Africa Enterprise Challenge Fund
Concept Summary

Summary & Background
The AECF is a Commission for Africa recommendation that will build on the learning and success of past challenge funds. The design has made good progress and the high level scoping is complete. This concept note provides a summary that captures the AECF ‘product’. DFID is committed to the AECF and is seeking like-minded partners prior to finalising the AECF design.

Vision Statement
The Africa Enterprise Challenge Fund will catalyse the private sector to innovate and find profitable ways of improving market access for the poor – especially in rural areas. The AECF will focus on stimulating innovation in agricultural markets and deepening access to financial services.

Why is it needed?
- Africa requires widespread economic growth that includes the poor and increases access for groups marginalised from the growth process.
- Whilst the business environment is improving, this will take time. Governments and donors should complement these efforts with effective tools and instruments that stimulate the private sector to innovate new ways of including the poor in markets in the short term.
- Bringing the poor into markets requires innovation from the private sector to find new ways of doing business profitably that serves the needs of the poor.
- High costs and risk of transacting business make rural markets less attractive to innovators. Yet it is here that greater access to markets can achieve the highest impact in terms of pro-poor growth.
- In Africa, although some progress has been made (mobile telephony provides one visible example), such innovation often ‘stalls’ due to:
  - A poor business environment – this leads to greater costs, risks and uncertainty in doing business.
  - A lack of competitive pressure – firms are often content to serve attractive low risk market segments with little market pressure to seek new market opportunities.
  - Information asymmetries - information on the poor as producers and consumers is weak. This creates uncertainty and prevents firms pursuing opportunities.
  - Failures in the innovation ‘cycle’ – in addition to inertia within larger firms, African SMEs generally lack the market linkages, expertise and finance to innovate and expand their companies to a size that impacts on the market. Research institutes also lack funding and capacity.
- As a result, the type of innovation that opens up lower income segments often ‘stalls’ in Africa.

The Response
- Challenge funds are a proven instrument in stimulating private sector innovation, increasingly used by DFID and other donors over the last 5 years. Their comparative advantage is their ability to be a powerful, lean,
light-touch instrument that stimulates private sector to test new ways of working where the returns and risks are unknown.

- They respond to innovations by the private sector and do not pick winners.
- They capture the strengths of the private sector – the ability to generate and test new ideas, and rapidly abandon them if they do not work.
- When well managed, they can catalyse systemic change in markets.
- They help prove the viability of new business models and enhance the ability of such projects to be replicated and access commercial finance.

Impact
Learning from previous Challenge funds has shown us that the AECF will deliver:

- A balanced portfolio of approx 60 innovative ventures - with some star performers, a solid group of steady performers, and some inevitable failures
- Leverage at least a further $80m of private sector investment.
- Resulting in pro-poor systemic change in agricultural and financial markets in 10 countries, creating jobs, enhancing livelihoods and improving access for the poor as consumers.

Key Characteristics:

- Provide grants of between $150k and $1.5m to private companies (or consortiums including NGOs headed by private firms)
- Require at least matching contribution from the applicant.
- Awarded through an open, competitive and transparent process.
- Based on a two stage filtering process – submission of concept notes followed by successful applicants then submitting a full business case.
- Selection criteria based on high social impact and financial viability.
- The generation of applications and oversight of projects undertaken by contracted ‘fund managers’ drawn from the private sector who understand the markets and the frontiers of business behaviour.
- Projects sourced through both open public solicitation and also targeted marketing where fund managers will ‘challenge’ the private sector to push specific market ‘frontiers’.
- Funding decisions will be made by an independent panel of private sector experts (including commercial finance) and also donor representatives.

Focus: Agriculture and financial services
The AECF will push the frontiers of market access for the poor in sectors particularly important to the poor - finance and agriculture. This will naturally focus on frontiers in rural areas. Sector focus is required to ensure the AECF can operate effectively based on market expertise. DFID’s Financial Deepening Challenge Fund (FDCF) demonstrated a strong value proposition for using the challenge fund in bringing financial services to rural areas and banking the un-banked. It also proved effective in catalysing financial deepening in countries with relatively weak enabling environments and where little previous work has been done.

In agriculture the AECF will form part of the response to ‘aid for trade’ and to the AU/NEPAD’s Comprehensive Africa Agriculture Development Programme (CAADP) aimed at boosting agricultural growth. The Business Linkage Challenge Fund (BLCF) has proven the challenge fund to be effective in (1) catalysing local supply chains, creating effective demand for the produce of smallholder farmers,
(2) supporting firms who provide intermediary services to small farmers so that they may access new markets, and (3) introducing new production methods and establishing local production processes where none existed before. The sectors are complementary.

**Governance and management:**
- A robust governance and management structure will be put in place with sufficient flexibility to facilitate subsequent entry of more donors.
- Contributing donors will be represented on a governing board responsible for oversight, policy-making and the appointment of the fund managers and selection panels.
- The specific institutional identity of the facility will be determined by the participating donors.

**Learning from the past**
Challenge funds have been used successfully by DFID and others for more than 5 years. The FDCF provided incentives to the financial sector to try new ways of extending financial services to the poor. The grant funding provided helped to pilot projects with assured social impact but uncertain financial returns to test their commercial viability. Of the 29 projects funded, 9 achieved high social impact combined with high financial returns whilst the majority achieved a combination of reasonable social and financial returns (see diagram 1 below). The £15m spent leveraged £72m in private sector finance.

![Diagram showing social and financial returns](image)

**Lessons learned**
Previous challenge funds have shown that social returns are increased through:
1. increased focus in terms of sectors and sub-sectors,
2. regional concentration which facilitates “hands on” fund management, and
3. greater sector-specific expertise on the side of appointed fund managers.

**Example projects from previous challenge funds**

**The Great Lakes Cotton Company, Malawi—catalysing supply chains**
A. BLCF funding (£290K) helped the company defray the initial cost of establishing a partnership between a consortium of large ginners and associations of smallholders in Malawi to provide pre-treated seeds, technical assistance and other inputs to registered farmers and to buy back the cotton produced. Results achieved: over 200,000 farmers increased cotton production 265% and obtained better prices for their cotton; the number of casual labourers employed increased by about 25000 in just one year; Malawi tripled its cotton exports.
**Café Direct, East Africa- improving market access**

In response to a demanding new private standard introduced by the British Retail Consortium, the company is working with 7 supplier's organisations to implement HACCP and train and appoint 3 local inspectors to assure product quality providing access to an attractive market for 40,000 farmers. The BLCF grant helped reduce the cost of technology transfer and training and allowed Café Direct to test the financial viability of a project with high social impact.

**Unilever, Tanzania: creating new product markets**

The BLCF grant provided the incentive for Unilever’s research department to implement a pilot scheme for smallholders to gather and cultivate Allanblackia nuts, a low cost source of vegetable fat, for export from Tanzania. The nuts occur naturally in tropical countries but have yet to find commercial use. The pilot aims to establish an international market for the nuts open to all prospective buyers and suppliers. To date 4,000 smallholders have benefited.

**Commercial Microfinance Facility: Deutsche Bank**

A $1.5 million grant from the FDCF helped Deutsche Bank raise upwards of $75 million from leading institutional investors. The Deutsche Bank wholesale microfinance facility seeks to graduate investors and commercial banks away from perceiving the microfinance sector either as an object for philanthropic assistance or as a high-risk investment, and toward recognising it as a viable target for commercial investment. The Facility, which is offering its investors a commercial rate return, provides domestic commercial banks in Africa, Asia, Eastern Europe and Latin America with back-to-back arrangements to underwrite advances to local MFIs. This transaction had a strong demonstration effect and helped in creating a commercial market for microfinance based instruments with managed risks as shown by J P Morgan with their microfinance bond issuance of $ 40 million.

**Vodafone – MPESA**

An FDCF grant helped Vodafone develop a mobile telephony based commercial platform known as “M-PESA” in partnership with a Kenyan mobile phone operator, Safaricom. This project has helped provide connectivity for retail financial institutions like MFIs to enable disbursement and collection of loans in more cost effective forms. The number of poor people with mobile phones is much higher than the unbanked population in Kenya and with technological innovation it is possible to bring financial services to many more people. The market was at a nascent stage with high growth potential but large multinationals like Vodafone may not have made the investment in absence of a challenge fund grant. These are early days but a success of this project should have a demonstration effect on increased use of new technology for market access in remote areas which were not considered commercially viable. Vodafone has now established a new department to invest in providing new services through mobile telephony and an internal challenge fund to replicate what FDCF assistance enabled it to achieve in Kenya.