## Theory of Change



## Impact strategy of the European Fund for Southeast Europe (EFSE)

## The fund's mission

is to foster economic development and prosperity in Southeast Europe and the EU Eastern Neighbourhood Region by supporting the success of micro and small enterprises (MSEs) and improving living conditions for households.

## **Impact Focus**

In working towards its mission, the fund focuses its activities on specific target regions and groups:

- 1. Target regions: EFSE's target regions are facing multiple development challenges including substantial rates of unemployment and labor underutilization in addition to limited access to infrastructure and financial services. At the same time, the economies strive for regional integration, including to the EU markets. The financial sector has a key role to play in addressing these challenges and supporting inclusive and sustainable economic growth.
- 2. Target groups: The fund targets MSEs, including those in rural areas, as well as households with limited access to housing. The local financial sector serving MSEs plays a key role in closing the fund gap, and thus also represents an important target group for EFSE.

## Impact Objectives

Through its activities, EFSE aims to trigger transformation and impact at the financial system level as well as in the real economy.

## 1. Impact at a socio-economic level

By enabling MSEs to grow, the fund aims to positively contribute to the following impact areas:



## Supporting income generation

Foster MSEs' ability to start, maintain, and grow their business activities



## Fostering employment stability & growth

Contribute to sustaining and creating MSE jobs



## Improving livelihoods and living conditions

Support low-income households in improving their housing conditions and starting/consolidating a development pathway

## 2. Impact on financial systems

Core to EFSE's impact strategy is strengthening the ability of local financial institutions to provide much-needed financing to the fund's target groups and generating systemic impact by strengthening the local financial system, which has been shown to act as a driver of and an important pre-condition to economic growth. By strengthening financial intermediaries and helping them to enhance their MSE lending, the fund strives to increase access to finance at scale and in a sustainable manner. At the same time, it seeks to further the development of inclusive and responsible financial systems, ultimately benefiting economies at large.



EFSE pursues this by extending debt **financing** to local partners, such as microfinance institutions (MFIs), leasing companies, commercial banks, and other financial intermediaries that share the fund's interest in serving the target groups. In addition, the fund supports the local financial sector in building its **capacity** to serve the needs of MSEs and low-income households in urban and rural areas. Sector players include EFSE's partner financial institutions as well as organizations and institutions that span the broader (entrepreneurship) ecosystem, i.e. central banks or business development and support organizations. Finally, the fund contributes to developing the wider **ecosystem** for economic development, such as the regulatory environment or support services for entrepreneurship, to embed and amplify the fund's strategic priorities and impact and strategically raise public and private resources for economic development.

## Contribution to the SDGs

EFSE's activities have been mapped toward the Sustainable Development Goals (SDGs) at an SDG target level. Based on these, six have been selected as core SDGs:

## EFSE contributes to...



... eradicating poverty by meeting the basic financing needs of MSEs and low-income households.



... inclusive industrialization by upgrading small-scale enterprises through improved access to (local currency) finance and innovative solutions.



... improving agricultural productivity and the livelihoods of small-scale food producers through secure and equal access to financial services.



... economic inclusion by sustaining and growing business income among marginalized entrepreneurs, such as women, youth, refugees, and rural populations.



... economic development and job creation by enabling entrepreneurs to establish and grow businesses through specific assistance such as tailored financial services and mentorship in addition to strong ecosystems that support entrepreneurship.



As a blended finance fund, EFSE brings together public and private investors for sustainable development.

## The path to impact: Theory of Change

The Theory of Change (ToC) demonstrates how the fund's activities are expected to result in fulfilling its mission as described above. The focus here is on the "in-between", the mapping of processes that EFSE's activities aim to trigger and how these ultimately lead to the intended impacts. These processes are interlinked and reinforce each other to drive transformation and systemic change in the market.

## **EFSE's ToC considers the following levels:**

# Activities Outputs Outcomes Final Impact

This level contains the fund's own activities — each with its own route towards achieving the final impact.

This level summarizes the tangible results that the fund's activities produce. This level includes systemic changes that are expected to occur in the short and long-term based on the activity-induced outputs.

This level contains the final socio-economic impacts at a regional level to which the fund aims to contribute.

Economic development and prosperity in the Southeast Europe region and in the European Eastern Neighborhood region, in particular by:

Supporting income generation

Fostering employment stability & growth

Improving livelihoods and living conditions

EFSE contribution to the SDGs













## Strong financial sector and (entrepreneurship) ecosystem to support economic opportunities

(Rural) MSEs in the target region utilize tailored financing and services to take up, grow, or sustain business activities (incl. income generating activities)

**Households** in the target region utilize tailored financing and services to improve their housing conditions and livelihoods

- **PLIs** tailor their strategy towards more inclusive and sustainable lending to EFSE target segments
- PLIs transform their processes to responsibly deliver finance to (rural) MSE and housing purposes

**Sector players** tailor their strategy towards EFSE target groups and deliver tailored non-financial services

Private investors increase capital for economic development and entrepreneurship in EFSE's target region

## Developing the financial sector and enabling (entrepreneurship) ecosystem for EFSE's target segments

- · (Rural) MSEs and households access a range of financial services for livelihood or business purposes
- (Rural) MSEs and households access non-financial services from PLIs and sector players to improve their business literacy
  - PLIs increase awareness for the needs of MSE clients
     PLIs increase outreach and financing to (rural) MSEs and households in line with EFSE's strategic priorities
  - PLIs improve access to sustainable, diversified longterm funding sources leveraging on EFSE partnership
  - PLIs and sector players promote innovation
- Sector players gain an increased understanding and awareness for EFSE strategic priorities
- Sector players increase outreach and nonfinancial services to EFSE target group

### Enhancing financial resources & services available for (rural) MSEs and households:

PLIs take up debt financing and on-lend it in line with EFSE's eligibility criteria & strategic priorities PLIs leverage TA initiatives to enhance services for EFSE target group Sector players leverage TA to promote tailored services for EFSE's target groups

**ESFE** facilitates networking, knowledge sharing and coordination among sector players

## Applying a comprehensive approach to fostering economic development and systemic change

Extend dedicated, tailored debt financing and capital support to suitable financial intermediaries that (can) responsibly finance underserved (rural) MSEs and households

Deliver tailored technical assistance to suitable financial institutions that (can) serve (rural) MSEs & households Conduct **technical assistance** projects
and **applied research** with sector
players

Alignment and awareness raising on strategic priorities among stakeholders

Strategic raising and blending of public and private capital

Direct effect

Indirect effect



The ToC was constructed based on a causal analysis, drawing on available evidence, and is used to frame the fund's impact measurement and management efforts. Underlying assumptions are continuously verified through EFSE's impact assessment.

Elements outlined in the ToC can be, to a large extent, directly under the control of the fund or influenced by both the fund and external factors. This spectrum is indicated in the ToC as an "Area of control", "Area of influence", and "Area of interest". Given the nature of the fund's work and the complex environments in which the fund's investees and stakeholders operate, EFSE does not attribute the change happening at an outcome and final impact level solely to its contributions. The ToC therefore defines how the fund *contributes* to causing the observed outcomes and final impacts.



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<sup>&</sup>lt;sup>1</sup> This distinction is often used in defining ToCs to differentiate between attribution and contribution.