LEARNING FROM THE ENTERPRISE CHALLENGE FUND:
ACCESSING FINANCE IN THE PACIFIC ISLANDS

May 2013

A review of a private sector development initiative funded by the Australian Agency for International Development (AusAID)
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**Introduction**

Effectively operating financial markets can vary economic growth rates by as much as two percentage points per year in overall economic growth\(^1\). In the Pacific Islands this level of annual economic growth is greater than average annual growth rates in the region between 1988 and 2008\(^2\).

AusAID recognises that increased economic growth in developing countries is an important factor in poverty reduction\(^3\) and Enterprise Challenge Fund (ECF) goals are consistent with AusAID’s Private Sector Development Strategy (June 2012).

This paper discusses emerging lessons from ECF grants to small and medium business enterprises in the Pacific Islands. A key eligibility criterion for an ECF grant was evidence that the business venture could not secure commercial finance for the intended project.

Many Pacific Island business enterprises supported by ECF show useful lessons on how improved access to finance can improve economic conditions for businesses that have substantial flow on benefits for the poor. This is particularly important in the Pacific Islands where access to finance is a crucial issue and is recognised as a significant barrier to a more vibrant and productive business sector.

**Background**

**About the Enterprise Challenge Fund for South East Asia and the Pacific**

The ECF is an A$20.5 million program funded by the Australian Government and managed by AusAID. It offered a competitive opportunity for businesses to obtain grants from A$100,000 to A$1.5 million for commercialising business projects that addressed local market failures. It operates in the Pacific and South East Asia and currently funds 21 projects in seven countries.

The pilot ECF initiative may reveal significant lessons in developing and managing private sector programs in the region. The key intended impact of its grant funding is to reduce poverty through employment and income generation, sustainability of initiatives, and creating wider systemic change. For more information please visit [www.enterprisechallengefund.org](http://www.enterprisechallengefund.org).

The rationale underpinning the ECF was that capable commercial operators could use matching grant funds to overcome local market failures and strengthen supply chains with pro-poor benefits. Such projects would provide a reliable and sustainable market for poor suppliers and, on the basis of commercial self-interest, the businesses would provide technical and other support through the supply chain to ensure reliable and consistent inputs for their operations.

**Approach and limitations of this review**

This paper relies on ECF monitoring and evaluation data, both quantitative and qualitative, collected over the last three years, desktop research, as well as numerous discussions with key financial market players, government bodies, NGOs, donors and private sector stakeholders. All commercial and development banks in the four ECF Pacific countries (Papua New Guinea, Fiji, Vanuatu and Solomon Islands) were consulted on a number of occasions.

Commercially sensitive financial information on individual ECF projects has either been excluded or given in broad terms. Lessons are drawn from specific case studies and may not be applicable to the broader sector.

**Accessing finance in the Pacific Islands**

Most ECF projects in the Pacific Islands are in the agricultural sector which presents serious challenges sustaining financial services along supply chains.\(^4\) According to this report ‘the past years have demonstrated that neither commercial banks nor the emerging micro-finance industry are willing or able to sufficiently meet (these financial needs), leaving farmers and agricultural SMEs unserved in the so-called “missing middle”.

Properly functioning financial markets are crucial to increased economic growth and improved living standards in the Pacific Islands. It is recognised that these generally small states are ‘the least banked region of the world’\(^5\).

The high proportion of Pacific business projects securing ECF grants (14 of the 21 (66%) implemented projects) reflects the difficulties new business ventures in the Pacific face when seeking commercial finance.

The impediments to improved access to financial services in the region have been extensively analysed. Table 1 synthesises the key limiting factors to improved access to finance in the region as a whole and in the ECF countries. These are classified by the stages of transition from the informal sector – the platform from which most locally owned and managed businesses will develop – to the formal SME sector.

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2. Asian Development Bank
5. UN Capital Development Fund. Branchless banking information sheet
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<th>Transition stage</th>
<th>Access to financial services</th>
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<td>Individual engaged in limited microenterprise activity</td>
<td>Microfinance and microcredit schemes have expanded but most microbusiness operators rely on traditional sources of funds, including family. Microfinance institutions (MFIs) in the region are challenged by poor accessibility to often geographically isolated communities, which increases their transaction costs, as well as capacity constraints. The Asian Development Bank said ‘… in most Pacific Island countries the provision of financial services by specialist institutions is relatively unprofitable as small market size limits the potential for economies of scale.’ Commercial banks are generally not involved in this sector.</td>
<td>The numerous government and donor programs implemented to improve the performance and reach of MFIs, to encourage branchless banking and other innovations, have seen improvements overall. But many potential indigenous entrepreneurs operating in the informal sector, including women, remain constrained by limited access to supportive financial services.</td>
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<td>Entrepreneur with developing skills and knowledge of market niche considers expansion, i.e. semi-formal SMEs with growth prospects</td>
<td>Microfinance/credit may be available but for many rural and remote entrepreneurs seeking to expand their microbusiness, access to finance is difficult and family sources are likely to be inadequate. Credit unions and cooperatives have declined in the region, offer limited products and are more relevant to their members in formal employment in urban areas. Commercial and development bank finance is also essentially unavailable.</td>
<td>Microfinance related programs have improved the situation but rural/remote indigenous entrepreneurs (a target group for AusAID) find it difficult to secure financial support to progress. Initiatives such as the Digicel remittances facility improved mechanisms and reduced associated costs (in 2008 remittances of US$470 million were sent to Pacific Islands with US$90 million in fees for remitters). The Fiji Government has mandated commercial bank involvement in this sector.</td>
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<td>Experienced business person with track record and knowledge of market moves to formal sector and establishes SME</td>
<td>Despite the focus on SME development and access to finance over recent years, entrepreneurs at this stage face difficulties in securing appropriate and affordable finance and supportive financial services. Interest rates are relatively high and the spread between lending and deposit rates is large (ADB). Financial products that could compensate for shortcomings in the enabling environment and provide valuable working capital, such as factoring and leasing, are unavailable or difficult for SMEs to access. The shortcomings stem from intrinsic weaknesses within many local SMEs (management experience/ knowledge, conflicting cultural pressures), deficiencies in the enabling environment and infrastructure (accounting standards, credit information and reporting systems, collateral and insolvency regimes) and geographical barriers. Commercial banks also report that many growing SMEs have inadequate equity in their business; one banker advised, ‘it is not uncommon for a company to seek 100% support for a new venture’. A significant barrier in the Pacific Islands for SMEs operating in areas outside major urban centres is the unavailability of land as collateral. Communal land ownership is still widespread so commercial lenders do not have access to land with clear and transferable titles that could be acceptable collateral.</td>
<td>Numerous programs have been implemented to address these impediments to SME development with worthwhile progress in some areas. For example, IFC support to Bank South Pacific (BSP) in PNG for the development of an SME credit scoring approach resulted in a ten-fold increase in monthly loans. Commercial banks, which are relatively liquid in the Pacific Islands, will remain the primary source of finance for SMEs and planned programs, such as tailored credit guarantee schemes, are intended to improve the situation for relevant SMEs. Nonetheless, in the perceived difficult business environment of the Pacific Islands they remain cautious in their lending and are unlikely to adjust their prudential standards; women-owned and indigenous SMEs in particular will struggle to secure financial services. National provident funds in the region are a source of investment funds but focus on larger projects. As at early 2013, no equity investment/venture capital funds operating in the Pacific would become involved in SME business projects, particularly in the agriculture, seafood or agribusiness sectors. The Solomon Islands Supplementary Equity Fund proved to be successful but is currently waiting for additional funds.</td>
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Compared to the features of an enabling environment that would facilitate increased SME lending shortcomings are evident, to varying degrees, in the four ECF Pacific markets:

- The legal and regulatory framework remains relatively under-developed. Insurance, leasing, factoring and security laws, for example, are either unavailable or inadequate and have not facilitated an expansion of financial products or encouraged banks to expand SME lending.
- Accounting and auditing standards are not sufficiently strong to reduce information shortcoming or to encourage lending against financial statements, even when they may be available from local SMEs. Banks advise that a major concern with loan/overdraft extension applications from SMEs is perceived weak financial management within the business.
- Shortcomings remain in public credit registries and private credit bureaus that can play an important role in SME financing by providing information on a borrower’s credit worthiness. Such services could also facilitate the adoption of lending technologies based on credit scoring models that the International Finance Corporation has promoted in the region.
- Collateral regimes and supporting regulations are not sufficiently developed to allow lenders to clarify the rights of secured creditors through collateral registries or effective enforcement of collateral (seizure and disposition) in the case of default. These regimes can be particularly valuable for SMEs because typically they have few immovable but a variety of movable assets.

The commercial banks in the four ECF Pacific markets, particularly the National Bank in Vanuatu and BSP, which operates in all ECF Pacific markets, have moved towards increased SME lending, BSP introduced a successful internal credit scoring model coupled with decentralised decision making by regional branch managers. All are relatively liquid and want to expand their SME lending but continue to complain that the core problem is a shortage of ‘bankable projects’, particularly from small and start-up businesses, that satisfy their prudential standards and give them confidence in the viability of the venture. One commercial bank pointed out that their percentage of bad debts among larger businesses was less than 2% but in smaller businesses was over 15%. The government funded development banks have a mixed record and generally unacceptably high default rates due to inadequate control procedures for the acceptable security for us is freehold or property with clear title.

- Cultural attitudes and relatively weak transport linkages can make seizure of movable assets in the case of default difficult and/or dangerous.
- High failure rates of smaller scale agricultural, agribusiness, fishing and other projects in more remote areas has increased lenders’ cautious attitudes towards such projects. (A common characteristic of expanding SMEs is a volatile pattern of earnings and growth but banks are concerned that for smaller businesses in particularly difficult operating environments this volatility will reach levels that impact adversely on the borrower’s ability to service a loan and remain viable.)
- Specialised equipment and other assets for processing operations may not be saleable in these relatively small economies and tend to be either highly discounted or disregarded as tangible security by lenders.

An additional, and very important, impediment to closing the SME finance gap in the four countries is the shortage of ‘management capital’. When banks and other lenders consider commercial credit, an over-riding issue is the personal factor – the credibility of the key people behind the business and the lender’s confidence in their ability to run a profitable business and service the debt. Relatively weak accounting, auditing and other intermediary services and support increase the significance of the personal factor but make it difficult for many Pacific Island SMEs to induce confidence in their credit worthiness. Cultural practices and perceptions, as well as enabling environment impediments, compound the difficulties women face in convincing lenders of their credit worthiness.

The examples of relevant ECF projects in Fiji, PNG, the Solomon Islands and Vanuatu below have lessons about access to finance for enterprises with potential flow on benefits to the poor. They failed to secure commercial finance, preventing the projects from proceeding without ECF support.

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6 IFC. 2010. Scaling-up SME access to financial services in the developing world.
Volcanic Earth, Vanuatu

Volcanic Earth is a small skin care manufacturing operation in Port Vila, Vanuatu, that is owned jointly and predominately managed by women. The company received an ECF matching grant of A$190,000 in late 2008 to expand and improve their operations, packaging, labelling and product standards for export markets. This included a coconut oil production facility operated by a local Ni-Vanuatu entrepreneur. The poor benefits were expected to include local input suppliers, including large numbers of tamanu nut input suppliers, primarily women, from various islands.

By late 2011 the business had moved into a purchased commercial building on the outskirts of Port Vila, increased production capacity by 400%, and between 2007 and 2010, increased turnover by 500%. The business expanded export sales, established four different websites for the Australian, New Zealand, Canadian and US markets (all linked to local agents/representatives), secured TGA approval for its skin care products in Australia and was commercially viable. The directors of the business told the ECF Fund Director that ‘none of this would have been possible without the support you gave us’.

The linked coconut oil production facility was moved to an area adjacent to the new premises and the subcontractor operating this facility, a young Ni-Vanuatu male, continues to be mentored by Volcanic Earth and has developed a viable small business. Financial performance in 2011 was weaker than the previous two years because of the costs associated with the move to the new premises – over 90% of these costs were borne directly by Volcanic Earth – and as a result of increased competition in the tamanu oil export market.

The project has several main beneficiaries:

- De-husked coconut supplies come from a number of rural areas. On the main island of Efate, six families in more remote areas supply coconuts which can earn them around Vatu 30,000 (A$340) per delivery, up to five times a year. For most of these families this income represents worthwhile additional money. Shipments from more remote areas, such as Palma Island, are also purchased to ensure consistent supply.
- The tamanu nut oil extraction facility that supplied Volcanic Earth was purchasing an average of 10 tonnes of nut per month from most of the main islands. Four to five women’s groups are paid to crack, slice and dry/cure the nuts. Total cash payments to suppliers in 2010 were around Vatu 3 million (A$36,000) across hundreds of villages for up to 1,000 women and 200 men. The women’s groups processing the nuts earned a further Vatu 2–2.5 million (A$23,000–$29,000) per year; these 40–50 women depend on this as their primary source of income.
- The coconut oil subcontractor, Donald, employs 3 young men, none of whom previously had full-time jobs, and pays them V6,600 (A$75) per week, the minimum wage. The subcontractor was previously working in different jobs but with the hands-on help of Volcanic Earth (ranging from payment of the initial business licence fee to no-interest loans and financial management advice) he has developed a profitable small business and has diversified into house painting. Donald told the ECF Fund Director, ‘I am very grateful for the help Volcanic Earth has given me – I feel like a real businessman now’.

The decline in Volcanic Earth exports of tamanu oil in 2011 clearly disrupted suppliers’ incomes but prospects for sales to existing and new overseas customers improved in 2012 and smaller volumes than previously were exported. Overseas sales of other skin care products remained steady in 2012. Volcanic Earth was unable to secure commercial finance for this project because of limited immovable assets, its relatively small size and a short-term performance track record. The ECF grant, to be used over three years, was greater than the company’s turnover in 2007 and an independent ECF review team queried whether this was a justifiable decision. Volcanic Earth did, however, grow in a sustainable manner, with worthwhile direct and indirect social impacts. Commercial bank finance was available for their new building as a result of the company’s improved financial performance and, because the building was in the Port Vila area, the bank regarded it as an accessible and realisable asset.

As this project developed a ‘management capital’ shortcoming became evident in the business, particularly in export marketing resources and skills. The ECF Fund Director and Pacific Trade and Invest office in Sydney provided practical guidance and assistance but in retrospect, it would have been better to refine the project’s business strategy from the outset and allocate some of the ECF funding support to recruiting an experienced person to handle the demands of the internet based marketing and sales. Export sales and flow-on benefits to local input suppliers may have been even more substantial.

From an access to finance perspective this project presents several lessons:

- A timely funding injection into an SME can set the foundation for a sustainable and beneficial business venture. The ‘kick start’ of a challenge fund type grant can, as evidenced by this and other ECF projects, improve a company’s financial performance to the point where a commercial bank will have increased confidence in providing credit to the enterprise.
- An equity injection in the form of a challenge fund grant is often not sufficient to ensure the business project achieves the broader and systemic impacts that underpinned the decision to provide the support in the first place. An effective business plan, technical support and strengthened management resources are equally important.
An ECF project in New Ireland province in PNG represents an interesting comparison to Volcanic Earth. Emirau Marine Products (EMP) was awarded a grant of A$996,000 for an integrated, export focused coconut processing operation that would employ over 100 people, provide incomes for mainly women rural suppliers of the large number of whole coconuts required each day to feed the operation and an associated program to distribute replacement and better quality coconut plants to address the challenge of an increasing percentage of senile coconut trees. Flow-on benefits were expected to small contractors in transport services, as were overall economic benefits to the New Ireland province.

EMP had been involved in the seafood sector for some time but was unable to secure commercial finance for the coconut project. This ECF project is a specialised, green-field operation in a remote province and the value of its equipment for collateral would be substantially discounted by a commercial lender. The ECF grant was therefore crucial to its implementation. When told of the ECF grant approval the owner said ‘this is amazing. It’s the first time anyone has ever helped my business – all I get is negative comments and trouble but I know I can make this work’.

Finalisation of the operation took longer and cost more than expected. By late 2011 it could not be effectively commissioned because of the absence of promised power from the nearby power plant and a shortage of working capital. Banks were not interested in supporting the still unproven coconut business and the seafood business was already highly geared.

By early 2012 the required high capacity power was installed, the EMP owner reorganised the financial structure of his two businesses and sought investment funding from outside parties. By mid-2012 the business was already employing over 20 men and women and, following an ECF facilitated linkage, technical support was being provided by the Secretariat for the Pacific Community (SPC) for organic certification. Limited funds from the reorganisation of the two companies’ finances provided were used for operating expenses and an export shipment of coconut oil.

Westpac had been approached by EMP for a working capital loan or extended overdraft facility. This was rejected based on the bank’s assessment of the project’s risks. Agriculture based projects in PNG do not have a good track record and at that stage the coconut processing facility was not operational, with no clear indication of its commercial viability. The Rural Banking division of BSP was at the time planning an expansion of its network and a move into full banking services. The head of Rural Banking showed strong interest in the EMP project based on its potential to increase incomes in the province and the expected need for contracted transport providers. Once the project was fully operational the coconut suppliers and transport contractors were seen as a good customer base for BSP’s services. An initial discussion between the two parties was arranged but because the business was not operational at the time there was no further action.

EMP has good potential for employment, increased incomes for disadvantaged communities, flow-on impacts for the local economy and as model for other Pacific Island countries. However, the risk remains that they will not be realised because of a working capital shortfall and the delayed start-up which has further strained the company’s cash flow.

This project has several relevant lessons:

- The long lead time needed to complete a large project in a more remote area means that commercial finance may lead to unsustainable loan servicing costs without a suitable repayment grace period. A generous equity injection along the lines of an ECF grant is likely to be crucial to starting a project with a long and costly implementation phase. These remote location projects are also most likely to contribute to AusAID’s rural livelihoods improvement objectives.

- ECF support was locked into the contract with EMP and had no flexibility to allocate additional funding support if required. A supplementary working capital loan facility, as distinct from a grant, may benefit this project.

- Additional ECF resources for a more detailed project evaluation process may have identified the project implementation problems and possibly developed alternative financial strategies or support from other organisations at an earlier stage.

- New, partly implemented business projects with no track record will find it difficult to secure commercial finance and the working capital problems encountered by EMP could see it fail. The ECF design did not incorporate sufficient resources or flexibility for supportive interventions. EMP was linked by the ECF to a potential Fiji investor but the latter’s requirement for majority control resulted in no outcome.

A potential flow-on benefit of this project would be development of several local SMEs to provide the extensive transport services required for the coconut collections. As was demonstrated by the interest shown by the BSP there may be prospects to arrange start-up finance for these small businesses but as ECF support of the EMP project is now concluded it cannot give facilitation support.
**Future Forests, Fiji**

Future Forests Fiji (FFF) is a teak nursery and plantation in the underdeveloped Ra province in Fiji. It received an ECF grant of A$190,000 in 2009 to expand and upgrade its teak seedlings nursery as the first stage of a larger teak plantation and timber processing business. The nursery is a crucial link in the company’s development plan. The seedlings are used for the company’s plantations and also sold to others.

With ECF support the nursery upgrade was completed on schedule. It now operates profitably and exceeds international yield standards. It is now the largest commercial tree nursery in Fiji.

FFF works harmoniously with landowners in the Ra province with mostly subsistence farmers benefitting. The operation employs 10 full-time, mainly female, workers but casual and contract workers represent the bulk of the workforce. Cash payments to the men and women who plant and maintain the plantations are around A$118,000 per year, or the equivalent of 250 part-time jobs.

Other significant benefits from FFF include:

- paying landholder lease payments for an increasing number of teak plantations
- developing local skills in nursery operations and plantation management
- establishing a new village based nursery that will provide income for 15 people
- donating 15,000 teak seedlings for planting on community land that will generate incomes of around A$540,000 in six years (when trees are thinned) and over A$800,000 when mature trees are harvested in 20 years.

FFF launched on the Fiji stock exchange in early 2012 and raised F$1.8 million (approximately A$1 million) of additional investment. The capital will be used to increase the number of leased plantations and to develop a plantation timber processing operation in Ra province bringing badly needed jobs for locals, and a reliable market for thinned and mature trees. A further capital raising will be undertaken in mid-2013 to implement the company’s development plans.

FFF has worked closely with Conservation International (CI) which has used carbon offset funds from Fiji Water to purchase teak seedlings and to pay landowners to plant and maintain plantations that incorporate both teak and native timbers. The CI payments to landowners in the planting year are around A$210,000 and A$130,000 in subsequent years for thinning and maintenance. In addition to this annual income, landowners have timber assets that will be worth a great deal in both medium and longer terms.

This project represents a good example of a commercially sound and environmentally responsible forestry project. The mutual benefits accruing to both landowners and the company are a good model for others to replicate. The project outcomes demonstrate the value of a timely public contribution to effectively kick start an operation that is driven by individuals with a clear understanding of the importance of, and a commitment to, a harmonious relationship with traditional landowners.

The project has relevant lessons on access to finance:

- A challenge fund grant can play an important role in the commercialisation of a beneficial green field project that has no chance of securing other financial support. The FFF business was a classic case of a project that ‘fell between the cracks’. Banks were not interested because of its new, unproven nature; microfinance and similar small scale institutes could not provide the required level of support; larger financial institutions and venture capital funds were not interested in this small project.

- ECF support was timely. FFF had trialed different teak species and had established strong and equitable relations with landowners and was ready to move to a commercial stage but none of these steps impacted on the attitudes of commercial lenders.

- The small equity injection represented by the ECF grant was sufficient to establish the project’s credibility for a partly successful float. The public float and associated investments in the project are noteworthy and significant scaling up outcomes.

Project beneficiaries can earn incomes totalling A$120,000–$200,000 per year for the involved community groups. FFF recognises the need for associated money management and thrift training support in the medium term and for even more extensive financial and business management training in the longer term when the teak trees mature and the landowners will be entitled to relatively large royalty and other payments. For example, the FFF gift to landowners of 15,000 teak seedlings for planting on community land will generate further incomes when trees are thinned in six years and harvested in 20 years.

A program to use these funds for equitable community development and micro/small business development programs would be beneficial and provide useful lessons for a range of stakeholders involved in financial inclusion. Unfortunately even the shorter term outcomes are outside of the ECF monitoring and evaluation timeframe.
An existing small scale poultry producer near Lautoka in Fiji, Reddy Farms, gained an ECF grant of A$149,900 in 2009 to start an integrated Pekin duck hatchery, feed mill and processing operation to satisfy local market demand. Commercial finance was not available for this start-up partly woman-owned business project because of its perceived risk and the limited collateral of the family business. The project planned to utilise a large number of households in the surrounding depressed cane belt area under a typical out-grower system. These contractors could earn a net income of over F$200 each 7–8 weeks, or F$1,400–$2,000 per year from the limited required work. Contractors are also allowed to keep two ducks from each batch for their own use. Reddy Farms provided suitable feed, technical guidance and support to out-growers and was responsible for marketing to hotels, supermarkets and other customers in Fiji.

Establishing the integrated facilities at Reddy Farms and the associated health and environmental approvals took longer than expected; a number of technical issues with the hatchery had to be resolved. By mid-2011 the project was operational and marketing to target customers began. The business owner told the ECF Fund Director ‘I had a dream to expand but I needed someone to support me because the banks are not interested in my small family business.’ While the project has not been as successful as hoped, there have been flow-on benefits, such as increased incomes for the contractor households, six new workers in the operation and scaling up of the locally owned small business. The project has given useful lessons about smaller scale contracted out-growers for both the Fiji Department of Agriculture (actively involved in monitoring the project) and other stakeholders.

On the other hand, processed duck sales have not achieved targets due to the price sensitive local market and the limited marketing resources of the business. The number of contractors has stabilised at 12–15 households, each household growing out 75–100 ducks, rather than the expected 50 ducks per batch. The business is, nonetheless, commercially sustainable because the owner has diversified into other activities – sales of live ducklings to farmers, processing of larger chickens to fill a gap in the market. Income increased by 39% between 2011 and 2012, a net profit in 2012 was well over 10% and the business has reduced outstanding debt.

This outcome is typical of other failed contractor agreements – despite the additional income from the non-disruptive grow out activities, the majority failed to perform to the required standard. Two noteworthy access to finance issues emerge:

- The business owners reported that once business facilities were established and incomes started to increase, local banks were interested in working with Reddy Farms. From a position where the banks ‘didn’t want to know us’ they were approached by three banks, including Fiji Development Bank, with offers of financial assistance. The company has managed to pay down and reschedule its debt and has negotiated a lower interest rate from one bank.
- The ECF Fund Director linked Reddy Farms with the local Westpac bank as a trial for provision of the bank’s recently introduced microloans service (mandated for all banks by the Fiji Government). Westpac had appointed five people to the new microfinance program, soft launched a microfinance account with no annual fees and secured a contract with the department of Social Welfare to provide financial services to 22,000 unbanked people. Their microloan facility had not been finalised and the bank liked the idea of working with the Reddy Farm contractors as a test case. The Westpac Fiji General Manager and a senior representative from the bank’s Sydney based Pacific Banking division personally visited Reddy Farms and followed up with a written offer to provide microloans to the contractors through the business, with repayments deducted from contract payments by Reddy Farms. Emerging difficulties with contractors meant this offer was not take up by Reddy Farms.

A microloan arrangement with Westpac would have been a very useful case study, but it is noteworthy that the concept appealed to the bank and that a workable repayment process was proposed.

Several clear lessons emerged from the project:

- More detailed and independently evaluated market research could have allowed Reddy Farms to structure a project that was more appropriate to its resources by excluding some aspects, such as the feed mill, or to implement a more diversified project with the required human resources.
- The ECF grant funding could have included provision for a full-time technical support person to work closely with the better short-listed contractors for at least 12 months. This is likely to have had beneficial commercial and contractor outcomes.
- The business needed a more effective marketing strategy and the associated resources to achieve the required sales volumes. ECF funding support could have incorporated funds for these purposes.
- The ECF grant resulted in a more professional and credit worthy project from the perspective of commercial lenders and, even though the small contractor model has proved difficult, the business is now able to secure more appropriate and affordable finance.
- Microloan providers understand the merit in working with small contractors/suppliers who have a reasonably secure income from a larger business that helps to ensure loan repayments. (In the case of a commercial bank obliged to offer microloans, the micro-entrepreneur could graduate into a formal business that would provide the bank with future business opportunities in areas more aligned to their core business.)

A specific contractor arrangement was organised by the ECF Fund Director as an access to finance test case associated with this project. A Rotary club in Australia provided an interest free loan to a single mother for construction of the duck holding pen and she was appointed as a contractor. The first three duck batches handled by this woman worked well and she received over F$600 in cash payments – subsequent batches suffered from high mortality rates, despite the extra guidance by Reddy Farms. The high mortality rates represented cash losses for Reddy Farms and the out-grower agreement was terminated. The Rotary club forgave the debt.
Solomon Islands’ projects

Two ECF projects approved in the Solomon Islands are also informative examples of the potential role of a challenge fund modality in addressing finance related barriers in fragile states.

The ECF international assessment panel approved a substantial grant for a biodiesel project that proposed use of local copra as the key input on the basis of its potential pro-poor outcomes and its contribution to energy self-sufficiency through the use of plentiful local feedstock.

A Perth based company, Burrows, provided evidence that their bank would not provide finance for the project because of the perceived sovereign risk associated with a business venture in the Solomon Islands. Burrows were not prepared to risk their Australian assets on the project but were willing to inject sufficient cash to cover over half of the project costs.

This project eventually did not proceed – Burrows agreed to terminate the grant contract following extensive and unsuccessful efforts to locate suitable land for the facility. This was compounded by changes in the international price differentials between coconut oil and diesel which meant that a project focusing on biodiesel was no longer a commercially viable option.

Another Solomon Islands project is the C-Corp cocoa export operation, which rehabilitates cocoa plantations, exports a premium branded Solomon’s cocoa beans and has joint venture arrangements with plantation landowners. It was supported by the ECF assessment panel for its obvious development benefits and potential as a model for other cocoa operations in the Pacific Islands and elsewhere.

The project has successfully rehabilitated most of the plantations, introduced new hybrid plants, established a replicable pest and disease management strategy and increased export sales. However, landowners have benefited from only limited increased incomes.

This project has also been beset by a number of problems. The joint venture arrangements with the two landowner groups proved to be divisive with associated disruptions to the operation. Inadequate communication processes are partly to blame but it is also evident there are gaps in the understanding of how a joint venture operates. The commercially inexperienced landowners believed that a joint venture should show dividends from the outset. They did not appreciate that dividends are only possible when a business is profitable and financially sound, which is not the case with this project. The landowners tend to disregard the future value of the business which, under the joint venture agreement, will be handed over to them once the project has repaid the investment and is profitable.

C-Corp was unable to secure commercial finance support for the proposed project because of lenders’ perception of its high commercial and sovereign risks. An ECF grant was also an important risk reduction consideration for the C-Corp owner, who has made it clear that he would not have started this project without ECF support.

The poor business environment, subsequent social problems in the area where the plantations are located (theft and assaults), conflicts over the proposed inclusive joint ventures that have not met landowner expectations and the sovereign risk profile of the Solomon Islands required ECF support to ‘sweeten the deal’ and maintain commitment from C-Corp’s perspective. The company’s option was to expand activities in the other Pacific Island economies where it has less problematic cocoa operations.

Lessons have been gained from these Solomon Islands projects:

- Generous ECF type equity support into a high risk project in a fragile/challenging environment can be crucial to its implementation when commercial lenders and investors are reluctant because of sovereign risk and other business enabling environment shortcomings. The potentially transformative Burrows project would not have been pursued to the point it was without ECF support.
- The C-Corp business owner has persevered in difficult circumstances because he felt a ‘moral obligation’ as a result of the ECF/Australian taxpayer support. This does not guarantee that the project will remain viable in the longer term if serious problems remain.
- If sufficient resources and additional time were available to the ECF it would have been useful to involve an experienced NGO and other stakeholders to review the proposed joint ventures with landowners and to institute a more culturally appropriate arrangement and more effective communications from the project’s outset. (This process is now being organised by C-Corp but the project has suffered in the meantime and the flow-on benefits have been limited.)
Summary of lessons from the Pacific Islands

The projects outlined above are aligned to AusAID’s sustainable economic and private sector development strategies and provide useful insights into how improvements in access to finance can result in pro-poor outcomes.

The key lessons from these projects can be summarised as follows:

- SMEs in the Pacific Islands face considerable difficulties in securing commercial and other finance for new or expanding ventures, particularly those with limited track records and relying on supply chains with rural and inexperienced suppliers. The banks’ perceived risk profile of these types of projects, which often offer the best scope for pro-poor impacts, will be difficult to address in the medium term without some form of external support.
- A challenge fund or similar grant injection can play an important role in kick starting a beneficiary’s commercial venture and, once the project achieves certain implementation milestones, commercial or investor finance can be secured for future expansion.
- External financial support for new ventures in fragile states with perceived high sovereign risk can be crucial for their implementation. This type of intervention can stimulate beneficial external investment in countries or regions where the business enabling environment is regarded as problematic.
- Funding support in the form of an ECF type grant alone is not sufficient. A more holistic approach is needed: one that incorporates links with other technical and financial support mechanisms; one that is underpinned by extensive upfront assessment to structure the best possible project for commercial sustainability, growth and impact.
- The first generation challenge fund ‘light touch’ management approach incorporated in the ECF will not achieve the best possible outcomes for AusAID in a Pacific Islands environment where ‘management capital’ is almost in equally short supply as risk capital, particularly for indigenous businesses and women.

Improving future programs

The lessons from these case studies should inform future programs:

- When assessing the commercial viability and potential development impacts of projects submitted for funding support, a detailed review of the ‘management capital’ of the management team is essential. Funding support for production improvements and marketing activities may not, in itself, be sufficient for sustainable benefits to disadvantaged suppliers. Funding or technical support to strengthen the business’s management capital should be determined either from the outset or at an early stage in its expansion.
- Improving access to finance for women is also a major consideration for investment but was not an explicit requirement of the ECF. Women entrepreneurs make a significant contribution to their economies yet research by the IFC found that access to finance for women is limited by cultural barriers. Women in developing economies are more likely to run smaller business operations but are disproportionately affected by the investment climate. Despite increasing efforts to improve women’s access to finance, the IFC found that the programs that focused on women business owners who have graduated from microfinance remain ‘small and siloed and often lack targets or monitoring and evaluation frameworks’. Additional investment in access to finance for women in particular should be considered.
- Relatively large scale, greenfield agribusiness projects in the Pacific Island environment need to be carefully reviewed for their likely working capital requirements during the usual lengthy establishment phase. This review should consider overall financing of the project and the need for supplementary or other short-term working capital during the crucial implementation stage.
- Support for projects like FFF can yield very positive outcomes and, particularly in the Pacific Islands context, such projects need to be included in the fund’s targets. Genuine inclusive arrangements with landowners, coupled with income streams for these beneficiaries from the outset, should be key assessment criteria. Links with appropriate money management support for beneficiaries would be a useful addition from a community development perspective.
- A business plan proposed by a relatively inexperienced SME owner needs to be independently verified and, if required, amended before funding support is provided. Technical support to suppliers may need to be implemented and, where appropriate, can be partly covered by the funding. Microfinance providers are likely to be interested in working in collaboration with business projects that offer a reliable market for rural suppliers, a facility that could be built into the supported project from the outset.
- Providing a timely and generous grant should be regarded as only one element of a package of assistance for maximising the pro-poor and broader impacts of a supported business project. Sufficient and flexible resources for tailoring financial and technical support activities for individual projects need to be developed from the outset and based on detailed project assessments.

The recommended key elements of a challenge fund type program in the Pacific Islands, with worthwhile indirect impacts on the availability of financial services to the poor, could include:

- a focus on high priority sectors, such as agribusiness and environmentally positive projects, to maximise the prospects for systemic impacts and allow for the accumulation of project assessment and evaluation expertise
- an inclusive approach with financial institutions and other supportive agencies to develop linkages from the outset that will benefit the supported business projects and potential beneficiaries, and promote maximum possible flow-on benefits to indigenous and women entrepreneurs operating in the informal sector who are associated directly and indirectly with the ECF supported project
- financial packages, where appropriate, in the project deal – e.g. bank loans, supplementary equity or venture capital investment, a pre-arranged working capital loan facility if required, a tailored SME finance facility for contractors servicing the project and microcredit/finance services, possibly coupled with more innovative credit scoring procedures for farmers and other small scale suppliers to the project; and consequently flow-on project assessment and structuring experience for local stakeholders, including intermediaries in the finance sector
- adequate resourcing to undertake detailed assessment and project structuring, establish and maintain supportive linkages, and undertake the important dissemination of the lessons learned to increase systemic impacts; the management team needs to be experienced and allowed to be flexible within the agreed parameters
- technical assistance to shortlisted bidders to help them work through the proposed business project and to guide them on refining their grant application – women-owned and indigenous businesses, in particular, would gain practical business planning, finance application training and longer term benefits irrespective of their success in securing a grant
- a minimum five year period for the monitoring, evaluation and technical support processes
- an increased focus on larger business projects with stronger systemic and beneficiary impacts that will also be of greater interest to other financial and technical support stakeholders – to the benefit of micro and very small business ventures in the arrangements linked to a large challenge fund project
- close liaison with agencies, such as the IFC and ADB, and government bodies involved in the important enabling environment improvement programs, for cross-fertilisation of lessons and to strengthen dissemination activities through the use of practical business models.

8 IFC. October 2011. Strengthening access to finance for women-owned SMEs in developing economies.