

# Enterprise solutions to poverty

Opportunities and Challenges  
for the International Development  
Community and Big Business

A Report by Shell Foundation

March 2005

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## Opportunities and Challenges for the International Development Community and Big Business

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First published by the Shell Foundation in 2005

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## Executive summary

### **A moment in history?**

The modern world has always encompassed extremes of affluence and poverty. But in 2005 the confluence of advocacy, political serendipity and natural disaster has rapidly pushed the plight of the impoverished up the agenda of the wealthy as never before. The sharpness of the challenge being thrown down on behalf of the poor and the pressure on the rich to take action in response is unprecedented, as is the level of debate on a topic previously all but ignored by the public and mainstream media.

As a result of this campaign by the International Development Community (IDC) and non governmental organisations (NGOs), rich governments are likely to raise their aid budgets and expand debt relief significantly while hopefully revising international trading rules in a more pro-poor direction.

This is good news. The more sobering side of this story is that deploying this political and financial capital effectively in the war against poverty will be a complex and difficult undertaking – as a look backwards tells us. Over the last 50 years, the international community has spent more than a trillion US dollars, and many times that amount in effort, exhortation and emotion, to relieve human suffering and create the starting conditions for poor people to escape poverty.

Clearly, this assistance has brought much short-term relief, achieved real breakthroughs against devastating diseases and the scourge of famine and contributed to the long-term development prospects of poor countries. But at the same time, much aid has been ineffectively and inefficiently used and failed to deliver the broad-based gains in growth and quality of life that had been promised.

This means past efforts to tackle poverty are not necessarily a reliable guide to what should be done in the future. And precisely *how* the international development community will use the new opportunities on offer to eradicate poverty is a vitally important question for many reasons.

There's a great deal of public money at stake and bold claims are being made about using it to 'Make Poverty History'. More importantly, there remains great need. After fifty years of international development assistance, two billion people still live

on less than US\$2 per day. Great uncertainty remains about the mix of policies and interventions needed to stimulate equitable economic growth. Yet set against this great need and the doom and gloom that still inform the aid debate, there are positive signs of progress in Africa, and elsewhere, that demand to be acknowledged and supported.

### **Enterprise first**

So the question of what to do now to most effectively overcome poverty is challenging. Much advice is being tabled by commentators and expert committees such as the UN Millennium Commission and the UK Commission for Africa. The ultimate focus of all of the wisdom on offer today is the same basic issue the international community has been struggling with for many years. And that is this: how, when and where should the international development community intervene to best help developing countries create the conditions that facilitate sustainable and equitable economic growth?

This is where the recent experience of Shell Foundation may be of value. Since 2000, we've been exploring systematically the questions of how to catalyse and scale-up market and enterprise-based solutions to poverty – and how to harness to the same task, the value-creating assets of multinational corporations

There are sound reasons for this focus. History demonstrates that a flourishing, responsible private sector, built on a broad base of enterprise, including small and medium sized enterprises (SMEs) and well-regulated foreign direct investment (FDI), has been key to delivering the sort of economic growth in developing countries that we know pulls poor people out of poverty.

Going forward, common sense suggests the SME sector in particular must grow on a massive scale if the Millennium Development Goals are to be achieved and sustained and if lasting gains are to be secured from the opportunities created by debt relief and fairer trade.

Most importantly, the growth of enterprise offers poor people the hope that there's an economic ladder to personal betterment they can climb by dint of honest effort. If this hope does not exist, there is a danger they stop looking up and forward and resign themselves to poverty – permanently.

To be sure, there are many other poverty priorities that need to be addressed. But what the poorest developing countries absolutely need in order to make poverty history is the growth of enterprise.

### The Shell Foundation experience

The Shell Foundation, through pilots and partnerships, success and failures, has been evolving an approach to the promotion of 'pro-poor' enterprise that has five key features:

- First, our concept of pro-poor enterprise is inclusive and encompasses productive entities that supply goods and services to poor people, employ poor people or are owned by poor people.
- Second, the prime concern of all actors involved in the intervention must be the long-term financial viability of the enterprises being assisted. Socially or environmentally sound projects or enterprises that fail or remain permanently dependent on subsidy help nobody.
- Third, the enterprise-support interventions must themselves have a financially viable business model that can be scaled up using local capital and local capacities. There will never be enough aid funding available to support enough pro-poor enterprises to make an appreciable dent on the scale of poverty that still exists.
- Fourth, the most effective partners are those who can apply *business principles* and *business thinking* – assess risk, know your market, offer what your customer wants, find least-cost solutions – to the challenge of catalysing pro-poor enterprise.
- Fifth, multinational corporations are a largely untapped source of value-creating resources such as skills, knowledge and networks that if accessed and deployed appropriately can add enormous social value to civil society efforts to promote enterprise and tackle poverty.

### Promoting pro-poor enterprise on the ground

Four case studies of Shell Foundation initiatives are described in detail. These include efforts to pilot and then scale up market-based mechanisms for reducing substantially the nearly two million extremely poor women and children who die every year from inhaling smoke from indoor cooking fires.

Another explains how an innovative consumer financing mechanism funded and jointly launched by Shell Foundation, other donors and commercial banks has catalysed rapid expansion of the market for solar home systems (SHS) among the underserved rural and peri-urban population in south India.

The third explains the way a 'social' merchant bank also operating in south India is using flexible finance, financial engineering skills and business development expertise to assemble a series of bankable, pro-poor energy and water infrastructure projects run at a profit by barefoot entrepreneurs with capital requirements as low as from \$1000 to \$20,000 dollars.

And the fourth case study describes successful SME investment funds being piloted in Uganda and South Africa whose 'clients' are entrepreneurs with little collateral and limited business experience, previously unable to access finance of any kind, for projects in the \$10,000 to \$500,000 range. Set up with local banks and supported by the skills and infrastructure of local Shell companies, more than 300 hundred SMEs have received finance and business training from these funds. More than a thousand jobs have been generated by the 170 enterprises in which investments were made, while the funds overall are delivering commercially attractive rates of return to investors.

### Propositions for change

The final section draws on the Shell Foundation experience – and the efforts of others working in a similar way – and invites the international development and international business communities to address three questions:

- First, how to increase the scale and effectiveness of pro-poor enterprise interventions;
- Second, how to make the objective of pro-poor enterprise growth an integral part of poverty-reduction strategies advanced by the international development community and pursued by developing countries;
- Third, how to more effectively engage the private sector but especially big business in efforts to tackle poverty through enterprise, both directly and as a source of insight, advice and skills transfer.

Proposals for change are tabled that relate to the ways donors concerned with enterprise promotion operate, challenging them to act more like investors and less like charities. This would involve them seeking, as accountable returns, measurable growth in the pro-poor enterprise sector – targets which grantees could be incentivised to achieve and penalised if they do not.

Donors are also encouraged to enter into new arrangements with big business in order to enlist its support in ‘re-engineering’ the international development supply chain via the injection of business thinking along its entire length.

Propositions are also made that aim to get big business to engage much more effectively with public-private partnerships tackling poverty issues. The key to this is the restructuring of the risk-return profile of such partnerships, ensuring empowered players really are able to deliver change and participate in the partnerships, and that these provide ‘returns’ to partners commensurate with their risk and expectations.

There are, of course, many other actors who have long been pioneering ways to harness the power of business and business thinking to the challenges of overcoming poverty. In that sense, most of the propositions advanced in this paper complement and reinforce the efforts of others.

Given the scale of the problem to be tackled and the encouraging signs that results can be delivered, the IDC, developing country governments and the big business community need to explore the enterprise-poverty territory together, robustly and urgently.

This does not mean more talking. Action must be agreed to pilot new ways of working together to tackle both the direct and the business-environment obstacles to pro-poor enterprise development and growth. The Shell Foundation over the coming months will be doing what it can to catalyse such initiatives and we invite others to join us.

# Introduction

This paper has two objectives. The first is to introduce the Shell Foundation and its way of working. The second is to offer up insights drawn from our experience as a contribution to the wider debate on how the private sector and the International Development Community (IDC) can most effectively catalyse equitable, self-sustaining development in poor countries (see annex 1).

The Shell Foundation is new – established by Royal Dutch/Shell Group of Companies as a UK charity in June 2000 – and a little different. Unlike many corporate foundations, the Shell Foundation focuses on social issues aligned to the core characteristics of our founder – an energy major and a multinational group of companies (MNC). Thus we address social problems arising from the links between energy and poverty, energy and the environment and the impact of globalisation on vulnerable communities.

In addition, while set up as a grant-making charity, the Shell Foundation believes the application of business principles and business thinking can be very useful in tackling social problems, especially the challenges of overcoming poverty in developing countries. Hence we tend to act more like an investor in deciding where and how to allocate our commitments of time and money. We also expect our partners to act more like entrepreneurs and businesses in the pursuit of their social and charitable objectives.

Finally, and because of our focus on energy issues, we're exploring ways of harnessing what we call the 'value-creating' assets of one of the largest international energy majors, the Shell Group, to advance our charitable objectives. We could not do this if our issues were traditional corporate philanthropy concerns of health, education or culture.

Moreover, because the Shell Group has long been present in many developing countries, we have ready access to practical experience and 'local' knowledge on enterprise–poverty issues simply not available to the majority of IDC actors – donors in particular. Taken together this means we are able to bring 'more than money' to the table when seeking strategic partners and working with them to develop and implement viable, scalable solutions to the social problems we target.

Of course, the Shell Foundation is still young and our track record relatively limited. However, our work to date tackling poverty in developing countries is throwing up intriguing challenges – not only for the Foundation Board and its staff,<sup>1</sup> our founders, the Royal Dutch/Shell and our partners – but more widely for practitioners concerned with international development and corporate social responsibility (CSR).

In Section 1 we set the stage for exploring these challenges by reinforcing a case for putting 'pro-poor enterprise' more at the heart of the efforts by the IDC and big business to help poor people escape poverty (see annex 1). In Section 2, we describe the core features of the approach taken by Shell Foundation to pursue this goal. Section 3 uses case study material to illustrate our way of working and the outcomes being achieved. Finally, in Section 4, we distil our experience into a set of propositions for wider debate and consideration by the international development and business communities.

## Section 1: The case for putting pro-poor enterprise at the heart of the war on poverty

2005 is set to be a big year for poverty. Doubling aid, making trade fair and dropping Third World debt are the headline goals of a campaign being waged and supported by many official and non-governmental aid and development organisations determined to make 'Make Poverty History'.<sup>2</sup>

Of course, the international community has long been trying to banish poverty. But this latest foray is notable for its scope, scale and populist appeal, having kicked off with the anti-globalisation protests and Jubilee Debt Campaign in the late 1990s. Establishment backing was added via the launch of the UN's Millennium Development Goals (MDGs), the Monterrey Accord and the Doha Trade Round in rapid succession between 2000 and 2004.

Throughout this period, a relentless wave of pro-poverty meetings, events and media coverage has contributed greatly to the momentum and pressure on the governments of rich countries to finally act after years of unfulfilled promises about tackling poverty. And during the same period even MNCs began to involve themselves *directly* in actions against poverty that extended beyond their normal contribution to development as investors, producers and employers.<sup>3</sup>

So as we head into the second half of 2005, it looks as if these efforts will lead to substantive action by OECD governments on upping aid flows, expanding debt relief and improving the trade rules in a pro-poor direction. Of course, there are many who voice contextual concerns about all this.<sup>4</sup> But the gains being achieved in securing more resources and renewed commitment from the North to tackle poverty in developing countries are a significant achievement and should be applauded.

However, the IDC must now address the challenge of using the new resources and opportunities being made available to kick-start a process of dynamic, self-sustaining economic development that will allow poor people in their billions to escape poverty – permanently.

This is a complex and difficult undertaking as a look backwards reveals. Over the last 50 years, at least a trillion US dollars<sup>5</sup> and many times that amount in effort, exhortation and emotional engagement has already been spent by the IDC to relieve human suffering in poor countries and create the starting conditions for poor people to escape poverty.

There is ample evidence this assistance has brought much relief in humanitarian terms, achieved great breakthroughs against disease and chronic food shortages and made many other diverse contributions to the long-term development prospects of poor countries.<sup>6</sup> Unfortunately, there's equally ample evidence showing that even allowing for difficult operating contexts, much aid has been inefficiently and ineffectively deployed and has not contributed nearly as much as had been hoped to economic progress in poor countries.<sup>7</sup>

So while aid gives much to build upon, the uneven track record of development assistance and the uncertainty that remains about how best to catalyse equitable economic growth means that what was done to tackle poverty in the past is not necessarily a reliable guide to what should be done in the future. So the issue of precisely what the IDC is now going to do with the new opportunities it's been given to untangle the Gordian knot of poverty in developing countries is a hugely important question for many reasons.

There's a great deal of public money at stake and some pretty bold claims are being made about using it to 'Make Poverty History'. The persistence of extreme poverty in some regions of the world is seen as a security threat and an economic drain on rich countries.

Most importantly, there's the urgent and massive backdrop provided by the two billion people still living on less than \$2 per day – many of them poorer than they were just 20 or so years ago.<sup>8</sup> And yet set against this great need, and the doom and gloom that still informs the aid debate, there are positive signs of progress in Africa and elsewhere that demand to be acknowledged and supported.<sup>9</sup>

### So which way now?

Not surprisingly, there's much advice being offered as to what should be done now to tackle poverty by commentators and expert panels such as the UN Millennium Commission and the UK Commission for Africa. The ultimate focus of all of the wisdom on offer today is the same question the IDC has been struggling with for many years. And that is: how, when and where should it intervene to best help developing countries create the conditions that facilitate sustainable and equitable economic growth?

This is where the recent experience of Shell Foundation may be of value. Working with a major multinational, we've been exploring systematically the question of how donors and large companies can most effectively catalyse and scale up pro-poor market-based and pro-poor enterprise-based solutions to poverty (see annex 1).

There are sound reasons for Shell Foundation (and other organisations)<sup>10</sup> adopting this focus. Most importantly, theory and past experience demonstrates a flourishing private sector, fairly regulated by government and populated by enterprises of all kinds but especially by what we referred to earlier as pro-poor enterprises including small and medium-sized enterprises (SMEs), is key to delivering the sort of economic growth that we know pulls poor people out of poverty.<sup>11</sup>

Moreover, looking forward, it is obvious that pro-poor enterprise growth, especially in the SME sector,<sup>12</sup> will be critical in meeting the headline goals of the current campaign to overcome poverty:

### **Millennium Development Goals.**

Pro-poor enterprise-based activity on a massive scale will be needed to deliver and maintain the basic goods and services whose provision will underpin the attainment of many MDGs.<sup>13</sup>

### **Fairer trade.**

Using the Doha Trade Round to secure a more pro-poor trade regime is an important start. But if this is to be converted into real benefit for poor people, then large numbers of internationally competitive farmers and enterprises will be needed to capture and retain a fair share of the available income gains.<sup>14</sup>

### **Debt relief.**

Much is made of how some countries have used the funds freed up after debt relief for education and health. This is good news. But countries benefiting from debt relief must invest some of this boon in pro-poor enterprise, job and wealth creation to consolidate and build on these quality-of-life gains that might otherwise be eroded over time.

Finally and most fundamentally, the growth of enterprise, and particularly SMEs, offers poor people a powerful weapon in their fight to escape poverty – hope. People must believe there's an

economic ladder out of impoverishment that they can get onto and climb by dint of honest effort. If they lose sight of this goal, they lose interest in helping themselves, they don't encourage their children to go to school, they stop looking up and forward and resign themselves to poverty – permanently.<sup>15</sup>

There are, of course, many qualifications that must be made about the pro-poor impacts of enterprise growth in developing countries.<sup>16</sup> These range from the potential for environmental damage to acknowledging there are many extreme poverty contexts where markets and thus enterprise cannot function in a normal way.<sup>17</sup>

And it's true that development is about much more than jobs and income; and that on balance, healthier, better fed, better educated, less oppressed people living in a cleaner environment are likely to be much more productive in what they do. This means there are, of course, many other poverty priorities that developing countries and the IDC must address.<sup>18</sup>

But common sense also suggests it's a lot easier for people to secure and retain the gains arising from interventions focused on health, education, gender equality and so on if they have a job in the first place or have prospects of securing one in the near future – which is why jobs are often at the top of poor people's lists of priorities.<sup>19</sup>

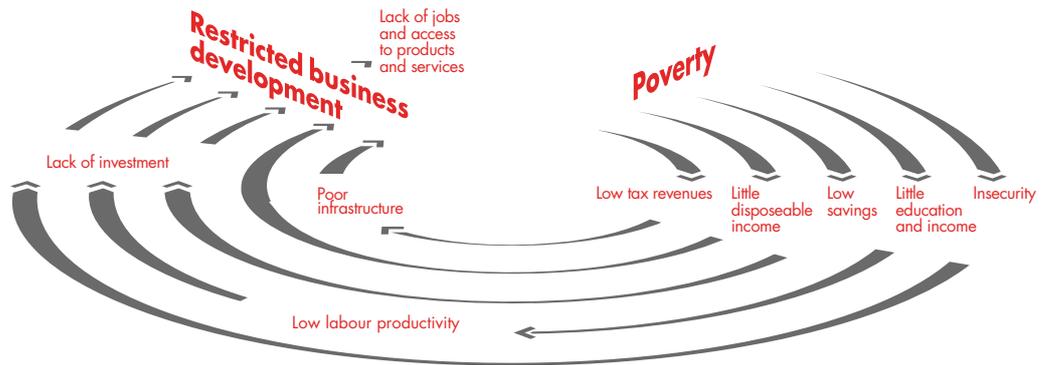
So in theory, practice and common sense terms, most routes out of poverty for poor people start with enterprise. To be sure, the starting conditions for addressing pro-poor enterprise development will be extremely difficult in many countries. Fortunately, however, there's plenty of entrepreneurial drive, traders' skills, risk awareness, consumer demand, innate talent, individual desire to improve and even disposable income in the poorest countries.<sup>20</sup>

But what there clearly is not enough of yet is enterprise and the wealth, income and empowerment that enterprise development offers poor people. And when there's not enough enterprise and not the right enabling environment, the downward trajectory of poverty is continually reinforced as shown by Figure 1.

So what the poorest developing countries need absolutely in order to make poverty history is the growth of pro-poor enterprise.

Figure 1

**Enterprise and development:  
the cycle of poverty**



Adapted from a figure in M. Forstater et al (2002)  
**Business and Poverty: Bridging the Gap**  
International Business Leaders Forum, London

## Section 2: Learning by doing: the Shell Foundation experience in catalysing pro-poor enterprise development

Since its launch in June 2000, the Shell Foundation has been pursuing a structured journey to learn how market forces can be harnessed to get affordable products and services to poor people, and which interventions and what kind of agents are most effective at catalysing the emergence and growth of pro-poor enterprise – especially SMEs.<sup>21</sup>

We've also explored how best to take advantage of the corporate environment we operate in so as to advance our charitable objectives and have observed carefully under what conditions and through what mechanisms large companies can most effectively contribute to development in general and pro-poor enterprise growth in particular.

At the outset of our journey we acted much like a traditional foundation. We consulted widely, publicised our areas of interest and then sifted through countless proposals submitted by professional NGOs and non-profit organisations. We used rigorous selection criteria to decide between proposals and wound up using our grant money to support a large number of relatively small, one-off projects scattered across many countries.

Most early projects were competently completed by our grantees. But for reasons explained below, we now judge many of these to have 'failed' because they did not leave behind initiatives capable of surviving or going to scale without our ongoing support or that of other donors.

Largely in response to that experience, we have been deliberately evolving to something more akin to a 'social merchant bank'.<sup>22</sup> In essence, this means we work with strategic partners and jointly deploy our money, project development and financial engineering skills and networks to launch what we hope will ultimately become scalable, financially viable enterprise – and market-based initiatives that deliver measurable financial and social (pro-poor and pro-environment) returns. (see annex 1)

There is still more to learn. But over time our approach has begun to bed down and has started to generate interesting insights and some encouraging results. And it is this accumulated experience that provides the empirical grounding for the four aspects of the Shell Foundation 'approach' we describe below and illustrate with examples in Section 3.

### Financial viability

When we consider providing support to a pro-poor enterprise either directly or indirectly through some form of intervention or initiative, our experience<sup>23</sup> leads us to look first at how the issue of financial viability is treated by other finance, by those running the implementing of the intervention and by the enterprise themselves. If financial viability is not given primacy in their plans and actions, we do not offer support.

The reasoning is simple. Achieving financial viability is not just about 'making a profit'. Many things happen as pro-poor enterprises become financially viable. First, they rely less and less on relatively scarce aid money, which is a good thing. Second, achieving financial viability usually means they can start to grow, thus employing more poor people directly or through their suppliers. Third, through the ongoing process of innovation and problem-solving that accompanies growing financial viability, they are able to provide more of their customers – poor people – with more appropriate and more affordable goods and services.

Our experience is that the best way we, as a donor, can help this process of poverty reduction is by ensuring our support is provided on terms that help *and* require the target enterprises to become ever more innovative, efficient and profitable at what they do as a business.<sup>24</sup>

### Going to scale with local capital and local capacities

We next look at the *interventions* proposed to us (financing schemes, training programmes, enterprise incubators, market development projects) and assess whether they are designed to 'go to scale' (via growth or replication) using local capital and local capacities.

Again, the reasons are straightforward. There will never be enough aid to provide the support required to the millions of pro-poor enterprises that need it. So the reach and scalability of any aid or donor-funded interventions will always be severely limited compared with need.<sup>25</sup>

Moreover, foreign grant money – however well intentioned – almost always comes bundled with other things – distant knowledge, foreign skills,

other agendas – whose presence for too long can ‘inhibit’ learning opportunities for the enterprises and local support institutions in ways that increase risk and inhibit growth.<sup>26</sup>

Foreign support can play a vital seed-capital role – and indeed is doing so in the current wave of pro-poor private equity funds and ‘blended value’ investment vehicles focused on providing financial support for a scattered portfolio of social entrepreneurs.<sup>27</sup>

However, what we look for are pro-poor enterprise or pro-poor consumer interventions that are designed to be taken up as quickly as possible by local suppliers – of capital and skills – and whose income stream has the potential to become less and less dependent on grant funding. Essentially, we set out to use our funding and other assets to ‘buy down’ the risks associated with the engagement of local capital and capacity in local enterprise development.

### **Transferring business DNA**

We have found that if our interventions are to successfully feature viability and scalability, then our partners need to be adept at applying business thinking and business principles to how they operate and to the interventions they propose.

What we have in mind here is the deployment by our partners of the same set of skills and entrepreneurial instincts – what we call ‘business DNA’ – that business people everywhere use to identify and assess business opportunities and then overcome the problems that must be solved en route to setting up and operating an enterprise.

These include understanding the market and knowing who your customer is, what *they* want and will pay for. It also means assessing and dealing with risk, instinctively seeking to keep costs down and ensuring the security and quality of input and final product supply and distribution.

Our experience suggests that the presence of business DNA in our partners usually means they will be particularly *enterprising* as they search for solutions. And as a consequence, they are best able to convert our support as a donor into large numbers of pro-poor enterprises able to survive and grow after the subsidy stops.

Obviously more than just business DNA is needed to cope with the complexities of running an enterprise in the context of poverty. Indeed, the ideal is where best practice from the poverty and business worlds can be integrated. And of course, there are IDC with no business record who have been able to engineer successful pro-poor enterprise interventions that also deliver valuable social benefits.

But our experience is that most actors from the non-profit or the public sector do not take easily to the business way of tackling problems – even if they ‘talk the talk’ of business. This is not a criticism or anybody’s fault. It is simply a recognition that either by virtue of education, experience or inclination, many civil society actors (at all levels in the IDC and including policy makers and policy advisers in developing countries) do not have business DNA in their make-up. They are, in effect, commercially illiterate. And, in our opinion, these characteristics greatly reduce their ability to develop successful business – and market-oriented solutions to poverty. Indeed, the widespread lack of business DNA and real commercial experience in the international development supply chain arguably reduces the ability of the IDC to solve many poverty problems.<sup>28</sup>

And in our opinion the absence of this greatly reduces their ability to develop successful business – and market-oriented solutions to poverty. So in the case of our partners, and of course with their permission and full engagement, we put a good deal of effort into transferring businesses DNA into them via various routes set out in the case studies to follow.

### **Harnessing the value-creating assets of MNCs**

Our core arguments so far – that enterprise and business DNA are keys to eradicating poverty and that a great deal more of both are needed – underpin the social benefits offered by the final element of our approach.

Simply put, our experience as a donor operating alongside a major multinational has convinced us that big companies possess a wide-ranging set of tangible and intangible ‘assets’ that can be of huge value in the fight against poverty, especially via an

enterprise-focused attack. So we consciously and transparently seek to deploy these assets in support of our work and that of our external partners wherever we can.

The 'assets' we are referring to fall into three categories:

- First and most fundamentally, established business is a vast repository of the generalised business DNA that is encapsulated in people, knowledge and techniques likely to be found in great profusion, especially in big business.<sup>29</sup>
- The second asset category falls under the heading of 'convening power'. This is shorthand for the subtle and overt ways by which a company's track record, reputation, brand, political reach and financial clout makes other people listen and respond to what the company has to say.
- And the third category includes the company – and sector-specific physical and market knowledge-based assets that lie at the core of the unique processes of value creation and capture on which every company relies.<sup>30</sup>

Usually, all these asset classes are fully and properly deployed in the interests of the business and its shareholders. And when business operates well in developing countries, this is a huge source of social value via jobs created, taxes paid, technology transferred, and so on. But typically these are *not* the assets MNCs offer, or are asked to use, in order to discharge their CSR or sustainable development commitments.

What our experience suggests is that deployment of these private value-creating assets via pro-poor enterprise interventions, could offer a huge but still unrealised contribution to the efforts of the IDC and poor countries to make poverty history.

## Section 3: Shell Foundation's experience on the ground

Below we illustrate how the four elements of our approach – financial viability, scalability, deployment of business DNA and harnessing of corporate value-creating assets – are present in and add value to what we do as a corporate foundation. We draw in detail in the main text on material from our *Energise* and *Breathing Space* programmes which address the energy and poverty challenge. We also refer extensively to other activities of ours in the footnotes and in Annex 2.

### Fostering pro-poor energy markets

As already explained, the Shell Foundation has elected to focus a significant portion of its efforts on tackling the issue of 'energy access' in poor countries. There is a robust poverty rationale for tackling these issues.

Many hundreds of millions, perhaps billions, of poor people in developing countries can't go home at night or into their workplace or out onto their farms first thing in the morning and switch on the lights or start up their sewing machines or irrigation pumps. They lack easy, affordable access to reliable, modern energy *sources* and the modern energy 'services' of light, heat, motive and mechanical power. This matters because increased consumption of modern energy services is one of the fundamental features of the economic development of poor countries.<sup>31</sup>

Thus pro-poor 'energy access' in poor countries has a critical role to play not just by improving quality of life but in dynamic development terms as power of some form is required for all productive activities. Moreover, allowing production to escape from the constraints of muscle power is a key stepping-stone to development. So the lack of energy access seriously constrains economic development and slams the door on billions of poor people trying to get started on the journey out of poverty.

The attention given by the IDC to energy access by the poor – especially the rural poor – has waxed, waned and changed over the years and now has the following features. First, there are new aid-funded, multi-stakeholder but NGO dominated initiatives underway, intended to help poor countries put in place sensible strategies to tackle energy access.<sup>32</sup>

Second, the size of the problem and limited public funding for rural electrification means market-based solutions to rural energy access are

considered necessary – though there is also a view that sufficient local capital is not available to finance these solutions. Finally, concerns about the global climate change impacts of billions of poor people escaping poverty by using the same fossil fuels as do rich people, means the IDC is heavily biased towards the promotion of renewable energy sources in tackling the energy access problem.

The Shell Foundation consulted widely with others to understand this landscape.<sup>33</sup> As a result, we decided to pursue a strategy to tackle the pro-poor rural energy access problem that complements and builds on the IDC's efforts but at the same time differs from the dominant approaches in a variety of ways.

Not surprisingly, market-based solutions to energy access problems are at the heart of our strategy. But we don't think local capital or income availability is the major challenge to be overcome in making the market work. We see the core problem being the lack of an SME sector (enterprises and supporting entities) able to deliver affordable energy services to poor people. The main contextual constraints to be overcome are institutional risk, rules that don't work and lack of the right kinds of capacity.

We're also concerned about the environmental impacts of poor people using fossil fuels but don't believe that distorting the market via renewables-only rules is the most efficient and most equitable way to make things happen. Finally, while planning clearly needs to be done, our strategy for catalysing action by others has been to build a track record demonstrating there are financially viable ways of ensuring greater and sustainable access by poor people to modern energy services.

Our portfolio of energy access initiatives include a fair number of social investments in individual enterprises from which we have learned a great deal. But we've found the greatest returns are coming from our institutional pilots, some with local financial sector partners, and involving innovation in the delivery of finance and technical assistance to our field partners and to pro-poor energy SMEs and their customers. Wherever possible the strategic exploitation of Shell Group assets has been pursued to advance our charitable objectives and those of our partners.

## Case study 1

### Sustainable solutions to Indoor Air Pollution: the biggest killer you've never heard of

#### Key features of the Indoor Air Pollution case study

Breathing Space is the Shell Foundation's programme for tackling Indoor Air Pollution (IAP) caused by smoke emitted from indoor cooking with biomass. Acute respiratory diseases linked to IAP kill about 1.6 million women and children every year in developing countries while hundreds of millions more suffer debilitating disease. Historically, aid-funded efforts to tackle this problem have had very little success.

Breathing Space is aiming to identify, test and then diffuse on a very large scale, 'market-based' mechanisms for getting killer smoke out of the 'kitchens' of poor households.

Supply and demand-side interventions based on business and market principles are being piloted in 8 developing countries. To date 200,000 households have been removed from risk – a figure that will rise to more than a million by the end of the pilot phase.

This is encouraging but trivial compared to the size of the problem. More significantly a number of the interventions tested are robust enough to take 'to scale.' So next stage scale-ups underway in India and Guatemala, based on financially viable business models, are targeting three million households.

By 2008, using our own resources as investment capital and smart subsidies, the target is to get 10 million households out of risk. In parallel, exploration is underway into the feasibility of securing strategic partnerships and setting up financially viable intervention mechanisms at the international and national level to reach the additional hundreds of millions of poor households who will otherwise continue to suffer from this 'killer in the kitchen'.

The common consensus is that at the beginning of the 21st century, more than 2 billion people are still relying on traditional fuels for cooking and heating. This translates into hundreds of millions of very poor households cooking family meals indoors on smoky stoves and open fires using 'traditional' fuels such as firewood, crop residues and animal dung. The smoke and fumes emitted (known colloquially as Indoor Air Pollution) contain

pollutants and particulates that when inhaled can cause deadly and debilitating diseases such as pneumonia and chronic obstructive lung disease.<sup>34</sup>

In October 2004, the World Health Organization (WHO) and the United Nations Development Programme (UNDP) labelled Indoor Air Pollution (IAP) the 'Killer in Kitchen' because it's responsible for 1.6 million deaths each year – largely woman and young children – and blights the lives of millions more. This makes little-known IAP the *fourth* largest health threat to these groups after water-borne diseases, malnutrition and HIV/AIDS.<sup>35</sup> IAP is also part of a well-known poverty chain (the poor, not able to afford cleaner, commercial fuels, must spend many hard hours collecting 'free' biomass fuel) whose direct and indirect costs are enormous.<sup>36</sup>

#### The Shell Foundation approach

For these reasons and because IAP is the most serious energy and poverty-related health problem, the Shell Foundation has committed \$10m to tackle IAP through its Household Energy and Health Programme (HEH) which we have branded *Breathing Space*. The most important feature of *Breathing Space* is not the money, however, but our approach to tackling IAP. This is basically to identify, test and then, ideally, cause to be diffused on a very large scale, 'market-based' mechanisms for getting killer smoke out of very large numbers of very poor people's kitchens.

We adopted this approach for three reasons. First, distorting regulations, health and safety concerns and geography have inhibited commercial suppliers of cleaner fuels from entering a market segment it perceived anyway as having no money to spend. Second, for a variety of largely 'silo-mentality' reasons, IAP as an issue, despite its significance, has failed to attract much donor funding compared to other poverty/health/environmental problems.<sup>37</sup>

Finally and most germane, the interventions that did get donor funding have not made real inroads into the problem on a significant scale. This is partly because of limited funding but largely we believe because the 'solutions' offered were basically subsidised, technical fixes (mostly 'cleaner' stoves) that were often designed elsewhere and bore little relation to what the 'market' (millions of poor households) wanted and could afford or to what overcoming the IAP problem required.<sup>38</sup>

In our language, very little business thinking appears to have been applied to tackling the IAP problem by either the donor or the project deliverers. In our view, this resulted in most IDC IAP interventions being neither financially viable nor scaleable. Thus they usually made little sustainable headway in eradicating the IAP problem.<sup>39</sup>

### A new customer value-proposition

The new generation of stoves designed to effectively reduce emissions are significantly more expensive than the lower-cost 'efficiency stoves', increasing the barriers to access for poorer customers. In some cases these improved biomass stoves are more expensive than liquid petroleum gas (LPG) stoves. But LPG as a fuel is often not available in rural areas. The combined effect of these product limitations and the low availability of desired alternatives is that there is often a very poor customer-value proposition for IAP reducing stoves and fuels. Consequently, demand is low and marketing costs are high.

Against this backdrop, we reasoned that by successfully demonstrating there might be at least partially market-based approaches to tackling IAP, we might be able to break the vicious cycle of ineffective IDC interventions by better understanding and tackling the market barriers. This in turn might provide the impetus to attract sufficient donor and/or private sector interest to tackle an avoidable poverty problem that has probably caused 40 million unnecessary deaths over the last 20 years.

### New partners and usual suspects

We kicked the whole process off via stakeholder consultation and a typical donor 'Request for Proposals' (RFP), asking for proposals for potentially commercialisable and scaleable ways of tackling IAP. The RFP attracted about 140 proposals, primarily from NGOs, of which most addressed the IAP issue but failed to understand what we meant by commercialisable or scalable solutions to IAP.

Nevertheless, we did find some very good NGO partners who could talk, and were willing to walk with us, a route to commercialising solutions to IAP. So we set up pilots in a number of countries<sup>40</sup> to explore systematically different market-related IAP 'solutions' including the development and sale of cleaner stoves, cleaner fuels, use of consumer finance on a micro-credit model, education via sophisticated marketing strategies, reducing costs through mass production and distribution and so on.

### Key actions for the pilot phase

Through these, we have sought, with our partners, to:

- a. assess whether among our target 'market' – rural households suffering from IAP – whether there was an interest, willingness and ability to 'pay' for IAP solutions;
- b. verify the effectiveness of the interventions: do the improved products really reduce IAP exposure;
- c. assess whether there was some form of business, financing and distribution 'model' or value chain that could produce and market appropriate and affordable IAP products to very poor households.

In parallel, we carried out a systematic review of the only two large-scale household energy programmes in the world: the National Improved Chulha Programme in India and the National Improved Stove Programme in China. Lessons from these two programmes have been extremely valuable in developing our own approach. In both cases the programmes were highly subsidised and had mixed results in reducing IAP. The China programme is largely deemed a success and has led to the establishment of a thriving stove market as well as some excellent technical innovation. The Shell Foundation review was the first of the programme since the 1980s and has brought the China experience to the attention of the international community. Neither programme is being continued by the national government in question.

### More than money

In addition to providing financial resources to the pilots, the *Breathing Space* programme has three features:

- the provision to partners of significant technical and business assistance through intensive hands-on engagement by Foundation staff, local Shell staff and finance and business consultants;
- complementary activities (separately funded) designed to answer key developmental and commercialisation questions thrown up by the pilots and especially by our 'going-to-scale' aspirations. These include development of a standardised monitoring methodology to measure the effectiveness of interventions,

whether the product offering meets customer needs and if there is a significant reduction in IAP. A set of tools is also being developed for market research, demand assessment, supply chain development and sustainable financing;

- In parallel, a second set of tools is being developed for market research, demand assessment, supply-chain development and sustainable financing.

### Lessons learned

Once the pilot phase is completed by the end of 2005 at a total cost of US\$7 million, it will have catalysed the market-based diffusion of smoke-reducing products to poor households and removed over one million at-risk individuals from the perils of IAP. This is the first systematic IAP intervention ever mounted though it is still limited compared with the scale of the problem.<sup>41</sup>

We've also learned along the way the value of and how to introduce business DNA into a development project context and how to help NGOs adapt their skills and ways of working. This is essential to meeting the rigorous demands of developing financially viable ways of tackling a classic poverty challenge.

This has not been an easy task because the non-monetised nature of the biomass fuel market, high distribution costs in rural areas, differences in tastes and diets, and the nature of the product offering means that the most effective business models are often decentralised, bundling together a network of dozens and even hundreds of micro-enterprises. The most successful pilots have combined centralised component production, quality control and supply-chain management with decentralised installation and assembly of products, linked to a network of social service providers (such as NGOs) which provide the link to communities, social marketing and awareness raising.

Successful models include both direct cash sales to customers and sales to NGOs or public institutions, which distribute the products through their own social programmes with various combinations of subsidies, micro-credit or in-kind payments. The key factor is maintaining the commercial integrity of the supply chain and keeping it separate from whatever facilitation process is used to get the product to the end customer.

Other advantages of this combined 'public-private' model is that the NGOs or public institutions can provide some of the ongoing training on stove maintenance and inspect installed products. Links to micro-finance institutions and other financing mechanisms such as revolving funds that provide both enterprise financing to businesses in the supply chain, and consumer finance to end customers, provide an avenue for market growth and scale up.

Most importantly, the pilots have demonstrated there may be viable business models, supply chains and consumer financing mechanisms that could be brought to bear on the IAP problem on a large scale.<sup>42</sup>

This has given us the confidence to take the next steps in our 'going-to-scale' journey. In Guatemala alone, for example, this means all involved moving out of the comfort zone of managing a typical, subsidised, low-risk (to the implementers and funders) poverty project with a target population of 5,000, to planning and implementing a self-financing market entry and distribution strategy to get IAP interventions sold into a significant percentage of the 600,000 at-risk and very poor households. Meanwhile, in one state in India, the scale-up approach will reach over three million people, from a pilot level of 100,000.

## Case study 2

### Catalysing the pro-poor market for solar home systems

In recent years, the IDC has invested a great deal of effort and money in supply-side initiatives to stimulate the use of renewable energy by developing countries. These have typically been of the technology-forcing and supply-side subsidy variety – often delivered via donor – or government-designed and managed interventions. There has not been as much success as was hoped, though some specific initiatives have worked well.<sup>43</sup>

A different approach was taken in a renewable energy initiative in Karnataka State in south India in which Shell Foundation has been involved along with United Nations Environment Programme (UNEP) and United Nations Foundation. The goal of the initiative – called the 'Consumer Financing Programme for Solar Home Systems in Southern India' – is to catalyse the market for solar home systems (SHS) among the underserved rural and peri-urban population in south India. It has two unique features. First, the private sector was extensively consulted about how the intervention should operate. Second, the initiative is actually being run on a day-to-day basis by Syndicate Bank and Canara Bank – two of India's largest banks with extensive rural operations.

In the \$7.6 million programme, donor money is providing a small interest-rate subsidy to this bank-run consumer loan scheme. The banks are administering the scheme much as they do other consumer financing products, but they have received strong training, marketing and other support provided by the approved vendors from whom customers can extract the best deal and system of their choice

It has catalysed extremely rapid growth in the SHS market (80% between start 2003 and end 2004 with 10,000 systems installed) and now accounts for an average of 60% of new business being secured by the four participating vendors. Over time the interest rate subsidy to the banks has been reduced but the success of the programme in catalysing market growth will likely lead SHS consumer finance to be greatly expanded by the India banking sector, but on an entirely commercial basis and involving no further donor contribution.<sup>44</sup>

## Case study 3

### Nurturing pro-poor small enterprise in southern India via the social merchant bank model

The Small Scale Sustainable Development Infrastructure Fund (S<sup>3</sup>IDF)<sup>43</sup> is another innovative financing initiative operating in south India in which the Shell Foundation is involved – and which demonstrates the value of applying business thinking and business principles to tackling even more extreme poverty contexts. S<sup>3</sup>IDF targets very small enterprises that require access to small amounts of capital (\$1000 to \$10,000) so they can offer energy, water and other basic infrastructure services to very poor customers. Typical projects are small community electrification schemes using renewable energy (solar, hydro, biomass).

The context in which S<sup>3</sup>IDF is operating is generic across developing countries and there is not an absence of technology, business ideas, or the willingness of even very poor customers to pay (energy expenditure of poor households can be between 15% and 30% of total income). The key problems are the lack of availability of finance and appropriate business development assistance (BDA) to support the growth of these enterprises, and the lack of experienced intermediary agents who can help bring these projects and their lead entrepreneurs to market.

Commercial banks and equipment suppliers won't lend to what are inevitably inexperienced entrepreneurs without collateral and little business experience (including experience in how to access start-up finance). The banks have no experience of these nearly invisible markets or of the particular needs of these enterprises. So all in all, it's just too risky. There are better, safer ways to earn a return. For similar and other reasons, these types of deals are simply off the radar screen of most pro-poor development agencies and development finance institutions.

So S<sup>3</sup>IDF brings to small scale, pro-poor infrastructure business opportunities, the innovative financial, institutional and technical engineering that is common in large infrastructure deals. To do this, S<sup>3</sup>IDF operates as a 'social merchant bank' targeting very small enterprises.

S<sup>3</sup>IDF applies business criteria and best practice financial engineering skills<sup>45</sup> in assessing, selecting and structuring its deals, and delivers the flexible mix of finance and specialised BDA its 'clients' need but which is not available elsewhere. And S<sup>3</sup>IDF works closely with select partners from the for-profit and not-for-profit sectors who can provide skills and assets to the deal engineering process that it cannot.<sup>47</sup>

S<sup>3</sup>IDF addresses its scale-up aspirations by always ensuring the involvement of local capital sources in its deals on a learning-by-doing basis. This is so commercial banks will see there is a return to be made and thus make more of their own capital available in future to finance very small pro-poor enterprises.<sup>48</sup>

S<sup>3</sup>IDF now has a portfolio and pipeline of 80+ projects. Almost 20 are in operation;<sup>49</sup> 30+ are under detailed pre-investment analysis and/or at the final deal-structuring stage. All but one live project is producing returns as expected (albeit still below market rates). The evolving S<sup>3</sup>IDF portfolio/pipeline is in effect verifying its business model and this process is helping it to line up the ingredients needed for a partially self-financing scale up over the course of the next 12–18 months.

Of course, it's early days for S<sup>3</sup>IDF as its portfolio includes some high-risk projects and very considerable subsidy for project preparation. This raises questions as to whether such a fund could (or indeed should) ever be fully commercial.<sup>50</sup> But S<sup>3</sup>IDF, operating like a merchant bank in an extremely impoverished market yet successfully catalysing enterprise-based solutions to poverty and doing it in a scalable fashion, deserves commendation and attention.

## Case study 4

### SME investment funds – deploying local capital and the challenge of going to scale

#### Key Features of the SME financing case study

The Shell Foundation is supporting the sustainable growth of SME's in Africa via the linked provision of both business development assistance and non-collateralised finance. African SMEs are typically unable to secure commercial finance because local banks are reluctant to take on the 'risks' represented by lending to entrepreneurs who lack both business experience and collateral

In the last 2 years, in partnership with local banks, we have set up the \$5 million Uganda Energy Fund and the \$8 million Empowerment through Energy Fund in South Africa. Our banking partners in these initiatives are fully at risk with us.

Results to date:

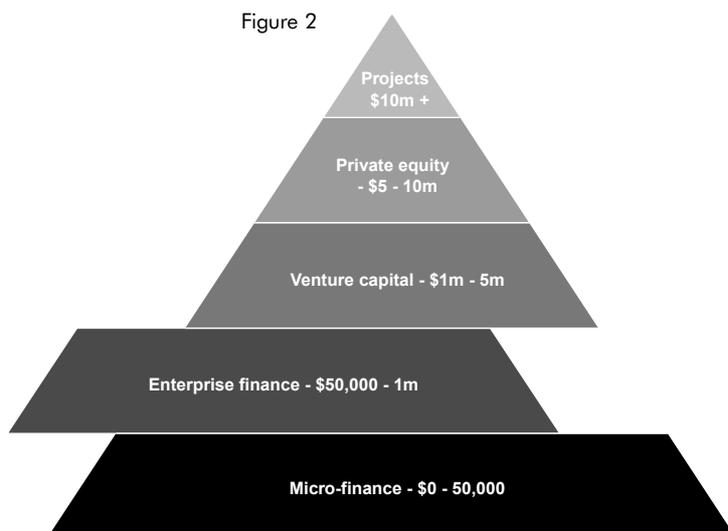
- 345 pro-poor enterprises have received business development assistance – of which 170 are now receiving finance and ongoing mentoring.
- It is estimated that these two funds have created almost a thousand new jobs plus generated a variety of other pro-poor outcomes
- Both funds have gained enormously from value-added and no-cost support from local Shell companies.
- Both funds are generating financial returns that are attractive to commercial investors
- \$20 million second stage funds are planned for both with the large majority of capital being provided by local banks

Things are further advanced in our SME investment fund programme – called *Investment Partnerships* – now operating in Uganda and South Africa, and soon to be extended elsewhere in Africa and beyond. The issue – lack of energy access by poor rural households and producers – is the same as in India only more extreme.<sup>51</sup> The energy access challenge being explored by Shell Foundation in Africa is also the same as in India: how to catalyse the development of a financially viable SME sector capable of supplying pro-poor energy sources and services.

### Energy access as market failure

In sub-Saharan African countries as in other poor regions, development of the SME sector in energy and other segments is constrained by market failure. Figure 2 highlights the SME finance segment from \$50,000 to \$1 million where the supply of enterprise finance is extremely limited in sub-Saharan Africa. It sits between the 'relatively' well served micro-finance segment (loans up to \$10,000) and project financing and venture capital (from \$1m to \$5m). Again as in India, African banks view lending to SMEs as high risk because entrepreneurs lack business experience and acumen and have little or nothing in the way of collateral or assets to secure against a loan.

Figure 2



### But some favourable conditions exist

There are, however, market, policy and business drivers that make African banks interested, in principal, in the SME energy sector. First, there's plenty of evidence that very poor segments of rural Africa are willing and able to pay for energy services and already can spend as much as 30–50% of their disposable income on energy.

Next, governments want the overall SME sector serviced with finance in order to trigger its growth and so often require local banks to earmark funds for this purpose. In parallel, international development finance organisations also have SME funds available to lend to African banks. Finally, the banks themselves recognise that a vibrant and expanding SME sector into which they can lend with confidence represents a major growth opportunity for their business.

But these positive preconditions have still not given local African banks the confidence to actually open their loan books to SMEs. This is because small enterprise requires finance and very specific kinds of business development assistance (BDA) at both the pre-finance stage and during operation.

African banks have neither the 'culture' nor the skills and experience to provide BDA to SMEs. Banks know how to manage assets which means if loans are not repaid, they know they can repossess the assets used as collateral to recover their money. They don't know how to manage businesses, especially start-up SMEs, to profit so the business can pay off its loans. So the banks deploy their own funds into lower risk sectors they do understand and resist pressures to finance SMEs. As a result, local and international finance earmarked for the SME sector in Africa goes unused or is invested elsewhere.

There have been other SME financing initiatives in Africa (some focused on the energy sector) where local capital has played only a small role and where governments or non-profits accessed development funding from abroad. But these initiatives have by and large not been very successful.

### Deciding on the right approach

We took explicit account of this reality in adapting our model (viability, scalability, business DNA and Shell Group assets) to develop a 'market entry' strategy into the Ugandan and South African energy SME sector. This strategy had four components:

- to look for local sources of finance and business know-how (DNA) as partners (because they are better at delivering on our charitable objectives than non-profits);
- harness the convening power and other assets of local Shell companies in ways that lowered the risk to local capital getting involved in SME financing;
- organise the provision of financing and BDA around the needs of the entrepreneur;
- design our initial forays into the sector in ways that would provide robust evidence, learning opportunities and a strong demonstration effect so that local capital would be willing to undertake subsequent scale-up activities.

The evolution of the Investment Partnership programme since 2002 first in Uganda and then in South Africa has robustly tested and validated the soundness of Shell Foundation's approach by delivering close to commercial returns from investments in the risky SME sector.

### Getting a foot in the right doors...

Having decided in Africa not to partner with non-profits, Shell Uganda and Shell South Africa's local knowledge helped the Foundation identify the most promising partner candidates from among the local financial institutions (FIs). But it was the commercial credibility and convening power of Shell that subsequently persuaded these FIs to meet the Foundation to discuss the model.

Having got the banks' attention, it was the packaging of the Foundation's funding and a sound business plan that helped secure commitments from local banks to join us at equal risk in launching our funds.

- In Uganda, DFCU Bank agreed to match the Foundation's \$2m investment capital and agreed to set up the \$4m Uganda Energy Fund (UEF).
- In South Africa, ABSA Bank and the Industrial Development Corporation, each contributed investment capital of \$3.5m alongside \$1m by the Shell Foundation to create the \$8m Empowerment through Energy Fund (ETEF).

Because of the small size of these pilot funds, the Foundation also provided a limited amount of grant funding to cover start-up and ongoing business development costs – a feature that will not be necessary in the case of larger second-stage funds.

Another feature of the business plan that attracted both sets of banks was that the funds were to be commercially managed to achieve, as a prime objective, financial viability of the funded enterprises and the funds themselves.

This was starkly different from the developmental goals the banks had previously been offered (and rejected) to get involved with other SME funding opportunities. Moreover, funded enterprises were to be charged full commercial finance rates while the banks were offered funds with a familiar seven-year, closed-end structure but with net returns of 5%. Such returns were clearly below normal commercial expectations, but were still attractive to our banking

partners for two reasons. First, they were perceived as realistic and attainable based on the size of the market and risk conditions (compared with the international rates of return some African venture funds propose). Second, they were acceptable to banks with a long-term view of investing in the SME sector in order to grow their own business.

### How Shell assets boosted bank learning, market awareness and deal flow

Having helped bring about a marriage between the banks and the Foundation, Shell's local knowledge was brought further into play by introducing the banks to the realities of SME energy sector financing. This was achieved by providing the banks with technical assistance relating to both the supply and demand sides of the small scale and rural energy sector.

In Uganda, this took the form of advising loan officers about the financial risks related to various energy technologies – an input hugely valued by DFCU. And for ETEF in South Africa, Shell became a useful source of client referrals – a critical input to portfolio funds reliant on adequate deal flow – while in both countries, fund governance and marketing was strengthened with Shell support.

Another feature of the business model that proved attractive to the banks and subsequently critical to the success of the funds was the remit given to loan officers on how and for what purposes the funds could be used. Their broad specification was to support SMEs that require energy-related inputs to boost production or that sell pro-poor energy services.

We put very few restrictions on the funds beyond that, aiming to ensure they were flexible enough to allow sufficient deal flow to make their portfolio finance structure work. Hence the deal range was broad: there were no restrictions on type of energy, meaning all sources of energy could be financed rather than just renewables (as was the case with less successful funds); and non-energy assets could be funded as well if they facilitated the productive use of energy.

These criteria thus allowed the funds to support a very broad range of SME activity. So, for example, financing was provided that allowed small farmers in eastern Uganda to acquire solar-powered agricultural crop driers. And in South Africa,

funding covered the capital costs incurred by an enterprise that wanted to use the waste products of shelled peanuts to make cheaper and cleaner alternative briquettes to charcoal. (A full list of enterprises assisted via our SME funds is available at [www.shellfoundation.org](http://www.shellfoundation.org))

### **Meeting the needs of the entrepreneur**

Simply making finance available in the \$10,000 to \$500,000 deal size was crucial to attracting the interest of Ugandan and South African SMEs since it had never been available before. But other features were also designed into the model to provide tailor-made support to entrepreneurs.

First, finance is offered in local currency rather than US dollars – a feature of other SME funds that in effect puts them out of reach of most SMEs. Second, we try to offer finance in a form that suits the particular needs of the SME client. Third, collateral requirements are kept low by the ability of the fund managers to lend against the business plan as opposed to only lending to the value of the assets the entrepreneur can pledge as security.

### **All together now: finance, business support and risk assessment**

But perhaps the most important and innovative feature of the Foundation's SME investment funds is that appropriate finance and BDA are jointly provided to clients via the fund manager. Elsewhere, these are provided separately with entrepreneurs picking up business advice where they can from people usually not experienced in business and in a form that is not useful to their specific needs and interests.

The concept embedded in our funds, is that the managers work first with the entrepreneur to develop a robust business plan. During this, the managers develop an understanding not just of the competence of the entrepreneur but of the particular package of finance and ongoing technical and BDA that will be required to ensure the profitable operation of the enterprise.

So the manager, while applying rigorous financial criteria, can base his risk assessment not just on the value of the collateral but on empirical insight into the prospects for success of the business. So in effect, lending decisions are based on the business

plan rather than the value of recoverable assets. And once the deal is completed this means there is a plan of ongoing assistance, tailored to the needs of the entrepreneur as he/she enters the most difficult stage of any business – start-up and early operation.

As our results show, this aspect of the model – though it has had to undergo adaptation to get it 'right' – lowers risk considerably in the portfolio, imparts valuable training even to those SMEs that don't get offered finance, and provides a useful vehicle for local banks to learn about the SME sector, thus changing their own perception of risk regarding the sector.

### **So far so good in Uganda...**

While both SME energy funds are still young, the pace of capitalisation in Uganda has been very rapid, indicating interest in the market and an encouraging depth of demand. UEF will be fully committed before the end of 2005 – well before the original close-out date.

For UEF, out of more than 160 deals closed, non-performing investments are running at 2% and no write-offs have yet been made. The expected net return on investment of 20% on a portfolio of deals ranging from \$10,000 to \$400,000 (in Ugandan shillings) is, of course, well above the original 5% return first anticipated.

The financial viability of the fund in Uganda has led to direct and indirect developmental returns. For example, 80 enterprises have received some form of BDA in addition to the more than 160 receiving finance so far. And an independent audit of nine sample enterprises revealed these alone have created 386 jobs. And interestingly, despite deliberately not having a renewables-only criteria, a majority of UEF deals involve renewable energy sources.

### **Real time adaptation of the model**

While the UEF's performance is pretty solid for a pilot, operational experience revealed aspects that could be improved to lower costs and risk. For example, UEF mainly offered lease finance as it was a product that 'worked' for both Ugandan entrepreneurs and our banking partner.<sup>52</sup> But we found that on its own, lease finance did not provide sufficient capital or flexibility to meet the needs of SMEs.

Second, it soon became clear it was not cost effective for the bank operating the fund to make large numbers of small lease deals. But increasing the deal size was not an option because SMEs were the target market. So we experimented in using an intermediary to carry out business development and part of the credit assessment role. This was feasible where we found SMEs operating in the same sector – dried fruit, mushrooms and honey – since all had similar finance and BDA requirements.

So in one case, a fair trade purchaser of dried fruits – a company called Fruits of the Nile – took on part of the bank's role because it already had commercial relationships with hundreds of the farmers our SME fund wanted to reach. This innovation significantly lowered unit costs and in effect greatly increased the portfolio size less than a year after launching the fund.

Third, though our local bank partner adapted well to the aspects of our model, the bank's asset-lending culture and incentive structure combined to reduce the potential value of the BDA component and constrain the growth potential of the funds.

### **Applying lessons learned from Uganda in South Africa**

Based on what we learned in Uganda through UEF (including the convening power that the Shell brand had with local banks) we established ETEF, our South African fund, with new financial products and an *independent* intermediary in the form of an independent fund manager with particular expertise in the small-scale energy sector in place from the start.

Both the financial products and the contract with the fund manager (who also had an equity stake in the fund) were designed to tackle the incentive/equity/exit problem that bedevils all SME financing in developing countries.

Offering finance to the SME in return for appropriately geared, performance-related returns – via profit sharing for example – is the key. It allows you to incentivise the entrepreneur (the better he or she does, the lower the cost of finance) and incentivise the fund manager (the better-performing the portfolio the better it does) so that both invest all their efforts in trying to succeed.

In the process you improve the risk–return profile of the portfolio. Also key is the fact that the fund manager is expert at *both* BDA for SMEs *and* investment assessment and thus is much more effective at making this crucial dimension of our model work in comparison to 'converted' in-house loan officers.

### **ETEF progress and impacts**

At the end of 2004, after less than a year's operation, ETEF was 45% committed to deals ranging between \$50,000 and \$600,000. There's been one write-off and the 5% target rate of return will be easily exceeded. Independently validated developmental returns include 120 new jobs created and 80+ enterprises – all pro-poor SMEs – received BDA. In recognition, ETEF and the Shell Foundation won 'Best Initiative in Support of the Millennium Development Goals' at the 2004 *Africa Investor Awards*.

### **Comparative performance**

Though it's difficult to obtain information from other donor-funded SME energy sector funds operating in sub-Saharan Africa, our best estimate is that for every \$10 available to these funds, only \$3 reaches the enterprises in the form of investment capital (typically in forex). By contrast, for every \$10 made available through our funds, at least \$8 in local currency (which is what SMEs need) reaches the enterprise.

### **First steps to scale-up**

The most important outcome of our pilots is that later in 2005, a \$20m east African regional SME energy fund will be launched alongside a similar petroleum sector SME supply-chain fund in South Africa.<sup>53</sup> Local bank contributions to both will exceed \$10m and these have been committed because of the success of our pilots. Moreover, based on firm expressions of interest from the international corporate and finance community, more pro-poor, SME investment funds in Africa, Asia and Latin America will follow.

These first scale-ups demonstrate how business thinking has produced an incentivised commercial vehicle that escapes the inherent constraints on scale and effectiveness that is associated with more traditional donor-financed and controlled schemes.

### **Grounds for optimism**

The progress of the pilots and scale-up efforts underway in our *Energise* and *Breathing Space* programmes is encouraging. But set against the scale of the problems being tackled and allowing for risk and room for error, it's clear we've made only a start. Nevertheless, we think the outcomes emerging from the Shell Foundation's business-minded approach to tackling poverty are worthy of consideration and, of course, challenge. They also provide the basis for the issues and questions raised in the concluding section.

## Section 4: Propositions and conclusion

We have argued throughout that the expansion of enterprise, particularly SMEs, is critical to economic and poverty reduction. This is hardly a new or revolutionary argument. It has been advanced by many others starting probably with Adam Smith. Indeed, a great deal of government policies and IDC interventions over the years have focused on creating the enabling environment for the expansion of the private sector in poor countries.

But given the proven importance of enterprise development in poverty reduction, direct intervention to promote enterprise and especially SME development has not been as high on the spending agenda of the IDC in recent years as it perhaps it should have been.<sup>54</sup> And a lot of what was done to promote SMEs in particular has not been particularly effective.<sup>55</sup>

The central role that enterprise development could play in the fight against poverty is also not getting a lot of 'airtime' in the context of the current 'Make Poverty History' campaign. Nor does it feature very prominently in the many recommendations being made to the IDC by commentators and experts about what it should be doing now.<sup>56</sup>

The IDC and poverty campaigners are not alone in the way they address the role of enterprise in tackling poverty. MNCs, whose very existence is enterprise-based, historically devoted only a small fraction of their CSR spend to pro-poor enterprise creation in developing countries. In more recent times, their focus has shifted more in this direction.<sup>57</sup> But there is still a very long way to go before tackling poverty through enterprise creation becomes a top 'business issue' or public engagement priority for the senior management of a majority of big companies.<sup>58</sup>

The above analysis leads us to our first set of conclusions. There are obviously many other poverty priorities that need to be addressed but the IDC and the international business community need also to give more effective attention to catalysing enterprise in the poorest countries. And their exploration of this issue might perhaps be structured around the following questions:

First, how to increase the scale and effectiveness of pro-poor enterprise interventions?

Second, how to make the objective of pro-poor enterprise growth an integral part of poverty-

reduction strategies advanced by the IDC and pursued by developing countries?

Third, how to more effectively engage the private sector but especially big business in IDC efforts to tackle poverty through enterprise both directly and as a source of insight, advice and skills transfer?

In Sections 2 and 3, we drew on the Shell Foundation experience and approach to explore two routes to answering these questions. These are the application of business thinking to pro-poor enterprise interventions; and how deploying value-creating assets belonging to international businesses can greatly enhance the impact of enterprise interventions.

The Shell Foundation's experience to date is still far too limited to generalise. But there are others operating in the same space as we are, and all are seeking to harness the power of business thinking and finance to the challenge of overcoming poverty.<sup>59</sup>

Taken together, this accumulated experience suggests a number of more specific propositions for wider debate and consideration by the IDC and international business community around the specific challenge of catalysing pro-poor enterprise development.

### Propositions for the international development community

The first set relate primarily to the role of donors (including corporate foundations and philanthropy programmes) who, because they control the money, are critically important influences on what issues IDC actors focus on and how they work.<sup>60</sup>

#### 1. Don't give, invest

The core proposition is that donors should act less like charities and more like investors. In part, this means allocating more of available resources (such as might be forthcoming from the 'International Finance Facility' proposed by the UK government) towards investment vehicles targeting the pro-poor enterprise sector. However, more fundamentally we also mean that when donors spend aid money through their normal partners – government agencies, NGOs, etc – the primary outcomes they should be after are *measurable* impacts on the pro-poor enterprise sector linked *directly* to the project or activity they are funding.

#### a. Make it hurt

To facilitate this, donors could do a number of things – some of which no doubt more progressive donors are already doing. They could require grantees to make real financial contributions from their own funds to the project. Grant payments could be phased against meeting performance targets. Financial incentives could be built into rewarding the grantee if the project exceeds its enterprise targets (including awarding bonuses or retaining any surplus). And the grantee could face sanctions and be held accountable if it does not deliver on what is promised – perhaps, for example, by having to return a percentage of the grant to the donor.

#### b. Do as I do

And just to demonstrate commitment, the donors themselves could use their own internal incentive structures to ensure staff and managers are rewarded or held accountable for the performance of their projects against what we would argue is one of the few ‘bottom lines’ that should matter in the fight against poverty – measurable growth among pro-poor enterprises and increased benefits flowing to poor people as a result.

These are clearly extreme steps for the donor community, non-profits and civil servants and to be sure even the Shell Foundation does not operate entirely along these lines. And many objections could be raised.<sup>61</sup> But we offer them up in such stark terms in order to encourage debate around the following proposition.

#### c. Put the poor ‘customer’ in charge – not the rich paymaster

Our hopeful assumption is that by *striving* towards the *ideal* of being held accountable for achieving measurable contributions to pro-poor enterprise and sustainable livelihoods, donors and grantees will be catalysed into becoming more enterprising, innovative and efficient in their search for solutions to poverty.

Why might this happen? Because this approach tackles a costly (for the poor) contradiction at the heart of the aid-poverty equation.

The ‘failure’ of many projects in our portfolio and elsewhere can often be traced directly to the fact that the project partners were not focused on best meeting the needs of their real *customers* but were responding to other incentives – including donor

agendas and their own professional interests (See annex 2).

If one were to apply this ‘who’s the market/who’s the customer’ filter to the aid-funded ‘output’ of the IDC, especially that part of the IDC located institutionally in the rich countries, we expect a very large share of what is done (and certainly the vast majority of what is studied and written) in the interests of development, is primarily undertaken to meet the agendas of the IDC itself rather than the material interests of the poor.

So we are arguing – along with others such as Easterly (2002) – that setting targets and incentives for donors and other IDCs that are linked to customer satisfaction (i.e. measurable success or failure in pro-poor enterprise creation) should ensure maximum effort is focused on delivering results that matter (See annex 2).

The logic of the approach we are proposing is simple. The challenges involved in actually implementing it are obviously not. It requires donors and recipients to think very differently about how they do what they do. More importantly, it would lead them to work within a risk–return relationship and ‘consequence accountability’ structure similar to that which exists between an investor and a start-up business, and between shareholders and management – cultures that are foreign to many donors and grantees.

Nevertheless, our experience and that of others suggest it is possible to structure interventions and incentives that powerfully and successfully focus everyone’s attention on the end game of pro-poor enterprise creation and we suggest the topic is worthy of wider debate and consideration.

## 2. It’s not the (aid) money that matters

This proposition harks back to our arguments that there will never be enough foreign ‘soft’ money to allow pro-poor enterprise financing to go to scale and thus the importance of getting *local* capital into a *lead* role in this area.

As argued earlier, using ‘softer’ money from abroad to invest in pro-poor enterprise can play an important starter or demonstration role. And clearly, in regions such as sub-Saharan Africa, it is very important we do everything we can to enhance investor confidence.

But our proposition is that the introduction of pro-poor enterprise aid funding should from the outset complement and catalyse the increasing involvement of local capital and local suppliers of business development services – not substitute for them. It's possible to do this and it can work as our efforts and those of others in Uganda and South Africa and those of S<sup>3</sup>IDF in India have shown.

### 3. Link MDG interventions, debt relief and other macro-interventions to pro-poor enterprise creation

We're conscious that the share of available resources and effort going to pro-poor enterprise creation will always be limited. However pro-poor interventions in other areas can be 'calibrated' to help contribute to the enterprise objective without detracting from their core objectives. Debt relief conditions, the way aid financing is delivered and various MDG programmes including the provision of education, health care and clean water can relatively easily incorporate pro-poor enterprise objectives that do not have negative impacts elsewhere.

In the case of MDGs, this would range from ensuring money spent on pro-poor service delivery catalysed local enterprise growth through to the application of enterprise or business thinking to better ensure MDG plans delivered specific measurable outcomes benefiting the most poor people at least cost.

The same logic applies in relation to interventions designed to tackle corruption or strengthening the management capacities of local government. These are very big problems in most poor countries and the resources don't exist to tackle them everywhere at once. Interventions in these problems areas must be prioritised.

So why not focus on those aspects of the generic problems of corruption or capacity that most inhibit the growth of enterprise? Entrepreneurs and businesspeople can help governments and the IDC map out the 'value chain' of activities and stages where corruption or lack of government capacities impinge on enterprise creation. Then, provided the political commitment is present, intervention could focus on tackling the most important blockages.

These are not backdoor strategies for the privatisation of the delivery of poverty services or the imposition of user fees. They are simply suggestions that those designing MDG policies

and programmes be aware, competent and incentivised to apply enterprise thinking to what they are doing and to leverage their resources to aid pro-poor enterprise creation.

There are probably some good examples of this happening but as aid flows targeting MDGs increase, many more opportunities will arise. Our concern is that if enterprise thinking and objectives are not mainstreamed now, these opportunities will be ignored at great long-term cost to poor people.

### 4. Re-engineering the international development supply chain

We argued and demonstrated earlier that in our experience the presence of business DNA in our partners – whether they were non-profit or for-profit – was an important ingredient in the success of pro-poor enterprise interventions. This experience underpins our proposition that donors should be considering the following options:

#### a. Transfer business DNA

The first is how they can best use their position and resources to promote the *transfusion* of business DNA and enterprise behaviour all along the international development supply chain. The examples given in Section 3 of our efforts on this front related mostly to 'front-line' NGOs who are traditionally donor-funded and operate in development project mode, insulated from market forces as it were.

Other parts of the development supply chain could probably do with an injection of business DNA as well. Most academics, policy makers, and development agency professionals endeavouring to catalyse pro-poor enterprise don't have real business-based experience to draw on. Their knowledge of how markets operate and the problems faced by business of all kinds is largely theoretical or conceptual.

Thus they operate on the basis of many partially informed and often downright incorrect assumptions about markets and enterprise. This means the policies and interventions they design and implement, with the best intentions, to catalyse the efficient operation of markets or the creation of enterprise just don't work or don't work nearly well enough.

This mismatch between theory and practice, between 'talking the talk' of markets and enterprise and actually knowing how to 'walk the walk', are

obviously not the sole reason why many enterprise-oriented (and growth-oriented) policies and interventions in poor countries haven't worked as well as intended. But there is a certain logic in the argument that if we want policies and interventions that help pro-poor enterprise grow, it would be useful to be able to inject more experience-based, business DNA into the project and policy design process. It's not easy<sup>62</sup> but it can be done and donors are perfectly positioned to drive this process – perhaps even via new forms of partnership with big business that would facilitate the transfer of their business DNA into the development supply chain (See annex 2).

#### b. Develop alternative sources of supply

The second option is to construct an 'alternative' development supply chain by working more extensively and more directly with the for-profit sector on devising and delivering pro-poor enterprise interventions. Our experience is that the efficiency of resource use is higher, the transaction and learning costs lower and the going-to-scale opportunities much greater than when trying to accomplish the same thing with the non-profit sector.

#### c. Promote hybrids

A third route could be to use market principles to encourage the emergence of financially viable, hybrid 'network business models' capable of delivering pro-poor services on a large scale. Donors could facilitate the coming together of private and non-profit entities into a new form of hybrid 'enterprise' that could use smart subsidies and commercial capital, best-practice business and developmental skills, to deliver differentially priced services to different segments of the poverty market.

This is an approach the Shell Foundation is piloting in the scale-up phase of its *Breathing Space* programme in India and elsewhere, where the aim is to achieve significant 'market penetration' of cleaner stoves and fuels among poor household 'markets' that number in their millions.

The re-engineering of the development supply chain along business lines is happening to a certain extent as some donors and non-profits try to apply business thinking to what they do.<sup>63</sup> But these business-like development entities and experiments are still in the minority and largely peripheral to the way most of the IDC is organised and incentivised. We suggest therefore that whether

and how to introduce business principles and business DNA into the mainstream IDC is a topic worthy of further urgent debate.

### Propositions for engaging the international business community

Our second set of propositions relates to the role of large businesses, especially multinational corporations, in tackling poverty. Our core position is that through harnessing its value-creating assets, big business is especially well-equipped to add enormous value to pro-poor enterprise initiatives – and elsewhere in the war against poverty.

As noted above, some of this is happening but not enough and our propositions below focus on how to make more of it happen.<sup>64</sup>

#### 1. A case of mutual myopia: the wrong 'ask' and the wrong 'offer'

An important and very simple reason why not enough of the 'right' type of business engagement with poverty takes place is that civil society is usually primarily interested in the financial contribution business can make – and business is used to and perfectly happy with doing just that.<sup>65</sup> The issue of seeking or offering access to a company's value-creating assets as the key contribution to tackling a poverty issue via a public-private partnership (PPP) simply doesn't arise.

No doubt this situation could be improved through education and exhortation directed at both sides. But we think something more fundamental has to occur in order to break through the self-reinforcing, mutual myopia that leads to the suboptimal involvement of business in the fight against poverty.

#### 2. Making poverty partnerships more like business partnerships

And this 'something' is to do with recasting the 'risk-return profile' of the poverty projects and public-private partnerships that business is asked to join.

Let us explain. Businesses participate in commercial partnerships with each other because they offer each partner specific value they cannot secure by acting alone. Both sides bring to the table an exclusive set of assets essential to accomplishing the task at hand. And both sides have a strong vested interest in a successful outcome.

The contrast with the typical poverty project or PPP in which business is asked to participate is illuminating. First business is often not consulted in their design and as we've noted money is usually the main input asked of business.<sup>66</sup> PPP objectives, though worthy, are frequently so generally specified that the outcomes, even if achieved, will have little real social or business relevance.

Moreover, the lead civil society partners are not really 'at risk' in any meaningful sense as they rely on aid or public money to fund their involvement.<sup>67</sup> Most importantly, while knowledgeable, articulate and full of ideas, these partners usually don't have influence or are not empowered to deliver change where it's needed in order to help achieve the PPP's objectives.

This is not a criticism of the competence or commitment of civil society partners or of their right to play a role or of the value of their contribution to PPPs. It's simply acknowledging that on their own, non-empowered civil society partners can't bring enough of value to the table to catalyse a high value-added response from business.

So not surprisingly, big business turns down most invitations to join PPPs because they have the wrong sort of risk–return profile. And when business does join up, the inputs that are sincerely offered, while appropriate to the circumstances are rarely the core value-creating assets where we believe real social value-added lies.

Clearly there are some very successful PPPs out there where the business partners are delivering real social value via deploying their core competencies. And there is already a sizeable 'literature' full of useful recommendations about the principles of effective public-private partnership.<sup>68</sup> But we want to draw attention to two fundamental weaknesses that undermine the ability of many pro-poor public-private partnerships to contribute to their full potential.

**a. Ensure the right parties are at the PPP table or don't bother issuing the invitations**

Big business is often appropriately criticised for not involving key stakeholders in discussions about actions by the business that directly affect them.

But very often, the civil society members of a PPP do not have the power or influence to effect the changes necessary to solve the problem the PPP was set up to tackle. Our proposition is that only

parties who add real value and are empowered and able to deliver change where it is needed should sit at the public-private partnership table.

**b. Set goals that make a difference to poor people but ensure that the partners also secure 'returns' they value**

Any pro-poor project or PPP of value must have achievable goals that deliver measurable (and wanted) benefits to poor people. But our main point here is not about the poverty *outcomes* of PPPs but about the *benefits* that devolve to the partners as a result of participating in the initiative.

It seems to us that to get big business to invest value-creating assets in PPPs, these need to generate 'returns' to all partners in 'currencies' they value and at a scale commensurate to the risk they are taking.

This is precisely the logic deployed in the design of our SME funds in South Africa and Uganda. The local banks felt that the SMEs helped initially would eventually become customers for larger commercial loans – while Shell Foundation got involved to demonstrate to other banks that investing in SMEs was good business.

The process at work in this example is linear and in the banks' case clearly linked to future profits. Other risk-return relationships are possible. For example, big businesses operating in the same country could pool their input needs and thus create a market for local SMEs in return for government efforts to introduce 'level playing field' policies with regard to adherence to standards or the removal of differential pricing structures.

The challenge is in crafting a PPP that will deliver to each of the partners a set of returns of sufficient value that it makes it worthwhile for them to exclusively commit whatever is necessary on their part to achieve the overarching social outcomes of the partnership.

**3. It's all about getting the risk and return balance right**

There are many other dimensions that could be explored arising from the proposition that PPPs should be structured like business partnerships. But they are all essentially thrown up by the fact that the parties involved would have to deal with the implications of a very new set of risk-return relationships. Again the challenges in doing this are

significant but we think the potential benefits are of such scale that this topic too is worthy of more extensive debate.

**Come together: an invitation to invest in proving and positioning enterprise as a key part of the solution to poverty**

Society is clearly in an era of renewed commitment to explore new ways of tackling the scourge of poverty with the aim of banishing it to the history books. This is a moment to be seized upon.

Already there is much creative and bold experimentation going on within the IDC, by developing country governments, by leading politicians and actors in the industrialised countries, and by big business.

So the propositions put forward in this conclusion that encourage focus and experimentation around the issue of enterprise and poverty reduction do not necessarily break new ground. This is very positive because it means there is already much to talk about and much to learn from each other.

Some of the right kind of talking and learning is taking place but not enough – especially since the ‘sales pitches’ are already being made and plans are already being laid to deploy the new pro-poor political and resource commitments that appear to be on the horizon in 2005.

Given the scale of the problem to be tackled and the encouraging signs that results can be delivered, the IDC, developing country governments and the big business community need to explore the enterprise–poverty territory together, robustly and urgently.

This includes not just more talking but action as well to invest in piloting new ways of working together to tackle business environment obstacles to enterprise development and growth. The Shell Foundation over the coming months will be doing what it can to catalyse such initiatives. We invite others to join us.

## Annex 1: Definitions

### **International Development Community**

The 'International Development Community' we refer to in this paper includes private and corporate foundations, individual philanthropists, multilateral and bilateral development agencies and departments, and non-profit groups concerned with poverty and development, including academic institutions and professional NGOs. Unless specifically mentioned, not included are donors, academics and agencies concerned with humanitarian and disaster relief, developing country governments or private sector actors who work on publicly-funded development and poverty projects.

### **Enterprise and pro-poor enterprise**

We use the terms 'enterprise' and 'pro-poor enterprise' extensively and often interchangeably in this paper and have in mind the following features of each. By 'enterprise' we mean primarily private sector enterprises but include also NGOs, social entrepreneurs, even public sector enterprises acting in a business-like way to deliver services to poor people. The 'pro-poor' enterprise boundary is quite broad and encompasses productive entities of any size or national origin that provide affordable and appropriate products and services that are bought by poor and often previously un-served populations; entities that employ poor people; and entities owned by poor people – from small farmers, through traders and into more conventional productive activities. Hence the main focus of our work on poverty issues is catalysing the development and growth of pro-poor enterprise.

### **SMEs**

Our notion of what constitutes an SME is not tied to numbers of employees or turnover but rather to start-up and first-stage enterprises which need capital of the order of a few thousands of dollars to upwards of \$500,000 to \$750,000. As such, some of our initiatives involve truly micro-enterprises at one end and big companies at the other which have operations with local supply chains that do or could feature SMEs.

### **The poor**

Ultimately we want the things we do or cause to happen to materially and measurably benefit 'poor people' which for us mostly means people in developing countries who live on \$2 a day or less. However, we don't draw any rigid dividing lines in terms of income level or asset ownership in deciding what to do and where to do it. This is because the dynamic development processes, on which we focus, work in complicated ways – as shown for example in the way that a rise in non-farm wages pulls agricultural labour into non-farm jobs, creates labour scarcity in the agricultural sector and thus causes rises in farm wages. See P. Lanjouw and N. Sterns (2003), 'Opportunities off the Farm as a Springboard out of Rural Poverty: Five Decades of Development in an Indian Village' in G. Fields and G. Pfefferman (2003), *Pathways out of Poverty: Private Firms and Economic Mobility in Developing Countries*, Kluwer Academic Publishers. So we believe it's possible to aid our target beneficiaries not only directly, but by influencing the actions of others, or by deploying lessons learned from interventions whose immediate beneficiaries may not in fact be poor people or be located in the poorest countries.

### **Financial Viability**

We have a flexible interpretation of the concepts of self-financing, financial viability and financial returns. Our ultimate aspiration is for the initiatives we support and the enterprises they support to rely on earned income (not grants) to cover all costs and deliver a commercial rate of return. But we are, of course, aware that in many of the poverty contexts we operate in, these aspirations may not be attainable at the outset and indeed may never be in certain circumstances and subsidies may be required – as is the case in many enterprise contexts in rich countries. So what we look for are plans, groups and people who will try to harness the disciplines involved in pursuing full commercial viability while they pursue their social objectives.

## Annex 2: Anecdotal evidence

### Meeting The Needs Of Real Customers

In one Shell Foundation project intended to test the commercialisation possibilities of village-scale biomass gasifiers, our partner – a team from a university engineering department who had developed the technology – spent most of their time and our money on R&D issues close to their hearts as engineers. But they didn't pay attention to the main developmental challenge (and objective of the project) of commercialising their technology and so carried out no market research and as a result were unable to secure the local investor interest that the plan called for. In another example, the social entrepreneur we supported – again in an effort to commercialise a technically viable village power production system – had a strong developmental aim which was bringing electricity to unserved villages and creating micro-enterprises able to use the power provided. Much donor money was raised and used to subsidise the pilots thus eliminating the 'need' to charge poor customers the full cost of the power provided. This confounded our efforts to assess whether commercial finance could be used to scale up to meet the needs of thousands of un-electrified villages. And this means that the NGO partner is now continually having to raise ever more 'soft' money just to keep their few pilots operational.

Those familiar with the history and current status of the famous 'Multi-Functional Platform (MFP) in West Africa' may recognise a similar conundrum. See UNIDO/UNDP regional Multi-functional Platform Programme (MFP), at [www.un.org/special-rep/ohrrls/UN\\_system/unido.htm](http://www.un.org/special-rep/ohrrls/UN_system/unido.htm) The MFP is a diesel-powered generator that drives a set of agro-processing equipment for productive use at village level and is managed by women's associations. Its development has been completely donor-funded with a social objective – to empower the women who operate the platform. As a consequence, not much business thinking is applied to the management of the platform (for example, capital costs are never factored into user fees) or to the challenge of going to scale. Intriguingly, there is evidence that the MFP (which is emphatically a pro-poor piece of technology) is in fact commercially viable. This means at least some of the costs of a rollout could be financed commercially and as long the operators are women's groups the original 'empowerment'

objectives could be met as well. However, significant donor and public money is now being used to finance rollout in some West African countries.

### Measureable Success And Failure

Our engagement with INTEGRA, a Romanian NGO involved in micro-finance, as part of the work of our Market Access programme, illustrates the point. Integra realised its clients were producing products for which there was no market. We engaged with them around this problem and pushed them to understand that they could offer much greater value to their clients if they both started by identifying market opportunities rather than just rushing to set up production and then looking for somewhere to sell. This engagement catalysed Integra into educating itself – with the help of expert consultants – about how markets work and the most appropriate 'routes to market' for their clients. This in turn kicked off a process whereby their clients started to produce more marketable products. Integra also realised that this new knowledge itself had commercial value and opened up a business opportunity for themselves that will produce more income for the NGO and benefits for its clients.

### Transferring Business DNA

The Shell Foundation is partnering with the World Conservation Union and UNESCO to do precisely this in a slightly different context by using the business and site management skills and techniques available in Shell Group to upgrade the local management of UNESCO's World Heritage sites throughout Africa and get these onto a more financially viable footing for the longer term. There are obviously other examples of this kind of skill transfer taking place between big business and the IDC. For a non-enterprise example see UNAIDS (2004), *Aids in Africa: Three Scenarios*, Joint UN Programme on HIV/AIDS, New York. This is a case where core value-creating assets of the Shell Group – its scenarios methodologies – are being used in partnership with the United Nations to tackle HIV/AIDS in Africa. We know of other current examples where large MNCs are deploying core skills and assets working in public-private partnerships (PPPs) to tackle the problems of AIDS, child malnutrition and community health.

# End notes

## Introduction

<sup>1</sup> The Shell Foundation is a UK registered charity established by Royal Dutch/Shell Group of Companies in June 2000. It is governed by a Board of Trustees composed of three senior Shell Group executives, including the Group's Chief Executive and three independent external Trustees. The management team has four members with extensive professional backgrounds in poverty, environment and business. See [www.shellfoundation.org](http://www.shellfoundation.org) for further information.

## Section 1: The Case For Putting Pro-poor Enterprise At The Heart Of The War On Poverty

<sup>2</sup> This slogan was initially coined by the rock star Bono and is now a headline sound bite for the 'Global Call for Action Against Poverty' coalition – a group composed largely of poverty-oriented NGOs. See [www.makepovertyhistory.org](http://www.makepovertyhistory.org). The work of this coalition is most visible in the United Kingdom. Elsewhere, the push for more help to poor countries is less high profile but just as earnest.

<sup>3</sup> Since 2000, there's been a marked rise in MNC involvement in the attack on poverty, especially via public-private partnerships launched through venues such as the World Summit on Sustainable Development and the United Nations Global Compact. See [www.sustainabledevelopment.gov.uk/wssd2/04.htm](http://www.sustainabledevelopment.gov.uk/wssd2/04.htm) for a review of public-private partnerships launched at WSSD; for the UN Global Compact see C. Fussler et al (eds) (2004), **Raising the Bar: Creating Value with the United Nations Global Compact**, Greenleaf Publications, UK and for the forerunner to the Global Compact see UN (2004) *Report to the UN Secretary General of the Commission on the Private Sector and Development*. United Nations, New York. Of course there's no shortage of cynicism about the sincerity of the increasing commitment of MNCs to tackling poverty. See, for example, Christian Aid (2004), **Behind the mask. The real face of corporate social responsibility**, Christian Aid, London, but equally there are powerful counterarguments as well. See Paul Lewis (2005), 'The Fight Against Poverty: Harnessing the Power of the Multinationals', **International Herald Tribune**, Monday 14 February 2005.

<sup>4</sup> Some argue the increased aid funding on offer is far too little while others fear heightened political interference in a post 9/11 world. And many worry giving more aid to misruled countries will just line the pockets of corrupt officials and remove the pressure for reform. See for example R. Righter (2004), 'Free Trade not Free Aid will help to end poverty' **The Times**, 14 December 2004; Christian Aid (2004), **The politics of poverty: Aid in the new Cold War**, Christian Aid, London; and J. Sachs (2002), 'Developing Africa's Economy' in **The Economist**, 22 May 2004.

<sup>5</sup> Between 1950 and 1995 OECD countries gave \$1 trillion (in 1985 dollars) in aid. See W. Easterly (2002), **The Elusive Quest for Growth**, MIT Press, Cambridge.

<sup>6</sup> For compilations of 'Aid Works' evidence, see Oxfam (2004), **Paying the Price: Why rich countries must invest now in a war on poverty**, Oxfam, London and UN Millennium Project (2005), **Investing in Development: A Practical Plan to Achieve the Millennium Development Goals**, United Nations, New York. For macroeconomic analyses addressing the same topic see C. Burnside & D. Dollar (2000), 'Aid, policies and growth', **American Economic Review** 90 (4) 847–868, and M. Clemens et al (2004), 'Counting chickens when they hatch: The short-term effect of aid on growth', **Center for Global Development, Working Paper No 44**, July.

<sup>7</sup> For anecdotal evidence of the 'Aid Doesn't Work' argument see M. Maren (1997), **The Road to Hell: The Ravaging Effects of International Aid and Charity**, The Free Press and R. Jacob (2005) 'Whose power, whose glory?' **FT.com**, 9 January 2005. For macroeconomic evidence see Easterly (2002) and L. Pritchett (1997), 'Where has all the education gone', **World Bank Policy Paper, Research Working Paper 1581**, Washington, D.C.

<sup>8</sup> Between 1981 and 2002, GDP per capita in sub-Saharan Africa contracted by 13%, nearly doubling the number of people living on less than \$1 a day, from 164 million to 314 million. World Bank (2004) **World Development Indicators** World Bank, Washington, D.C.).

<sup>9</sup> These include the outstanding economic performance turned in by China and India over the last two decades, the more recent growth spurts recorded by some of the poorest countries in Africa and the impressive commitment to and progress towards democracy and better governance in large parts of the continent. See UN Millennium Report (2005).

<sup>10</sup> We should mention early on that the best of the current round of initiatives focusing on enterprise and development is the *Growing Sustainable Business* programme of the UN Global Compact. See [www.undp.org/business/gsb](http://www.undp.org/business/gsb)

<sup>11</sup> See for example Jagdish Bhagwati (2004), **In Defense of Globalisation**, Oxford University Press; Martin Wolf (2004), **Why Globalisation Works**, Yale University Press; and David Dollar and Aart Kraay (2000), 'Growth is Good for the Poor', a World Bank Working Paper cited by Easterly (2002) which demonstrates the long-accepted relationship that an additional 1% per capita growth causes a 1% rise in the income of the poor.

<sup>12</sup> As is well known, SMEs account for the large bulk of employment in poor countries, provide goods and services to poor people, create jobs when they grow, are key in the transition from agriculture-led to industry-led growth and provide supply chains that attract foreign direct investment. See especially UNDP (2004) *Partnerships for Small Enterprise Development*, Sustainable Business Programme, UN Global Compact, New York and B. Wedder (2003), 'Obstacles facing Smaller Business in Developing Countries' in G. Fields and G. Pfefferman (2003).

<sup>13</sup> Just think of how many plumbers will be required to carry out the real work needed to meet the MDG for clean water.

<sup>14</sup> The access versus capacity trade point is made by many in relation to the agricultural sector but is even more critical in relation to securing trade gains in industrial goods. Not just exporting but remaining competitive in an increasingly technology-intensive world is a huge challenge for poorer countries because expansion of industry and industrial exports is essential to escape the inherently low-growth trajectory associated with an agricultural-based economy. See S. Lall with E. Kraemer-Mbula (2004), 'Stimulating Industrial Competitiveness in Sub Saharan Africa', Paper presented at the **Tokyo International Conference on African Development**, November 2004; and A. Beattie et al (2005), 'Trade, aid and debt relief: can this year's ambitious anti-poverty promises be kept?', **Financial Times**, Thursday 6 January 2005.

<sup>15</sup> See Theroux (2004) **Dark Star Safari: Overland from Cairo to Cape Town**, Penguin for vivid accounts of this sense of hopelessness in some African countries.

<sup>16</sup> And the same can be said for the pro-poor impacts of economic growth, trade and direct foreign enterprise. For example the negative environmental impacts of growth in developing countries have been shown repeatedly to fall excessively on the poor. There are many other ways growth, and trade for that matter, do not necessarily work out to the benefit of the poor. See S. Bromley et al (2004), **Making the International: Economic Interdependence and Political Order**, The Open University

<sup>17</sup> However, even extreme poverty contexts do not constitute an impenetrable impediment to enterprise having positive impacts or, as we will show later in the case study section, to the added value enterprise-like thinking can bring to poverty-reduction strategies targeting the poorest of the poor.

## **Section 2: Learning By Doing: The Shell Foundation Experience In Catalysing Pro-poor Enterprise Development**

<sup>18</sup> And many of these address important enterprise development-enabling conditions. See for example the UN Millennium Project (2005).

<sup>19</sup> The importance to poor people of having work is brought home by a recent journalist's report on UK Chancellor Gordon Brown's trip to Africa. This recounted the plight of a 67 year old woman from a Nairobi slum, living on the equivalent of \$6 a month who, after making it clear she had never heard of Gordon Brown and his initiative to eradicate poverty, was quoted as saying: 'Nothing ever gets through to us. The money does not get past our leaders. The best thing they could do is help us set up some business. With transport I could sell vegetables and earn money to buy food.' See J. Clayton and Xan Rice (2005), 'Where poverty means living on just £3 a month', **The Times**, Saturday 15 January 2005.

<sup>20</sup> For much evidence of this and a compelling recasting of the way the development community should look at poor people see C. K. Pralahad (2004), **The Fortune at the Bottom of the Pyramid: Enabling Dignity and Choice through Markets**, Wharton School Publishing

<sup>21</sup> See annex 1 for our concept of SMEs and UNDP (2004) for a good conceptual discussion.

<sup>22</sup> A phrase we have adopted from the description used by one of our partners – the Small Scale Sustainable Development Infrastructure Fund – which is discussed in the case study section.

<sup>23</sup> Which includes not just what we've experienced via the Shell Foundation but also in the many years of professional development and business and entrepreneurial experience of the management team.

<sup>24</sup> The simple point here is that when donors impose their own 'public benefit' agendas on enterprise initiatives – whether requiring only renewable energy be used, hiring disadvantaged employees or even monitoring social impacts and telling others about them – this has a tremendously distorting effect on enterprise effort and inevitably makes it very much more difficult for the enterprise simply to survive.

<sup>25</sup> The history of development assistance – and more immediately our own project portfolio – is littered with good 'projects' that have never gone to scale and while perhaps helping locally for a short while, have left the majority of the poor untouched.

<sup>26</sup> So for example, in a number of developing countries, SME-focused investment funds launched in the renewable energy sector have failed largely because of the 'starting conditions' they were lumbered with by the northern donors who set them up. In our own portfolio, we have frequently found, for example, that when a pro-poor service delivery intervention starts off fully funded by grant money, it's often difficult for the project managers to pursue a full cost-recovery model because of the primacy given to developmental objectives. This means they spend a lot of their time at conferences – but more

importantly, continually need to chase donor money to cover operating costs (which is hugely time-consuming and diverting) and can never expand properly because of the limits of donor funding.

<sup>27</sup> See background papers, conference report and work of individual participants at 'Private Investment with Social Goals: Workshop on Building the Blended Value Capital Market', WEF Headquarters, Geneva, 21–22 September 2004, sponsored by IFC, The Rockefeller Foundation and the World Economic Forum.

<sup>28</sup> For example, the instinctive reaction of much of the IDC and many developing country policy makers when confronted with poverty problems is to see these as 'public good' issues and thus they look first to what the public sector (using grant funding and applying development principles) can do to solve the problem. There is an almost automatic assumption than in many poverty contexts markets can't operate so the options aren't explored rigorously. But much more importantly, business principles of the sort we have been talking about (which are themselves all about finding least cost solutions to the problem of getting people what they want) are not applied in the search of solutions to poverty. And when IDC actors and policy makers do acknowledge or allow for markets or private sector enterprise activity being part of the poverty solution, there is an almost naive assumption that if you just apply market principles to structuring the enabling environment, somehow efficient markets and profitable enterprise will follow automatically. Markets and enterprise can and do work against the interests of poor people, obviously. But getting markets to work in a pro-poor way and especially catalysing successful SME development requires a great deal of attention to very specific and very practical details and is not at all automatic or formulaic as our case studies demonstrate.

<sup>29</sup> The business purposes in using these assets are straightforward but they are usually wrapped up in business speak – project framing, carrying out a risk assessment, developing a customer value proposition, analysing the value chain – and are not well understood by the 'outside' world. But we have found that their appropriate use can have tremendous value in tackling poverty.

<sup>30</sup> We are not referring here to proprietary assets but on the physical side to distribution networks, retail outlets, supply chains, etc and to knowledge derived from a long-term presence in a country or market, from the experience of building a business under specific circumstances, and so on.

### **Section 3: Energy access, poverty and our experience on the ground**

<sup>31</sup> See World Bank (2000), **Energy and Development Report 2000**, Washington, DC; Netherlands Ministry

of Foreign Affairs (2004), **Energy for Development 2004** and IEA (2004), **World Energy Outlook**, Chapter 10, International Energy Agency, Paris.

<sup>32</sup> The most well-known of these is the Global Village Energy Partnership launched at WSSD in 2002 (see [www.gvep.org](http://www.gvep.org)).

<sup>33</sup> We did this via a series of on-line dialogues and stakeholders' workshops. See [www.shellfoundation.org](http://www.shellfoundation.org) for further information.

### **Case study 1: Sustainable solutions to Indoor Air Pollution**

<sup>34</sup> The concentration of particulates and pollutants in indoor smoke is many times higher than even the worst outdoor pollution. See ITDG (2003), **Smoke: the Killer in the Kitchen**, Intermediate Technology Development Group ([www.itdg.org](http://www.itdg.org)).

<sup>35</sup> Because the technical solutions – ventilation, cleaner fuels, better stoves – are well known and low cost, IAP is one of those 'unnecessary' dimensions of extreme poverty the 'Make Poverty History' campaign wants to do away with.

<sup>36</sup> See V. Laxmi et al (2003), 'Household Energy, women's hardship and health impacts in rural Rajasthan, India: need for sustainable energy solutions', **Energy for Sustainable Development** Vol VII, No 1, March, which reported the results of a study that valued the annual cumulative economic impacts (imputed health and labour costs) of Indoor Air Pollution on a rural population of 5 million households at \$725 million – for one year for just one state of India.

<sup>37</sup> For more on the IDC and IAP prevention see ITDG (2003).

<sup>38</sup> The commercial success stories for biomass stove products such as the charcoal 'jiko' in East and now in West Africa do not necessarily lead to reductions in IAP for a number of reasons, primarily because they were originally designed to increase fuel efficiency, not to reduce emissions. For detailed analysis of the Indian case see article by R. D. Hanbar and Priyadarshini Karve (2004), 'National Programme on Improved Chulha (NPIC) of the Government of India: an overview', **Energy for Sustainable Development**, Vol 6 Issue 2, published by the International Energy Initiative ([www.ieiglobal.org/esd.html](http://www.ieiglobal.org/esd.html)).

<sup>39</sup> See ITDG (2003) especially Appendix 1 and references therein.

<sup>40</sup> In India, Guatemala and Mexico in the first round launched in 2002; and then subsequently in 2004 in Ghana, Ethiopia and Kenya and in 2005 in Brazil and Pakistan.

<sup>41</sup> By comparison, some multilateral institutions have been trying and failing for years to work through governments in Asia to launch IAP interventions. These institutional roadblocks are starting to ease, at least partly as result of *Breathing Space* and the efforts of the Shell Foundation. For example, the launch of *Breathing Space* helped catalyse the launch by the US EPA at WSSD of a 'Partnership for Clean Indoor Air' ([www.pciaonline.org](http://www.pciaonline.org)). And in autumn 2004, Shell Foundation worked with ITDG, UNDP and WHO to generate significant media coverage of the IAP issue during World Rural Women's Day, 15 October 2004. See Fiona Harvey (2004), 'Where there's smoke, there's a health risk', *Financial Times*, 29 October 2004 and *BBC World's Asia Today*, 15 October 2004.

<sup>42</sup> For example in India, the pilots uncovered that there could be enough margin in a smokeless chula (stove) for which poor women are willing to pay 300 rupees, to give profits to artisans and pay for social marketing costs. In Kenya and in India, financial institutions have, through the Foundation's work, recognised the demand for improved energy products and services and are offering consumer financing for the purchase of improved products and services and enterprise financing for businesses in the supply chain. The households and villages involved here are extremely poor, including, in India, tribal communities. The uncovering of a sustainable business model for getting smoke out of the kitchens of these people is a good example of the value added from applying business thinking to the identification of poverty solutions in contexts where 'markets won't work'.

### **Case study 2: Catalysing the pro-poor market for solar home systems**

<sup>43</sup> For example, reviews of donor efforts and major aid-funded programmes such as the Global Environmental Facility to advance the use of renewables and promote the creation of renewable energy enterprises in developing countries at the cost of many, many hundreds of millions of aid dollars have identified many problems. See Andrew Barnett (1999), 'A Review of the Renewable Energy Activities of the UNDP/World Bank, Energy Sector Management Assistance Programme 1993 to 1998' ESMAP, World Bank, Washington DC; and Eric Martinot et al (2002), 'Renewable Energy Markets in Developing Countries', *Annu Rev Energy Environ* 27:309–348. And for a detailed discussion see Kurt Hoffman (2003), 'The Role of Public/Private Partnerships in improving access by poor communities in developing countries to modern energy services', paper presented at Rice University, Houston, Texas. Available from the Shell Foundation.

<sup>44</sup> See D. Sreedharan (2004), 'Here solar power brightens up people's lives', *The Hindu*, 26 November 2004; and S. John (2004), 'Forget Electricity: rural folk tap solar power' *The Times of India*, 30 November 2004

### **Case study 3: Nurturing pro-poor small enterprise in southern India via the social merchant bank model**

<sup>45</sup> Details of S<sup>3</sup>IDF's origin and descriptive and analytical material on its activities are available on its website (see [www.s3idf.org](http://www.s3idf.org)).

<sup>46</sup> Which means there must be client capital at risk; deals do not go to financial closure unless pre-investment work indicates financial feasibility, and the business plan demonstrates all capital and operations costs are covered including financing costs for any capital injected by S<sup>3</sup>IDF and local financial institutions.

<sup>47</sup> Selco India is one of the pioneering for-profit solar energy companies that has struggled and succeeded in creating a market for solar energy systems in India and works very closely with S3IDF.

<sup>48</sup> S<sup>3</sup>IDF leverages its involvement by its 'gap-filling' financing menu (debt, equity, partial guarantees) inducing the participation of local banks and other financial institutions in pro-poor viable small projects that were otherwise non-bankable under 'business as usual' practice. And in so doing, S<sup>3</sup>IDF begins changing the mindsets of local banks and their willingness to provide more financing to this sector in the future.

<sup>49</sup> One set of examples are its 'Light Point' investment projects which feature support for small enterprises supplying poor consumers such as street hawkers with solar 'lanterns' to replace the kerosene or gas lamps used previously. The entrepreneur charges the lanterns' rechargeable batteries at his PV-powered battery charging station (financed with the help of S<sup>3</sup>IDF) and delivered to the hawkers on a 'pay for charge' fee that is cheaper than the running costs of kerosene and gas lanterns. The hawkers are able to save money and the quality of lighting service is improved while the entrepreneur makes a handsome profit after meeting his capital and operating costs. In one specific project, S<sup>3</sup>IDF helped an NGO – MASARD – launch a Light Point company (servicing 35 street hawkers in the Viveknagar, Neelasandra and Koramangala areas of Bangalore, Karnataka) by providing business planning skills, a partial risk guarantee and transaction assistance to allow it to access bank financing. MASARD is now both expanding its business and using the profits to create a 'Hawkers' common' or 'revolving fund' from which its clients can borrow to make additional investments in their own businesses.

<sup>50</sup> S<sup>3</sup>IDF generally provides know-how free because small, pro-poor projects do not allow capitalisation of knowledge, project preparation, etc into the project costs (as with large projects). These must be grant financed and grant support is also needed for Monitoring & Evaluation and lessens dissemination efforts.

#### **Case study 4: SME investment funds – deploying local capital and the challenge of going to scale**

<sup>51</sup> More than 500 million people in sub-Saharan Africa did not have access to electricity in their dwelling or place of work in 2002. By 2030 it's estimated that half the population of sub-Saharan Africa will still be without electricity. International Energy Agency analysis also suggests that if the main MDG poverty-reduction target is met, governments would need to take new measures to extend the use of modern cooking and heating fuels to more than 700 million people from 2002 to 2015. For more information see IEA (2004).

<sup>52</sup> Lease finance lowers up-front capital costs and overcomes the collateral constraint – both aspects that typically constrain SMEs from accessing finance – and provides the bank with an acceptable level of risk.

<sup>53</sup> Mining giant Anglo American launched the Khula Mining Fund in partnership with the South African government to invest in SMEs in its sector.

#### **Section 4: Propositions and conclusions**

<sup>54</sup> This is understandable perhaps given the public pressure to spread aid money and effort across an ever-widening array of urgent poverty issues. But it does mean that direct support of pro-poor enterprise development has garnered a relatively small share of available support. At least that's what appears to be the case. Our admittedly rough calculations (based on a simple analysis of Development Assistance Committee aid allocations between 1990 and 2000 at the three and six-digit SIC level and the annual grant allocation of the 10 major private US-based donors with international programmes) suggest direct pro-poor enterprise interventions have attracted less than 10% of official and private aid flows of the last decade.

<sup>55</sup> See K. Hallberg and Y. Konishi (2003), 'Bringing SMEs into Global Market' in Fields and Pfeffermann (2003) for a review of the failure of government and donor-funded SME interventions and policies and the donor's response to their failures in this area, see Committee of Donor Agencies for Small Enterprise Development (2001), **Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention**, SME Donor Committee Secretariat, World Bank, Washington, DC.

<sup>56</sup> Rarely mentioned in press releases, sound bites or speeches of poverty campaigners, enterprise also hardly surfaces on the agendas of the many pro-poverty conferences and talkfests taking place and in the many recommendations being made. For example, enterprise doesn't feature in any of 24 recommendations given in Oxfam (2004) on aid reform. The Report of the distinguished UN

Millennium Project (2005) addresses the role of the private sector and the need for a pro-enterprise-enabling environment more extensively. The problem is that it also addresses every other aspect of poverty comprehensively thus embedding its enterprise recommendations in an enormous shopping list of action proposals all calling for fundamental change in the way the IDC operates.

<sup>57</sup> This is evident via a number of channels. For 'social performance' examples see the case studies cited in IFC (2003), 'Addressing the Social Dimensions of Private Sector Projects', **Good Practice Note No 3**, December, IFC, World Bank Group, Washington, DC; and Titus Moser (2004), 'Social Performance: Key Lessons from Recent Experiences within Shell', Social Performance Management Group, Shell International, London. For 'supply chain' examples see M. Winner (2005), 'Levers & Pulleys: Extractive Industries and Local Economic Development in Poor Regions – Incentivising Innovation by Lead Contractors through Contract Tendering', Briefing Note No 3 in the **Enhancing Social Performance in the Engineering Services Sector Programme**, Overseas Development Institute, London; and for 'bottom of the pyramid' examples see C. K. Pralahad (2004), **The Fortune at the Bottom of the Pyramid: Enabling Dignity and Choice through Markets**, Wharton School Publishing Pralahad. And for more general review of business and poverty issues, opportunities and case studies see especially UNDP (2004); WBCSD publications such as 'Doing Business with the Poor – A Field Guide' and 'Finding Capital for Sustainable Livelihoods Programme'; and A. Maitland (2005), 'From a handout to a hand up', **Financial Times**, Thursday 3 February 2005; and M. Forstater et al (2002), **Business and Poverty: Bridging the Gap**, IBLF, London.

<sup>58</sup> There are of course strong counter-arguments that business should never go beyond its normal activities to tackle issues such as poverty. See Clive Crook (2005), 'The Good Company: A Survey of corporate social responsibility', **The Economist**, 22 January 2005.

<sup>59</sup> We've mentioned already the UN Global Compact and its Growing Sustainable Business programme, the International Business Leaders Forum, and the work of the World Business Council for Sustainable Development but there are many other forums such as Business for Social Responsibility and the Resource Centre for the Social Dimensions of Poverty and individual actors such as TechnoServe and Development Alternatives International in the US and many NGOs in developing countries such as TERI in India and ApproTec in Kenya. Some donors have small but imaginative mechanisms in this area such as DfID's Business Linkages fund. There are players subsumed under the heading of 'blended value' or double bottom line investors such as Acumen Fund,

the Provenex Fund of the Rockefeller Foundation. The Gatsby Charitable Foundation, the Skoll Foundation, Schwab Foundation for Social Entrepreneurship and the Lemelson Foundation. See also the various initiatives of the participants at a meeting in London in early 2004 on financing the SME sector in developing countries, organised by the Shell Foundation and Forum of the Future; and those attending the previously mentioned 'Blended Value' meeting hosted by the World Economic Forum in late 2004. See Forum of the Future (2004), **Sustainable Investment in Africa: pipedream or possibility? Innovative financing mechanism for SMEs in Africa**, Forum of the Future, London.

<sup>59</sup> The community of donors we have in mind spreads from the treasuries of rich country governments who approve aid budgets (including special windows such as the FFI) through the bilateral and multilateral aid organisations, private foundations and philanthropists, the charitable grant-making arms of big business and the larger international NGOs who act like donors by redistributing charitable funds to others to carry out poverty projects in developing countries.

<sup>59</sup> Not least of which is that some elements might contravene charity law, others could introduce the more negative aspects of profit-seeking behaviour, and that cause and effect is terribly difficult to measure in poverty environments.

<sup>60</sup> Many development agencies report that when experienced business people do wind up working with them on development issues, they often become 'softer' than the development professionals!!

<sup>61</sup> See footnote 58. And in some cases quite innovative experiments are being attempted such as the emergence of 'development marketplaces' on the web and under the aegis of some multilateral agencies such as the World Bank.

<sup>62</sup> We have been talking mainly about interventions more or less directly targeting enterprise development but of course there are many obstacles in the 'enabling environment where big business can deploy its knowledge and other assets in support of enterprise. These start with tackling micro problems such lack of property rights, enterprise financing or appropriate skills, and run through all manner of regulatory and other issues at the level of the market, and into the big governance concerns of corruption, stakeholder engagement and the rule of law. Big business operating in poor countries faces and overcomes these issues on a daily basis. In so doing they generate specific pools of practical knowledge that if deployed properly could help unblock huge obstacles to enterprise development in poor countries.

<sup>63</sup> There are understandable reasons why not enough of the 'right' kind of business engagement with

poverty takes place. Some are internal to business and linked to its natural tendency towards cost and risk minimisation. Frequently, this orientation is reinforced by a traditional corporate philanthropic mindset that dictates business deals with poverty by giving money away to the neediest. So business in effect doesn't 'think' or know how to deploy its **value-creating** assets when tackling poverty. It mainly offers money – although it usually does so via a sophisticated and highly professional approach. But typically the good causes supported are not connected to their business and the skills deployed by the company in support of this are those associated with giving money away rather than creating value. See M. Porter and M. Kramer (2002) 'The Competitive Advantage of Corporate Philanthropy' Harvard Business Review, December.

These internal drivers are reinforced by external expectations. The traditional CSR community largely wants business to concentrate on obeying the law, doing less bad and mitigating or remedying operational harm – rather than creating value. At the same time, those closer to the problem such as host governments, donors, NGOs and local communities first don't appreciate 'where' in business value-creating assets can be found or indeed even what these are. But primarily they have other expectations and agendas when they approach business about tackling poverty – most of which boil down to requests for money. As a result, governments and civil society don't make the right 'ask' when they approach business for help in tackling poverty.

<sup>64</sup> Though speaking opportunities at high-profile tables are also often attached to invitations to participate in PPPs.

<sup>65</sup> And the individuals involved are not likely suffer any consequences if the project fails. This is certainly the case in our different but still analogous experience as a donor where we have provided financial support to grantees from the non-profit sector to allow them to develop commercial initiatives where they failed to even come close to delivering what they promised but never took any action against the project managers who presided over the failures.

<sup>66</sup> See for example M. Winner (2003), **The New Broker: Brokering Partnerships for Development**, Overseas Development Institute, London; J. Nelson (2004), **Partnering for Success**, World Economic Forum and UN Foundation (2003), **Understanding Public Private Partnerships**, Washington, DC. See also George C. Lodge (2002), 'The Corporate Key: Using Big Business to Fight Poverty', **Foreign Affairs** July/August Vol 81, No 4, who proposes a World Development Corporation with some of the features we call for in PPPs. For non-enterprise example see UNAIDS (2004), **Aids in Africa: Three Scenarios**, Joint UN Programme on HIV/AIDS, New York, for a case where core value-creating assets of the Shell Group –

its scenarios methodologies – are being used in partnership with the United Nations to tackle to HIV/AIDS in Africa. See Porter and Kramer (2002)

<sup>67</sup> The Extractive Industries Transparency Initiative (EITI) is a good example of a PPP where the right parties are now involved and there are good prospects for significant advances on the governance and transparency front that will ultimately benefit poor people. EITI really only began to make progress towards its ultimate goal of getting more state revenues from energy and mineral exports flowing to help poor people once host governments joined the international energy industry at the negotiating table (see [www2.dfid.gov.uk/news/files/extractiveindustries.asp](http://www2.dfid.gov.uk/news/files/extractiveindustries.asp)).

# Over to you...

As part of the Shell Foundation's commitment to engage in 2005, we would like to know what you think. So if you have any comments and suggestions relating to the contents of this paper, please write to us at:

[info@shellfoundation.org](mailto:info@shellfoundation.org)