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**United Nations Capital Development Fund**

## **Management response to the independent impact assessment of the United Nations Capital Development Fund\***

### **I. Introduction**

1. This document provides the management response on the final report of the independent impact assessment (IIA) of the United Nations Capital Development Fund (UNCDF). This response aims to address the key issues raised in the IIA as they pertain to the current situation of UNCDF. Further, it seeks input from the Executive Board on the changes being proposed, which are designed to reinforce the relevance of UNCDF and ensure its financial sustainability as it contributes to international efforts to achieve the Millennium Development Goals (MDGs).

### **II. Background, content and findings of the IIA**

2. In its decision 99/22, the Executive Board requested that an independent evaluation of the impact of UNCDF programmes and projects be conducted. The findings of the independent evaluation, henceforth referred to as the IIA, are presented in Executive Board document DP/2004/18.

3. The primary objective of the IIA was to determine whether UNCDF is performing as an effective, efficient, sustainable organization that has remained relevant in carrying out its mandate to reduce poverty in the least-developed countries (LDCs). The IIA also assessed (a) whether UNCDF had responded appropriately to implement the 1995 policy shift, which narrowed the focus to microfinance operations and local development programmes; and (b) the extent to which UNCDF has implemented the recommendations of the 1999 independent external evaluation

\* The collection of data required to present the Executive Board with the most current information has delayed submission of the present document.

conducted by the information, training and agricultural development consultancy group (ITAD).

4. The IIA found UNCDF to be an effective organization that has, in the main, successfully organized its existing portfolio according to the 1995 policy shift and responded to the recommendations of the 1999 ITAD evaluation. The IIA confirmed that the Fund had contributed to significant results through its microfinance and local governance programmes in poverty reduction, policy impact, and replication of its projects by donors. UNCDF areas of expertise were found to be very much in demand in LDCs and to respond to the MDGs as well as to country needs. UNCDF was praised by the majority of its stakeholders as a flexible partner active in developing knowledge, effective in implementing projects, and influencing the orientation of the sectors in which it works. Moreover, the IIA found that UNCDF had been creative in remaining a relatively efficient organization and achieving a balanced budget in 2003.

5. The IIA determined that UNCDF was 'a success' based on various factors, including its dedicated and talented team of staff and leaders, its well-defined niche and its ability to match its expertise to the needs of the LDCs. The report noted areas of weakness – for example in gender mainstreaming, knowledge management, communications, and branding – which are highlighted as needing improvement. The critical issue, though, is the fundamental question of the financial viability of the Fund in 2005 and beyond.

6. The report made several recommendations, key among which are the two that focus on the UNCDF niche and business model, respectively. The present management response focuses on those two recommendations, which are addressed in some detail in the present report. Follow-up actions on the other seven recommendations will be determined largely by the outcome of exchanges with the Executive Board on the outline of the new UNCDF business model.

### **III. Overall reaction**

7. Management welcomes the findings of the IIA, which reaffirm the excellent track record of UNCDF as an efficient, effective and relevant small United Nations fund, focusing on small-scale investments in the LDCs. These results are very much in line with the self-assessment contained in the cumulative ROAR of UNCDF (DP/2004/17), which is being presented to the Board during this session. They reflect broadly the positive feedback and appreciation that has been expressed by donor and programme countries alike for the work of the Fund.

8. At the same time, the report emphasizes the core problem of the financial viability of UNCDF. The IIA rightly questioned the existing UNCDF business model, which was based on the assumption that good results and an efficient, effective organization would lead to more donor support and sustained core funding. This has proved not to be the case: core contributions have dwindled and have only partly been offset by increases in non-core resource mobilization.

9. In response, and in order to maintain the financial integrity of the Fund, management has had no choice but to make a significant reduction in programme approvals and expenditures over the past three years. These painful cuts have

inevitably had a negative impact on overall UNCDF performance; they have had an adverse effect on partner governments, client organizations and local populations in LDCs; and they have affected the credibility of the Fund vis-à-vis its clients.

10. Given the continued failure to meet the core resource target called for by the Executive Board, in its decision 2002/26, of \$30 million a year to support the work of UNCDF, there is an urgent need to review the business model and make appropriate adjustments. Management is committed to make the Fund an even more strategic partner in the United Nations family so that it can effectively contribute to poverty reduction and the achievement of the MDGs.

#### **IV. Positioning, niche and relationship to UNDP**

11. Recommendation 1 requested a clarification of the role and responsibilities of UNCDF within UNDP and its associated funds and programmes as part of a larger strategy for the UNDP group that would position both organizations to tackle the development challenges central to their respective mandates.

12. Pursuant to Executive Board decision 99/22, UNCDF oriented its capital investments and technical support towards microfinance and local development, two areas which are crucial for the achievement of the MDGs. It has done so in strong complementarity with UNDP. In joint programmes in more than 20 countries UNCDF has matched capital support and specialized expertise with UNDP technical assistance, thus contributing directly to several of the UNDP service lines. Most importantly, this package of capacity building coupled with investment interventions has reinforced the overall effectiveness of the United Nations in support of the achievement of the MDGs. There are opportunities for UNCDF to expand this type of joint programming not only with UNDP, but in a wider partnership involving other partners.

13. The UNDP Human Development Report 2003 classified all the LDCs as 'top priority' countries where urgent action is needed to meet the MDGs. UNCDF, which serves the LDCs first and foremost, is well placed to reinforce United Nations action in precisely these top priority countries, where the MDGs run the highest risk of not being met. The detailed knowledge acquired by UNCDF from working in LDCs at the local level could be tapped to reinforce United Nations efforts to localize the MDGs. UNCDF experience with small-scale investments in water supply and natural resource management could reinforce United Nations implementation of some key recommendations of the World Summit on Sustainable Development in such areas as renewable energy and water and sanitation.

14. In addition, drawing on the report to the Secretary-General entitled *Unleashing Entrepreneurship: Making Business Work for the Poor*, there is a clear role for UNCDF in developing programmes in partnership with UNDP, donors and private sector actors, to support the service line on private sector development. UNCDF has a mandate to provide capital assistance by means of grants and loans, particularly long-term loans. The ability of UNCDF to tap private sector capital for sustainable investments could allow the United Nations to establish new partnerships with the private sector. Under a new dispensation, the Fund could be recast to invest in private as well as public-private partnership opportunities that show potential to

recover original investments and are supportive of achieving the MDGs, especially in those countries at high risk of failing to do so.

15. To support private sector development more effectively, UNCDF could widen the scope of its programme activities in local governance and microfinance to further involve and support the local private sector. To this end, UNCDF is developing a series of interventions in the area of local economic development and building inclusive financial sectors. UNCDF also intends to explore avenues whereby the Fund itself can tap the financial resources of the private corporate sector in line with the principles of the Global Compact.

16. From the above, it can be seen that the activities of UNCDF are, and will continue to be, fully aligned with the UNDP multi-year funding framework (MYFF). UNDP and UNCDF are also working towards further sharpening the UNCDF role and responsibilities within UNDP and its associated funds and programmes. This process will be facilitated by the planned UNCDF focus, in partnership with UNDP, on developing programmes that support private sector development, inclusive financial sectors and local economic development. Some practical issues need to be resolved, such as the most appropriate way for UNDP to benefit from the strong technical advisory capacity of UNCDF and the manner in which the synergy between the resource mobilization efforts of UNDP and UNCDF can be enhanced.

## **V. Towards a new business model**

17. Recommendation 2 calls for analysis, review and development of a new business model and the appropriate corporate governance arrangements to support it. To facilitate exchanges on the future business model, the management has come up with some basic principles and directions, the details of which will be worked out, with guidance from the Executive Board, during the present session.

18. The overall goal of the Fund – poverty reduction – remains central, as does the focus on the LDCs. In addition, tapping its experience in providing basic infrastructure and services to the poor through strengthened local authorities and the building of inclusive financial sectors, UNCDF will engage and support the development of the private sector, building on its work with local private sector actors, and developing new, international private sector partnerships. The mission of UNCDF can then be articulated in terms of support to three interrelated service lines, namely, support to inclusive financial sector development, private sector development and local economic development.

19. In order to move forward from the current funding model, which relies too heavily on one-year pledges and voluntary contributions, it is imperative to develop a multi-year, multi-pronged financing strategy. The strategy should ensure a diversification of funding sources through the development and marketing of the redefined UNCDF product lines. The proposals below represent options that could contribute to the funding base for a new UNCDF business model.

(a) Voluntary core contributions; these should preferably reflect more predictable multi-annual commitments, and might be channeled directly to UNCDF or through UNDP.

(b) Non-core resource mobilization for specific country operations, or for thematic activities, building on existing partnerships with multilateral and bilateral donors and also targeting private sector institutions.

(c) Fee income from technical services, given the proven demand for UNCDF expertise, but mindful of the need to ensure full recovery of the costs involved in providing these services.

(d) Capital lending, through development of loan and investment products for specific service lines, and specific countries. If successful, this might allow the Fund itself to borrow from capital markets at a later date, once a track record has been established.

(e) Concessional loan funding of some elements of UNCDF capital assistance – to private enterprise and to governments in LDCs – although with an eye to the Fund’s specific comparative advantages, its legal statute, and the activities of other bilateral and multilateral funding agencies.

20. The IIA correctly underscored the lack of alignment between the existing governance structure and the resource mobilization strategy for core funding. This issue must be addressed in the context of the proposed changes. In deciding on the modalities for the necessary alignment, it will be important to take into account the drive by donors to support ongoing United Nations system reforms.

21. To conclude, the Fund will have to undergo urgent transformation to become more ‘market-oriented’ in its programmes and financially viable as an institution, while preserving and capitalizing on the hard-earned gains made in its support of local development and microfinance activities. Management would like to express its appreciation for the dedicated oversight by the Executive Board in past years and looks forward to the continued support and guidance of the Board through the transition period.

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