commercial gain;
- The potential replicability (demonstration impact) of projects;
- The extent to which the proposal is able to demonstrate that it will benefit women as well as men and advance gender equality; and
- The potential for multiplier effects, including through positive impacts on the business enabling environment.

106 To ensure compliance with the Environmental Protection and Biodiversity Conservation Act 1999 applicants will be required to provide answers to the following five questions:

- Is the activity in an environmentally sensitive location?,
- Is there potential for the activity to have an impact on the environment?,
- Is the explicit, or implicit, aim of the activity to have a positive environmental impact?,
- Is the activity relevant to multilateral environmental agreements?, and
- Could the activity have significant negative environmental impacts?

107 The fund manager will be required to conduct due diligence on all applications to verify the information provided in the proposal, and in accordance with the AusAID environmental management guideline.

108 While there may be donor pressure to avoid giving grants to projects that exhibit a significant risk of failure, either commercially or in terms of pro-poor benefits, this must be balanced against the intended aim of encouraging innovation in new business models which may by nature be high risk. Even when projects fail to achieve their originally stated objectives, they can still have important demonstration effects and/or make it more likely that projects which follow will succeed.

Award of Grants

109 Assessment Panels will award grants to those eligible applications that they consider offer the potential for the highest development impact, taking into consideration geographical balance and any particular targets set for the fund (as reflected in fund manager arrangements). All decisions will be final with no right of appeal. The fund manager will communicate decisions to the applicants, including indicating how proposals could be made more appealing to the ECF should this be appropriate.

Management

Fund Manager

110 The findings from the field work have reinforced the key learning taken from previous ECFs, and emphasised the need for a manager that is very knowledgeable about pro-poor business, and that can act as a facilitator of ideas and proposals. Businesses spoken to were overwhelmingly in favour of working with a manager from the private sector, rather than directly with AusAID or another public body.

111 It is therefore recommended that the Fund Manager responsibilities be outsourced to a private sector contractor that will operate at arms length of AusAID, and be accountable to it. While AusAID will provide supervision and oversight, the manager will be responsible for:

- Developing and implementing a marketing and communications strategy, including for implementation in Australia and other developed countries,
- Conducting specific market research designed to help the private sector better understand and respond to the commercial opportunities that exist in low income markets, in areas offering the greatest potential for systemic change,
- Maintaining a detailed database of all contacts and correspondence with market actors,
- Guiding market actors on how to respond appropriately to calls for Concept Notes (CNs), including providing assistance in ensuring proposals are gender sensitive,
- Fostering appropriate linkages and partnerships between market players,
- Receiving and processing all CNs and presenting these to the bodies responsible for awarding grants (that is, the Assessment Panels) ,
- Acting as Secretariat to the Panels and helping them to operate effectively and efficiently,
- Informing applicants of the Panel's decisions on CNs,
- Guiding bidders on the preparation of full applications,
- Receiving and processing of all applications, including performance of basic due diligence,
- Preparation of application packages for the consideration of the Assessment Panels,
- Acting as Secretariat to the Panels and ensuring they have all the information required to determine which applications merit grants,
- Conducting and completing contract negotiations with successful applicants,
- Administering disbursement of funds to grantees and maintaining detailed records of how monies are utilised, as compared to agreed purpose,
- Maintaining data on performance of the Fund Manager, to measure management costs against its objectives,

- Conducting supervision of funded projects to ensure implementation remains in accordance with contracted purpose,
- Working with funded projects to identify links with and pursue associated improvements in the BEE, and
- Conducting monitoring and evaluation (M&E) of funded projects to assess their impact at an individual project and aggregated portfolio level.

The Fund Manager will be accountable in terms of:

- Making sure that the ECF is widely known about amongst its target markets, so that all eligible bidders have equal opportunity to take advantage of the scheme,
- Ensuring that the ECF operates transparently and according to publicised schedules,
- Generating a pipeline of projects sufficient to ensure real competition for the funds and the opportunity for all funds to be disbursed to deserving projects,
- Ensuring that contracts with grantees allow for adequate supervision and impact assessment, including for gender equality results, of funded projects,
- Linking individual funded projects into the broader PSD agenda in the countries/regions to maximise ECF impacts,
- Alerting donors at the earliest possible opportunity of any unsatisfactory grantee performance, and
- Providing regular progress reports on portfolio performance.

112 The Fund Manager will establish a geographical presence appropriate to ensuring that all eligible enterprises are afforded fair opportunity to interact with the ECF, whilst making adequate use of e-management and other modern communication facilities to optimise efficiency and cost effectiveness.

113 The Fund Manager, whilst operating with the objectivity and prudence normally expected of a financial service provider, will also adapt their methodologies to the distinctive nature of challenge funds, in particular working as a facilitator of new and innovative ideas. In this respect the application of sophisticated marketing techniques and activities will be critical.

Marketing

114 The first requirement of marketing is that it effectively puts knowledge of the ECF in the public domain, so that all eligible bidders have equal opportunity to access the facility. Having achieved this pre-requisite the manager should develop and implement targeted communication and marketing strategies, to enable it to inform the business community of the types of opportunities that exist in pro-poor markets, and to facilitate the generation of ideas and preparation of applications. It should seek to achieve this to help the development of ideas at a regional as well as a country level.

115 In the context of targeted marketing the fund manager must find the appropriate balance between effectively stimulating market responses on the one hand, and favouring particular businesses on the other. To safeguard against the latter the fund manager should endeavour to ensure that information on specific market opportunities is made generally available to relevant players, it then being legitimate for the managers to engage more substantively with those organisations that demonstrate the most interest. Given the standard ECF practice that fund managers are not involved in decisions on grant allocations they should legitimately help interested parties to develop their thinking, facilitate partnerships that might strengthen

proposals, and advise on the preparation of submissions. Such support should be equally available to parties that seem to have ideas of potential interest to the ECF.

116 Marketing should also recognise that the number of potential applicants is likely to be limited in any one market. With appropriate facilitation the weak ideas of today might become the pioneering projects of tomorrow. Feedback on failed concept notes and other ideas that are not taken forwards therefore forms a critical part of on-going marketing.

Achieving Relevance to the Business Enabling Environment

117 Whilst DFID's ECFs did have an impact on the BEE the approach to achieving this was not altogether systematic, and AusAID has the opportunity to learn from this experience to enhance the returns it gets on its investment. It is therefore recommended that, in each country of operation and for the sectors deemed to be of most significance, the ECF managers develop a list of the most significant legal and regulatory impediments to growth in pro-poor business (this would ideally be based on material such as the World Bank's Cost of Doing Business surveys, augmented by primary research where necessary). The fund manager should be tasked to elicit responses from the market that specifically address these prioritised issues; for example, their performance could be assessed on the number of approved projects that fit this requirement each bidding round. Given the potential leverage that AusAID may get on its investment from encouraging this type of application then it is recommended that consideration be given to including bonus payments to the manager where grants are awarded to projects that satisfy BEE requirements. These should be regularly reviewed with AusAID and modified by mutual agreement in order to ensure that they best reflect the evolving requirements of the scheme.

Emphasising Systemic and Behavioural Change

118 Similarly AusAID will maximise the return on its investment when projects have a systemic impact on markets – that is, they help bring about improvements in the general conditions for pro-poor business. It is therefore recommended that the following arrangements be built into the design.

- To inform the market of where prime opportunities exist, the managers should review the existence of studies into value chains relating to the sectors identified as offering the highest potential impact, to gain a better understanding of where the major blockages and/or growth points exist. Where information is deficient the managers should commission surveys to correct any gaps. All relevant information should be consolidated and publicised to reach the market segments to which it will be of most relevance. All research into opportunities to engage with communities, support economic activity and deliver better services to communities will be gender sensitive and all relevant data will be sex disaggregated.

- The managers should then actively consult those firms most likely to be able or motivated to pursue the opportunities which were identified by the market studies, and help facilitate the development of projects that will remove blockages in the value chains.

- The managers should then be required to make objective assessments of the secondary/ multiplier impacts for all projects for which applications are submitted.

- Guidelines should be developed for Assessment Panels that ensure appropriate weight is given to projects that help open up markets to increased pro-poor business and that are socially responsible, including producing positive gender equality results. Interpretation of assessment criteria will be a critical part of Assessment Panel training.

Project Supervision

119 All funded projects must be closely supervised, primarily to ensure that AusAID funds are being used in accordance with agreed purpose (that is, in compliance with contract). The grantee's contract should specify their reporting obligations, which should simplify supervision without placing undue administrative burden on the grantee. As far as possible this reporting should be based on management information that a business would normally be expected to gather, plus any specific impact measurements necessary to justification of public sector investment.

120 The fund manager's facilitative role might usefully extend into supporting funded projects, as its supervisory work may help identify problems and/or opportunities. Similarly the fund manager might, with the necessary permissions, share information across grantees, to help them in tackling the challenges they face, and "clustering" projects around common areas of interest, to help optimise ECF impact. They should also feed relevant market information to grantees as appropriate.

121 At the same time it is necessary to recognise that each project is to be implemented by the grantee and its partners, and any such implementation support should be limited to facilitation. Grants are awarded on the basis of the proposal received, and successful applicants should largely be left to their own devices when implementing projects.

Contract Management

122 Providing that the grantee is using funds according to agreed purpose then a project must be allowed to continue, even if legitimate concerns over prospects for success emerge over time. The grantee will have committed at least 50 percent of the resources and, therefore, must be allowed to continue with implementation should this be their decision. Of course, if failure seems probable, it might be expected that the grantee would be motivated to bring the initiative to an early close.

123 For this reason, effective supervision is particularly essential, as misuse of funds will need to be identified and acted on as early as possible. In all other circumstances the fund manager should be viewed by the grantee as an arms length adviser.

Relationships with AusAID Posts and Country Programs

124 The fund managers must ensure there is effective liaison with AusAID Country Offices at all times. Key to this liaison will be discussions on targeted marketing, so that this can take account of broader AusAID work in the country, as well as involvement of staff from at least some country offices in Assessment Panels. In particular Country Offices should have the opportunity to veto Concept Notes on the grounds of conflict of interest (once CNs had been approved then this right of veto would be ceded). The objective is that this liaison should be achieved without placing undue work load on Country Offices; at the same time Country Offices should have adequate visibility of the ECF to enable effective interaction.

Relationships with Donor PSD Activities

125 Through the combination of activities described above the ECF should create the potential to add substantial value to PSD programs in the region. Attempts to develop proposals that respond to deficiencies in the BEE will obviously create synergies with other initiatives focusing on these issues, and specifically commissioned research will help fill market information gaps, whilst financing of projects will also complement other investment initiatives. Therefore it could reasonably be expected that the ECF will contribute to PSD coordination through the processes designed into the management of the facility.

126 Again to ensure that these processes become rigorously pursued it is recommended that the following be built into the design.

- For each country the manager documents the main elements of all ongoing PSD initiatives and systematically connects all research and project concepts into these parallel activities, to ensure synergies are maximised.

- With the permission of applicants (recognising ownership of intellectual property), the details of unsuccessful applications be circulated to other donors that might be interested in supporting them.

Lesson Learning/Information Dissemination

127 An ECF, as well as being a catalyst, should have an influencing agenda. It should seek to raise the awareness amongst business of commercial opportunities in low income markets, and leave them keener to pursue such opportunities. It should also help inform governments of what kinds of steps it should take to unleash the potential of the private sector in the interests of growth and poverty reduction. Additionally it should seek to inform donors of the benefits that can accrue from the use of instruments such as challenge funds, and the opportunities for engaging the private sector in the interest of poverty reduction.

128 Lesson learning strategies should be developed and implemented to help achieve each of these specific influencing agenda. This requires that critical sex disaggregated baseline information be established at the outset, and that the fund managers gather data that helps determine the effectiveness of the ECF programme (that is, as a donor instrument), the individual projects that are funded, and the funded projects at an aggregated level (that is, in terms of returns on donor investment).

129 Particular attention should be paid to techniques for measuring the kind of secondary level impacts that are critical to reliable assessment of ECF costs-benefits. In particular it would be useful to: establish comparators that enable measurement of the “crowding-in” effect of funded projects (that is, the degree to which an ECF project leads to additional pro-poor business that would not otherwise have happened); and use market research to track changes in general business behaviour and decision making resulting from successes achieved by funded projects.

Governance

Governance of the Fund

130 The ECF will become a high profile AusAID program and therefore requires appropriate stewardship. Whilst it may not be in AusAID’s best interests to seek to have significant

involvement in ECF management it should ensure that it is properly engaged with its strategic development. Therefore a dedicated program manager should be appointed, who would devote part of their time to oversight and guidance of the fund manager. This might be significant – say up to 25 percent – of their time during initial launch, decreasing to perhaps one day per month once effective operations have been established. Throughout the life of the ECF this program manager should be supported by AusAID's Advisory Group, on an as required basis. Between them they should ensure that the ECF always benefits from:

- Well defined sectoral priorities,
- Clear performance targets for the fund manager,
- Regular assessment of fund manager performance, and
- Being championed within AusAID.

Assessment Panels: Configuration

131 It is recommended that the ECF has a dual Assessment Panel structure consisting of local (or what might be termed "regional") panels and one international panel. It is recommended that the local panels be given the authority to award grants of up to AU$200,000. For grants above this size the relevant local panel would conduct a full assessment in the usual way and would make recommendations to the international panel, which would then be responsible for the final funding decision.

132 Given the anticipated geographic coverage of the ECF, it is recommended that four local/regional panels be established, one each for:

- The Pacific,
- Eastern Indonesia;
- The southern Philippines, and
- Cambodia and the Lao PDR.

133 The international panel would be responsible for ensuring that the award of funds is geographically balanced, so that both regions benefit from the scheme. Any proposals involving activity in countries from more than one region would need to be referred to the International Panel for decisions.

Assessment Panels: Members

134 It is recommended that panels consist of members with an appropriate balance of commercial business experience, pro-poor development and donor work. Panels should typically comprise up to a maximum of 10 people (to allow for some redundancy). Providing this balance can be achieved, composition should reflect quality of people available rather than any particular desired configuration. Clearly it is important that gender balance and geographical representation be achieved, and experience points to the potential benefits of including people from regulators and similar industry bodies. AusAID should have the right to appoint a representative to sit on every Panel.

135 Candidates for Assessment Panels will be identified through market consultation, including by reference to donors, regulatory bodies, business associations, leading enterprises and NGOs. Identification of candidates would be coordinated by the managers who would make recommendations to AusAID. Final selection would rest with the AusAID project manager.

136 Experience elsewhere suggests that international panel members (who will presumably be predominately taken from the Australian community) will be prepared to work on a pro bono basis (all expenses to be covered), whilst local/regional panel members will require a basic honorarium to cover the time they allocate. Such costs will need to be included in budget projections.

137 Allowance will also need to be made for initial training of panel members (best practice indicates that a two-day course be allowed for at the outset, with one day of one-to-one training for any subsequent joiners). Priority areas to be covered by this training include identification of different types of pro-poor business impacts, assessment methodology, gender equality and probity. The latter should be provided by a specialist in probity matters, to ensure capacity building in these matters.

138 It is recommended that all panels be anonymous, so members can make decisions free from undue pressure. A strong chairman is essential to the performance of a Panel.

Reporting - Grantees

139 It is recommended that project reporting be undertaken on a quarterly basis. This is a reasonable compromise between the need for effective and transparent monitoring and accountability, and the imposition of unnecessary bureaucracy that may particularly deter significant parts of the private sector. Quarterly reporting should allow for problems to be picked up early and rectified. Since all the target countries operate on a December year end, standardisation of quarterly and annual reporting should be fairly easy to accomplish.

140 The contract drawn up between the fund manager and the company receiving a grant will specify how the company is to report and against which benchmarks the ECF grant will be disbursed. As well as reporting on commercial aspects of a project, companies will also have to specify how the project is proceeding against intended pro-poor outcomes. Failure to achieve benchmarks may result in a halt in ECF fund disbursements until a project is back on track.

Reporting – Fund Managers

141 Reporting from the fund managers to AusAID should also be conducted quarterly, to provide a detailed summary of the performance of funded projects against their contracted variables, and an up-to-date assessment of the overall impact of the portfolio, both in terms of the degree to which targets are being achieved and the absolute impact of the scheme. Particular assessments should be provided of the impact being achieved on the BEE, and the extent to which systemic impact is being achieved in the target countries.

Monitoring and Evaluation

142 It is recommended that the ECF be accompanied by an extensive and ongoing monitoring and evaluation program. It is recommended that this is undertaken by the fund manager, supported by an independent third party, the latter taking full responsibility for assessment of the performance of the fund manager as well as contributing to evaluation of the aggregated performance of the ECF. Given that an ECF is ultimately trying to generate long-term systemic change, there needs to be heavy and ongoing emphasis placed on monitoring, lesson learning and dissemination. Monitoring and evaluation will include measurement of gender equality results.

4 Arrangements for Implementation

Phasing

143 It is recommended that the ECF be initially launched in a sample of countries, to keep the management load at reasonable levels during start-up and allow for one clear bidding round during which policies and procedures can be fine-tuned. The proposed (pilot) ECF should comprise three continuous phases:

- Phase 1 (year 1): launch in two selected countries in each of Asia and the Pacific,
- Phase 2 (years 2 to 3): roll-out to the remaining selected countries in both regions, and
- Phase 3 (years 4 to 6): final monitoring and evaluation of funded initiatives.

144 The proposed phased nature of the project enables increased resources to be mobilised, once the instrument has been tested and fine-tuned. Given the proposal that projects awarded ECF grants should have a maximum life of three years, this implies that bidding cycles would be completed by the end of year 3, all subsequent activity being devoted to project monitoring and supervision, and lesson learning and dissemination.

145 This further implies that the majority of efforts to create a multi-donor initiative should be conducted during the first year of Phase 2, once practical experience had been gained from Phase 1 and allowing sufficient time to put together an operational scheme before the cessation of bidding at the end of year three. This would create additional resources to enable bidding to continue for a longer period, and without any break that might disturb the momentum created by the Pilot.

Establishing Fund Management Arrangements

146 Given the recommendation that management be outsourced, clearly these services will need to be procured ahead of the launch of the ECF. Given the relative novelty of the ECF instrument, inevitably experience in its management is fairly scarce. AusAID should use an open tender that is widely publicised, in order to attract relevant experience from the international market place. Clearly the performance of the fund manager will be central to the success of the ECF, and due attention must therefore be paid to the procurement process. The following guidelines should be applied in order to achieve the best value for money.

Key Skills Required

147 The results of the field work reinforce what has been learned from previous ECF implementations, and highlight the need for a manager with the following key skills and credentials:

- Intimate knowledge of the workings of markets in the target countries,
- Clear understanding of what makes business specifically pro-poor,
- Understanding of BEE and other issues impacting on local conditions for business,

- Excellent marketing and communication skills,
- Credibility with the private sector,
- Facilitation skills, and the ability to provide objective advice and guidance to potential applicants, and
- Analytical skills, to underpin effective project reviews and due diligence.

148 These market-facing skills must be supplemented by excellent administration and financial management skills. If the average grant size is around AU$650,000 as indicated by the field work, this implies that something in the order of 30 projects will need to be managed. Prior experience also suggests that 60-70 applications will be required to generate this volume of projects, and that 600-700 CNs will be required to generate this volume of applications. Clearly effective management of this volume of activities, in particular to simplify the task of the Assessment Panels, will require excellent administrative skills. The application of rigorous financial control will also be essential to the protection of significant sums of public money. In addition it will be important to ensure that the manager can demonstrate an understanding of gender and development issues.

Procurement

149 Feedback obtained during the field work indicates that there is no obvious contender for the management role, particularly once the multi-national scope is taken into consideration. The one type of firm mentioned with any regularity was accountants, which should certainly be able to provide the requisite administrative and financial management skills. However, it is questionable that they would also offer the vital marketing and facilitation skills, so might only be seen as a partial solution.

150 This analysis combined with past experience suggests that the overall management would need to be assigned to a contractor (from within or outside the target regions) with extensive experience working on an international basis, and in-depth knowledge of both regions essential to the formation of effective country management teams. This contractor should then be required to form a management infrastructure that responds to the characteristics of an ECF as well as the profile of the countries being targeted. The cyclical nature of ECFs means that management capacity will need to similarly vary, whilst the small scale of some countries may call for relatively limited management resources.

151 The reality is that a unique management solution may need to be found for each targeted country. A manager should use their knowledge of both ECF management and international markets to devise the optimum solution. Accordingly it is recommended that the invitation to tender includes a statement that it is anticipated that the costs of management are expected to amount to a specified percentage range of the total value of the fund, but otherwise require bidders to state how they will ensure they fulfil the fund manager responsibilities. Ultimately these will be to:

- Generate a sufficient volume of quality applications to enable full disbursement of allocated monies;

- Ensure applications include a sufficient proportion of those expected to bring about systemic change and/or improvements in the BEE (where sufficiency will be determined by the manager's performance targets);

- Ensure assessment panels are provided with all the skills and information necessary to their effective performance;

- Enable AusAID through the ECF to contribute to donor coordination in PSD in the region;

- Properly supervise projects so that any performance problems or breaches of contract are identified as soon as possible;

- Efficiently gather and store all information relevant to the performance of the ECF and funded projects; and

- Ensure all necessary steps are taken to effectively measure ECF impact.

152 The invitation to tender should make clear the expectation that there would need to be a resident representative and physical presence in every target country, although the representative is always likely to be part-time and perhaps only called on to a very limited extent in the smaller markets. Significant use of local personnel would also be anticipated. To maximise cost effectiveness the physical presence should be an existing or appropriate shared facility (maybe the offices of a donor programme or business membership organisation), with clear branding being used to raise the profile of the ECF. This branding will be a critical element of the marketing and communications strategy.

153 Under this scenario the critical requirement is for an internationally experienced contractor with the ability to establish, train and administer this distributed management infrastructure, to achieve consistency of brand and quality of outcome. Bidders should be required in their tenders to define in some detail the management arrangements proposed for the first wave countries, so it is clear that rapid and effective start-up would be feasible. Within this context there seems to be clear scope for the manager to forge relationships with agencies such as UNDP or IFC, either regionally or for specific countries. AusAID would be in a position to help facilitate these types of arrangements if they were preferred, although it is possible that a manager would opt for relationships with private sector contractors or other providers of Business Development Services (BDS), to maximise their efficiency in identifying and facilitating projects.

Key Management Activities in ECF Phases

154 Whilst many management activities are recurrent there will be different emphases during the ECF life cycle, as highlighted below.

- Phase 1: document all policy and procedure, establish M&E framework, help identify and appoint members of Assessment Panels, train members of Assessment Panels, train all members of country teams to ensure consistency of process, create marketing collateral, establish knowledge management systems, establish financial management systems, establish performance targets, conduct high profile launch in Australia/developed countries, conduct high level launch in first wave countries, complete first bidding cycle, contract successful applicants, and assess and document lessons learned from Phase 1;

- Phase 2: help identify and appoint members of Assessment Panels in new regions, train members of new Assessment Panels, train all members of country teams in added countries to ensure consistency of process, conduct high level launch in second wave countries, implement M&E processes in all countries, complete remaining bidding cycles, contract successful applicants, and assess and document lessons learned from Phase 2, in particular to contribute to negotiations with donors interested in collaborating; and

- Phase 3: undertake further detailed M&E, impact assessment and dissemination of lessons learned.

Fund Manager Performance

155 The invitation to tender should make it clear that the management contract will be subject to annual performance review and that unsatisfactory performance would result in termination of contract. Bidders should be required to state what financial management systems they will employ and how they would make sure that back office systems could be easily transferred should this be required by AusAID.

156 It should also be made clear that the contract would include an element of performance related pay. To ensure that the management function is adequately funded it is recommended that 80 percent of the potential total payment be paid on a standard time and material basis, the other 20 percent to be paid on the basis of achievement of pre-agreed targets. The tender should invite bidders to propose workable performance related pay mechanisms, these being designed to reward the attraction of the required volume of projects likely to bring about systemic change and/or improvements in the BEE. Under such a system targets will be reviewed and agreed annually with the AusAID programme manager.

157 As a matter of principle it is essential that any such mechanisms relate bonus payments to achievements up to the award of grants. Beyond that the performance of funded projects is the sole responsibility of the grantee and there should be no incentives for the manager to try to influence project outcomes. To ensure that the manager properly balances their responsibilities it is also recommended that bonus payments be made contingent on satisfactory M&E arrangements having been made for all funded projects.

158 Given the hope of attracting increased funding in the future the tender documents should also make it clear that AusAID has the right to extend the management contract, to ensure on-going management provisions are proportionate.

Timetable

159 If funding is available in FY07, and allowing a six month period to advertise, tender for and award the fund management role, this suggests that it may be possible to commence implementation of the ECF in say July 2007. The fund managers may then require a further three months to establish regional operations, this making possible the public launch of the ECF in the four nominated Pacific and Asian countries around October 2007.

160 This is an ambitious timetable but is achievable if the necessary approvals and funding commitments are made on time. There is enough prior knowledge of what is essential to successful ECF management to ensure that AusAID is able to complete a thorough procurement exercise in the allotted six months, and the right management contractor should be able to set up and launch to the proposed timetable.

Costing

Allocation of Funds

161 There are three primary elements to the cost of the ECF, namely:

- Funds to be awarded to projects,
- The cost of the management contractors, and
- The cost of the Assessment Panels.

162 Field work has indicated that AU$16million should be appropriate for the Pilot fund. Experience from elsewhere further indicates that up to 15 percent of the value of the fund should be allowed to cover the costs of management, this indicating that AU$2.4 million be allocated to the second element. However, the design recommendations include:

- Allowance for a greater amount of market research and PSD coordination than is typically included in ECF management; and

- Suggestions for performance related pay to help enhance the performance of the ECF.

163 It is therefore suggested that up to 20 percent (or AU$3.2 million) should be allowed to cover basic management costs. Additionally it is estimated that around AU$40,000 would be required for surveys in each of the eight target countries, for a total of AU$320,000. It is also thought that bonus payments of in the order of 10 percent of total management costs (or a further AU$350,000) would be the kind of incentive that could produce a step up in fund performance. This implies that around AU$3.9 million should be allocated to fund management.

164 Whilst the members of the international Assessment Panel could be expected to provide their services on a pro bono basis the 12 meetings during Phases 1 and 2 are likely to incur average expenses in the order of AU$15,000, for a total of AU$180,000. Local panel meetings will almost certainly incur more travel expenses, so this amount should be increased to AU$250,000. Local panels will also require payment of honoraria. At an assumed rate of AU$500 per day, and allowing for 16 days per year for 16 panel members, this implies AU$384,000 in honoraria across the three years of Phases 1 and 2. Therefore a total allowance of around AU$814,000 should be made for Assessment Panels.

165 This analysis implies that a total of something in the order of AU$4.7 million will be required to cover management and governance costs, this leaving for disbursement in grants around AU$15.3 million of the recommended total allocation of AU$20million for the ECF Pilot.

Disbursement of Funds

166 Given the time it often takes for projects to start and build up momentum, combined with the fact that many projects will not be awarded funds until year 3, it should be expected that disbursements will peak in the early stages of Phase 3. Some provisional projections of disbursements have been provided in Figure 4.

Figure 4: Projection of Disbursements

Funding Element	Value AU$'000					
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Funds for projects	1,000	2,000	3,700	3,700	2,900	2,000
Management contractors	900	900	850	550	400	280
Assessment panels	200	310	310			
Total	**2,100**	**3,210**	**4,860**	**4,250**	**3,300**	**2,280**

5 Performance Assessment

Dimensions of Performance

167 An ECF is intended to achieve high impact through the projects it funds, and to bring about broader and sustainable influence through improvements in the ways that markets work for poor men and women as well as changes in corporate behaviour. Therefore, thorough impact assessment is both essential and complex. The FDCF and BLCF have started exploration of appropriate mechanisms and the design recommendations for the ECF build on this initial learning.

Performance of Fund Manager

168 The performance of the Fund Manager is relatively easy to measure and should be assessed in terms of the following.

- Number of organisations that have registered enquiries with the ECF (this provides some indication of the outreach the scheme has achieved through its marketing).
- Number of (eligible) CNs submitted (this provides a measure of the degree of interest generated in the ECF).
- Number of eligible CNs submitted by organisations that had not previously engaged with donor programs (to measure the degree to which the ECF was attracting interest from new "development actors").
- Number of applications invited by the Assessment Panels (this provides a measure of the degree to which market interest corresponds with the objectives of the Fund).
- Total value of grants awarded (the ultimate objective of the manager must be to create a pipeline of projects that merit the award of all available funds).
- The proportion of projects that are expected to have targeted levels of impact on the BEE (which would in turn be reflected in the bonus payments made to the manager).

169 With the exception of the latter point, reasonable benchmarks could be established by reference to FDCF/BLCF experience. Actual measurement requires that the manager maintains a comprehensive contact database that enables tracking of cause and effect from initial point of contact (for example, what type of marketing gave rise to the enterprise's awareness of/interest in the ECF?) to organisational characteristics at completion of funded project (for example, does the enterprise now allocate increased resources to pro-poor business projects?).

Performance of Assessment Panels

170 No formal effort was made to measure FDCF/BLCF Assessment Panel performance. Given the significance of this to the eventual impact of the scheme it would obviously be desirable to assess this in some appropriate way. Any such mechanisms would need to be cognisant of the fact that members of the international panel would be providing their time on a pro bono basis.

171 The reality is that quantifiable measures are not available. The Panels can only award monies based on the quality of the pipeline created by the managers. What is most critical is to gain a sense of the degree to which allocations of monies are optimised, in terms of the development impacts that will result. As far as possible, the aim should also be to avoid creating distress amongst bidders as a result of the decisions made. Accordingly the following performance measures are recommended.

- The extent to which the AusAID representatives and/or fund manager considers funding awards to be sub-optimal. (As the former is involved in an executive role and therefore will be complicit in any decisions, it is likely that fund manager appraisal will be most significant in this regard.)

- The number of legitimate complaints received from unsatisfied bidders that could not be resolved through reasonable information exchange.

Performance of Funded Projects

172 ECFs encourage bidders to identify the benefits that their projects will deliver, in terms of development impacts. Inevitably there will be considerable variety in how these benefits are defined. At a simple level therefore performance of projects should be measured in terms of the degree to which targets included in contracts are achieved.

173 Critical amongst these measures is the degree to which commercial sustainability is achieved, as this will provide a primary indication of whether resources are likely to be devoted to an activity after the grant has been used, and therefore of the likely scale of impact.

174 To aid on-going management the degree to which projects are meeting – or on target to meet – their objectives should be used to categorise performance, in terms of for example:

- Will fully meet its objectives,
- Will likely only partially meet its objectives, but no management action required,
- Will likely only partially meet its objectives, and supervisory action required, and
- Unlikely to meet its objectives.

175 This will provide the governors and managers of the ECF with up-to-date insight into the relative strength of projects, and help channel attention and management resources to those activities where there is clearest danger of under-performance.

Performance of ECF Portfolio – Direct Impacts

176 Whilst it is appropriate to measure the performance of projects in their own terms it is also necessary to have comparative measures, as this will enhance the extent to which impact

can be assessed, as well as helping to improve future decision making. This requires that common performance measures be applied across a likely diverse range of projects.

177 Part of the fund manager's start-up task will be to devise a model that will enable effective comparative assessment. It is possible that this will be reasonably straight forward for direct impacts. For example, it should always be possible to assess direct livelihoods benefits in terms of employment and/or income generation. Consumer access would be harder to assess, but the aim should be to devise comparable and quantifiable sex disaggregated measures of the degree to which projects improved access to vital goods and services and the approximate numerical value of these benefits.

Performance of ECF Portfolio – Indirect Impacts

178 Inevitably assessment of performance in terms of indirect benefits will be extremely difficult to assess. However, given their perceived significance, it is essential that the ECF makes a systematic effort to obtain the necessary measures.

179 The following types of indirect impacts can be anticipated:

- Systemic impacts – improvements brought about by the project (for example, in terms of transport and distribution or enhancements to the BEE) enable increased pro-poor commercial activity;
- Replication – having seen what has been achieved by an ECF-funded project, other businesses (in same/different sectors/territories) imitate the project approach, and create additional pro-poor benefits (as opposed to simply replacing the benefits already achieved);
- "Crowding in" – having seen what has been achieved by an ECF-funded project, other businesses follow into the commercial servicing of particular markets;
- Scaling-up – because projects are commercially sustainable they continue beyond the life of the grant and therefore deliver further gender equitable pro-poor benefits; and
- Behavioural Change – having witnessed the commercial opportunities in the BOP, organisations become more disposed to channelling their resources in this direction; such change might be evident in enterprises that have not been involved in implementing ECF projects as well as those that have.

180 It would be very difficult to devise ways of meaningfully quantifying the degree of impact that projects had in any of the above respects. What might be more appropriate would be to grade the degree to which each of the above results from any particular project (for example, 1 = no impact, 2 = minor impact; 3 = some impact; 4 = significant impact). At award of grant the managers would need to devise ways of determining to what extent a project achieved a specific grade against the different criteria. This would then enable an objective assessment of the secondary impacts that the ECF has brought about. It should also contribute to deeper insight into the relationship between pro-poor projects and these types of broader impacts.

181 What must also be recognised is that assessment of these secondary impacts – with the exception of "scaling up" – requires understanding of what happens in the market outside of the recipient of the grant. Clearly, whilst grantees should provide data that enable measurement of

direct impacts, it is not reasonable to expect them to monitor what is happening more generally. The implication is that comprehensive assessment of costs-benefits will require the application of market research techniques. Some of these could be applied through the fund manager contract, as these could contribute to ECF marketing simply by raising awareness amongst businesses of both the issues and the scheme. However, other dimensions of this research really extend beyond what could reasonably be expected to be covered by the manager (at least without access to additional budget), and may need to be subject to parallel initiatives established by AusAID. Because they would provide vital insight into PSD from a generic perspective, such initiatives may provide opportunities for joint-donor approaches and therefore further foundations for enhanced PSD coordination. Specific research requirements would be made apparent by the work of the manager in defining how project achievement of secondary benefits could be objectively assessed.

Achievement of Intended Outcomes

182 Clearly the objective of the ECF is to generate the highest possible level of developmental benefits relative to its investment. It should also set specific targets at outset, against which program performance could be meaningfully assessed.

183 In terms of direct benefits, it is recommended that a minimum target should be to achieve employment generation performance at least equal to that indicated possible by the performance analysis of the BLCF. Given the proposal to establish a fund of AU$15-16 million this should equate to at least 75,000 (direct and indirect) jobs.

184 In applying this benchmark it should be remembered that these sorts of direct benefits are not necessarily the most important outcome of ECF projects, and due attention must be paid to indirect benefits as well. In terms of indirect benefits it is recommended that:

- If each project is allocated a score of 1 to 4 to designate degree of impact achieved against each of the secondary criteria;
- And therefore each project could achieve a maximum secondary impact of 20 (that is, 4 x 5 criteria);
- The minimum average secondary impact achieved across the portfolio should be 8.

185 This mechanism, or something similar, as well as helping impact assessment, will provide useful guidance to the Assessment Panels when deciding how to most effectively allocate available funds.

Cost-Benefit Analysis (CBA)

186 The framework recommended above, combined with data on the size of grants and the total budgets allocated to projects, would provide a clear foundation for CBA of the ECF. It could reasonably be expected that, given a consistent framework and the availability of specific targets in relation to approved projects, a more refined CBA would ultimately be possible. Attempts to achieve this enhanced refinement should significantly advance donor understanding of how to relate pro-poor business activity to development impacts.

187 To this end it is recommended that a specialist be separately contracted to undertake a CBA for the ECF, to enable the formulation of more reliable future benchmarks for ECF

performance, as well as to ensure effective measurement of project impact. At least one project would be selected from each bidding round to compile a random sample of around 10 projects, on which more detailed CBA would be undertaken. This would be organised to develop specific measures of the different types of benefit stimulated by ECF grants, so that Internal Rates of Return can be calculated. It is recommended that around AU$250,000 be allocated to this work, which may need to come out of the AU$15.3 million available for grant disbursements.

Gender Impacts

188 It will be possible to assess direct gender impacts from measurements provided by grantees. To be considered by the Assessment Panel, applications will need to identify gender equality impacts, and these targets will then be reflected in contracts with grantees and subsequent M&E activities.

189 Not unreasonably, assessment of secondary gender impacts will be relatively harder to achieve. It is recommended that the manager make an assessment of likely secondary gender impacts when determining the objective measures of achievement for funded projects. Those achieving greater gender impact would be assigned higher levels of secondary impact.

Baseline Information

190 For an initiative covering numerous business sectors in eight countries it is clearly impossible to have baseline information across the board. Therefore the following is recommended.

- At outset in each country the fund manager must ensure there is adequate baseline information on the BEE to enable meaningful assessment of the contribution the ECF has made to its enhancement.
- It must be ensured that adequate baseline information exists to be able to measure the direct impacts of each funded project. The grantee should be required to ensure such information is available.
- On identifying the objective measures of secondary impact for a project, the managers should determine what baseline information might be required to enable their reasonable measurement. These requirements and the ways of satisfying them should then be reviewed with AusAID, and in particular addressed by the CBA.

Measurement and Data Collection Processes

191 Data on direct impact will be collected and provided by the grantee as part of their standard reporting agreement.

192 Data collection methods on secondary impacts will be defined by the manager following grant award, the implementation of these methods to be agreed with AusAID.

Systems for Performance Enhancement

Annual Performance Updates

193 The manager will update the ECF contacts database on a real-time basis and will therefore always have information available on the causality and volume of market interest. Using this information, the manager will be required to analyse the reasons for the market response to the ECF on an annual basis. This, together with achievement of performance-related pay targets and a review of the manager's fulfilment of its key responsibilities, will be used for the annual review of fund manager performance.

194 Appraisal of Assessment Panel performance will be made by the manager following each bidding cycle. This, combined with data from the contacts database recording any "customer complaints", will be sex-disaggregated and analysed by the manager on an annual basis to form a consolidated opinion.

195 The standard grantee reporting process will ensure that an updated assessment of the performance of all funded projects will be available quarterly. Using this information, the manager will be required to analyse the reasons for the state of performance on an annual basis.

196 A fund manager review of ECF portfolio impact will be made annually, this being confined to completed projects, and incorporating measurements of direct and indirect impacts, incorporating as necessary information from bespoke market research and/or independent M&E/ impact assessments.

Opportunities for Performance Enhancements

197 The annual performance updates defined above will be used to:

- Help AusAID ECF supervisors assess the degree to which the intended outcomes are being and will be achieved;
- Make clear to the fund managers any deficiencies that will require correcting in subsequent years; and
- Provide guidance to the Assessment Panels on how to optimise the allocation of funds in terms of development impacts.

Implications for AusAID Programming

198 The proposed performance measures will simultaneously provide AusAID with a wealth of understanding on how to most effectively engage the international private sector in the interests of poverty reduction (which can be used to inform other areas of its programming as well as contribute to PSD donor coordination) as well as precise feedback that enables the continuous fine-tuning and performance enhancement of the ECF. In this regard it is recommended that detailed annual performance reviews be made at the end of each of the first two years, the results of these being shared with other donors that might be interested in jointly funding follow-on initiatives. Whilst only limited information will be available at this stage it is essential that attempts be made to secure future funding commitments on this basis, as otherwise there will likely be a discontinuity in bidding for funds (this halting at the end of year

three). Previous experience indicates that any such discontinuity results in significant loss of momentum.

199 Irrespective of the outcome of this process a detailed Mid-term Review should also be organised during year four, at which point all funds should have been awarded and a few projects will be in the final stages of implementation. A post completion review will also be required to ensure a full impact assessment can be completed.

6 Risks and Risk Management

Risk Factors

200 Inevitably a relatively new instrument – and particularly one that seeks to support private sector profit making activities – carries risks for a donor such as AusAID. Figure 5 identifies the key risks, their possible impact, and methods of mitigation.

201 This matrix suggests that the ECF is a project with low to medium risk, although the potential impact of the risks that have been identified is medium to high[5]. Intuitively this would seem reasonable. An ECF is a risk sharing mechanism and as such it might be expected that any "failures" would have a high impact on the program's performance. At the same time the challenge fund instrument has been specifically developed to help donors manage the kinds of risks associated with the provision of subsidy to the private sector, so it would be reasonable to expect the probability of risks occurring to be relatively low.

202 In general the risk factors can be categorised as follows.

Reputational Risk

203 AusAID's standing in the public domain could be damaged if it were perceived to be using public funds in inappropriate ways. This risk is a clear possibility when the ECF is seeking to subsidise profit making endeavour. This risk is increased by the expectation of working with large and often powerful enterprises.

204 At the same time the ECF could actually enhance AusAID's reputation. The ECF is a direct response to the White Paper and provides AusAID with a potential niche in the context of PSD in its countries of operation. DFID has gained considerable credit for its work on ECFs and AusAID has the opportunity to build on the learning from this earlier work, thereby potentially achieving greater impact from its investment. Given that the nature of the ECF provides very effective ways of managing this risk impact on reputation could perhaps be seen as an opportunity rather than a threat.

205 Perhaps the most complex risk is the discovery that a grantee is operating in a corrupt or disreputable way in order to safeguard the progress of an ECF project. Given the nature of some of the markets that the ECF is targeting this is a real risk, even if it were something that the grantee would avoid in more normal circumstances. In such a situation AusAID could be faced with a choice between continuing to fund a project that it knows is involved in malpractice or terminating funding of something that could otherwise be a considerable success, and in which the private sector has also invested. This risk should be eliminated by inclusion of a clause in the standard grant contract that states a grant will be terminated as soon and whenever corrupt or similar malpractice is discovered, and whatever the circumstances. This removes any doubt and encourages the grantee to protect its investment by working in reputable ways.

5 If in Figure 8 "low" is assigned a score of 1 and "high" a 3, then the average risk score is 1.27, and the average impact score is 2.33.

Figure 5: Risk Analysis

Nature of Risk	Probability of Occurrence	Likely Impact	Risk Management and Mitigation
The ECF fund manager is unable to stimulate adequate demand for grants	Medium – whilst feasibility has been established finding a qualified manager may be difficult	High	Seek specialist business development skills in procuring a fund manager
AusAID is perceived to favour chosen firms	Low – the nature of the ECF demonstrably prevents this	Low	General publicity will be used to extend opportunity to all eligible businesses
Grants are used for private gain more than as an approach to poverty reduction	Low	Medium	Private gain is encouraged providing likely poverty impacts can shown to be significant
Funded projects fail to meet their objectives	Medium – this is a risk sharing mechanism so there will be some failures	Medium	Grantees meet at least half the costs so are motivated to succeed
The public benefits derived from the projects are insufficient to justify providing subsidy to profit makers	Medium	High	Assessment criteria should ensure applicants focus on maximisation of public gain
Grants awarded by the ECF distort markets	Low	High	Grants should only be awarded where commercial finance is clearly not justified
The ECF funds projects that have detrimental impact on the environment	Low	Low	Eligibility criteria should eliminate any such proposals
The ECF funds projects that sustain or worsen gender inequities	Low	Medium	Eligibility criteria should eliminate any such proposals
The ECF clashes with AusAID country programs	Low	Medium	Liaison on marketing and involvement in Assessment Panels should ensure cohesion
The ECF clashes with other donor PSD initiatives	Low	Medium	ECF fills a niche and is supported by other donors. Managers can use ECF to contribute to PSD coordination

Nature of Risk	Probability of Occurrence	Likely Impact	Risk Management and Mitigation
Projects are implemented but grants are used other than in accordance with agreed purpose	Low	High	Grants disbursed incrementally and providing grantee can demonstrate appropriate use of funds
Grants are obtained fraudulently and projects are not implemented	Low	High	Grants disbursed incrementally and providing grantee can demonstrate appropriate use of funds
Grantees are perceived to be involved in corrupt practices	Medium	High	Grants disbursed incrementally and providing grantee can demonstrate appropriate use of funds
Outsourcing of management weakens or even undermines AusAID control	Low	High	Donors have relevant experience in the procurement and contracting of facility managers
Grants exacerbate gender inequalities	Low	Medium	Fund manager provides advice and support for development of gender sensitive applications, and the assessment of applications takes account of gender equality objectives

Financial Risk

206 There is always a danger of grants being used inappropriately. The biggest concern would be that monies be misappropriated altogether (as happened once under the FDCF). The use of local knowledge in decision making reduces the danger of awarding money to disreputable organisations. On the rare occasions this happens then the incremental disbursement of grants means that only small sums are likely to be lost before a problem is identified and a grant terminated.

207 What might be harder to detect is money awarded being used other than strictly in accordance with approved purpose. The ECF quarterly reporting cycles should again prevent this from ever becoming a serious problem. Grantees are required to account for the utilisation of monies disbursed in these reports and failure to do so could result in suspension of the contract. Past experience indicates that the most likely scenario is that grantees seek management approval for variations in the application of funds, to take reasonable account of evolving circumstances. It must be remembered that the grantees are investing their own resources in the initiative, which is an incentive to work cooperatively with the ECF and in accordance with agreed purpose.

208 Whilst financial risks must be acknowledged it should also be recognised that ECFs have developed techniques for minimising these and have a strong track record in this regard.

Operational Risk

209 There are two main forms of operational risk, namely clashes with other donor activity and unintended (distorting) impacts on the market. The feasibility study suggests there is little real danger of the former – donor responses were generally very positive and suggested that an ECF would be largely complementary – and the design work has highlighted practical ways of avoiding these risks through prudent management. Indeed every effort would normally be taken by the fund manager to ensure that proposals were not of interest to (or perhaps had been reasonably rejected by) other suitable donor initiatives.

210 In terms of the latter the risk of an ECF displacing existing financial instruments is minimal, as one of the primary ECF principles is that grants should only be awarded where it is clear that commercial finance would not ordinarily be suitable. Grants are awarded to projects rather than necessarily to specific companies, which tends to make commercial financing less appropriate. Indeed the aim of an ECF should be to fund projects characterised by one or both of the following:

- Embedded externalities that lead to benefits for the wider market and which would therefore not necessarily be financed commercially (for example, infrastructure investments); and/or
- High levels of risk (for example, due to innovation) that require abnormal up-front investments in order to achieve a satisfactory risk-return profile.

211 Providing best management practice is followed it should be possible to counter any operational risks. Indeed it should be possible to turn its position as a “market actor” to advantage through facilitating synergies across different pro-poor PSD activities.

Risk of Ineffectiveness

212 Even if all the above risks are controlled there remains the possibility that the ECF will fail to achieve its intended impacts, and therefore potentially represent an inappropriate use of public funds. The competitive nature of an ECF should mitigate against this risk. The whole management and decision making philosophy should stress quality rather than quantity, and in particular the Assessment Panels must be clear that they should only award funds to genuinely deserving projects. If in any round no strong ideas emerge then no funds should be awarded.

213 AusAID can now also benefit from the many years of practical experience that have been gained in assessing ECF project proposals, and the much greater level of understanding of the difference between a project that is pro-poor in a relatively self-contained way, and those that have the potential for substantial secondary impact. The design recommendations have been devised to help emphasise the latter type of project, and if such recommendations are properly applied then there is no reason why the ECF should fail to achieve its intended impact, and given that the option not to award funds is a real one.

Assessing Failure

214 Because of the nature of an ECF it is essential that due consideration be given to the concept of "failure". Typically it might be said that a project funded by the ECF would have failed if it did not achieve the objectives originally set. However, this is probably too simplistic a viewpoint. For example:

- A project could fail to achieve commercial sustainability but at the same time produce a wealth of knowledge about pro-poor business;
- A project could fail to achieve commercial sustainability but at the same time greatly improve the conditions for doing business at the BOP and thereby significantly contribute to poverty reduction; and
- A project could achieve all its agreed direct benefits but create only limited secondary impact and therefore contribute relatively little to poverty reduction.

215 Therefore a broad and informed view must be taken when assessing success and failure. The approach to performance measurement recommended in Section 5 has been designed to assist in this respect.

A1 Methodology for Costs-Benefits Analysis of Previous ECFs

Dividing Projects by Business Motivation (Figure 1)

Below is an expanded version of Figure 1, which categorised the BLCF portfolio by business motivation. The table provides the list of surveyed projects divided by the business motivation for the project. Projects in the Reduction of Supply Costs category include businesses engaging the BOP to reduce their own cost of inputs. These businesses also tend to distribute (sell) their products in the same markets in which they are obtaining supplies. Projects in the Obtain Vital Resources category, on the other hand, are largely devoted to sourcing inputs that were previously unavailable in that particular region due to a variety of barriers to the private sector. The New Markets for Existing Products category includes those projects in which businesses take a proven product to a new BOP market. Lastly, the New Products category includes projects in which businesses developed wholly new products to be sold to the BOP

Business motivation	Project Name	Grant Amount £	Private Sector Contribution £
Reduction of Supply Costs	Ferrogrow Fertilizer Manufacturing	149,000	312,000
	BlackGold Forest Products	114,110	115,880
	Water Testing Equipment to Detect Arsenic	450,000	843,000.00
	Aquaculture Technologies for Rural Developmen	150,000	394,000
	Fair Trade Horticulture in the Gambia	196,800	226,660
	Mining in South Africa	450,000	1,350,000
Obtain Vital Resources	Private Sector Initiative	243,700	1,012,718
	Smallholder Essential Oil Production	88,400	238,300
	Thandi Fruit	340,000	368,424.0
	Mozambique's Fruit Industry & Global Market	123,389	223,944.0
	Fair Trade Organic Chocolate	189,000	369,500.00
	Maya Gold - Chocolate	225,000	279,000
	Biotechnology for Infectious Diseases	520,000	5,681,000
	Pre-treated Cotton Seed	295,000	1,319,000
	Cultivate Fynbos Crop	327,236	336,000
	Technical Textiles for South Africa	290,000	790,000
	Support to African Honey Producers	172,100	16,100
Create New Markets for Existing Products	Sports Partners UK/ South Africa	176,700	225,000
	Medicine 2 Africa	213,300	197,000
	Female Condom in India	998,000	1,613,000
	Bushman Traditional Village	158,540	161,663
	IT Training Program	350,000	648,000
Create New Markets for New Products	Tourism Development in Rwanda	419,150	374,050
	Low Power Fuel Cell Technology	137,200	138,537
	Stable Liquid Vaccines	946,165	1,312,741

Calculating Job Creation (Figure 2)

216 Although job creation is one of the most measurable poverty impacts of the BLCF projects, quantification of both direct and indirect job creation is very difficult. The methodology employed by the prime management contractors (Emerging Markets Group, or EMG) was as follows[6].

- Table created by EMG with questionnaire and instruction sheet, and sent to regional fund managers for distribution to their grantees.
- Introductory email was sent and recipients were invited to respond via email by a given date. Respondents then received a follow-up telephone call.
- Spoke directly with approximately 60 percent of the grantees and provided instructions on how to complete the table. Some grantees provided data over the telephone to EMG who then entered the data.
- Fund Managers were then asked their opinion of the data given their familiarity with the projects so as to try to eliminate obvious mistakes.
- London Grantee files contained copies of completed tables plus any notes compiled by EMG.

217 Using the compiled job creation data, it was then possible to calculate the "cost" of each job that was created. This is calculated by dividing the total grant amount by the total number of jobs created. This calculation was performed within each business motivation category. It should be noted that the job creation cost does not include the private sector contribution, which would make the job creation cost higher. However, incorporating the private sector contribution into the total "cost" figure does not change the nominal ranking of which projects create jobs at the lowest cost. Below is an expanded table with the costs of job creation by business motivation

		Grant Amount £	Private Sector £	Total £	Leverage (Grant Amount/Project cost)	Direct jobs created/retained	Estimate # of indirect jobs created
Reduction of Supply Costs	Total	1,509,910	3,241,540	4,751,450	32%	884	492
	Average	251,652	540,257	791,908		147	82
	Cost £					**1,708**	3,069
Obtain Previously Unobtainable Resources	Total	2,813,825	10,633,986	13,447,811	21%	12,708	85,139
	Average	255,802	966,726	1,222,528		1,155	7,740
	Cost £					**221**	33
Create New Markets for Existing Products	Total	1,896,540	2,844,663	4,741,203	40%	261	3,235
	Average	379,308	568,933	948,241		52	647
	Cost £					**7,266**	586
Create new Markets for New Products	Total	1,502,515	1,825,328	3,327,843	45%	66	500
	Average	500,838	608,443	1,109,281		22	167
	Cost £					**22,765**	3,005

[6] As reported by Baker Kiggundu in "The Business Linkages Challenge Fund as a Private Sector Development Instrument".