AusAID

Enterprise Challenge Fund – Mid-Term Review

Final Report

David Elliott, Sarah Barlow and Harald Bekkers

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THE SPRINGFIELD CENTRE
FOR BUSINESS IN DEVELOPMENT

Suite One, 4 Saddler Street
Durham DH1 3NP
United Kingdom

Tel: +44 191 383 1212
Fax: +44 191 383 1616
Email: global@ springfieldcentre.com

EXECUTIVE SUMMARY

A growing private sector, which is more inclusive of the poor, and more responsive to the needs of the poor is critical to meeting the poverty reduction targets enshrined by the MDG's; to which AusAID is committed. In working towards this the private sector is increasingly being seen by development agencies as being a more active and direct partner in the development process. Challenge funds have emerged in recent years as a new aid instrument and modality which can be used in support of working with the private sector in a more direct partnership approach.

The ECF was conceived and designed in this context and represented a fairly new departure for AusAID at the time. The ECF, managed by Coffey International Development, opened its doors for business in July 2007 and is scheduled to run for six years. The ECF is currently operational in the following nine countries: Cambodia, Laos, Eastern Indonesia, Southern Philippines, East Timor, Papua New Guinea (PNG), Solomon Islands, Fiji and Vanuatu.

The ECF shares risk with business in support of pro-poor growth objectives. Through open competition, grants of between AUD100,000 to AUD1.5mn are awarded to business projects. Eligible projects should justify public intervention through demonstrating: significant externalities, innovation, and discernible pro-poor benefits. Projects should be commercially sustainable within three years.

According to the design, through its focus on innovation and overcoming externalities the ECF aims to contribute to wider systemic change. This means demonstrating new and successful ways of working with the poor (*how to do it*), which in turn improves private sector perceptions (and those of other development partners) on the costs and benefits of doing business with the poor (*why to do it*). As a result of these systemic changes - changed perceptions and practices - the ECF expects to multiply impact of any actual projects it funds.

At the time of this mid-term review, all available investment funds totalling AUD 13,352,846 had been committed to projects. Hence, this review was timely in the sense of considering whether additional funds should be made available for investment. However, as most projects have only started recently, or are yet to start, this review was not timely from the perspective of the ECF having only a very limited track record of investment performance to evaluate.

The primary aims of this mid-term review are to:

- Independently assess the efficiency and effectiveness of the current ECF Pilot Program and advise on how this could be enhanced; and
- Critically assess the merits of a second phase of ECF funding.

In terms of effectiveness the ECF has recruited 24 projects, committing an ECF investment of AUD 13,352,846. Against this it has leveraged a matched funding commitment from bidders of AUD 21,073,257. This leverage ratio of 1.59, whilst slightly lower than comparable challenge funds, is certainly acceptable. In terms of outreach, the portfolio aims to "impact" on the lives of around 767,861 persons, at an average cost per beneficiary of AUD17.39. However, it is noted that almost 90% of this outreach is attributable to just two projects in Cambodia.

Given the early status of projects these figures represent a paper promise rather than tangible achievement. The review finds that this good promise is likely to be seriously undermined by the lack of sufficient application in practice of established good practice principles and practices of more successful challenge funds. This notwithstanding, the review finds that the ECF has managed to attract a small number of genuinely innovative and potentially scalable and transformational projects which might impact discernibly on large numbers of target poor.

In terms of efficiency, overall, the Fund Manager has performed creditably. At 27% of total funds, the management costs are comparable with those of other challenge funds. The conversion rate, from concept notes to approved projects increased over the three bidding rounds from 6%, to 33% to 50% respectively. Much of this improvement was down to the improved learning from bidders, the Fund Manager and the approvals Panel.

The absence of a strategic framework and the subsequent confusion amongst key stakeholders within and outside the ECF team has had a negative impact on efficiency at several levels: from ensuring the appropriate staffing mix, to establishing project evaluation criteria which assess projects in light of the Fund's strategic objectives, to the format and content required in project application forms. Ultimately this has directly impacted the quality of the projects.

The review found a concerning accountability gap. No person, body or organization has clear ownership of the vision for ECF, or accepts responsibility for the programme's success or failure. The ECF Fund Manager has little influence over which projects are approved, and it is unwilling to take on this overall responsibility. Likewise, while grant allocation decisions are made by the assessment panels, the panels have limited influence over the other aspects of the Fund. As a result there is a significant accountability gap with no-one clearly responsible for the quality and performance of ECF, and the projects it supports.

As a final dimension of efficiency, the review was surprised and rather perplexed at the level of contractual tightness imposed on the fund management function. Any accountability framework needs to be counterbalanced by considerations of flexibility and dynamism. This is particularly so in the case of the ECF, being the pilot application of a new instrument. The lack of balance has, in the mind of the review team, supported a more directive "box-ticking" project management approach rather than a more social entrepreneurship approach which is more appropriate for the task at hand.

The limitations of having no clear strategic framework are felt equally, if not more so, in the context of monitoring and evaluation (M&E). The results framework which should outline a hierarchy of objectives and causal impacts is structurally incoherent, and suffers from a lack of conceptual and definitional clarity and consistency. As such the measurement framework within this – *what* to measure and *how* to measure it – is equally affected. The final dimension concerns the question: *who* should undertake the measurement. In this respect there is over reliance on information expected from grantees, too many people doing piecemeal roles, and hence concerns exist on the quality, rigour and efficiency of M&E data.

The ECF clearly has considerable room for improvement. However, overall, it has sufficiently demonstrated the value and potential of a challenge fund instrument as a programming option for AusAID going forward. The ECF has attracted quality propositions, and has levered considerable co-investment commitments from private firms in support of a more pro-poor business focus. For AusAID, the instrument is seen to be flexible, responsive and complimentary for more established aid modalities.

As to the ECF itself, recommending any new investment capital would be dependent on the review team being sufficiently confident about the expected social return to the investments already made. We are not, and hence our primary recommendation is that no new funds should be invested through the ECF at this time.

Going forward the ECF should focus efforts on responding to the lessons from this review with the aim of managing better for results from existing investments. If it improves in this direction it can offer genuine learning to inform the design and operation of any new challenge fund programmes. In this regard, the review recommends that a next such programme might focus (subject to further scoping and feasibility assessments) on supporting the push for improved renewable energy progress in the Pacific region. This review outlines a range of options that the current ECF programme might play in such an endeavour.

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1 INTRODUCTION

1.1 Activity Background

1. The White Paper on Australian Aid published in June 2006 called 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; issues supported by the current Government of Australia. The ECF emerged in this context. It recognised the value of continuing with AusAID's more established "technical assistance and capacity building approach"[1], but felt the ECF could compliment these efforts through offering an instrument which aimed at a more direct partnership approach with the private sector. Such an approach is based on a premise that the private sector can offer innovative solutions to development challenges, which on the one hand generates a commercial return to the private sector, and on the other hand delivers a strong social return.
2. The ECF was designed as an innovative means of sharing risk with business to achieve pro-poor growth. Through open competition, grants are awarded to business projects. Eligible projects should have three characteristics which justify public intervention: significant externalities, innovation, and pro-poor benefits. Projects should be awarded a grant only if it will be commercially sustainable within three years and if it would not have proceeded without the grant. At the project level, ECF aims to generate significant impact on measures such as the direct creation of jobs, income-earning opportunities and increased access to goods and services by poor people and small businesses.
3. Through its focus on innovation and overcoming externalities the ECF aims to contribute to wider systemic change. This means demonstrating new and successful ways of working with the poor (*how to do it*), which in turn improves private sector perceptions (and those of other development partners) on the costs and benefits of doing business with the poor (*why to do it*). As a result of these systemic changes - *changed perceptions and practices* - the ECF expects to multiply impact of any actual projects it funds.
4. In line with the demand assessment and feasibility findings in the ECF scoping study (2006), the ECF operates in the following nine countries: Cambodia, Laos, Eastern Indonesia, Southern Philippines, East Timor, Papua New Guinea (PNG), Solomon Islands, Fiji and Vanuatu.
5. ECF offers grants of between AUD 100,000 and AUD1.5mn for projects of up to three years duration[2]. ECF's initial design proposed six bidding rounds over the first three years of the fund, with the remaining three years focusing on monitoring and evaluation of project impacts. However, disbursement progress has exceeded expectations and all available ECF grant funding, totalling AUD 13,352,846 has been committed at the end of this current bidding round (bidding round 3).
6. The management of the ECF was put to competitive tender. It was awarded to Coffey International Development who is the current ECF Fund Manager. Via a separate tender, Triple Line Consulting was appointed as the Independent Monitoring Team (IMT). Their role is primarily to oversee and confirm the performance of the ECF Fund Manager.

1.2 Review Objectives and Questions

7. This report was commissioned as a Mid-Term Review of the ECF. The reviews primary aims are to:

[1] Approach as referred to in the ECF RFT Document, March 2007.

[2] Projects must demonstrate commercial viability after three years. The schedule of grant disbursements does not need to span the same time period, but is limited to the three year period.

- Independently assess the efficiency and effectiveness of the current ECF Pilot Program and advise on how this could be enhanced; and
- Critically assess the merits of a second phase of ECF funding.

8. Specifically, as confirmed in the Terms of Reference (ToR), the objectives of the review are to:
   - Assess the Enterprise Challenge Fund (ECF) Pilot Program's progress towards meeting its objectives (including positively impacting on business growth and development, generating livelihood opportunities and poverty alleviation). Refer to original design document and ECF Monitoring and Evaluation Framework (MEF) for further details.
   - Assess the efficiency and effectiveness of the ECF model and how this could be enhanced.
   - Determine whether ECF is the most appropriate model for achieving the desired, long term development outcomes.
   - Determine how the ECF Pilot Program compares with other challenge funds.
   - Provide advice and recommendations to AusAID on these issues in the form of an Independent Progress Report.
9. The list of minimum questions to be answered, along with the proposed stakeholder consultation list is provided for further reference in Annex 1.

1.3 Review Scope and Methods

10. The ECF comprises a portfolio of projects contributing to rather broad developmental objectives. It arguably presents a laboratory of experiences. This presents challenges to any evaluation team. The evaluation cannot visit and review each and every project. On the other hand, with such a diverse portfolio, technically, and geographically, it is not always obvious that the lessons from one project are reflective more generally across the portfolio.
11. In response to the challenges outlined above, the team has tried to mitigate various risks through:
    - Reviewing the documents for all projects to get a general overview of the context;
    - Choosing projects to be visited which are reflective of the types of business linkage / partnership pursued across other projects in the portfolio;
    - Visiting a mixture of larger and smaller projects;
    - Visiting projects in different country contexts; and
    - Balancing these specific review findings with broader consultation to triangulate in on key themes and issues which do hold generally across the whole portfolio.
12. Following agreement between AusAID and the Fund Manager, the review team visited projects in Vanuatu, Fiji, and Laos. Time did not permit a visit to a second Asian country.

13. In terms of sector balance, the following was achieved:

Sector	Number of projects funded	Number of projects visited/(reviewed)
Agri-business	11	4
Energy	5	1
Tourism	3	1 /(1)
Financial Services	2	0 / (1)
Education	1	0
Shipping	1	1
Manufacturing	1	1
TOTALS	24	10

14. In addition to projects visited, the team has considered in detail the applications from one financial services project (Wing, Cambodia), and a second tourism project (Carnival). The balance of projects visited and reviewed blends well with the overall sectoral composition. It also represents ten projects reviewed out of twenty-three projects funded, which is a high ratio. Arguably, the review was slightly unbalanced as regards energy related projects, although one sizable energy project was reviewed.

15. Finally, the review process incorporated a strong consultative element to it. Broadly, the review team did manage to consult according to the list of stakeholders outlined in the ToR. Further, questionnaires seeking structured feedback and input were drafted and sent to key AusAID staff at Posts in each of the nine ECF countries. Whilst not all felt it necessary to have their say, the views of those who did were welcomed and appreciated. Finally, in conformity with the ambition to cross-reference the ECF to other DFID Challenge Funds, the review solicited and received good responses from Hugh Scott, Manager of the African Enterprise Challenge Fund (AECF).

1.4 Evaluation Team

16. It is acknowledged that the diversity of the ECF portfolio presents challenges to any evaluation team to demonstrate a sufficient breadth of expertise and experience. However, it is our feeling that the composition of the review team met these challenges well. The team comprised two core consultants, and one support consultant with a more focused remit to assess monitoring and evaluation issues. The team was structured as follows[3]:

17. The team was led by **David Elliott**, a Director with The Springfield Centre (UK). He is responsible for the overall conduct of the evaluation and for the final report. Technically, David focused specifically on issues of rationale, relevance and effectiveness. He visited Vanuatu and Laos.

18. **Sarah Barlow,** an Associate of the Springfield Centre, is the second of the core consultants. She undertook field missions to Vanuatu and Fiji. Her role on the team was to contribute across the entire review process in support of the team leader, and specifically to lead on all matters related to questions of efficiency.

19. Supporting the core team, and leading on issues pertaining to monitoring and evaluation is **Harald Bekkers**. He undertook field missions to Vanuatu and Fiji. Harald is an independent consultant.

[3] Further details on the team can be found in the Evaluation Plan annexed to this main report.

1.5 Review Findings

20. In line with the evaluation plan, our findings are presented under the headings of Rationale and Objectives, Relevance, Effectiveness, Efficiency and Monitoring and Evaluation. In line with Challenge Fund logic, the “outputs” are the projects themselves, and as such are reviewed under the heading of Effectiveness. However, projects themselves also embody impact and sustainability considerations. For example, sustainability is rooted in the commercial viability of projects, and immediate impacts should be delivered directly by the project.

21. Therefore, dimensions of sustainability and impact are considered explicitly in the report, but are not represented under direct report headings.

22. The main report findings are supported by various annexes, as follows:

    - Effectiveness Annex: this presents aide memoires for all projects visited and written according to the evaluation framework agreed with AusAID, which is presented in full in the annex, and referenced in the main body of this report.
    - Efficiency Annex: the presents a detailed assessment of efficiency matters, whereby the key findings are synthesized in the main report.
    - Monitoring and Evaluation: similar to the Efficiency Annex, this presents a more detailed assessment of M&E issues, the key of which are synthesized into the main report.

23. Further supporting annexes relate to the ToR, Evaluation Plan, and Mission Schedule.

2 POVERTY, THE PRIVATE SECTOR & CHALLENGE FUNDS

24. As a precursor to the review itself, it is helpful to orient the reader to the linkages and dynamics between poverty, the private sector and the emergence of challenge funds as a key development instrument for development agencies.

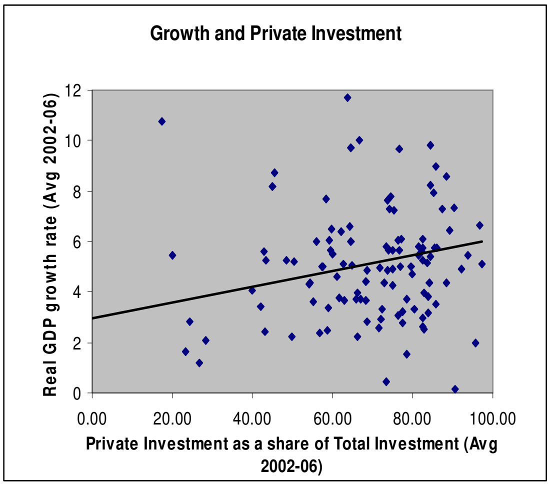
25. Approximately one-fifth of the World's population live in absolute poverty. Almost half of the World's population struggle to survive on less that USD 2 per day. The problem is chronic and the development challenge substantial.

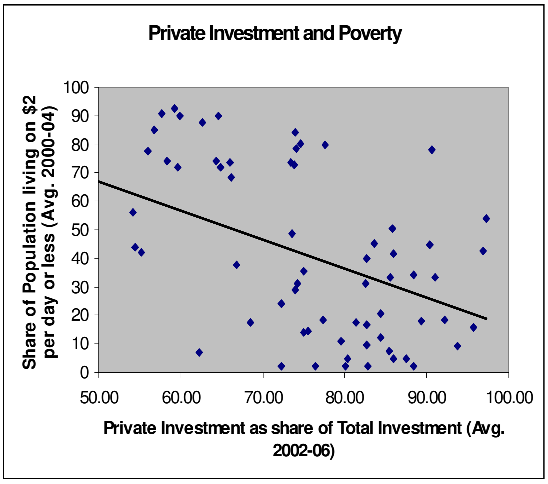
26. The scale and scope of this poverty epidemic is captured in the Millennium Development Goals (MDGs), which collectively represent a shared international commitment to work together to eliminate world poverty. As confirmed by the MDG's, at its heart poverty is about lack of incomes, but it is also about a wide set of characteristics associated with lack of income, such as access clean water, shelter, basic medical care and education.

27. The private sector is increasingly being seen as a key part of the solution to poverty reduction. As a driver of economic growth the private sector is essential for increased employment and income of the poor. Furthermore, the growing contribution of the private sector to delivering essential basic services to the poor is increasingly being recognised by Governments and development agencies alike.

28. The empirical evidence in this regard is compelling. There is a clear and positive relationship between the share of private investment as a proportion of total investment and the rate of growth in GDP in a country (Figure 1). In other words, the higher the level of private investment, the higher the rate of growth. Similarly the same measure of private investment is negatively associated with poverty incidence. In other words, if private investment is higher – poverty incidence is lower.

Figure 1: Relationships between private investment, growth and poverty





29. However, the evidence also confirms that there is no definitive or linear rate at which economic growth translates into reduced poverty levels. What is clear is that growth which is more directly *inclusive* of the poor delivers greater impact. This demands that private sector activity makes best use of the assets which the poor have, and it demands an increase in the productivity of those assets. Further, growth that is *responsive* to the needs of the poor also delivers greater impact. This demands public policies and corresponding investments are shaped by and are responsive to the needs of poor people.

30. Shaping growth patterns to be more directly inclusive of, and responsive to the poor, is the point of entry for challenge funds. As the name implies, the “challenge” lies in ways in which the mainstream private sector can engage and deliver better value to the poor – be they as consumers, as producers or as employees.

31. In practice, challenge funds are employed against many different and distinct development challenges. However, they are united by a common set of principles, as follows:

    - *Innovation:* is absolutely fundamental to the very concept of challenge funds. With innovation comes risk. Challenge funds aim to reduce this risk, encourage innovation and in doing so push out market frontiers and increase access and choice of the poor.
    - *Leverage:* the approach encourages matched funding or leverage of other contributions in cash or "in kind" from bidding organizations. This increases their ownership and commitment and ensures public funds stretch further.
    - *Competitive process:* funds are allocated on a competitive basis. This ensures only the best projects are funded. It also means one-time funding of private companies, where the exit strategy is clearly defined and time bound and hence any anti-competitive effects of grants are minimized.
    - *Partnerships:* challenge funding is particularly suitable where it brings together partners from the private, public and not for profit/community sectors within a framework for cooperation that can achieve mutual benefits.
    - *Changing attitudes:* a challenge fund approach can work particularly well where a change in attitude or aspirations is needed to remove barriers to opportunities. Within a "can do" culture the risk and innovation can be managed effectively and with the involvement of many partners.
    - *Local solutions to local problems:* the intention is to allow bidders to come up with their own ideas about how they can develop local solutions to solve local problems, which in turn facilitates greater ownership and innovation in their approach.

32. Of course, there is no great mystery behind challenge funds. At their core they are an instrument of competitively tendered matching grants. As with any instrument its efficacy depends largely on the context to which it is being deployed. Where challenge funds have been most successful they have been used strategically and in support of wider systemic change ambitions. In practice this has meant that successful challenge funds:

    - Are deployed in full alignment with clearly defined development challenges and corporate priorities.
    - Are focused and specialized, typically sectorally or thematically, rather than geographically.
    - Offer a discernible value beyond that of the actual grant money.
    - Focus on innovation, learning and active stimulation of a wider competitive response.

33. It is within this context and wider learning that the ECF has emerged. It is a first venture of its kind by AusAID, and likewise of the instrument itself in the Asia-Pacific region. It has clearly resonated with AusAID staff, as it has with the private sector generally which has co-invested more than AUD 21mn in matched project funding at an encouraging leverage rate of 1.59 private to public funds. Opportunities going forward are defined in the remainder of this review report, and rest on a tighter application in practice of the core challenge fund principles and strategic objectives outlined above.

3 ECF RATIONALE AND OBJECTIVES

34. The review team finds the ECF rationale and objectives, as defined in the original design documents, compelling. This is because it responds well to lessons learned from the experiences of "first-generation" challenge funds[4]. These lessons included:

- *The role of the fund manager should be less "hands-off" disburser of grants, and more a "hands-on" investor of social venture capital;*
- *The purpose of any challenge fund should be to contribute to wider systemic (i.e. beyond project level) change;*
- *The "challenge" of challenge funds should be clearly defined, and informed by research, engagement and experience;*
- *Money should be seen as just one of the tools a fund manager has for engaging effectively with private firms;*
- *Larger firms represent stronger partners, with greater implementation capacity, and larger projects with larger firms tend to offer more potential for systemic impact;*
- *Firms should concentrate on delivering the commercial (private) objectives of the project. The fund manager should concentrate on ensuring the social (public) objectives of the fund are measurable and significant.*

35. -The other key lesson emerging at the time of the design was that more specialised challenge funds offer greater strategic coherence, efficiencies and impact than open and more general challenge funds. This particular lesson was not reflected well in the ECF design, but is a lesson to emerge strongly from this review.

36. The design of the ECF represents a second-generation challenge fund. However, much of the essence of this rationale has not been translated into the operations of the ECF. Hence, before presenting our main review findings, it's important to restate and discuss around the rationale we find compelling, and to highlight where we see deviations from this. It is in these very deviations that much of the critique of the ECF presented in this report has its roots.

37. The rationale of the ECF is confirmed in the ECF Request for Tenders, which states: <u>"Eligible projects should have three characteristics which justify public intervention: significant externalities, innovation, and pro-poor benefits".</u> These three characteristics are absolutely fundamental. They should define and shape everything about the ECF: in its marketing and messaging, in its pre-appraisal engagement work with potential applicants, in its appraisal criteria and decision making process, and in its evaluation and lesson learning.

38. Before we consider in more detail how and where the ECF deviates from the design rationale, it is necessary to confirm what is meant by externalities, innovation and pro-poor benefits, and how they are linked to form a coherent rationale for challenge fund interventions.

39. <u>*Externalities:*</u> The economic rationale for grants to private business is centred on market failure arguments[5]. Market failure, it is argued, is endemic in many areas critical to private sector growth in developing countries. Externalities exist whereby the benefits of certain investments "spill-over" to others which have not invested, but nevertheless

[4] This refers to the pioneering DFID Business Linkages (BLCF) and Financial Deepening (FDCF) Challenge Funds.

[5] This same rationale is central to the ECF Project Design Document. Although the term "failure" is felt to too be too definitive. Really, in situations relevant to the ECF, we are concerned more with degrees of market "weakness".

benefit in terms of learning about the results. Because of such information externalities the socio-economic benefits of technology transfer investments are greater than the returns to any individual firm that undertakes them. As a result the private sector can invest too little in technology transfer relative to what is socially optimal for sustained long term growth.

40. *Innovation:* in response, a challenge fund is looking to support new and innovative business models, processes and partnerships that represent credible private sector solutions to clearly defined systemic (market) weaknesses which are inhibiting the private sector from working more productively with and for the poor. Challenge funds aim to partner and trial with “first movers” through offsetting that portion of “innovation risk” which is preventing firms from investing. This is often referred to as “disruptive innovation”, whereby grants might give an initial competitive stimulus to the “early adopter”, but that a wider catch-up response from the competition is expected.

41. Innovation is the route through which challenge funds can move upwards from project to wider systemic impact. This point is highlighted through the findings of a recent and comprehensive evaluation of all EU development support to Private Sector Development in Africa, the Caribbean and the Pacific (ACP) over a ten-year period from 1993: *“…interventions are less likely to be sustainable when they offer direct support to private sector operations without generating a substantial change in behaviour, practices or knowledge.”*[6]

42. *Pro-Poor Benefits:* just as information externalities are disincentives for private investment, they are the very rationale and motivation for public investment. Challenge funds invest for clear social – pro-poor – returns. Hence, economic benefits resulting from the type of “technology transfer” investments being made by a challenge fund should generate:

    - *private profits to investing firms, plus*
    - *wider benefits to the economy in terms of externalities (information / knowledge spill-over).*

43. Good grants are the ones that generate spill-overs as the justification for public support is based on these wider economic benefits and not the size of private benefits. Investing firms should be willing to pay for the private profits generated by the added investment, with public agencies willing to pay for the spill-over because they generate added economic growth for society.

3.1 The gap between ECF design rationale and operational practice

44. If the above is the rationale, what are the implications for the ECF, and how does it fare against these?

45. The rationale confirms that grants are put to overcome market failures. Hence, one would expect the appraisal process to include some reasonable degree of market diagnostics / problem definition to highlight just what the nature of such market failures are. However, detailed analysis is contrary to the concept of “light-touch” first generation challenge funds – and likewise such analytical rigour tends to be missing. Unfortunately, such depth is also missing from the ECF.

46. Presently the ECF process centres on the “opportunity” – what will the project do, what it will deliver, who will benefit etc. Whereas, the first logical question the ECF (and in fact, any development programme) should ask of any application might be “what is the development problem to which this project can contribute”.

[6] Evaluation of European Community Support to Private Sector Development in Third Countries – Final Report”, ADE, December 2005

47. This deficiency of analytical content can be addressed through a variety of ways:

- *Pre-Launch* – typically second-generation challenge funds[7] are deployed in direct response to the definition of a particular development problem which has been identified. They are more specialized, thematically or sectorally. They rely on a clear understanding, often supported by research, and articulation of the "challenge" to which the challenge fund is being deployed. Such challenge funds also tend to be positioned (albeit centrally) within a wider programme of activities[8].

- *During the appraisal process* – where the fund manager aims to define the development problem in response to the presentation of an opportunity in an applicant's bid. Such work is basically an expanded form of due diligence. It would check and test the application in light of more detailed sector / market analysis.

- *By the decision making process* – where a Panel is convened such that it has such sufficient knowledge and skills whereby to obviate the need for the type of expanded fund manager due diligence referred to in the option above.

48. However, of the above options, only the "pre-launch" specialisation option offers the required level of strategic coherence and objectives (at a Fund level), and the necessary efficiencies required to run any challenge fund cost-effectively. The ECF does not comply with this finding.

49. Innovation is absolutely central to the rationale of grants being used to overcome externalities typically associated with the types of market failure to which private sector solutions (the focus of the ECF) might respond. However, inexplicably, innovation does not seem to feature anywhere in ECF operations:

- *ECF Marketing – Innovation does not feature anywhere in the Key Messages of the ECF Media Communications Plan (April 2009)*
- *ECF Applications – Innovation is not explicitly explored*
- *ECF Project Assessment – Innovation is not included in the criteria against which bids are scored*

50. Pro-poor benefits must be the central consideration for any development programme, and the ECF is no exception. The ECF process asks bidders to talk about "who" is expected to benefit – directly and indirectly – from any project. Such consideration features in the appraisal of projects.

51. However, typically the qualification and quantification of pro-poor benefits at the time of grant approval remains relatively undefined and is ultimately unsatisfactory. For example:

- *Target groups are generally not considered as formal partners in the process, and hence applications typically shed little light on just who these "poor" are, how relevant the project is to them, and just how they expect to benefit.*
- *Without having a stake in the project directly, one is left to assume that the target poor can and will automatically be able to respond to the opportunities offered by the project and/or that the project understands exactly what they need and will meet such needs. Such assumptions are considered generous. They are also not particularly empowering[9].*

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[7] These would include DFID's African Enterprise Challenge Fund.

[8] For example, CGAP run a Pro-Poor Innovation Challenge Fund. The learning and lessons from such feed into and inform their wider microfinance remit.

[9] Note that both of DFID's BLCF and FDCF had partnerships as a key objective and requirement. Typically the grant element was to be invested in the partnership, and specifically to support the weaker partners (e.g.

- *There seems to be little consideration (formally at least) of the ratio of grants to pro-poor benefits generated. The commercial viability of the lead firm is the route to the sustainability of any benefits. But the ECF should also consider with much more scrutiny the likely size and distribution of any pro-poor benefits relative to the size of the grant.*

> ***<u>How "the poor" are poorly articulated in applications</u>***
>
> *<u>Sarami Farms (Vanuatu)</u> was awarded a grant of circa AUD1.4mn. Their application focuses on technologies which can add value to the cattle fattening process. Some of this value is passed on to small holders through a) higher prices for animals, b) earlier sale of animals and c) distribution of improved breed bulls. After some years Sarami expects to purchase up to 2000 animals from small holders (how frequently though is not clear). The application talks of up to 6000 men and women benefitting from this project. However, the application (confirmed also by a visit to the applicant) also talks of offering bulls against every 40 animals supplied by a farmer (or more likely a community comprising farmers). Dividing 2000 by 40 suggests that only 50 farmers (or perhaps communities of farmers) might benefit. Whether this lucky "50" equates to 6000 poor men and women is not at all clear. It needs to be[10].*
>
> *<u>Marine Consultancy Services (Vanuatu)</u> was awarded a grant of circa AUD750k. This application focuses on the provision of a regular and reliable shipping service to the circa 9000 population living on the more remote Banks Islands of Vanuatu. The hypothesis is a good one. That a lack of regular and reliable shipping means people cannot plan or make investments given the uncertainly of getting produce to market. However, the application presents no assessment whatsoever of the resources, capacities, organization or ability of the local population to respond in the way (or to the degree) which would be necessary to support the commercial viability of the new shipping service.*

52. The above are clear failings of the ECF to put into practice the rationale and objectives of the original design.

53. The ECF, to its credit, has managed to generate some projects that do offer consistency with the original design logic and criteria, and hence which do offer significant impact and outreach, and which are sufficiently innovative so as to offer clear replication potential:

    - *Sunlabob (Laos) – potentially offers a first example of a public-private partnership between private power generator and public power grid and distributor which supports increased outreach of rural electrification and which can serve as a model for many other such partnerships all across Laos.*

    - *ANZ-Wing (Cambodia) – at a project level offers the potential for as many as half-a-million rural Cambodians access to formal financial services. Beyond the project there is real potential for ANZ to replicate this across others of its operations in the region, and perhaps to spark other providers to join the race also.*

54. Both of the above examples present clear development problems: lack of access to finance, and energy, is constraining livelihoods of the poor. They are both clear about the causes of market failure. For ANZ-Wing, failure lies in the lack of financial literacy and low understanding of mobile phone technologies amongst target rural populations. Overcoming these hurdles requires public investment, upon which private investment in

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producers associations, BMO's etc, rather than the lead firm) being able to truly participate with the stronger partners.

[10] We understand that these questions are being addressed through the M&E process, but they should have been clearly articulated at the time of approval.

more commercial marketing and management of the new service can piggyback. Both projects represent clear innovations as they are breaking new ground in their respective countries. Again, both of the applications are supported by strong analysis of their target populations, they offer strong impact and outreach at project levels, and they offer clear replication possibilities.

55. These two projects offer such potential exactly because they do embody the rationale and objectives of the ECF design.

3.2 Overcoming barriers to innovation

56. Challenge funds seek to reduce risk pricing and increase risk appetite.

57. Risk pricing refers to the gap between perceived and real risk attached to any investment. By supporting the innovation of "first movers" a challenge fund aims to close the gap between perceived and real risk to a level where firms are prepared to make the investment decision. Having made the investment, the experience will help firms to better price similar risks in future, and hence challenge funds support the reduction in risk pricing.

58. Having supported the "first mover", and confirmed a re-pricing of the risks associated of working more productively for the poor, a challenge fund needs to ensure an increase in the appetite for risk, such that a wider and more systemic response and impact is realised. Increasing risk appetite demands that a challenge fund is clear:

- what it is demonstrating (though the initial pilot),
- to whom the demonstration is aimed, and
- how the demonstration will result in a wider systemic response.

59. Issues of risk pricing and risk appetite are explored below.

3.2.1 How the ECF can better support reduced risk pricing

60. There are four key ways in which the ECF can support risk mitigation for private sector firms: cost-sharing of risks, information provision, partnership and branding, and social entrepreneurship of the fund manager. In doing so, good challenge funds – as with many other development initiatives – offer more than just money. Such issues are explored below:

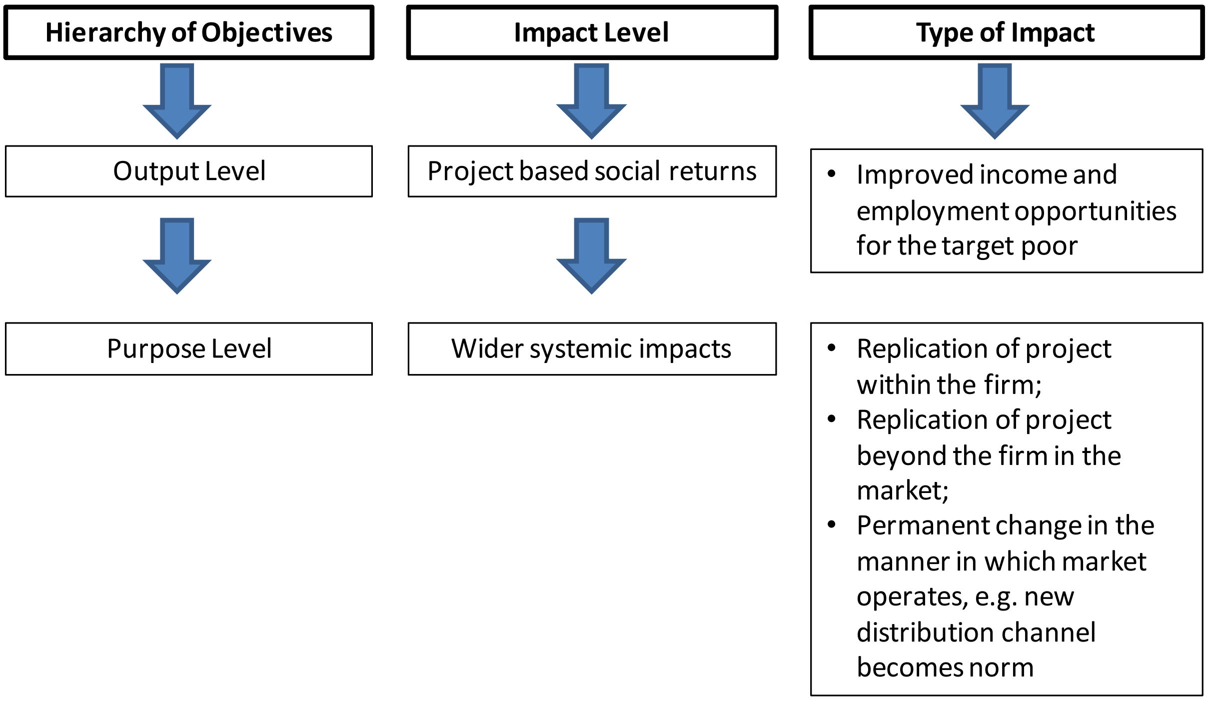
Reasons for firms not innovating	How ECF can overcome these reasons
1. Risks perceived as being too high	• Cost sharing seeks to reduce risk sufficiently for project to proceed
2. Information asymmetries (which increase perceived risk)	• Cost sharing seeks to reduce risk sufficiently for project to proceed • Fund Manager leverages information and facilitates partnerships
3. Inertia within firms (caused by lack of internal resources, inbuilt bias against going "downmarket", lack of competition, etc)	• Cost sharing, coupled with: • Brand value of donor/CF connection • Social entrepreneurship by Fund Manager catalysing behavioural change in firms

61. The ECF responds more to reason 1) above. It is mainly about the money, which is again consistent with a first-generation challenge fund. This is limiting its potential impact. As challenge funds learn, gain knowledge and skills, and specialise, they can – and should – start to move to a more social venture capital approach as embodied in

reason 3) above. This shift is entirely consistent with the expanded offer of the second-generation challenge fund which the ECF purports to be.

3.2.2 How the ECF support increased risk appetites

62. As stated above, if the first objective of a challenge fund is to reduce risk pricing, its second objective is to increase risk appetite. In more general terms, this latter term refers to the wider replication and systemic change impacts which are set as higher level objectives for the ECF. This is represented graphically as follows:



63. The above logic model, whilst partial and illustrative only, is consistent with the design of the ECF.

64. The ECF does not have a logical framework, or any strategic framework. However, the use of a logical framework (or similar), to develop, articulate and "lock-in" to practice the above hierarchy of objectives, and levels and types of impact might well have ensured that ECF operations more closely match the promise of its design – findings that will be explored in more detail through this report.

3.3 Systems and the confusion of BEE

65. The ECF has an objective to contribute to wider systemic change, as the route to multiplying impacts and increasing outreach beyond the project. The ambition of systemic change is synonymous with the strong ECF focus on Business Enabling Environment (BEE). However, as currently expressed, the concept of BEE remains poorly defined, and hence its application in practice is confused and limited.

66. This is highlighted by the limited usefulness (and use) of the BEE country reports, prepared for each of the nine ECF countries. They are long, costly, and seem to serve little purpose beyond the ECF Fund Manager discharging a contracted activity to AusAID.

67. In principle these reports should identify the source of strategic development problems, market failures and associated externalities. They should define the "challenge" for the challenge fund. The problem is of course, that the ECF is open to any application. As such it's neither practical nor feasible to define the "challenge" or "innovation frontier" for

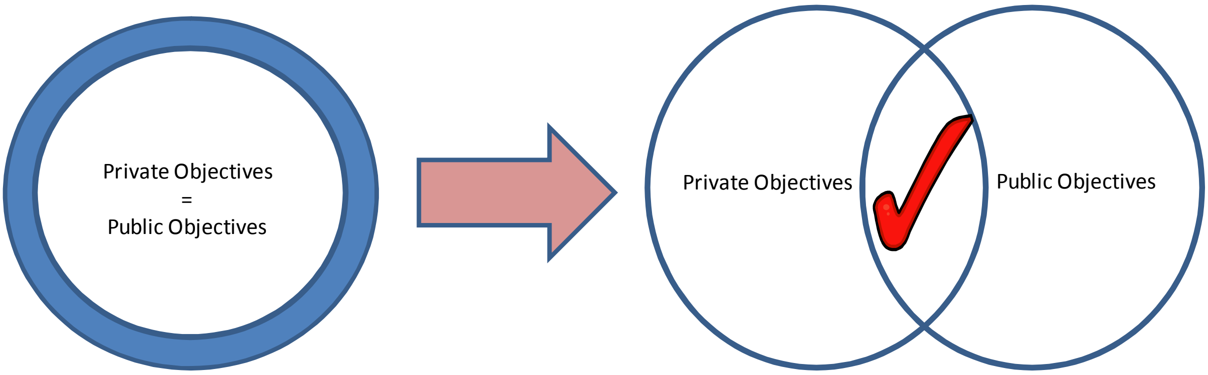
every sector, in every country open to the ECF. In this respect they were always likely to fall short.

68. Of more concern though is the lack of conceptual clarity about what systemic change might mean, and how the ECF can support such a vision practically. It is beyond the scope of this report to re-define this in detail, but this issue is tackled more thoroughly in the Effectiveness Annex, where the review team present its framework for assessing projects in the field and in doing so, offer a way forward to the ECF for making more conceptual and operational sense of the concept of BEE.

3.4 The distinction of ECF objectives from those of private firms

69. The ECF represents a form of public-private partnership. However, this does not mean that both parties have the same objectives. They do not – or should not at least…! The primary motivation and objective of the private partner should be to grow their business and make profits. The primary motivation and objective of the public partner is to ensure that the business process through which the private partner generates its profit is more inclusive of the poor, that value is generated / vulnerability is reduced for the poor, and that this is at scale (directly, or through spill over effects).

70. As shown graphically below, the ECF assumes a more direct overlap between public and private objectives (depicted in the left hand side of the graphic). This is because the application itself is the basis of any grant award decision. Hence, in additional to delivering on its private objectives (making profits) the ECF also expects the private firm to understand, define, qualify, quantify and deliver all of the public objectives of the ECF. This is a very passive approach. It too frequently involves firms (sometimes with the assistance / feedback of the Fund Manager) saying the things we need to hear to make an award.



71. It would be more appropriate for the ECF to take a more active role as depicted in the right hand side of the above graphic. This would represent a move towards a second generation challenge fund, which is clearly warranted. There is far too much of a sense – from the ECF Fund Manager, and certainly from the ECF Panel Members interviewed - that the ECF is a grant fund to be disbursed, rather than public funds to be invested.

72. A challenge fund, focused on innovation risk, should be less risk averse and more flexible than more traditional venture capital. But equally it should aim to take a social venture capital approach – investing public money for maximum social gain. This means moving beyond a hands-off / light touch award against-application-approach.

73. To make this point more clearly, the typical conversation with ECF Panel Members went as follows:

- *<u>Review Team:</u>* *Were you comfortable with the decisions you made…?*
- *<u>Panel Member:</u>* *Yes. We're comfortable we made the right decisions based on the information we had in front of us.*

- *Review Team:* *Was the information in front of you sufficient to make such investment decisions, say if it had been your money…?*
- *Panel Member:* *No. Generally not.*

74. This is not to say that bad or wrong decisions were necessarily made. Nor is it to say that Panels did not take their job very seriously and add real value. They did. Rather, what it does say is that ECF is making serious investments, and currently it is far too reliant on a simple paper application. More detailed due diligence, more interrogation and negotiation with partners, more qualification and quantification of expected social returns, all key roles for the fund manager, would be more consistent with an "investment" of public money, than the current sense of "disbursement" of public grants.

75. The above are not criticisms *per se* of the ECF. Rather they serve to further highlight the limitations of first generation challenge funds. The ECF design responds to such limitations. However, the ECF in practice does not yet (sufficiently at least).

4 RELEVANCE OF THE ECF

In this section we consider the relevance of the ECF. We do so against the following dimensions, as follows:

- Relevance to AusAID's emerging approach to PSD
- Relevance to AusAID Country Strategies / in-country PSD efforts
- Relevance to AusAID corporate priorities

The assessment here is more reflective. It is not based on an exhaustive assessment of the above dimensions of relevance.

4.1 Relevance to AusAID's emerging approach to PSD

76. As confirmed earlier, the ECF was conceived in the context of the White Paper on Australian Aid (June 2006) which called for a renewed emphasis on economic growth and stressed both the importance of the private sector as the main source of growth and the need to strengthen partnerships with the private sector.
77. The ECF offered a different aid modality to the more traditional instruments which AusAID has used to support private sector development. The value of these more traditional approaches was not in question. Rather the ECF aimed to offer something additional – a more direct engagement and partnership with the mainstream private sector.
78. AusAID was not alone in its thinking and actions here. Numerous other aid agencies had, or were planning more direct partnership initiatives with the private sector in home and target countries.
79. The concept of a challenge fund for ODA[11] was pioneered by DFID. It was a key response from DFID to this perceived need for new instruments with which to engage the private sector more directly as partners in the development process. Like AusAID, DFID saw challenge funds as complimentary and additional to its other approaches. This "fit" was explained by DFID as follows[12]:

[11] Overseas Development Assistance

[12] This table is adapted from an internal DFID presentation made as part of the early design process of the AECF.

	Enabling environment	Sector programmes	Enterprise development	Challenge funds
Objective	Improve business and investment environment for all businesses to grow	Integrate poor into sector value chains	Build enterprises, especially MSMEs	Re-orientate existing firms to deliver pro-poor outcomes
Response required from	Government & public sector agencies	Government and private firms	MSMEs	Private firms
Examples	ICF; infrastructure programmes	Financial Sector Deepening Programmes	BDS programmes; SME finance	FDCF, BLCF, PPIC, DM
Timeframe	Long term	Medium to long term	Medium to long term	Short to medium term
Reward	**Potentially high** if private sector responds	**Medium to high** depending on govt and private sector response	**Medium to low** depending on local entrepreneurship	**Medium to low** depending on potential for systemic impact
Risk	**High** • Pol. econ can scupper best efforts • Priv. firms may not take up new opportunities	**Medium to high** • Pol. econ can scupper best efforts • Difficult to implement	**Medium** • Crowd out priv sector activities • Market distortion • Donor dependency • Fin'ly unsustainable	**Low** •Market distortion •Project failure
Risk mitigation	• Withhold further aid • Very difficult to manage public sector stakeholders	•Withhold further aid •Very difficult to manage public sector stakeholders •Provide technical assistance	•Withhold further aid •Project management	•Manage contractually, easier to sanction private companies •Implementation support to firms

80. The above representation applies, in the main, to how challenge funds do / should fit and be additional to AusAID's wider PSD work. In this sense, the challenge fund instrument is highly relevant to AusAID's emerging approach to PSD.

81. The review team would, however, qualify this statement. A challenge fund simply defines the process through which cost sharing grants are allocated to businesses. The quality of this process defines how well, or not, these grants deliver a social dividend. In this sense, challenge funds, being seen as a process, can be whatever you want them to be.

82. Hence the point is less that challenge funds, *per se*, are relevant to AusAID. Rather, what should be seen as highly relevant to AusAID is the ability to cost share risks with the private sector to innovate in pursuit of new business models, processes and partnerships which, for significant numbers of the poor, promote access to poverty reducing goods and services, increased economic opportunities, and reduced economic vulnerability.

83. The ECF was a first, and the review team thinks a positive and significant departure for AusAID. The principles behind it remain relevant and valid. The process can always be refined and improved. However, so long as it continues to "stand alone" as an instrument within AusAID's portfolio, it can expect to continue to attract a particularly high level of scrutiny from different constituencies.

4.2 Relevance to AusAID Country Strategies / in-country PSD efforts

84. The review process sought views from Post through:

- *Direct interviews with key staff in those countries visited by the review team, and*
- *E-questionnaires distributed to all posts.*

85. Between these two approaches, the review team managed to solicit views from six of the nine country Posts. Key messages are as follows:

86. The ECF is a centrally managed, multi-country operation. Country strategies are specific and unique to each country, as are programme management and implementation arrangements. The ECF cannot be "programmed" within this context, and cannot therefore be seen as being of *strategic* importance to the delivery of country strategy objectives. Of course, this is likely true of any such centrally managed, multi-country initiative.

87. Where countries have advanced value-chain / sector / lead firm related private sector development programmes (e.g. Indonesia), the ECF might offer stronger synergies with, and be reinforcing of, country strategy objectives. Equally, fit might work well in countries where AusAID is obliged to work beyond government (e.g. Fiji). Where not, at best, the ECF can operate in the "space" left open by less developed PSD programmes.

88. In this sense, alignment is less of a problem. In reality though, AusAID country objectives are defined fairly broadly and hence the "space" for alignment of the ECF is a wide one. The point is can / does the ECF contribute to AusAID country strategy objectives? The answer is not straightforward. Certainly we received several responses in the affirmative. However, it rather depends on the question posed, for instance, if the question was:

    - *If the ECF was in operation, could it contribute to the delivery of objectives…? The answer would likely be yes (to greater or less degrees); however,*
    - *If the ECF was not in operation, would this hinder Post delivering against their country strategy objectives…? The answer would more likely be no.*

89. There is another dimension to alignment of course, which is coherence with the donor harmonisation principles embodied by the Paris and Accra Declarations. It is not easy to think how the ECF, in its current form, can meet such principles. If other donor's were to co-fund, and funding windows were opened specifically in response to country led priorities, then it could align more meaningfully. However, whilst there is a sense that other donors would welcome pulling ECF funds into their programmes (as grants to their private partners), there is deemed no discernible appetite from other donors to capitalise the ECF.

90. On balance, the feeling of the review team is that there is a lot of interest and support for the principles of the ECF, if perhaps not the ECF itself, from Posts. The ability to engage directly with the private sector is certainly deemed valuable. It is certainly seen as a welcome departure from the "drudgery" of working solely with and through government in support of PSD objectives.

91. Partnering directly with the private sector can be of strategic importance to the delivery of AusAID country strategies. To achieve such strategic value however, the "instrument" needs to be used strategically and this means that it can be programmed by and within any country operation.

92. Following the strategy theme, Posts felt that for the ECF to offer more strategic value to them it needs to fund larger projects, with greater potential for scale, genuine innovation and demonstration, and therefore greater replication potential. Many also acknowledged however, that:

    - In some cases there are not that many large firms operating and/or of the type which might be relevant to ECF aims and objectives.
    - In other cases it was felt that many large firms were / would be put off by applying for grants through a competitive process. For them, fund manager value beyond money would be required.

93. Overall, the ECF itself is hard to fit as neatly as one would like into supporting country strategy priorities. However, the instrument of competitively awarded cost-sharing grants to business, in response to clearly identified development needs and priorities, would we feel be very much welcomed by Posts (when used discerningly and in context).

4.3 Relevance to AusAID corporate priorities

94. As mentioned, the ECF was conceived in response to a clear call to action by the 2006 White Paper. In this sense it was designed to, and broadly is (performance notwithstanding) contributing generally to AusAID corporate priorities.

95. However, whilst the ECF is coherent with various policy priorities, it is not harmonised directly in support of the delivery of any specific corporate policy or programme. As such, whereas it struggles to fit neatly and strategically into supporting the delivery of country objectives and programmes, neither is it central to the achievement of any specific corporate policy or programme.

96. The review team was made aware of three emerging corporate priorities for which the ECF (or a challenge fund at least) might well be deployed more strategically:

- *Pacer Plus – this relates to trade development, promotion and facilitation. The private sector can certainly innovate to support improved access by the poor to regional export markets. However, many hurdles to trade cannot be met by the private sector alone. As such the review team feels that a challenge fund on its own would be far too limited and blunt instrument for such a task. However, a challenge fund offered as part of a wider programme which is geared to tackle wider policy, institutional and infrastructural issues might be warranted.*
- *Microfinance – this relates to AusAID's expressed desire to do more in the field of microfinance. Challenge funds have, and are being used by various agencies to support microfinance, and financial services more generally. In the main though, such agencies are working with challenge funds as just one instrument supporting within a wider programme of activities. Further, they are increasingly moving towards specialisation and specific deployment. For example, DFID's Financial Education Fund, is time bound, and specifically aims to generate lesson learning about the most cost-effective methods for achieving both outreach and impact of improved financial awareness and literacy.*
- *Renewable Energy – this relates to recent pledge by the Australian Government that it would provide funding of at least $25 million over four years for initiatives in clean and affordable energy in the Pacific region. After agri-business, renewable energy is the second largest sector of ECF projects. Most of these are located in the Pacific. As such, the ECF has shown that a challenge fund can be used to leverage private sector engagement in pursuit of cleaner energy in the Pacific. The renewable energy challenge is a strategic one, and again, solutions will likely require efforts beyond the private sector alone, such as policy, institutional, technology, coordination. However, the review team could certainly conceive of a challenge fund (perhaps even the ECF itself) being a key component of a wider facility for the promotion of cleaner energies in the Pacific.*

5 EFFECTIVENESS OF THE ECF

97. Effectiveness is defined as the quality of the outputs delivered by the ECF. We will consider quality in three dimensions:

- Commercial viability (at project level);
- Pro-Poor Impact (at project level); and
- Likelihood of contribution to Purpose[13] level objectives.

98. Before this though, it's useful to lay out a few key facts and figures for the ECF portfolio:

- *A total of 24 projects have been awarded from three bidding rounds at a total ECF grant commitment of AUD 13,352,846.*
- *Funds are fully committed and no further bidding rounds are envisaged.*
- *Asia boasts 7 projects with an average grant size of AUD565,544, and the Pacific 17 projects with an average grant size of AUD509,767*
- *The total commitment of matched contributions from bidders is AUD 21,073,257.*
- *The leverage ratio of grant to bidders' contribution is 1.59.*
- *With 11 projects, agribusiness (including forestry) is the most popular sector, closely followed by energy (mainly biodiesel). Tourism and financial services are the next most represented sectors, followed by transport and education with one project each.*

99. Clearly there is a private sector in the Pacific, and Asia, which is prepared to co-invest considerable sums of their own money in expanding and/or innovating their business, and which have clear market linkages to the communities of prime interest to AusAID. In a small number of cases (mainly related to larger firms[14]) the review team would accept the ECF did push these firms to do something they might not have done otherwise. In more cases, ECF funding has facilitated firms to invest more and more quickly than arguably they might have done otherwise.

100. ECF leverage of around 1.59 is lower than the 3.9 achieved by the FDCF, and the 2.1 achieved by the BLCF. Leverage is important as it serves as a proxy for motivation and commitment of firms.

101. One should be clear what is meant by leverage. It is a mixture of cash, in-kind (labour and assets), and working capital / reinvestment of net sales revenues. The latter tends to account for the lion's share of matched funds, followed by in-kind contributions, with cash investments making up the residual.

102. For example, Sarami (Vanuatu) received an ECF grant of AUD 1,375,000, against which it's pledged a matched contribution totaling AUD 3.161,500. Of this total, 60% will comprise the purchase of animals from small holders over the three years of the project. For ANZ-Wing, 80% of their AUD 4,393,958 matched contribution relates to the costs of employing new sales staff as the business expands in line with sales over the period of the project. Presumably, if actual sales / net revenues prove less than projections, matched funding in both cases may well be lower than anticipated. Of course, the reverse might also be true, though predicted growth rates generally in applications seem fairly aggressive.

[13] The ECF has no log frame and therefore no Purpose per se. However, we refer here to the higher level impacts related to innovation, replication and the wider system.

[14] For example, ANZ-Wing and Carnival which both represent genuine innovations for the companies concerned.

5.1 Commercial Viability

103. Most projects in the ECF portfolio have just started, are just about to start, or have just been awarded. Projects are forecast to reach commercial viability only after three years of funding. So, with so little or no track record of performance, it's impossible for the review to give any sort of definitive judgement about the likelihood of projects being effective in delivering their promised commercial viability.

104. However, the Effectiveness annex to this main report presents structured aide memoires for each of the projects visited during this review. These give an all round view from the review team on the projects. The lessons from which are synthesised in the reminder of this section.

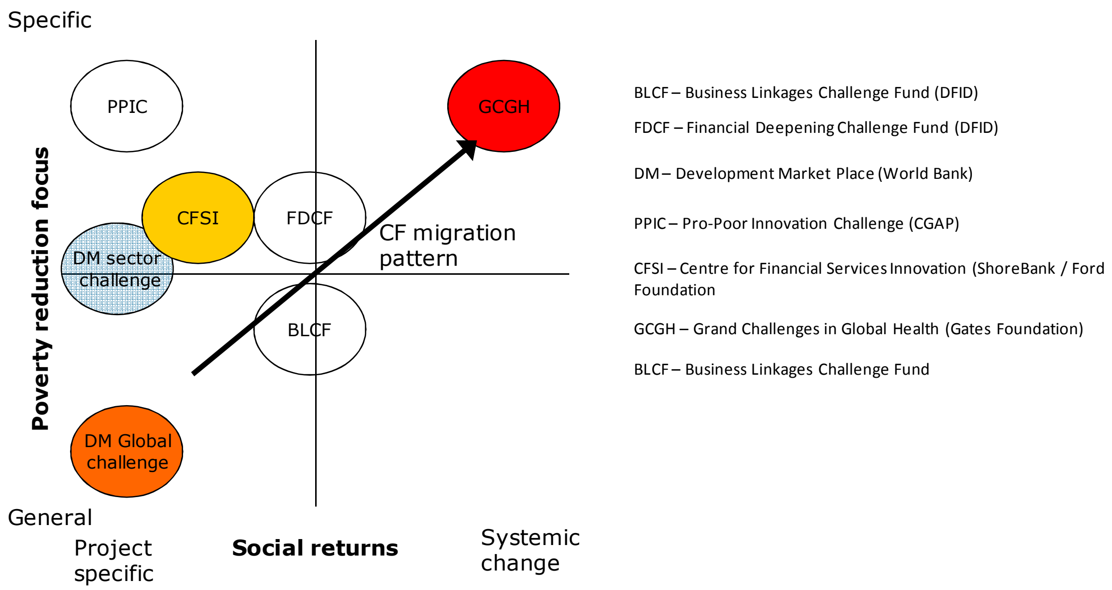
105. In light of the above, our approach to assessing likely commercial viability is twofold: firstly, we briefly review performance of more mature DFID challenge funds, and secondly, to highlight a number of risk factors and issues related to, and which might impact on, future commercial viability.

5.1.1 Learning from wider challenge fund experience

106. There is not a lot of reliable independent data from any of the DFID challenge funds. However, the AECF design process did present two key findings:

- Specialised funds (i.e. FDCF) had a higher impact than more general funds (i.e. BLCF); and
- For the FDCF, it was anticipated at the mid-term review stage that "20% of projects were likely to succeed; 50% of projects had only a moderate chance of success; and 30% of projects were unlikely to achieve success."

107. The first lesson presented above is highlighted clearly in the following graphic[15]:



108. Of course the review accepts there are many differences between the DFID experience and the ECF. For example. the ECF operates in a new time, across different countries, and is managed by a different contractor. Hence, a suitable health warning should be applied to any general comparisons. Equally though, between them the BLCF

[15] This graphic is adapted from an internal DFID presentation made as part of the design process of the AECF.

and FDCF funded more than 100 projects, in 26 countries, over a 5 year period. Their experience is not irrelevant.

109. Applying the above ratios to the ECF, one would expect 5 projects to deliver to their fullest ambition; up to 11 projects to deliver some degree of stated ambition; and around 7 projects to fail. Of course, the ECF is one of the more general types of challenge fund referred to in DFID's analysis, so success rates would be expectedly lower.

110. It is early days for ECF projects. If the DFID experience is any sort of comparator, three lessons should be learned and prepared for:

- *There will be a number of failures;*
- *There may also be a smaller number of "stars";*
- *Stakeholder expectations should be managed carefully in light of the above;*
- *The Fund Manager's task is only just beginning;*
- *Monitoring and evaluation are valuable, but active investment management will also be required to mitigate failure and manage success (again in line with a more social venture capital approach referred to several times in this report).*

5.2 Additional risk factors

111. The following are considered as additional risk factors to the performance of the ECF. Some relate to risks which might have been mitigated further through a more robust ECF process. Others can be mitigated through a more pro-active investment management approach above and beyond that of the envisaged M&E activities.

5.2.1 Implementation capacity and smaller firms

112. The ability of businesses to effectively absorb grants / finance is a key issue. It is irresponsible to financially overload a business, particularly when one is overloading it with public funds, and particularly when much of the funding is going directly to support business expansion and growth (i.e. internal rather than external to the firm). Hence, there should be real consideration given to the size of any grant relative to the "size"[16] of any grantee.

113. As a general rule (and there are always exceptions of course), it's not good practice for challenge funds of the nature of the ECF to be awarding grants in excess of the gross revenue of a business.

114. The review team accepts that the ECF process claims to be sensitive to such issues, however, one can't escape the fact that there are a number of examples where the size of the grant swamps the size of the business.

Two examples of grant size outstripping the financial size of the business:

According to their application *Volcanic Earth (Vanuatu)* just prior to the ECF grant award, had that year achieved sales revenues of AUD 15k, made a trading loss of AUD 4k, and had only AUD 4k cash at bank out of a total net asset value of AUD 33k. They were awarded an ECF grant of AUD 190k. The grant is almost thirteen times larger than their total annual sales revenue, and six times bigger than their total net worth.

[16] Some challenge funds use net worth of the business as an indicator. Others, perhaps more correctly so, use gross revenue as measure, as this is considered a more accurate indicator of business processes, systems and management capacities.

> _Teamworkz (Laos)_ represents a second example. It was awarded a grant of AUD 195k, against a net worth of AUD 111k, and a posted annual gross margin[17] for its hotel booking service of AUD 58k. Again, the grant bears little relation to the size or performance of the business.

115. The review team recognises the importance of having flexibility in decision making, and hence proposes no hard and fast rules for this. But there must be clearer and more tightly applied guidelines in respect of this matter.

116. A second and related dimension of implementation capacity relates to the skills and expertise of the individuals driving the project. CVs are generally offered and reviewed, and the general track record of the company is considered. Further, the ECF Country Manager often knew, or made a point of meeting the principal concerned. However, the review team would still like to make three comments in this regard:

- *Many grantees are smaller firms, where the owner / manager(s) is the key (often only) principal driving the project. Limited management capacity of small firms is considered a particular risk[18]. Working with larger firms, where the executive management demonstrate a clear commitment (and offer real matched investment) to the project would represent a much lower risk. This is important as funds like the ECF are entirely dependent on the firm to implement the project.*
- *Many applications predict rapid and high growth rates. Managing such growth effectively places considerable and additional demands on the managers of any business. Larger firms, with access to a wider skills set can handle this better. Venture capital, investing into high growth potential businesses would often seek to help (or insist) the investee to find and recruit the right skills to help grow the business. A more social venture capital approach by the ECF might also mitigate growth risks through adding value in a similar way.*
- *Ultimately, investments in any business are a risk and balanced judgements are called for. Presently the ECF relies far too much on the strength of the application, and not enough on a more detailed assessment of the business and the people involved. Visits to the business and interviews / assessments with its principals (by someone suitably qualified) should be considered as a minimum standard for any ECF investment.*

5.2.2 Distinguishing the project from the business

117. In many instances ECF grants are being invested in the core activity of the business. Often, in doing so, they are not financing anything "innovative". Often grants are being put to procuring new assets, or upgrading existing assets, of the main business in support of its planned expansion. A common argument seemingly being that "if we can grow, we can buy more from our suppliers (the so-called "poor"), and in doing so we have a business operating viably, at a larger scale, and with a resulting increase in market access opportunities to small holders". This is consistent with the requirements for commercial viability. It might also be consistent with a required pro-poor focus (though this is likely to be stronger if expansion opens opportunities for growth and access to those currently without access). However such a narrow focus does not necessarily support the overarching rationale and objectives of the ECF. Financing such

[17] Gross margin here refers to the total margin taken on bookings before any operational costs.

[18] For example, the Principal of Teamworkz in Laos, who conceived the application and who is seen to be driving the project, confirmed to the review team that he's recently signed a contract with SNV (a Dutch NGO) for 200 days this next year as a tourism consultant. Small business owners / managers often have competing calls on their time.

basic business expansion should be considered more the remit of commercial finance, and less that of grant funds.

118. Often the argument put forward in the ECF approvals process is that financial markets are thin, businesses lack access to finance for their planned expansion, and hence ECF is not crowding out when making its investments. This might well be true. But the rationale of the ECF is to finance only that risk of innovation in working with / for the poor in new and novel ways. The ECF is not there to fill the general access to finance gap in the countries where it operates. Unfortunately, with the dropping of any focus on innovation across the entire ECF operation, this is exactly what it's in danger of becoming. The issue, as observed by the review, is less about the dangers of crowding out commercial finance (given the type of risk the ECF should be focused on). The concern we have rests in the lack of any clear strategy as to how the ECF expects the crowding in of commercial finance to emerge in light of the lessons successful projects should be demonstrating to others (the risk pricing and risk appetite issues referred to earlier in this report).

5.2.3 Ownership and motivation of the bidder

119. To its credit the ECF made a conscious decision to insist that a minimum of 15% of the matched contribution from bidders is made in the form of genuine cash investment. This goes some way to ensuring there is sufficient "hurt" money involved to keep the bidder focused and committed to the project.

120. However, as mentioned above, it is highly questionable whether this money actually represents real investment that the business might lose if things go wrong, as shown:

- *Often "cash" is invested in assets which have a re-sale value and/or could be utilised by the wider business. For example, Sunlabob (Laos) is investing the majority of its money in hydro turbines. In interviews the owner confirmed that if the project fails, he'll simply redeploy the turbines to another part of their business and use them there.*
- *Equally often a large proportion of the "cash" is invested over time, in line with sales and out of cash flow. This is the case, for example, with the Reddy Farm (Fiji) project. If sales don't meet expectations there is every likelihood that firms won't invest.*

121. Of course firms will always want any grant to offset risk, and they'll also want it to cover any realised risk before they do. Such sequencing of risk is entirely legitimate and understandable. We simply make the point to show that there's often not an awful lot of "hurt" involved in reality for most grantees.

122. A further point here relates to what the ECF will and won't pay for. Financing of assets, which it does, is generally fine. However, it is much less acceptable when such assets are wholly owned by one private firm. Take two examples:

- *Carnival (Vanuatu) – they are investing in "private" assets such as the landing jetties, and various tourist related equipment. The ECF is investing in more "public" assets such as the water and sanitation blocks located on the three islands of project focus. If the project fails, or Carnival decides to move its focus elsewhere, arguably, the communities still have an asset with a value. This is more justifiable.*
- *MCS (Vanuatu) – the ECF is financing the purchase of a new vessel. Other than putting up existing assets, MCS is financing the operations of the new vessel (fuel and labour). If the new route proves unviable / partially viable, then MCS will simply use the vessel on other more established routes[19]. In such a case, no value of the*

[19] It is noted that in this particular case, there is no definition of how many services MCS must deliver as a minimum to the Islands over the period of the project. It is a significant failing of the ECF not to ensure such.

asset resides with the stakeholders of prime interest to the ECF. This is much less justifiable.

123. Generally the ECF should aim to invest in the "linkage" element of projects – forward to consumers, or backwards to producers. This might involve investment in assets, rather than just in technical assistance related activities. However, in so doing it aims to ensure that should the project fail, at least some residual asset value is retained by the communities of prime interest. The grantees, as private businesses, should invest in private assets owned and controlled by them. If the ECF is doing this, then it should at least have some recourse to the investment made (until such time as it decides to give up such recourse).

5.2.4 General due diligence

124. The general levels of ECF due diligence, whilst consistent with first generation challenge funds, are not sufficient for purpose. This is not so much about the ECF Fund Manager not doing as it was requested. Rather, that what was requested is not sufficient. As stated above, at a minimum the ECF should visit, interview and thoroughly assess the applicant and the business (and as commented on later in this section, those the project aims to impact upon). This should be done at application stage, and the ECF Fund Manager's report and recommendation should be detailed and considered of key value and import to the decision making Panel.

125. Such an activity does imply a certain fixed cost which is more easily borne by larger rather than smaller projects.

126. ECF grants are "one-time only". This defined "exit" requirement is consistent with minimising the potential anti-competitive effects of continued phased grant funding. However, venture capital more typically follows a growth phased investment path. By not following such a path, the ECF is in danger of over-funding projects; and there is a sense by the review team that many project awards are particularly generous[20].

127. One could argue that overfunding is not a problem. That grants are conditional on performance, and can be withdrawn if performance milestones are not being reached. However, this would demand that a) grant disbursement is indeed phased, and scheduled against key milestones (which it is not), and b) that the ECF has a sufficient post-investment management to be able to judge performance. Again, it does not. Some grants are paid in advance. Others against proof of expenditure rather than performance.

128. Of more concern is the attitude expressed by some of the visited grant recipients. As far as they are concerned, the grant has been awarded and they will spend it.

129. Mitigating such risks lie not in some false scheduling of grants or unnecessarily onerous draw down requirements. It lies in stronger due diligence and a closer investment partnership with the grantee.

5.2.5 Anti-competitive nature of grants and their context

130. Any public grant to a private business has the potential to be anti-competitive. It also has the potential to stimulate innovation and competition for wider public benefit. The ECF wants to ensure the latter, and mitigate against the former.

131. In practice, the review team finds little evidence of any negative anti-competitive impact of the ECF. The following factors support this observation:

[20] For example: a) when compared to the size of the firm, b) to the scale of projected growth, and c) to the relative pro-poor impact.

- *The grants are one-time only, matched with private contributions, offered competitively, and are time bound. If they do boost any one firm over another, then it's arguably not too big a boost so that competitors are unable to catch-up.*
- *The portfolio is pretty well balanced between sectors and countries so as not to distort at a sectoral or country level.*
- *Anecdotally, the review team is not aware of any cases whereby competitors to grantees have complained that the impact of the grant has been detrimental to their business (though we understand some complained that they too did not get a grant…!).*

132. However, the review team is concerned that the application form calls for the applicant to show how they will "beat their competitors". Many aim to show how the grant will in fact lead them to outperform their competitors. This is perhaps the wrong message to be expressing, particularly as ECF explicitly wants (or should want) to see competitors reacting quickly and robustly. Generally though, as mentioned above, we've not seen any real evidence of the anti-competitive impact of ECF grants. However, there is one exception to this where we do have a concern. ANZ-Wing (Cambodia) talks explicitly in their application about their new service requiring a minimum scale to achieve competitive efficiency. The grant is helping them to achieve this, and in doing so creates a barrier to entry to new firms:

- *"…first to market which will achieve significant scale. The fixed cost base of the business in terms of technology, call centre and operations lends itself to profit at scale leaving other competitors unable to operate at profit as the cost to persuade customers to switch may be prohibitive". (source: ANZ-Wing ECF application)*

133. Overall though the real issue for the review team is not, from observation, that in practice ECF grants are anti-competitive. The ECF should certainly strive to ensure grants are not anti-competitive. However the real issue is a concern that grantee projects don't have a sufficient level of "disruptive innovation" so as to drive changed practice, competition and wider public benefits.

134. The context of grant awards is another critical dimension for consideration. Context is critical for three main reasons:

- *Ensuring programming coherence with AusAID country work;*
- *Ensuring synergies with wider PSD related efforts at a country level; and*
- *Realising higher level objectives of the ECF.*

135. The application process does not really explore the wider context into which any project would be delivered. This presents a series of limitations, related to the above factors, and which are best explored through an example:

Sunlabob (Laos): this project aims to define a new form of public-private-partnership, with EdL (the national electricity utility). At a village level Sunlabob would put in the power generation capacity, grid, and consumer connections. EdL would then expand the national grid, and take over the retail end of electricity provision. Sunlabob's role would change to a supplier of power to EdL.

AusAID is supporting rural electrification efforts in Laos through the World Bank led Rural Electrification Programme I (REP-I). The Sunlabob project does not fit in with the objectives of REP-I.

It might fit within the objectives of REP-II. However, under this new programme, the IFC is in the final stages of negotiation with the Government of Laos, and EdL for a package of support to stimulate public-private-partnerships for pushing out rural electrification in Laos.

The Sunlabob proposal was approved in isolation of any consideration of this wider context. At best, it might serve as an early adopter which can inform the on-going process under REP-II. At worst, it could derail or disrupt current negotiations (though the AusAID adviser is now informed and working hard, with the ECF Fund Manager, to ensure the former, rather than the latter, outcome is realised).

136. Risks, such as those highlighted in the above example could be mitigated through a various strategies. Possibly the most effective strategy would be through the sector specialisation and focus of the ECF, which should support greater understanding and profile, closer links, and a stronger matching of various interests.

5.3 Pro-Poor Impact

137. As with the above considerations of commercial viability, given that projects have only recently, or are yet to start, it is simply too early to assess ECF impact on the poor. Hence, our approach has been to identify key issues and risk factors. In focusing on risk factors, the reader needs to understand that we're focusing on how the ECF could ensure even greater impact than perhaps it might do given its current operations.

5.3.1 Potential pro-poor outreach

138. The project design makes a projection that the ECF could impact as many as 800 direct beneficiaries for every AUD 100k of grant invested. This offers a benchmark against which the review can comment from its observations.

139. With AUD13,352,846 of ECF funds committed, this would equate to circa 107,000 direct beneficiaries accruing across the portfolio.

140. The ECF Fund Manager supplied the following data showing anticipated numbers of beneficiaries across the portfolio:

Region	Company Name	ECF Grant (AUD)	Total Intended Beneficiaries (Direct and Indirect)	$ per beneficiary
Asia	ANZ WING	$1,500,000	560,905	$2.67
Asia	Cagayan de Oro Handmade Paper Crafts	$407,139	1,800	$226.19
Pacific	Carnival Australia	$805,000	2,330	$345.49
Pacific	C-Corp	$1,155,000	1,135	$1,017.62
Pacific	Future Forests Fiji	$190,000	494	$384.62
Pacific	Mainland Holdings	$453,745	10,384	$43.70
Pacific	Marine Consultancy Services.	$750,000	9,052	$82.85
Pacific	Nature's Way	$263,321	572	$460.35
Pacific	Puritau	$170,000	2,160	$78.70
Asia	Sunlabob	$526,682	2,502	$210.50
Asia	Teamworkz	$227,030	4,400	$51.60
Pacific	Volcanic Earth	$190,000	1,010	$188.12
Pacific	Burrows Pty Ltd	$1,175,615	3,060	$384.19
Asia	Bright Hope Institute	$199,300	471	$423.14

Asia	CHC Limited	$198,450	111,439	$1.78
Pacific	Didao	$680,000	900	$755.56
Pacific	Emirau Marine Products Ltd.	$996,000	2,250	$442.67
Pacific	Masurina Ltd	$183,166	320	$572.39
Pacific	Pelena Pty Limited	$198,898	1,991	$99.90
Asia	Pupuk Alam	$873,100	25,000	$34.92
Pacific	REDDY FARMS LTD	$149,900	172	$871.51
Pacific	Sarami Plantation	$1,375,000	1,025	$1,341.46
Pacific	Solutech	$575,500	24,029	$23.95
Pacific	The Wilderness Lodge	$110,000	460	$239.13
TOTAL		13,352,846	767,861	$17.39

141. According to the above figures, the ECF expects to "impact" on the lives of around 767,861 persons, at an average cost per beneficiary of AUD17.39. There are of course a number of qualifications that need to be made to these figures.

142. The ECF feasibility study talks of direct beneficiaries, whereas the ECF Fund Manager numbers shown above includes indirect beneficiaries also.

143. We are talking here of "outreach". We are not talking of "impact". This distinction should be made clear. The two are linked, but are fundamentally different.

144. Two projects skew these figures considerably: ANZ-Wing (Cambodia) and Solutech (Cambodia). Taking these two projects out of the calculations rebalances the figures to around 95,000 people reached, at an average cost of AUD 122, which equates almost exactly to the projected cost as outlined in the ECF feasibility study.

145. A simple average of outreach across the number of grants shows around 100,000 for Asia (noting the two "outliers" indicated above), compared to around 3600 for the Pacific. Of course, this should be no real surprise given respective population sizes and densities.

146. For the projects actually visited by the review team[21], according to the feasibility study there should be around 30,000 direct beneficiaries. Counting the numbers in the applications however show that at 9864 persons, only around one-third of the projected number. Interestingly in this example, the numbers of men and women are almost equal. The review team does find such a balance rather convenient.

147. Those projects concerned with "access" to the poor as consumers achieve far greater outreach numbers that those projects concerned with offering "growth" opportunities to the poor as producers / employees. It is noted though that the plausible attribution of growth/poverty impact for consumption goods will likely be much more difficult to establish and measure than it will be for impacts accruing to producers / employees.

5.3.2 Potential pro-poor impact

148. As shown above, to a large extent, the figures can be presented however one wishes to present them. As such they need to be interpreted with caution. What matters is a)

[21] MCS is excluded as its application simply refers to the total population on the Bank's and Torres Islands, rather than direct beneficiaries; Carnival is included as it was considered at least during the fieldwork, it's also in Vanuatu, and grant size is comparable to MCS.

robustness of the figures in the first place, and b) robustness of the monitoring and impact assessment process (this point is discussed in the M&E section of this report).

149. Pro-poor impact is the very thing that the ECF is designed to deliver against. The ECF does not expect a commercial return to its investments. It does though expect a clear social return on its investments. However, the review team feels that the ECF is simply not clear enough, or robust enough, on either qualifying or quantifying the issue of pro-poor impact at the time of grant award.

150. In part this comes down to the stated over reliance on application based funding. More so, however, pro-poor impact is just one of a number of evaluation measures; all of which are given an equal weight. Funding decisions should be made in light of greater clarity of the expected social dividend due from any project.

151. Applicants should be expected to outline clearly the business case. They can also be expected to outline how they see the project meeting the social agenda of the ECF. However, it should be for the ECF itself to investigate, deepen and confirm the social conditions, and returns expected for any one project.

152. The ECF Fund Manager has confirmed that it does sit with the applicant and agree jointly the issue of numbers of beneficiaries. However, firstly, it does this as part of setting the post-award M&E frame. Secondly, from what we can observe the numbers agreed are either the same as, or higher than those given in any application. It's interesting that following this closer scrutiny, numbers do not appear to be negotiated downwards.

153. As a final point here, it is noted that some applications did offer clear and detailed poverty profiling and impact assessments. Unsurprisingly, these tended to come from larger applicants. For example, ANZ-Wing presented detailed consumer market research findings that show exactly the type of clients they intend to reach.

5.3.3 Lack of pro-poor partnerships

154. The concept of "partnerships" was central to the original concept of the challenge fund as applied in social and economic regeneration fields in the UK. DFID's BLCF and FDCF were true to this concept, and both demanded partnerships be clearly identified in any application. The rationale is clear: *we are focused on the poor, we want them to participate in the development process, and hence they should be more actively represented in any bid*. Further, the fund demands innovation and firms trying things they've perhaps not done before. Partnerships might include stakeholders who bring required expertise.

155. In practice, partners in the BLCF certainly would include producer and trade associations, cooperatives, government and public bodies, NGO's and other specialist private sector partners.

156. The focus on partnerships supports in three key areas:

- It adds to the credibility and transparency of any bid;
- It ensures that any specialized partners are identified and qualified in the bid. For example, Sunlabob (Laos) intends to work with a variety of specialist partners. Some are absolutely critical, such as Helvetas who will be responsible for a significant component of the project;
- It gives the target communities a voice in the process (either through direct representation, and/or other partners who can offer a more indirect representation); and

- It adds real depth and clarity to just who the target group are, how they're organized, how they'll participate, how they'll benefit and by how much.

157. The review team feels that a similar partnership approach may well have strengthened the pro-poor focus of the ECF; in terms of transparency at the very least.

158. Certainly, the review team would argue that a partnership approach might have responded positively to the slightly uncomfortable fact that many / most ECF projects have been awarded to multi-national firms, or more commonly expatriate owned or led businesses (as was the case, for example, for each of the Vanuatu and Laos projects which were visited).

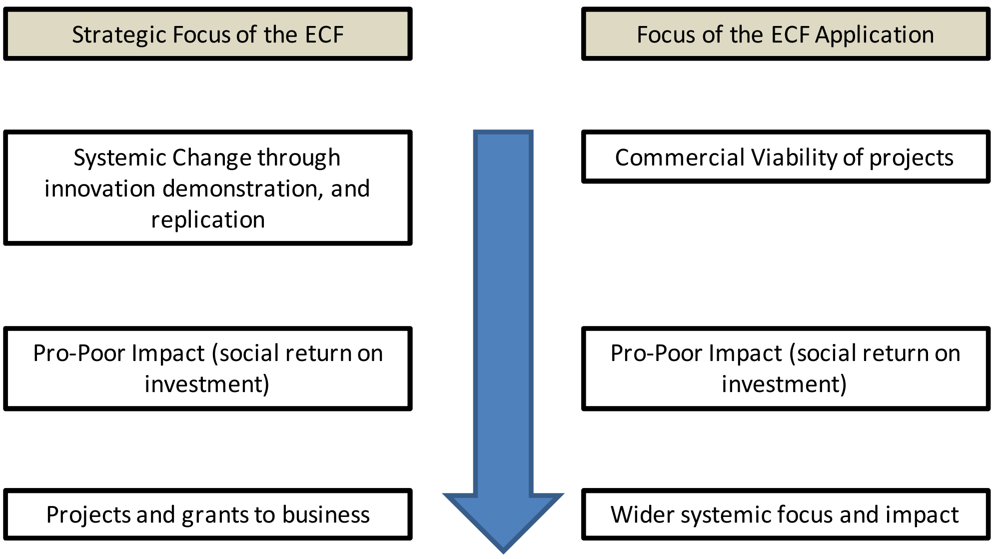
5.4 Contribution to higher level strategic objectives

159. The final component of our evaluation of the Effectiveness of the ECF lies in an assessment of the extent to which the outputs (i.e. projects) are likely to contribute to the stated higher level objectives of the ECF.

160. As stated previously, the ECF rationale and higher level objectives are clearly stated in the project design. However, they are not reflected either in a log frame, or any clearly presented strategic framework that guides the operations of the ECF.

161. This is a serious weakness of the ECF. As shown below, the strategic focus of the ECF is to offer grants to business which deliver project level pro-poor impact, and which can lead to wider systemic change and even greater impact.

162. However, ECF grants are awarded mainly on the strength of applications. These applications are stronger on the commercial dimensions of any project, with some qualification of anticipated pro-poor impact, and hardly any comment on wider systemic change. This is of course to be expected. It is not for firms to tell the ECF how it will contribute to wider systemic change. This should be the explicit assessment of the ECF Fund Manager and Panels.



163. As confirmed in the ECF design, wider systemic change can be achieved in two ways. Firstly, the project itself is so large that in itself it can be considered as systemic. Secondly, and most relevantly, it is through innovation, resulting in clear demonstration which then leads to wider take up and adoption which in turn delivers wider system change.

164. In this regard the current concept and application of BEE constraints is misguided. Overcoming BEE constraints is important, but the route to systemic change lies in "how" BEE constraints are overcome. For example, the MCS (Vanuatu) shipping project

evidently tackles the BEE constraint of shipping. But it does this through the ECF directly financing a vessel, which MCS undertakes to run. If the definition of BEE is “anything external to the firm, but which impacts on the performance of the firm”[22], and the ECF response is simply to finance solutions directly, then this is not much of a development vision.

165. It is understandable that private businesses applying to the ECF should not concern themselves with such strategic considerations. Only the ECF itself can and should concern itself with such wider strategic considerations. Unfortunately, the ECF ambitions seem to start and finish with the recruitment of projects.

166. In the absence of clarity of higher level objectives, no associated indicators of performance, and no discernable strategy for delivering at this level, it’s hard to conclude anything other than the ECF is highly unlikely to contribute to any higher level purpose. Its impact will likely be limited to that at a project level.

167. There are clear failures here. However, it is not all bad news. As stated previously, some of the projects being financed by the ECF do offer the potential to translate directly into wider systemic impacts. For example, if ANZ-Wing (Cambodia) works as planned, it can be expected that ANZ itself might well replicate directly to its operations in other countries. It might also spark the emergence of other competitors in Cambodia / the region more widely. A second example might well be Carnival (Vanuatu). Carnival hope that the project will show to governments how a joined up public-private investment approach can deliver real and significant economic benefits to the country as a whole, but particularly to more remote and hard to serve populations. In this regard, discussions with Carnival revealed that they are now in the latter stages of negotiations with the Government of Fiji for realising just such a partnership (though it’s not clear if such a development can be attributed to the ECF experience in Vanuatu).

[22] Definition given by the Donor Committee for Enterprise Development in its Guidelines on Business Environment Reform

6 EFFICIENCY OF THE ECF

168. The efficiency of a programme is a measurement of its outputs and outcomes in relation to its inputs. Efficiency measures therefore consider whether the resources available to a programme were used in the best possible way to maximize the likelihood of achieving the programme's stated objectives.

169. Assessing a programme's efficiency involves assessing the use of resources, the processes followed by the programme, the timeliness of activities in relation to agreed work plans, and the management and governance arrangements. The review team assessed ECF's efficiency by answering the following key questions, adapted from those suggested by OECD's DAC, and by making comparisons with relevant and similar grant allocation funds as appropriate and where information is available.

170. As confirmed earlier in this report, there is an absence of any ECF log frame and/or strategic framework. Hence, in assessing ECF's efficiency, the review has relied on the general hierarchy of objectives outlined earlier in this report

171. A comprehensive assessment of Efficiency matters is presented in Annex 3. The main findings and lessons are synthesised in this main report.

6.1 Grant fund management processes: do they maximize ECF's impact and the likelihood that it will achieve its strategic objectives and purpose?

6.1.1 Marketing:

172. Generally, awareness of the ECF by the private sector and government in the areas where the ECF was being marketed seems reasonable. Likewise, the ECF engaged well with AusAID and other donor staff in-country.

173. Understanding is however a different proposition from that of awareness. The fund was a new concept to AusAID, and to those to which it was being marketed. Hence our finding that, anecdotally, understanding of ECF (its objectives, the types of impact and project it's looking for etc) appeared to be patchy.

174. For the reasons stated, this patchiness is understandable amongst applicants. However, lack of clarity – or rather inconsistency in clarity – was also observed from amongst various Country Managers and panel members. This is less the case when explaining "what" the ECF was looking for: "commercial projects, with pro-poor linkages, which are currently beyond the reach of commercial finance". More so it is the case when explaining the "why" of the ECF – its rationale and purpose. Again, this is understandable as there is no operational clarity of such things (as commented on throughout this report).

175. Of course, a lack of understanding of the "why" has led to a limited interpretation of the "what" type of project ECF should fund.

176. As has been the case in other challenge funds, the more bidding rounds there are the less speculative applications are received, and the more familiarly are the bidders' which tends to result in higher quality propositions. As such, the proportion of eligible Concept Notes increased round on round.

177. Likewise, the approvals rate of applications went up round on round from 6%, to 33%, to 50% respectively. Certainly, we would ascribe much of these increases to improved learning and appreciation from bidders, but also the ECF Fund Manager, and the Panellists. However, there was some evidence offered by certain Panellists that they felt under some pressure to be less risk averse. Further, there is some sense that had there been more bidding rounds to follow, the approval ratio in the Third round would more likely have been closer to that of the Second round.

178. There is a clear regional bias in approved applications, with noticeable under-representation from Indonesia, Philippines and East Timor. No doubt there are several reasons for this, but as the review did not visit any of these countries, we're not in a position to comment with authority. From what we observe, given the number of concept notes generated, awareness was less the problem. The problem lies in the poor conversion rates of PCN's to applications, and then from applications to approvals. This suggests a number of things. Certainly, it suggests that genuine understanding of what ECF required was weak. Secondly, and related, it probably suggests that ECF did not target the best quality and most relevant firms in these countries. This is supported by various feedback that argues that lead firms and/or key decision makers within lead firms were not to be found in the areas where the ECF was actually marketed[23].

179. As mentioned previously, the recipients of a high proportion of grants were either multi-national firms, or more frequently locally based expatriate owned or run businesses. This has resulted in some negative political reaction. In Vanuatu for example, where all the grantees are expatriates, a compliant from a national politician was published in the local press. This issue does present implications in terms of a) potential political fall-out for the ECF and/or AusAID; and b) political and economic consequences from reinforcing inequalities between ni-Vanuatu and expatriates.

6.1.2 Specific practicalities:

180. Sensing the limited value in the more generic / public / scatter gun type of initial marketing, to its credit the ECF Fund Manager switched to more face-to-face engagement. This was required to improve understanding of what are fairly complex messages and requirements of the ECF.

181. In this vein, there is a strong feeling emerging from wider DFID challenge fund experience that the value of the "time bound competition" is limited. It can be a quick and efficient market entry strategy, setting out one's stall, getting profile and generating interest. But after some time it can become self-defeating. The early engagement should highlight the type of sectors, opportunities and companies which are most relevant for the challenge fund, in any given context. This should allow for a more targeted approach to just these types of company. Such direct engagement can be limited when, one the one-hand you're talking of a partnership, and on the other you talk about the need to compete in a two-stage process that will last several months.

6.2 The application process

182. The value of a two stage process is recognised in challenge funds more widely. PCN's represent a low barrier to entry, and can encourage a high response. Applications require considerable effort, and it's prudent to only request such effort based on a solid appraisal of the PCN. Overall, the review finds the two step process highly relevant to the ECF. Further the high standard of organisation, administration and communication around the process is deserving of particular mention.

183. In this vein, the application forms are generally clear and guidance offer to bidders seemed genuinely appreciated.

184. As mentioned earlier, the ECF should expect the applicant to talk in detail on the business case, and comment on the pro-poor nature of the application. However, the ECF should be more subtle in the questions is asks about wider issues related to poverty and systemic impact. It should make such assessments based on the information

[23] In Indonesia, such lead firms / decision makers were seen to be located outside of the region where the fund was actively marketed. The same was said of East Timor, where many decision makers are located off-shore.

provided, rather than expect applicants to do this fully for them. Hence we find such direct and open questions on, for example, BEE unhelpful and unwarranted.

185. In this context, we refer again to the limitations caused by the lack of a clear strategic framework for the ECF. Consistent with this, the application forms are not structured in any way so as to guide applicants towards developing or presenting projects which meet the wider ECF purpose, through exploring more thoroughly issues of the development problem, current market weaknesses, innovation, or the competitive context which might set a platform for considering issues of demonstration and replication.

186. Finally, in line with the "light touch" challenge fund approach, the ECF Fund Manager generally does not provide much support to applicants. When it has done, applications and projects tend to be 'better'. Such a finding is supportive of our overall sense that the challenge fund needs to be conceived more as the investment of social venture capital, rather than the disbursement of grants against application.

6.3 Proposal Assessment Process

187. Whilst a stated requirement from AusAID, the review feels that the combination of regional and local panels was not particularly beneficial, and does not offer good value for the time and costs involved.

188. This is not a comment on the quality or commitment of Panel members. Both of which were clearly very high. The comment relates to the overall process.

189. The review team would support there being one Panel comprising a mixture of members from the region, and those from outside. We suggest this for the following reasons:

- *The exceptionally high technical calibre of many regional panellists means that the value of the international panellists arguably lies as counter for possible regional bias. Such a counter could still be effective in a mixed regional / international panel.*
- *Related to the above mentioned point is the frustration expressed by some regional panellists that they felt perfectly well qualified to make decisions beyond the AUD 200k limit imposed for regional panels. As well qualified at least as the "expatriates" sitting on the international panel.*
- *The regional panel were supposed to bring local knowledge. Arguably this is to make up, to some degree at least, for the severe limitations of the due diligence work of the ECF Fund Manager. More of the latter, as called for in this review, would negate the need to rely so heavily on the local knowledge of the regional panellists – some of whom would contribute anyhow under one regional / international panel.*

190. The review accepts the additional level of work such consolidation would place on Panel members. Such commitment strengthens the belief of the review that Panellists should / should have been paid. This would ensure ECF was able to attract as well as retain appropriately qualified people.

191. As commented on earlier in this report, whilst comfortable in the decisions they've made, several Panel members expressed a view that they did not receive sufficient information upon which to make as robust an investment decision as they would have liked. They articulated a need for more input and depth from the ECF Fund Manager to a) substantiate application claims (due diligence); b) check out the business and business owner; and c) provide additional supporting information which the applicant may struggle to find / present (particularly on wider development impact related issues).

192. Overall, the review finds that the strictly delineated roles of the ECF Fund Manager and the assessment panels have resulted in an unhealthy ownership and accountability gap. The ECF Fund Manager does not recommend, or rank, applications. It simply

presents this task to the Panel. As such it does not consider itself accountable for the success or otherwise for the projects. The Panel makes its decisions, and hence accountability stops here (excluding obligations to monitor and evaluate), as panellists do not see themselves as fully accountable as they have little influence over other parts of the ECF.

193. Closing this gap means either the Panel starts managing downwards towards the ECF Fund Manager. This would likely imply more of a Board, rather than Panel type of structure and arrangement. Alternatively, and supported by this review, is that the ECF Fund Manager should be managing up to the Panel. This means going beyond the application as discussed several times in this report, giving clear additional information to the Panel, and giving a clear view of what they think about the projects and applicants, why, and how they rank them.

6.4 Overall management arrangements: do they maximise impact and achievement of strategic objectives?

6.4.1 Staffing:

194. Whilst not conducting a formal assessment, the staff assigned to the ECF team is clearly highly competent, diligent and professional. The only issues of note are:

- *Whilst the management and administration systems appear robust, it is not deemed ideal that virtually each of the core staff work out of different offices in different States or Cities of Australia.*
- *Whilst there is clearly a considerable amount of administration involved in any challenge fund, on balance and in light of the technical nature of the task, the staffing structure is considered too heavily biased on administration, with insufficient PSD or specialist knowledge assigned. Though no doubt a firm such as Coffey would have access to PSD expertise if absolutely deemed necessary.*
- *The technical lead lies with the ECF Fund Director, who is clearly a positive driving force behind what has actually been achieved to date by the ECF. However, the idea, as originally conceived that this role was part time (13 months over 72) was naïve in the extreme, and not just with hindsight.*

6.4.2 Governance:

195. As mentioned previously, the review team perceive an ownership and accountability gap. As such, it is not clear who provides strategic governance for the project. The Panel do not. The ECF Fund Manager reports to AusAID, and is overseen by the IMT. However, much of this relates to contract management issues, which along with the Performance Measurement Framework (PMF) is mainly focused on activities, rather than strategic issues.

196. The ECF Fund Manager has, or feels it has, limited flexibility to try out new approaches. If the ECF Fund Manager is to really drive this programme then more flexibility needs to be offered, albeit with sufficient accountability measures. This would be particularly important in the context of the ECF Fund Manager playing a active more social venture capital role.

197. Exploring this further, the review team were surprised at the prescriptive and activities driven contract. This was a pilot, and was a particularly innovative initiative for AusAID. One the one hand we can see why AusAID would want a tight contract. However, this comes at the expense of flexibility, and runs the risk of creating a tick box delivery culture with the contractor implementing activities instead of achieving outcomes. The extent to which this focus contributed to the lack of strategic insight across the ECF is conjecture; but arguably it did have a role to play.

6.5 Finances/Cost Effectiveness:

198. The management cost of implementing ECF, at 27% of the total budget, is slightly higher than comparable DFID challenge funds. But given its relatively smaller overall size this is not unexpected. The AECF management contract is, for example, limited to 20% of the fund size. However, the fund is much bigger than the ECF, and the AECF Fund Manager confirms that such a limitation is hampering their ability to deliver what they are tasked with.

199. There are some individual budget items that stand out and are worthy of note:

- *The assessment panels have cost AUD 467,000, at an average cost per panel meeting of AUD 55,000.*
- *The ECF Fund Manager staff costs sit presently at AUD 3,378,089, which seems high given the primacy of administration over technical task functions.*
- *At a projected budget of AUD 450,000, Country Managers seem particularly high, particularly in light of wider challenge fund experience, and in light of their rather limited role in assessment and monitoring.*

200. Overall, however, the review team is comfortable with the quality of the financial management systems, which all seemed robust.

7 MONITORING AND EVALUATION OF THE ECF

201. In this section we focus on an assessment of ECF monitoring and evaluation (M&E). The assessment is broken down into three sub sections as follows:

- The results framework – relating to the strategic framework within which M&E is / should be conducted.
- The measurement framework – covering issues of "how" and "what" to measure.
- The measurement process – reviewing M&E roles, responsibilities and functions.

7.1 The Results Framework

202. The ECF design and subsequent RFT present an extensive list of varied objectives, to which the ECF should contribute. These include: poverty, pro-poor business models, leveraging private investment, systemic change, tackling BEE constraints.

203. Although a hierarchy of objectives is not provided, it should be recognised that these objectives are not all at the same level and there is a causal relationship between them. It is this hierarchy of objectives that should define the strategic framework for the ECF.

204. A strategic framework is critical as not only does it shape and define what you do and how you do it; it also defines what you measure and how you measure it. These points are expanded in earlier sections of the report.

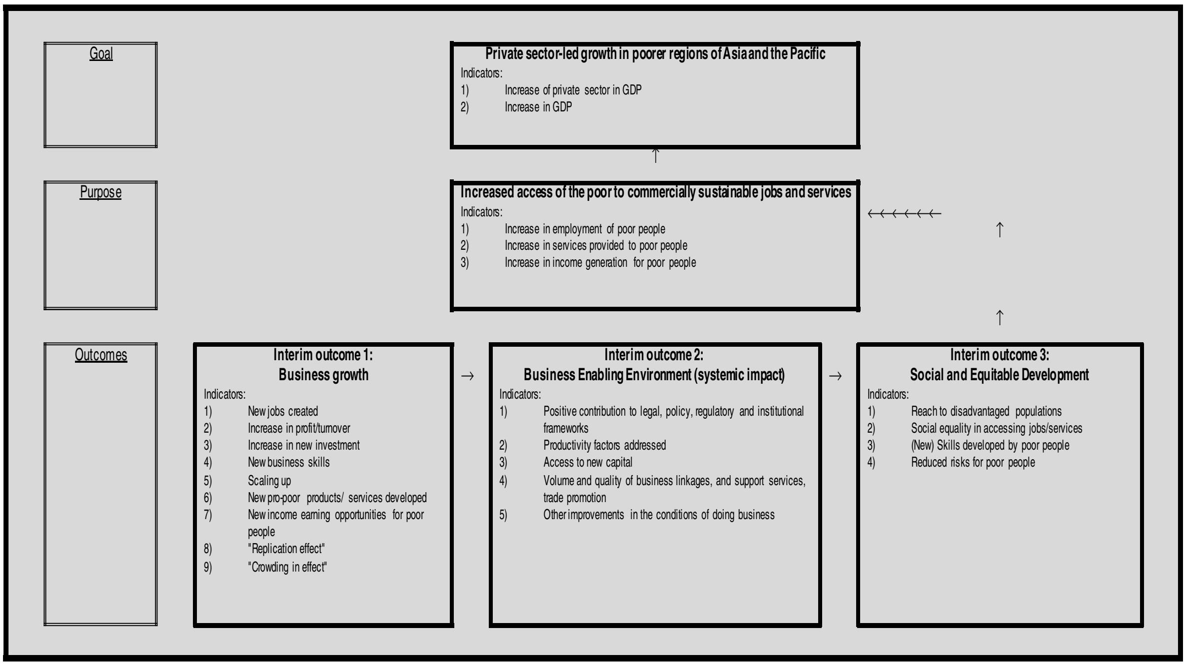
205. The ECF does not have a strategic framework. A logical framework would have "structured" the ideas behind the ECF into a clear hierarchy of objectives. Not having a log frame was a conscious choice at the time of the design; the thinking seemed to be that the ECF was a pilot, that it was likely to fund a wide variety of very different projects, and that a log frame might unhelpfully "straightjacket" the ECF.

206. Paradoxically, it is exactly because the ECF wanted such flexibility, that a log frame was so essential to ensure it did not lose sight of what it was funding, why it was funding it, and how it should measure and aggregate impact across the fund. Projects might be disparate in terms of country, sector and focus, but they should all contribute coherently to a common strategy.

207. In its Program Monitoring and Evaluation Plan, the ECF has attempted to set a strategic framework for the ECF (which is assessed below). Whilst this is a positive effort, the M&E framework should not define the strategic framework. It should be the other way around...! By demoting this to an M&E issue, the ECF has lost the opportunity to better shape and define the marketing, assessment and approvals process to be more directly supportive and coherent with its overall strategy.

7.1.1 The current results framework

208. The Programme M&E Plan presents the following strategic framework for the ECF:



209. The review has a number of criticisms of this representation:

- It still does not sufficiently represent a clear causality of impacts. For example, under business growth, there is no difference between project level impacts (jobs and profits), and wider systemic impacts of replication, crowding-in, which themselves result in scaling up, additional investments and jobs.
- Poverty impacts are at Outcome level, below jobs, and below growth. This is counter-intuitive to the more common logic of how PSD contributes to poverty reduction: interventions overcome barriers to private sector investment, that drives a wider private sector response, that results in higher economic growth which is directly relevant and inclusive of the poor.
- The indicators presented are both poorly defined (as things which can be measured), or impossible to attribute (such as GDP growth).

210. Expanding on our earlier presentation, the review team would expect a more coherent strategic framework to look more like the following representation:

Hierarchy of Objectives	Impact Level	Type of Impact
Output Level	Project based social returns	• Improved income and employment opportunities for the target poor
Purpose Level	Wider systemic impacts	• Replication of project within the firm; • Replication of project beyond the firm in the market; • Permanent change in the manner in which market operates, e.g. new distribution channel becomes norm
Goal Level	Growth and Poverty impacts	• Higher levels of private investment • Reduced vulnerability of the poor • Increased employment and incomes of the poor

211. The above is consistent with our understanding of the rationale for the ECF: new and innovative business models, processes and partnerships that represent credible private sector solutions to clearly defined systemic (market) weaknesses which are inhibiting the private sector from working more productively with and for the poor. The ECF aims to partner and trial solutions with “first movers” through offsetting that portion of “innovation risk” which is preventing firms from investing. In proving the commercial viability of the innovation, the ECF is reducing risk pricing. In being clear about the competitive context, what the project is demonstrating, and who it’s demonstrating too, the ECF aims to increase the appetite of others for risk and thereby to stimulate wider systemic impacts of replication, crowding in and market system change, which in turn deliver the required growth and poverty impacts AusAID is looking for.

212. This revised logic has a number of clear implications for the ECF for how it recruits and appraises projects. These issues have been covered earlier in this report. However, it also implies a key role for the ECF beyond the projects themselves. The experience of first-generation challenge funds was that outputs are unlikely to achieve the purpose directly. In reality, rarely do challenge fund projects in themselves offer sufficient demonstration impact so as to naturally stimulate replication and wider systemic impacts. Active facilitation by the fund manager is required for this to happen.

213. If the ECF is to deliver to this higher level, it will need to provide assistance (the type, level and amount will vary by project) to ensure they deliver against their promise. However, it will also need to define clear strategies and work plans qualifying how each project is expected to contribute to higher level objectives, and what facilitation work beyond the project the ECF Fund Manager will have to do to ensure projects can indeed reach the purpose level objectives. Likely this will be a mixture of tight M&E work that meets the accountability requirements of AusAID, but which also presents project learning and results in ways that facilitate other private companies to learn, re-price their perceived risk, and to try similar innovations.

214. Getting more significantly more involved in facilitation work with ongoing projects, will have implications for the staffing requirements within ECF.

7.2 The measurement framework

215. The ECF Program Results Framework is translated into a Monitoring and Evaluation Framework (MEF). The MEF serves to operationalise the results framework. It provides operational definitions for indicators listed in the results framework; it identifies tools for measuring against these indicators; and it allocates responsibilities in terms of who will apply these tools.

216. MEFs are applied to each of the 24 projects funded by the ECF. MEFs list the specific indicators to be measured, the baseline information, anticipated changes in indicators across years, targets and assumptions. Such a system is coherent and makes sense. However, the system is applied to a results measurement framework that, as argued above, the review team finds fundamentally deficient.

217. This notwithstanding, within the current system, the review team finds a number of areas which might be improved. We present our findings in three parts as following:

- Indicators
- Baselines
- Use of impact logic models

7.2.1 Indicators

218. Indicators define the points of change, that can be measured and which can be used to demonstrate impact. Which indicators are chosen and how in turn they are translated in to measurable units strongly influences the effectiveness of an M&E system in terms of capturing impact.

219. Firstly, we have two minor comments to make on actual indicators:

- The current goal level indicators are not suitable for measuring or sensibly attributing impact, as already discussed.
- Crowding in is currently defined as "the number of non ECF funded businesses providing other products/services in the supply chain to support ECF funded initiatives...". It is not clear why this particular formulation was chosen, but crowding in has little to do with supporting ECF funded initiatives. What one hopes to see is other businesses “crowd in” to the market opened up by the ECF funded innovative business model.

220. In order to faithfully measure against the indicators in the MEFs, the ECF needs to have a clear and attributable impact story. There are two reasons why this does not and is unlikely to, exist:

221. Firstly, the MEF asks for percentages whereas absolute figures would be much stronger. Absolute figures have two advantages:

- Absolute figures can be aggregated across projects to produce figures for the ECF programme as a whole.
- Absolute figures can be used for impact calculations relating change at one level to change at the next level hence ensuring triangulation and attribution.

<u>Example: the importance of absolute figures</u>

For example: if the business supported by the ECF reports a 500 MT increase in purchasing a certain crop from farmers, and if you know that on average farmers produce 0.1 MT then it is likely that the outreach is around 5,000 farmers. If you know that the profit (not the sales figure!) per MT should be around 100,000 units, then each farmer earns an additional income of 10,000 units. If you know that the average household income in this region is 50,000 units and the poverty line is drawn at 55,000 units, you can also say something about the relevance of these additional 10,000 units per household for poverty alleviation.

222. The above example demonstrates how changes at one level directly feed into and inform changes at the next level. This ensures attribution. And because this relation is so clear, changes can be checked from both sides: the business reports an increased purchase of 500MT, but can farmers confirm this, did they see their sales increase by around 0.1 MT? This ensures triangulation.

223. As commented above, the credibility of figures and attribution of change go hand in hand. If one works with percentages making these connections and calculations is simply not possible (unless percentages are reworked again into absolute figures.

7.2.2 Baselines

224. Too often programmes invest heavily in more generic baselines, often involving large surveys or big studies. They can be very insightful, but for the purpose of impact assessment they often remain too general to capture the specific changes brought about by a program activity. There tends to be no credible baseline value in the “big” report.

225. Aside from defining baseline practices and baseline values it is also important to formulate what is the expected impact from a certain program activity. Defining the cause and effect of anticipated impact helps to focus on what needs to be measured to capture that impact. It is against such a framework that baselines are most useful (see 6.2.3. on the use of impact chains for more discussion on this).

226. The ECF commissioned a serious of BEE baselines. These studies, prepared for all nine ECF countries, were supposed to serve a double purpose:

- To give strategic direction to the ECF grant allocation process by identifying areas to focus on; and
- To serve as an ECF baseline, so that the effect of ECF funded projects on the BEE could be compared against the baseline scenario.

227. The outcome, actually, is a far too generic set of studies without sufficient strategic depth to serve either of these purposes.

228. We should be clear that the BEE baseline studies are not badly executed. It is simply that it’s impossible to expect such generic studies to serve as a credible baseline for ECF projects.

229. The limitations of the BEE baseline studies make the baseline work done in the context of the project MEFs all the more important. We have the following comments to offer:

- The MEFs overly rely on a mixture of BEE baseline data, and particularly data provided in the application. As mentioned earlier, the ECF should be able to expect applications to be more reliable when presenting business data as this relates to the principle objectives of the applicant. Business issues are what they know most about. ECF should rely much less on pro-poor impact data as this is generally beyond the competence of private firms, and is likely to be much less reliable.

- The applications do not capture any information which might inform likely higher level impacts (i.e. beyond the project) such as replication, crowding in and wider market system change.

230. Incomplete baselines and copying application figures (instead of accurately recording baseline scenarios and practices) means that at this point in time there is a lack of clarity about the different projects funded, the exact working of the business model and the exact nature of the potential benefits for the designated beneficiaries.

7.2.3 Use of impact logic chains

231. The current MEF is set up as an inventory list, and asks for, for example, 'the number of new products and services developed by ECF projects', the 'number of new income earning opportunities', the 'number and types of change in the BEE for beneficiaries', 'number and type of change in factors that influence productivity', 'number and type of change influencing access to finance', 'number and type of change in business linkages', the 'number of new skills acquired', 'percentage of services provided to poor people', 'number of new jobs created', and the 'percentage increase in income for poor people'. Measuring against such a checklist might indicate valuable 'signs of change', but because there is no cause-effect relationship structure between these various measures it will be exceedingly difficult to present comprehensive and compelling impact story, with clear attribution links.

232. The Donor Committee for Enterprise Development (DCED) has published working guidelines on improved results measurement practices. Central to this is the promotion of impact logic chains. These present a clear “hypothesis” of what changes an intervention should bring about, and in what order. By specifying dimensions of change, they facilitate appropriate measures and units of measurement. Further, they also support strongly where to measure, and the choice of which methods might be most suitable to do the measurement.

233. The review team is absolutely clear that the use of such a tool will support the quality of ECFs M&E work going forward. Doing so will bring the ECF closer in line with current good practice for results measurement as advocated by the DCED (of which AusAID is a member).

7.3 M&E roles and functions

234. Ideally, M&E roles should never be divorced from implementation roles, because only with implementation comes the insight that is so useful when thinking about how to capture impact. Someone needs to be familiar enough with the project to understand what kind of cause-effect changes it should realise and, hence, what type and form of impact it should generate. That same person also should think about how to capture and measure these changes and impact. And that same person should also be in the position to direct the various impact measurements needed to capture the transformational process.

235. However, presently the responsibility for the M&E process is scattered over a large number of persons. The ECF program enjoys a double monitoring and evaluation structure. The ECF Fund Manager is responsible for monitoring and evaluation, but there is also the Independent Monitoring Team (IMT) contracted to validate specific aspects of the ECF Fund Manager’s reporting and to add value to the M&E process.

236. The ECF Fund Manager team involves four 'levels': an M&E specialist, project staff to maintain the MEF database (but who rarely visit the field), the country managers and the 24 grantees. The hiring of various NGOs for specific studies is also being considered.

237. The IMT employs at least two more persons for different studies, one engaged in validating direct and indirect impact as reported by the ECF Fund Manager, the other engaged in making Cost Benefit Analysis (CBA) for a limited number of projects.

238. All of these people involved in M&E might imply a level of robustness. However, the review team feels that in practice it is more likely to create unnecessary confusion and foster a lack of responsibility and accountability.

239. The person who is most familiar with the projects and their context is the ECF Fund Director, but he does not have the time to be more involved in M&E. The M&E specialist has a limited number of days, most of them used to set up the M&E process together with the IMT. The ECF Fund Manager staff, most of whom are full-time on the programme, could have a much larger role effectively running the M&E process, but so far have had far too little exposure to the field. The ECF Country Managers do not always have an affinity with doing research and in any case lack a sufficient number of days for doing so (20 days per year for the last three years of their contract). Finally there is the grantee, which is expected to carry the bulk of the M&E burden.

240. This set up creates the following problems:

- Impact assessment depends too heavily on the grantees that are basically expected to report on 'everything' except the two goal-level indicators. This is unrealistic and undesirable. Grantees should run their businesses and deliver the project. They should not be expected to engage in wider impact issues. Further, not only are grantees likely to be unqualified for such a task, they are hardly independent.
- Too many different persons visit the same project for different research efforts (but basically repeating many of the same basic questions). Equipped with incomplete MEFs it can happen that up to four persons visit the same project for different research requirements: the country manager who needs to collect some figures for general monitoring reports, the M&E specialist who wants develops a case study, an IMT person who needs to check results, and another IMT person doing a Cost Benefit Analysis (for some projects at least). This is clearly not the most efficient organisation of effort.

241. The review team considered recommending a new structure for managing M&E functions. However, on reflection we believe it is more effective to tighten the M&E process – the results and measurement frameworks, impact logic models for each project, with more robust MEFs emerging with clearly defined indicators. At this time, the ECF Fund Manager should consider what data (baseline and on-going) can be reliably supplied by the grantee, and what data will need to be generated outside of the grantee. Staff can then be organised accordingly.

242. The review team feels that much of the costs associated with this action can be recouped through greater efficiency savings. However, we do feel that the M&E task going forward is generally underfunded. If needs to be redefined, and scaled up as it moves away from an over reliance on grantees, to a much more active investment management role. This is not “administration”. This is “investment management”; which if not done robustly will severely limit the returns to ECF investments.

8 SUMMARY CONCLUSIONS AND RECOMMENDATIONS

243. The main analysis and findings from the review are presented in previous Chapters. The purpose of this Chapter is to summarise the main conclusions of the review and the main recommendations.

8.1 Summary Conclusions: Relevance

244. In the context of AusAID's work on PSD, the ECF is seen as highly relevant and complimentary to the more common institutional approaches applied by AusAID.

245. The private sector is the driver of economic growth, jobs and incomes for the poor. The private sector also plays a key role in delivering key poverty reducing goods and services to the poor. It is clearly a partner in the development process. The ECF, as an instrument, affords AusAID the ability to engage in much more direct partnerships with the private sector. In so doing, instruments such as the ECF have the power to shape the way in which the private sector understands and responds better to the challenges of working more productively and inclusively with the poor – as employees, as suppliers and as consumers.

246. As a centralised multi-country competitive grants programme, with no particular thematic or sectoral focus, the ECF struggles to offer real strategic value to AusAID country programmes. That is not to say there was no interest in the ECF from AusAID country Posts. Interest was expressed by many. However, the review feels that what the staff in country most appreciated, was the instrument, rather than the ECF per se. Deploying the challenge fund instrument within the specific context of a country programme could offer real value.

247. In light of this, initiatives such as the ECF (centrally managed and multi-country) need to offer strategic value to the more corporate and strategic objectives of AusAID. This demands focus and specialisation and it demands embedding the challenge fund within a programme (albeit the challenge fund might actually define the programme) specifically designed to deliver on these higher level corporate objectives. As an example of this, DFID's latest challenge fund is called the Food Retail Industry Challenge Fund (FRICH). This fund is aimed specifically at UK's largest supermarket chains, to help them try new approaches for opening opportunities for food suppliers from across Africa. FRICH emerged in the context of the "Business Call to Action" supported by the UK Prime Minister.

8.2 Summary Conclusions – Rationale and Objectives

248. In terms of rationale and objectives, the ECF design generally responds well to the lessons emerging at the time from the first-generation of challenge funds pioneered by DFID.

249. The rationale for the ECF is that it is looking to support new and innovative business models, processes and partnerships that represent credible private sector solutions to clearly defined systemic (market) weaknesses which are inhibiting the private sector from working more productively with and for the poor. The ECF aims to partner and trial with "first movers" through offsetting that portion of "innovation risk" which is preventing firms from investing. This "disruptive innovation", gives an initial competitive stimulus to the "early adopter", but a wider catch-up response from the competition is expected.

250. The ECF rationale expressed in the design is compelling. However the ECF has failed to translate this rationale effectively into practice:

- The ECF process jumps straight to the "opportunity" without first being clear what is the development problem (market failure) to which the project is responding.

- Innovation, the route through which projects can contribute to wider systemic impacts, is hidden entirely from the entire ECF process.
- The qualification and quantification of anticipated pro-poor benefits at the project appraisal is generally poorly defined and is ultimately unsatisfactory.

251. The lack of a coherent strategic framework is a failure that resonates throughout all aspects of ECF operations. It is a key and overarching constraint for the ECF.

252. In terms of objectives, the ECF aims to find common ground between private commercial objectives, and public social (poverty reduction) objectives. This should be a partnership, where both parties are clear on the respective objectives and desired outcomes, and both know what's expected of each other in respect of delivering this. The ECF has effectively delegated its responsibility to the private firm, which is asked to define, deliver and report on both private and public objectives. Had the ECF seen itself as an investor of social venture capital, rather than a manager of grants, it would have been much clearer on the social dividend required from projects. It would also have recognised that there are limitations as to what should be asked, and expected of private firms in regard of delivering and reporting on wider social impact issues.

253. This last criticism is one of the first-generation challenge funds, which unfortunately the ECF has slipped back into; rather than the second-generation challenge fund promised by its design.

254. This review is not about assigning blame for this slippage and the failure to effectively translate the promise of the design in to operational practice. What we see is a RFT and contract from AusAID which is very prescriptive and activity focused. Whereas, in light of the ECF representing something brand new, and very much a pilot, the focus on activities should have been more balanced with a focus on outcomes and strategy. However, what we also see is a contractor which did not take the opportunity to challenge the RFT in any way. It simply offered to do exactly what was asked of it, and in many ways it has delivered very well on this.

8.3 Summary conclusions - effectiveness

255. The ECF has contracted with 24 projects, and now fully committed its funds. It achieved a leverage of public to private investment of 1.59, which represents more than AUD 21mn of private investment. Clearly there is a private sector with an interest and capacity to partner with the ECF. This supports the view expressed that the challenge fund instrument is highly relevant to AusAID being able to partner more directly with the private sector, in pursuit of more public objectives.

256. Contrary to projections, the Pacific has delivered 17 projects, and Asia 7 projects.

257. Most ECF grantee projects have only recently started, or have yet to start. As such, it is too early for this review to really assess actual versus planned performance. Hence our approach was to focus on three dimensions of effectiveness: commercial viability, pro-poor impact and contribution to higher level objectives.

8.3.1 Risks associated with commercial viability

258. There should be some correlation between the size of the firm and the size of the grant. Such considerations have not been sufficiently considered. As a result, in one case the grant size was thirteen times larger than the total annual sales of the grantee in the preceding year. In another case, the grant was three times bigger than the gross margin earned by the grantee in the preceding year. This is considered by the review team to be a mis-use of grant funds. Either clearer guidelines should have been in place, or more diligent judgement should have been applied.

259. Many applications predict considerable (exponential in some cases) business growth impacts. Smaller firms, with more limited access to the skills and resources to effectively underpin and steer such rapid expansion, may well struggle to realise (or sustain) such high levels of predicted gains. Larger firms represent a lower partner risk in this regard.

260. In several cases the ECF project is virtually indistinguishable from the parent business. The project represents expansion of the existing business. Often there is nothing innovative or new in the way through which firms are proposing to expand. Such projects are therefore unlikely to contribute to the wider strategic objectives of the ECF.

261. The ECF was absolutely right to insist on a minimum value of bidder cash contribution to the project. The ECF Fund Director refers to this as “hurt” money, which presumably means that bidders are putting a significant portion of their total investment at risk, just as all of the ECF funds are. If the project goes bad, both parties lose.

262. However, in reality there does not seem too much “hurt” actually involved for bidders. Cash is either invested in assets which can be used, or which have a resale value, beyond the project. More commonly, cash is invested in line with projected business growth, and often represents more working capital than real investment money.

263. Encouragingly, there are a small number of cases where bidders are investing serious money with the potential to “hurt”. Rather unsurprisingly these firms tend to be larger, with presumably deeper pockets. Carnival, for example, is investing in a variety of private assets (landing jetties, and navigation systems) at the same time as the ECF money is being invested in a variety of more public assets (water and sanitation facilities on the islands, and hospitality training of local villagers).

264. The review has considered the potential anti-competitive nature of ECF grants. Overall, the review finds little evidence of this risk being realised in practice. However, this outcome is more by luck than judgement, as the ECF does not sufficiently consider, as part of its due diligence function, the competitive context for any application.

265. ECF grants should be seen as supporting “disruptive innovation”, which stimulates a positive competitive reaction. However, the application form (and presumably therefore also the appraisal process) asks firms to confirm how the grant will help them to “beat their competitors”. This is a contrary message to be sending.

266. The review did find one case for concern as regards anti-competitive impact of ECF grants. This relates to the ANZ-Wing project in Cambodia (see paragraph 121 for details). In this case, the ECF might have funded only a partial roll-out of Wing to rural areas, rather than the across whole country. This, or a similar strategy, might well have kept the door open for competitors.

8.3.2 Scope and scale of anticipated pro-poor impact

267. According to figures laid at in Chapter 4, the ECF expects to “impact” on the lives of up to 767,861 persons, at an average cost per beneficiary reached of AUD 17.39.

268. The referred impact is actually outreach, although the review accepts that the two concepts are linked.

269. Almost 90% of the projected outreach is accounted for by two financial services projects in Cambodia (ANZ-Wing and CHC). Generally projects concerned with the poor as consumers (of finance, of energy…) are projected to reach much higher numbers of outreach than projects concerned with the poor as either employees or producers.

270. The numbers claimed read very well, and the ECF has done well to find and partner with projects that can offer significant scale and outreach. Interestingly these projects offer such potential exactly because they respond well to the rationale of the ECF – the market failure is clearly identified, there is clear innovation in the proposed approach, and the anticipated pro-poor impact is well defined and targeted.

271. However, where the ECF falls down, again, is on an over-reliance on the application to define pro-poor impact. Applications present numbers of people the projects expects to reach, and impact on in some way. However, as an investor of social capital, the ECF should be much more concerned to qualify and quantify the anticipated social return from any project investment. Applications rarely offer any real detail on exactly who the "poor" are, how they will benefit, and by how much. The ECF needs to ensure that the social dividend is calculated more transparently and more robustly. If not, its poverty reduction credentials will be much reduced (un-necessarily so, as the review team believes there are some genuinely strong pro-poor projects within the portfolio).

272. The review accepts that the ECF Fund Manager aims to qualify anticipated beneficiaries as part of its M&E work. However, the review team considers that this is taking place too late. Such calculations should feature firmly at project appraisal stage.

273. Unlike the early DFID challenge funds, the ECF does not have "partnerships" as a central requirement, or even as a 'desirable' aspect, of its funding criteria. Such a focus might have contributed to:

- Greater transparency of the bid, as many applications referred to key partners, but as they were not formally partners to the bid, they were not sufficiently referenced or qualified.
- A stronger sense of real engagement and empowerment of the poor in the process. For example, where farmers groups are the "poor" partners, they should have been a partner in the project more formally. In other cases, partner governments or regulatory bodies might have played a key role. For example, the ANZ-Wing project might have benefitted from having a national consumer rights body involved as a partner, to better ensure that the financial products are sold responsibly.

274. Many grantees are either multi-national, or national expatriate owned / managed businesses. Whilst the review does not criticise this per se, it does believe that a focus on partnerships, than involve local stakeholders more formally and more transparently in bids might be more sensitive and more empowering.

8.3.3 Likely contribution to higher level impacts

275. The absence of a strategic framework means that these higher level impacts have never really been framed (this review offers some guidance in this respect), and therefore it's technically not possible to say if projects are likely to deliver against them.

276. Clearly though, projects should demonstrate something, which they and competitors can replicate, invest more in, and innovate further around. This review argues that what they should demonstrate is how the private sector can deliver innovative solutions that show how barriers to working more productively and inclusively with the poor can be overcome. These so-called barriers equate to the BEE constraints more commonly referred to by the ECF.

277. Clearly the innovation lies in "how" firms can overcome these barriers. However, all too often ECF financing is not consistent with this. For example, shipping is a BEE constraint to market access for many living on the smaller islands of Vanuatu. However, financing a vessel directly, and in isolation of anything else, is not a particularly sophisticated or credible way to tackle such constraints.

8.4 Summary conclusions – efficiency

278. The absence of a strategic framework and the subsequent confusion amongst key stakeholders within and outside the ECF team, has had a negative impact on efficiency at several levels: from ensuring the appropriate staffing mix, to establishing project evaluation criteria which assess projects in light of the Fund's strategic objectives, to the

format and content required in project application forms. Ultimately this has directly impacted the quality of the projects.

279. No person, body or organization has clear ownership of the vision for ECF, or accepts responsibility for the programme's success or failure. The ECF Fund Manager has little influence over which projects are approved, and it is unwilling to take on this overall responsibility. Likewise, while grant allocation decisions are made by the assessment panels, the panels have limited influence over the other aspects of the Fund. As a result there is a significant accountability gap with no-one clearly responsible for the quality and performance of ECF, and the projects it supports.

280. The management of the ECF, particularly as this was a pilot phase, has been fairly inflexible; the Fund Manager should have been allowed greater opportunity to try out different approaches and systems, and make better use of the pilot phase. A less prescriptive contract agreement with AusAID would have helped with this.

281. The Fund Manger began the pilot phase with a hands-off role. This changed slightly during the course of the pilot phase, with the Fund Manager getting more involved in application development. However, the review team believe that if the Fund Manager were to become more of a Facilitator, at application, project assessment and project implementation stages, it would improve the efficiency, as well as effectiveness of the programme.

282. The project assessment process could be made more efficient (and cost effective) not only through greater involvement of the Fund Manager, and improved assessment criteria which support the strategic objectives of the fund, but also through providing more detailed appraisal information on applications, and by amalgamating the regional and international panels into one appraisal panel.

283. With an estimated management cost of 27%, the cost of implementing ECF is slightly higher than the other comparable challenge funds, but given its smaller overall size this is not unexpected.

284. ECF has sound administration procedures: this is important for a challenge fund operating in nine countries and would provide a good basis for expansion.

285. Lastly, AusAID aims to provide incentives to the Fund Manager to encourage 'better' fund management. While a performance based contract seems sensible in theory, it will only work when the incentives are tightly linked to the strategic objectives of the programme. Unfortunately this is not the case with ECF's bonus criteria.

8.5 Summary conclusions – monitoring and evaluation

286. A clear strategic framework defines what you are doing and why. M&E tells you how well you are doing it. In other words M&E should be embedded within a clearly defined strategic framework. In the absence of such a clear strategic framework, the review unsurprisingly finds a number of weaknesses with the ECF M&E systems and process.

287. The Programme M&E plan does define a strategic framework for the ECF. However, by doing this as part of a "back-end" M&E task, its value is limited as it does not feed into the main marketing, application or appraisal process of the ECF.

288. The review finds the strategic framework that is proposed is lacking in causal logic and hence in its overall coherence.

289. This lack of coherence in causal logic has likely contributed to some identified definitional problems with certain indicators. Further, the review finds that there is still room for improvement in the actual indicators being applied to measure impact.

290. In terms of baselines, the BEE reports are generally well written, but they are of far too general a nature to serve as credible baseline data. Overall the BEE baseline reports are deemed poorly conceived and with little practical utility.

291. The baselines that are used are too reliant on the data offered in the applications. However, few applications satisfactorily present clearly defined and articulated baseline data. The review welcomes the additional baseline qualification work undertaken by the ECF Fund Manager. However, it feels that these efforts will be of far greater value once the strategic framework is strengthened, and clear causal logic established.

292. In line with DCED good practice guidelines for PSD results measurement, the ECF can benefit considerably by using impact logic chains as a central tool in its M&E work. These will help to tell the "story" behind the numbers that the ECF generates. This "story" improves transparency and underpins claims of impact additionality and attribution.

293. The responsibility for the M&E process is scattered over a large number of persons. The review team feels this is inefficient, and might create unnecessary confusion and foster a lack of responsibility and accountability.

294. The ECF is overly reliant on the grantee to generate, collate and supply impact information. The review would support the ECF Fund Manager to define what they feel they can rely on from the grantee, and what they feel they will have to collect outside of grantee reporting.

8.6 Main Recommendations

295. Following from these summary conclusions, which emerge from the analysis presented in earlier sections, are the main recommendations as presented below.

8.6.1 No recapitalisation of the existing ECF fund

296. Recommending any new investment capital for the ECF would be dependent on the review being sufficiently confident about the expected social return to the investments already made. We are not, and hence our primary recommendation is that no new funds should be invested through the ECF at this time.

297. Our lack of confidence stems from three sources:

- At the time of this review, the existing investments have simply not had sufficient time to mature and demonstrate a clear track record of investment performance.
- Being unable to review and comment on actual performance, the review team used an assessment framework informed by wider experience and good practice guidelines for challenge funds. ECF operations are quite divergent from many of these good practice guidelines. As a general fund it struggles to be strategic. It's complete abandonment of any focus on innovation means it will struggle to contribute to wider systemic changes. Its lack of focus on partnerships undermines its pro-poor credentials. Further, the role of the Fund Manager has been relegated to that of a more passive project promoter and grant administrator, rather than a more active social venture capital investor.
- In principle, the ECF should be able to respond to many of the shortcomings identified in this review. However, even if it does this, the wider experience of challenge funds suggests that general funds, of the nature of the ECF, will always struggle to achieve the quality of results from more specialised challenge funds.

8.6.2 Managing for results

298. The review team believes that the ECF Fund Manager should now concentrate all of its efforts on maximising the returns to existing investments. Recommendations below are all made in this context.

299. The ECF needs to rework its strategic framework in line with the analysis and recommendations outlined in this report. Critically important is setting the basic hierarchy of objectives and anticipated causal impact. Doing this will set a clear results framework.

300. This results framework should be applied to each project, using an impact logic model. This will set a clear causal impact chain for each project.

301. The existing MEFs should be updated and aligned in accordance with the impact logic. This will involve setting clear indicators at different levels.

302. A revised M&E plan should be defined in line with each newly worked MEF. This plan should be clear on data sources and methods, and what can, or cannot, be expected to be provided by the grantee.

303. The M&E plans should be clear who is responsible for what from across the ECF Fund Manager team.

304. The above process will support the ECF Fund Manager to think through what each project is demonstrating, and who these lessons might be relevant to. Not all projects will offer such wider demonstration or replication potential. But where they do, the ECF Fund Manager should generate a clear strategy and work plan aimed at stimulating wider learning and change. This should go well beyond the PSD Linkages work planned presently by the ECF Fund Manager.

8.6.3 Further independent review of performance

305. As mentioned, this review has taken place at time where there is a very limited track record of performance. The review team believes that a further independent assessment of performance a year from now is warranted.

306. This assessment is seen as materially different from, and hence additional to those oversight functions currently performed by Triple Line Consulting.

307. This review believes that the ECF responds well to a gap in AusAID's current programming options. It has done enough to warrant AusAID considering further use of the instrument both centrally and at country levels (as recommended below). If the ECF responds to the analysis and recommendations of this review then a year from now it should offer a more tangible laboratory of experiences from which any wider application of challenge funds by AusAID can be informed.

308. Hence, the type of assessment envisaged here is more learning and knowledge capture focused, with the specific purpose of generating insights which can inform the design and operations of any new challenge fund programmes.

8.6.4 Taking challenge funds into AusAID – Central level

309. A growing private sector, which is more inclusive of the poor, and more responsive to the needs of the poor is critical to meeting the poverty reduction targets enshrined by the MDG's.

310. In working towards this, the private sector is increasingly being seen by development agencies as being a more active and direct partner in the development process.

311. Challenge funds have emerged as a new aid instrument and modality which can be used in support of working with the private sector in a more direct partnership approach.

312. This review of the ECF has shown the relevance of the instrument to AusAID, and to the private sector in much of the Asia-Pacific region where the ECF has been piloted. As an instrument, consultations with AusAID confirmed that the challenge fund is seen to be flexible, responsive and complimentary to other aid modalities. As an approach, the high level of response from the private sector to the call from the ECF shows that challenge funds do resonate well. To some extent this is not surprising as private firms do tend to

show an interest in large and relatively untied grants. However, in spite of the limitations highlighted in this review, the ECF has managed to attract and recruit a number of projects with genuine developmental value.

313. Challenge funds do not represent any sort of panacea or short cut to good development practice. They are an instrument, which if deployed strategically, and in clear context, can in principle add value to future AusAID programming. As such, the review recommends that AusAID should aim to normalise this instrument within their suite of current aid modalities.

8.6.5 A new challenge fund in support of renewable energy in the Pacific

314. As mentioned, the ECF has done enough to show the relevance of the challenge fund instrument to AusAID and to development challenges in the Pacific region in particular. However, it is limited by its lack of specialisation, lack of alignment / embeddedness with specific AusAID development policies and strategies, and by its limited fund management role beyond that of offering cost-sharing grants.

315. An ECF model that responded to these limitations would be powerful indeed. For these reasons the review feels that an ECF model would be highly relevant to delivering the pledged commitment of the Australian Government to support the promotion of renewable energy across the Pacific Islands. This would offer the degree of specialisation required to support improved effectiveness and efficiency considerations. It would also ensure a clear alignment with Australian Government priorities.

316. However, any such model would need to go beyond the challenge fund instrument. It would likely need modalities to support:

- Engagement with research capacities;
- Engagement with Governments on policy and regulatory matters; and
- Knowledge management, learning and dissemination.

317. In short a challenge fund as a central feature within a broader "facility" resonates strongly.

8.6.6 The role of the ECF within a new Renewable energy facility

318. Energy represents the second most represented sector in the ECF portfolio. Most of these projects are located in the Pacific. As such, there are various options open to what role the ECF might play in such an initiative. This review sees four possible options, as follows:

- *Option 1: ECF has no role -* a new facility is informed by, but designed and tendered independently of the ECF.
- *Option 2: a distinct ECF role within a new facility -* any new facility could sub-contract / partner with the ECF to manage its challenge fund component and portfolio.
- *Option 3: the ECF specializes and expands into the new facility -* under this option, the ECF would absorb new funds, expand into new roles, and build up wider capacities to support its specialization in the renewable energy sector.
- *Option 4: ECF energy projects are transferred / linked into the new facility -* under this option, the ECF portfolio of energy projects would be transferred and be managed forward by the new facility.

319. Options 1 and 4 are considered the least viable of those options presented. The ECF has the benefit of experience, systems being in place and an existing portfolio of relevant energy projects. As such Option 2 is considered the most viable option at this point in

time. Option 3 might be limited by factors concerned with competitive tendering requirements, and the technical capacity, competence and profile of the Fund Manager to transform into the said facility.

320. A more detailed consideration of options can only be explored further in the context of a scoping study commissioned specifically to look at the feasibility for a new facility to support renewable energy in the Pacific.

8.6.7 Taking the challenge fund into AusAID - Country level

321. The ECF has clearly resonated positively with many AusAID country managers. The instrument offers welcomed flexibility, visibility, and relatively quick programming. It complements AusAID's more institutional reform efforts with partner Governments, and more direct livelihoods work with communities.

322. The review is aware of a host of new PSD related programmes currently being designed and/or initiated by AusAID (e.g. CAVAC, SADI-II, Regional M4P Facility). The review would support these programmes making use of a challenge fund instrument; if such an instrument was deemed valuable to their planned work.